

TO OUR SHAREHOLDERS



ZYGO's metrology and optical divisions experienced many highlights in fiscal 2008 amidst a challenging business environment. We saw solid performance in both our core instruments and optical businesses. Within the metrology division, core instruments revenues grew 17% over the prior fiscal year and had a compound annual growth rate (CAGR) of 12% over the six years through fiscal 2008. The optical division increased by 10% over fiscal 2007 and had a CAGR over the same six-year period of 26%.

The high precision stage metrology OEM component section of our company experienced a steep decline in revenue in fiscal 2008 over the previous year. This was due to the failure of a major customer to introduce the latest lithography technology, resulting in a significant drop in its market share and subsequent loss of revenue at ZYGO. Absent this, ZYGO would have continued to expand in fiscal 2008.

We are now well into the 2009 fiscal year. The global recession has impacted virtually all sectors of our business – some more than others. The semiconductor market has been particularly hard hit.

To address the slowing economy, we have taken a number of measures, including work force reductions, unpaid furloughs, salary adjustments, suspension of the 401k match and reductions in director fees.

Recent orders in the semiconductor and data storage manufacturing processes have validated our technology in these markets. To increase market penetration of our technology, we are now discussing partnership opportunities with established semiconductor equipment manufacturers to combine the strength of our core semiconductor metrology with a partner's strength in the system automation, sales and service of high volume manufacturing equipment. Pending successful conclusions to these OEM discussions, we continue to focus on achieving significant cost reductions and improved margins while adding to the unit volume of our instrument business.

In summary, the core ZYGO business is solid and well positioned for growth as the economy improves. The initiatives related to semiconductor and display manufacturing have reached a degree of technological maturity that, going forward as an OEM product, should allow us to validate our investment and reward our shareholders. Technology and high precision optical manufacturing continue to be the backbone of ZYGO, and our employees are highly motivated and extremely skilled. With their support and dedication, we are confident of achieving success in driving operational excellence.

J. Bruce Robinson
Chairman and CEO

ZYGO CORPORATION

2008

Annual Report

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As used in this Annual Report, unless the context otherwise requires, the terms “we,” “us,” “our,” “Company”, and “ZYGO” refer to Zygo Corporation, a Delaware corporation.

FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included in this Annual Report regarding our financial position, business strategy, plans, anticipated sales, orders, market acceptance, and growth rates, market opportunities, and objectives of management for future operations are forward-looking statements. These forward-looking statements include without limitation statements under “Business,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Risk Factors.” Forward-looking statements are intended to provide management’s current expectations or plans for the future operating and financial performance 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. Actual results could differ materially from those contemplated by the forward-looking statements as a result of certain factors such as those disclosed under “Risk Factors.” Such statements reflect our current views with respect to future events and are subject to these and other risks, uncertainties, and assumptions relating to the operations, results of operations, and our growth strategy.

Any forward-looking statements included in this Annual Report speak only as of the date of this document. ZYGO undertakes no obligation to publicly update or revise forward-looking statements to reflect events or circumstances occurring after the date of this Annual Report.

PART I

Item 1. Business

OVERVIEW

Zygo Corporation (“ZYGO,” “we,” “us,” “our,” or “Company”) designs, develops, and manufactures ultra-high precision measurement solutions to improve our customers’ manufacturing yields, and top-tier optical sub-systems and components for original equipment manufacturers (“OEM”) and end-user applications. We operate with two divisions. Our Metrology Solutions Division (also referred to herein as the “Metrology segment”) manufactures products to improve quality, increase productivity, and decrease the overall cost of product development and manufacturing for high-technology companies. Our Optical Systems Division (also referred to herein as the “Optics segment”) provides leading-edge product development and manufacturing services that leverage a variety of core technologies across medical, defense, semiconductor, laser fusion research, biomedical, and other industrial markets.

Our Metrology Solutions Division serves the semiconductor and industrial markets by providing process control for surface shape, roughness and film thickness, which are critical to all of our markets, through product offerings that measure surface and material characteristics such as roughness, figure, film thickness and transmitted wavefront of flat, spherical, and aspheric components. Our semiconductor product offerings include semiconductor metrology tools, OEM solutions, in-line automated yield improvement systems for both flat panel displays and advanced integrated circuit packaging manufacturing and technology development projects for the semiconductor capital equipment industry. Our displacement measurement systems are used extensively in ultra-precise wafer positioning systems for the semiconductor capital equipment industry. One of our continuing strategic initiatives is to expand our product offerings by applying our patented technology to integrated in-line technology. During our fiscal year ended June 30, 2008, we made continued progress on this initiative by expanding our semiconductor applications to a fully integrated wafer based metrology solution, the Uni-Fire-7900™. In February 2008, we acquired the assets of Solvision, Inc., a Canadian-based company, including its Singapore subsidiary, and entered the market for in-line inspection of flip chip substrates and integrated circuits (“IC”) packaging. This progress continues our transition from our traditional lab environment to the production floor.

Our industrial market products serve the defense/aerospace, automotive, consumer electronics, and commercial optics, as well as various other miscellaneous markets other than semiconductor. Industrial market products include measurement-based process control systems for defense and aerospace customers, and measurement-based process control and yield-enhancement systems for automotive, consumer electronics, and commercial optical customers. During the last two years, we introduced and marketed the NewView™ 7000 systems, NewView™ 600, VeriFire™ Asphere, and GPI™ PE systems. The NewView 7000-series 3D Optical Profilers enable higher throughput rates, reduced operating cost, increased sampling rates and tighter tolerances for optimized process control and yield. The VeriFire Asphere product provides the opportunity for us to penetrate the growing asphere measurement market supporting consumer electronics and defense/aerospace markets.

Our solutions are primarily based on optical interferometric technology. We continue to be a world leader in optical interferometry with a patent portfolio of approximately 290 active and 206 pending patents, most of which are related to the broad field of interferometry and its practical application.

Our Metrology Solutions Division is headquartered in Middlefield, Connecticut with operations in various domestic and international locations.

Our Optical Systems Division specializes in producing high precision integrated optical systems and unique system-critical optical components for a variety of applications that include medical laser delivery systems, U.S. Department of Defense (“Defense Department”) applications, 3D medical imaging, and semiconductor lithography. The division creates long-term customer value through, among other things, proprietary manufacturing technology, design for manufacturing and assembly services and specialized manufacturing know-how required to produce Food and Drug Administration (“FDA”) regulated medical devices.

Our integrated system assembly operation for our Optical Systems Division located in Tucson, Arizona is a tier-one optical system assembly facility for high-precision, volume production. We assemble and integrate devices ranging from medical laser delivery systems to 3D dental imaging to opto-electronic surveillance devices. Our integrated system design and prototyping operation, located in Costa Mesa, California, designs and manufactures prototypes utilizing multi-axis alignment, optical contact assembly, custom tooling, single point diamond turning, and our proprietary metrology equipment such as those used to produce lithographic optical systems. We also operate a large format optical fabrication and coating center located in our Middlefield, Connecticut facility. Our vertically integrated approach encompasses CNC glass machining and lightweighting, rotational and double-sided polishing, magneto rheological finishing polishing, and thin film coating, supported by our proprietary metrology equipment. We are one of the world's largest manufacturers of laser fusion optics and meter-class plano optics, including low aspect ratio and advanced materials such as sapphire.

We were incorporated in 1970 under the laws of the State of Delaware. The address of our principal executive offices is Laurel Brook Road, Middlefield, Connecticut, 06455-1291. Our telephone number at this address is (860) 347-8506. Our website address is www.zygo.com. The information on our website is not part of this Annual Report.

MARKETS, PRODUCTS, AND CUSTOMERS

Our business is organized into two operating divisions – Metrology Solutions (Metrology segment) and Optical Systems (Optics segment). The Metrology segment consists of OEM and in-line products primarily for the semiconductor and industrial markets. The Optics segment consists of components and opto-mechanical assemblies primarily for the medical, defense, and aerospace industries, which are part of the industrial market.

Manufacturers in the semiconductor and industrial markets strive to improve their manufacturing processes and product performance. These improvements allow them to compete more effectively in a marketplace characterized by decreasing product dimensions, increasingly complex manufacturing processes, decreasing product life cycles, declining product prices, and intensifying global competition, among other factors. As such, our precision metrology and optical components and systems are designed to help these manufacturers continually achieve process and design improvements.

Metrology Solutions Division

Semiconductor Market

We serve several areas of the semiconductor market, notably semiconductor manufacturers, and capital equipment suppliers, as well as the flat panel display and advanced semiconductor and integrated circuit packaging manufacturers. We have a broad and growing range of products that serve these market areas.

Semiconductor manufacturing processes require demanding metrology and inspection technologies. From bare silicon wafers through the packaged die, metrology and inspection are critical to meeting technology development and process control demands. Recent products introduced by us are enabling high volume semiconductor manufacturing customers to address the challenges of today as well as advanced processing down to and lower than the 45 nanometer (“nm”) node. The majority of our automated semiconductor systems are built on a common, high-throughput platform with a common, configurable sensor head. This approach allows us to leverage engineering and manufacturing investments to produce reliable and cost effective solutions for our customers.

With the acquisition of the assets of Solvision, Inc., including its subsidiary, Machine Vision International, Ltd., and the patented Fast Moiré Interferometer (FMI™) technology, we expanded both our technology and market application to penetrate the flip chip and advanced IC packaging markets.

Semiconductor Products

The transistor and associated integrated circuit have transformed the way people work, live and play, creating several multi-billion dollar industries that thrive through innovation, technology, and ultra-large scale integration of micro/nano circuitry. These industries provide components used in everyday appliances, including the more modern mobile phones and wireless internet devices. Due to the ubiquity of the integrated circuit, it is sometimes difficult to fathom the complexities involved in development and manufacturing. State-of-the-art

microprocessors have in excess of a billion transistors comprised of components which have physical dimensions as small as 45 nm.

ZYGO's semiconductor products, the Z3D-7000, Z3D-7200 and Uni-Fire™ 7900, are designed to help semiconductor and data storage customers control their high volume manufacturing process. The semiconductor products target wafer based applications (prior to die singulation) and can be utilized for all parts of the process flow, from the production of silicon substrates, through the transistor formation in the front end of the line to the interconnects and bump redistribution layers in the back end of the line. A single, configurable sensor sits on a common platform, each system having a unique sensor configuration and associated applications. ZYGO's semiconductor products are non-destructive, high throughput, optical metrology systems that measure a variety of process features needed to control high volume manufacturing such as roughness, form, topography, critical dimensions, registration, and film properties. With multifunction capability and state of the art performance, our products enable the consolidation of different metrology measurements into a single system, thereby lowering the overall metrology cost of ownership for the customer.

Photolithography scanners form the core of the semiconductor manufacturing process. These scanners image the patterns of stacked layers of circuitry that make up transistors. The photolithographic scanners image the circuitry onto silicon wafers for both microprocessors and memory chips, as well as flat panel displays for computers, televisions, and other display products. Several of our products enable these scanners to image these circuit patterns reliably and with nanometer precision.

Precision Positioning Systems

The layers of circuit patterns must overlay on top of each other to nanometer precision. To achieve nanometer precision overlay, the silicon wafer must be repeatably positioned to one-tenth the overlay tolerance. Photolithography scanners, mask and reticle writers, and yield improvement metrology tools rely on displacement measuring interferometers to provide precise feedback to control the position of the silicon wafer. Our Metrology Solutions Division's ZMI™ 2400 and ZMI™ 4000 precision positioning feedback systems are designed primarily for photolithography scanners. They are also used in a broad range of semiconductor metrology and backend process tools.

Technology Development Projects

Lithography scanners image the electronic circuit pattern through a precision projection lens. The optical performance of the lenses required for next-generation lithography scanners often exceeds the capabilities of commercially available measurement systems. Our expertise in optical interferometer technology, and the practical skills needed to apply this technology, make us well suited to deliver custom solutions to leading photolithography equipment suppliers.

Display Solutions

Flat panel displays ("FPD") were first used in cell phones and laptop computers, and have grown in popularity for most personal electronics. Many large screen televisions are based on flat panel display technology. Our systems, with ultra high precision measurement solutions, enable our customers to improve flat panel display manufacturing yields. Our OneShot and SureShot™ systems are in-line process control, yield enhancement tools. The FPD OneShot tool measures the topography and critical dimensions of key color filter features prior to being combined with the thin-film-transistor panel in the "one drop fill" assembly process. This fully automated system incorporates the latest ZYGO Intellisensor™, optical profiler technology, integrated conveyors or robotics with motion stages, mini-clean room environmental enclosures, and factory floor command and control software. The system measures the height and width of key optical components and predicts the fill volume to increase upstream manufacturing yields.

The SureShot™ FPD product provides overlay and critical dimensions metrology of the individual mask layers post-lithography and helps identify process control problems such as those found in the half tone process. These defects, left unchecked, can lead to product performance issues including variances in luminescence (called MURA) in the finished display. The SureShot tool can be used as an off-line process analysis device, or in-line in conjunction with closed loop lithography process control.

In addition to process control, ZYGO manufactures inspection tools used to protect color filter manufacturing processes from the yield-robbing effects caused by the introduction of foreign particles. The ZYGO ClearShot™ tool works in conjunction with automated optical inspection systems to review particles and sort those that will cause optical defects due to their height and lateral dimensions, from those that will not. The use of ZYGO technology in the inspection area results in increased manufacturing yields and increased utilization of the panel maker's deployed capital.

Advanced Chip Packaging and Assembly

During the manufacture of a semiconductor chip, after the chip making process is complete, the silicon wafer on which the chips are fabricated must be diced into individual chips and packaged for customer use. In advanced chip packaging fabrication facilities, the new CP 6300i™ system measures patterned features and films on the surfaces of diced and un-diced chips for process control and yield improvement. The system incorporates a specialized ZYGO NewView optical profiler and wafer positioning system with pattern recognition software. It can be configured for clean room or laboratory use.

Advanced IC Packaging and Assembly

Before an individual semiconductor chip can be placed on a printed circuit board it must be packaged or encased for protection, identification, and wiring/electrical connection. ZYGO AV9000™ systems inspect these final packages for defects using standard 2D image defect and metrology analysis, as well as rapid 3D metrology. The AV9000 systems are based on ZYGO's FMI technology acquired with the Solvision, Inc. assets. This product is designed to meet today's requirements, as well as future requirements of the rapidly growing IC packaging market.

Printed Circuit Board Substrates

Printed circuit substrates interface IC flip chip packages to printed circuit boards ("PCB"). These substrates make the circuit connection via arrays of miniature solder bumps and balls and ZYGO manufactures several tools to measure these bump and ball arrays for process control and yield improvement. Tool applications range from quality control (NANO 3D™) to high volume manufacturing (HS1000), on singulated substrates (HS2000). The newly released Flip Chip CSP2000H tool enables process control on strip and panel formats. These systems are based on technology acquired with the assets of Solvision, Inc.

Major Metrology Semiconductor Customers include:

Amkor	Ibiden
Applied Materials	Intel
AU Optronics	KLA-Tencor Corporation
Canon	Nanya
Chi Mei	Nikon

Industrial Market

Our industrial market covers all areas other than semiconductor. Metrology products for defense and aerospace companies include measurement-based process control systems. Products for automotive, consumer electronics and other customers are measurement-based process control and yield enhancement systems.

Consumer Electronics

Consumer electronics, including cell phones, digital cameras, DVD and CD players, and optical computer drives, have significant optical content. Consumer electronic optics, which provides imaging and data storage, are manufactured in quantities in the hundreds of thousands to millions of components per year. These complex miniature optical systems require precise optical testing—from development to in-line process control—which our measurement-based process control and yield enhancement systems are designed to perform.

VeriFire Asphere System

The VeriFire Asphere provides high resolution 3-Dimensional surface metrology for aspheric shaped surfaces using patented non-contact interferometric techniques for production and process control. Aspheres are important in consumer electronics products, cameras, military/defense optics, and commercial optics and represent a fast growing segment in the optics markets.

GPI and VeriFire Systems

The development of new optical systems for any application requires very flexible and easy to use test equipment. The ZYGO GPI and VeriFire systems are our latest products in our established product family that has improved optical testing and continues to evolve to meet changing requirements. Consumer electronics production applications for larger optics, greater than a 25 mm diameter, and research and development for any size application rely on these products for critical developmental data and process control feedback in production. These products are widely used due to their configuration flexibility in both hardware set ups and ZYGO's MetroPro™ data analysis software.

PTI™ 250

Consumer electronics typically contain small optics, less than 30 mm diameter. The PTI 250 is a small bench top optical test system in the tradition of our industry standard GPI. The system meets the consumer market demand by combining high-quality optics with ZYGO's MetroPro data analysis software.

DVD™ 400, BluRay™, and HD DVD™

The next generation of DVD players and computer memories use blue light at 405 nm wavelength to increase the amount of data on a DVD disk. ZYGO's DVD 400 interferometer is used by the developers of these next generation systems. ZYGO's DVD 400P is our system for the production floor.

Automotive Industry

The automotive industry is striving to improve fuel economy and decrease environmental pollution to meet customer demand and adhere to government regulation. Improving both requires more efficient engines, including the fuel injection system. Since high-pressure valves and sealing surfaces found in the fuel injection system must be manufactured to high precision, our measurement-based process control and yield-enhancement systems are used in the development and manufacture of these components.

NewView 7200/7300 and Delta Systems

Our high precision metrology equipment is well suited for fuel injector components, which are ground or lapped to tolerances of one-hundred billionths of a meter. Our patented "FDA" data acquisition system for the NewView optical profiler meets this high-precision measurement requirement. We recently introduced the NewView 6200 and NewView 6300 for these applications, offering increased speed and better performance at a lower price point. The NewView Delta is a production floor packaged system, also targeted to this growing market.

Defense/Aerospace

GPI and VeriFire Systems: Developing state-of-the-art optical designs and manufacturing technology for the defense/aerospace market also requires leading edge metrology systems for manufacturing process control and development. Our industry standard GPI and VeriFire optical interferometers test both the optical components and systems for design compliance. During the last two years, we introduced and marketed the VeriFire Asphere, GPI PE, and GPI FlashPhase systems. The VeriFire Asphere rapidly measures asphere shaped optics in a production environment. The GPI PE continues our move to the production floor providing laboratory level results in a production environment. Using patented algorithms, the GPI PE removes the degrading effects of vibration from the measurement without the need for new expensive hardware. This system is primarily used in the production of military and commercial optics.

The GPI FlashPhase system operates on the production floor where standard interferometers cannot measure or do not meet the demanding requirements of the defense/aerospace market. With our proprietary data acquisition, GPI FlashPhase can measure in the turbulent and vibrating environments that are often found in defense/aerospace applications. We are also active in designing and manufacturing custom systems for defense/aerospace applications, especially interferometers that operate at infrared wavelengths, which are unique to this market.

Major Metrology Industrial Customers include:

Bosch	Goodrich
Canon	Lockheed Martin
Corning	Raytheon

Optical Systems Division

Industrial Market

Supporting both the projection lens and stage positioning systems, we supply high precision stage mirrors and lithographic lenses to leading photolithographic OEM's and end users. In addition we design and manufacture deep UV objectives, inspection systems and components to a wide range of industrial customers as well as supporting the optical needs of our Metrology division.

Defense/Aerospace

Defense and aerospace companies use optical technology in a broad range of applications. One application is the enhancement of human sight through imaging systems, such as telescopes, that are used in satellite and airborne reconnaissance, fire-control systems, and hand-held viewers. Defense Department areas of focus include fire control, remote sensing, flight simulation, avionics, tracking, stealth systems and high energy weapon systems. Our Optical Systems Division participates in a variety of defense applications ranging from high performance sapphire electro magnetic interference ("EMI") windows used in stealth aircraft and ships to satellite optical sensing packages and state of the art flight simulation helmet mounted displays. In addition to mainstream Defense Department and foreign government applications, we are a leading manufacturer of several critical path components to the largest nuclear research laser system ever deployed by the National Ignition Facility ("NIF"), which is used for both weapons maintenance programs and the development of nuclear fusion energy sources. In addition, our Optical Systems Division has expanded into long range surveillance systems valuable to home land security applications, such as nuclear power plant perimeter control, border surveillance, and seaport monitoring.

Nuclear research for both weapons maintenance programs and the development of nuclear fusion energy sources also use large optical lasers at a number of worldwide facilities, including NIF. In addition, projection systems in computer-based flight and battlefield simulation use sophisticated optical systems. Several of our products support these and other defense/aerospace programs.

Medical/Biomedical

The medical and biomedical markets are growing rapidly. The increased demand for high precision medical devices continues to be driven by an aging population and consumers' desire to improve their quality of life. Our Optical Systems Division addresses this demand with specialized design for manufacturing and assembly services tailored to producing high-end diagnostic, processing and surgical devices. In addition, the group offers a variety of process control advantages including medical device quality management systems, such as ISO 13485:2003. Key application areas are diagnostic and surgical ophthalmic devices, inter-oral 3D imaging, and biomedical cell sorting. Supporting these applications are our facilities in Tucson, Arizona (manufacturing) and Costa Mesa, California (development and prototype manufacturing). Strategically located, these facilities are capable of providing highly focused engineering support to fast growing medical and biomedical regions for both manufacturing and research.

Major Optics Industrial Customers include:

AWE	University of Rochester
IntraLase	Zeiss
Lawrence Livermore National Laboratory	

Competition

The semiconductor and industrial markets in which we participate are intensely competitive and are characterized by price pressure and rapid technological change. Furthermore, these markets are dominated by a few market leaders. We are one of a limited number of companies that develop and market yield-enhancement solutions. Our primary yield enhancement competitors include Agilent's Laser Interferometer Positioning Systems Division, Veeco's Metrology Division, SNU Precision, KLA-Tencor, and Rank Taylor Hobson. The principal factors upon which we compete are performance, flexibility, value, on-time delivery, responsive customer service and support, and breadth of product line.

Research, Development and Engineering Operations

We operate in industries that are subject to rapid technological change and engineering innovation. As such, we dedicate substantial resources to research and development. At June 30, 2008, we employed 146 individuals, or approximately 25% of our workforce, within our research and development and engineering operations. Our strategy is to form close technical working relationships with customers and OEM suppliers in our markets to ensure that our products are commercially relevant. We also maintain a close working relationship with various research groups and academic institutions in the United States and abroad. We have been recognized as an innovator in commercializing technology, as evidenced by our numerous achievement awards, including R&D 100 Awards, Photonics Spectra Circle of Excellence Awards, and others. We believe that continued enhancement, development, and commercialization of new and existing products and systems are essential to maintaining and improving our leadership position.

Patents and Other Intellectual Property

Our success and ability to compete depend substantially on our technology. We have been developing a portfolio of intellectual property for over 30 years, and we rely on a combination of patent, copyright, trademark, trade secret laws, and license agreements to establish and protect our proprietary rights for our products.

Since we introduced the first optical interferometer in 1972, we have had approximately 275 United States patents issued, of which approximately 213 are currently active, and approximately 110 foreign patents issued, of which approximately 77 are active. We have approximately 55 United States and approximately 151 foreign patent applications pending. In addition, we have a number of registered and unregistered trademarks.

While we rely on patent, copyright, trademark, and trade secret laws to protect our technology, we also believe that the technological and creative skills of our personnel, new product developments, frequent product enhancements, and reliable product maintenance are essential to establishing and maintaining a technology leadership position. We do not expect expirations in the near future related to our active patents to have a material effect on our business.

BACKLOG AND ORDERS

Backlog at June 30, 2008 was \$72.3 million, an increase of \$0.1 million as compared with \$72.2 million at June 30, 2007. The fiscal 2008 year-end backlog consisted of \$44.9 million, or 62%, in the Metrology segment and \$27.4 million, or 38%, in the Optics segment. Orders for the fiscal year ended June 30, 2008 totaled \$159.1 million and consisted of \$121.0 million, or 76%, in the Metrology segment and \$38.1 million, or 24%, in the Optics segment.

MARKETING AND SALES

Our sales and marketing strategy is to establish and/or solidify strategic relationships with leading OEMs and end-users in targeted sectors within our markets. The selling process for our products is performed through

our worldwide sales organization operating out of regional sales offices in California, China, Connecticut, Germany, Japan, Singapore, and Taiwan. Supporting this core sales team are business development, marketing, service, and engineering specialists representing our various optics and metrology units in Connecticut, Arizona, California, Florida, Canada, and Singapore. Product promotion is done through trade shows, printed and e-business advertising, and industry technical organizations.

The following table sets forth the percentage of our total sales by region (based on shipping destination, including sales delivered through distributors) during the past three years:

	Fiscal Year Ended June 30,		
	2008	2007	2006
Americas	<u>48%</u>	<u>39%</u>	<u>35%</u>
Far East:			
Japan	28%	37%	45%
Pacific Rim	10%	13%	11%
Total Far East	<u>38%</u>	<u>50%</u>	<u>56%</u>
Europe	<u>14%</u>	<u>11%</u>	<u>9%</u>
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

Customer service is an essential part of our business since product up time is critical given its effect on our customers' production efficiency. As of June 30, 2008, our global sales customer support and service organization consisted of 110 people skilled in sales, marketing, optical and electro component repair, software, application and system integration, diagnostics, and problem-solving capabilities.

MANUFACTURING, RAW MATERIALS, AND SOURCES OF SUPPLY

Our principal manufacturing activities are conducted at our facilities in Middlefield, Connecticut and Tucson, Arizona. We also perform manufacturing activities in our Canada, Singapore, China, and Florida facilities and utilize a third-party assembly operation in Taiwan for our Flat Panel Display systems.

We maintain an advanced optical components manufacturing facility in Middlefield, Connecticut, specializing in the fabrication, polishing, and coating of plano, or flat, optics for sales to third parties, as well as the manufacturing of a wide variety of optics that are used in our metrology products. Our manufacturing activities for our metrology products consist primarily of assembling and testing components and sub-assemblies supplied by us and third-party vendors, and then integrating these components and sub-assemblies into our finished products.

Our optical assembly manufacturing activities are conducted in our Tucson, Arizona facility. We integrate our optics, optics from third party vendors, and mechanical sub-systems utilizing our metrology in this facility.

Certain components and sub-assemblies incorporated into our systems are obtained from a limited group of suppliers. We routinely monitor limited source supply parts, and we endeavor to ensure that adequate inventory is available to maintain manufacturing schedules should the supply of any part be interrupted. Although we seek to reduce our dependence on limited source suppliers, we have not qualified a second source for some of these products and the partial or complete loss of certain of these sources could have a negative impact on our results of operations and damage customer relationships.

AVAILABLE INFORMATION

We make available free of charge through our website, www.zygo.com, our annual reports, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission ("SEC"). These reports may also be obtained without charge by contacting Investor Relations, Zygo Corporation, Corporate Headquarters, Laurel Brook Road, Middlefield, Connecticut 06455-1291, phone: (860) 347-8506. Our Internet website and the information contained therein or incorporated therein are not intended to be incorporated into this Annual Report. In addition, the public may read and copy any materials we file with the SEC's Public Reference Room at 100 F Street, NE, Room 1580, Washington, DC 20549 or may obtain information by calling

the SEC at 800-SEC-0330. Moreover, the SEC maintains an Internet website that contains reports, proxy, and information statements, or other information regarding reports that we file electronically with them at <http://www.sec.gov>.

EMPLOYEES

At June 30, 2008, we employed 595 people and 13 temporary agency and independent contractors worldwide. We employed 255 in manufacturing, 146 in research and development, 110 in sales and marketing, and 97 in management and administration. Our employees are not represented by a labor union or a collective bargaining agreement. We regard our employee relations as satisfactory.

EXECUTIVE OFFICERS

At June 30, 2008, our executive officers were:

J. Bruce Robinson – age 66 – Chairman and Chief Executive Officer

Mr. Robinson has served as our Chairman and Chief Executive Officer since December 2006, as Chairman, President, and Chief Executive Officer from November 2000 to November 2006, as President and Chief Executive Officer from November 1999 to November 2000, and as President from February 1999 to November 1999. Previously, he spent 25 years with The Foxboro Company, where his most recent positions were President Worldwide Operations from 1996 to 1998 and President of European Operations from 1990 to 1996. Mr. Robinson is also a director of our company.

James R. Northup – age 47 – President, Metrology Solutions Division

Mr. Northup joined our company in October 2006 and has served as President, Metrology Solutions Division since December 2006. Previously, he served as Executive Vice President of Sales and Marketing and then Chief Operating Officer for Toppan Photomasks, Inc. (formerly DuPont Photomasks), a worldwide manufacturer of photomasks used in the manufacture of integrated circuits, from January 2002 to July 2006. From July 2000 to January 2002, he served as a consultant and as CEO of Gray Scale Technologies, a start-up company specializing in thin film technology serving the semiconductor industry. From April 1990 to July 2000, he held various management positions at Photonics, most recently as President.

John M. Stack – age 43 – President, Optical Systems Division

Mr. Stack joined our company in November 2006 and has served as President of the Optical Systems Division since December 2006. Previously he spent 18 years with Edmund Optics Inc., a supplier of optics and optical components, where his most recent position was President and Chief Operating Officer from 2001 to 2006. Prior to that Mr. Stack held several management positions at Edmund Optics Inc. including Executive Vice President, Director of Engineering and Application Engineering Manager.

Walter A. Shephard – age 54 – Vice President, Finance, Chief Financial Officer, and Treasurer

Mr. Shephard has served as Vice President, Finance, Chief Financial Officer, and Treasurer since February 2004. Previously, he was a Principal with the Loftus Group, LLC, a management consulting firm, from November 2002 to January 2004. From 1983 to 2001, Mr. Shephard served in various capacities with GenRad, Inc., including Vice President Finance and Chief Financial Officer, Vice President of Investor Relations, and Treasurer.

Douglas J. Eccleston – age 59 – Senior Vice President, Precision Positioning Systems

Mr. Eccleston has served as Senior Vice President, Precision Positioning Systems since February 2007 and as Vice President, Precision Positioning Systems from March 2003 to January 2007. From 1977 to 2002, he held various management positions with Corning Incorporated, including most recently as a Business General Manager for the Photonic Technologies division.

Brian J. Monti – age 52 – Senior Vice President, Display Solutions

Mr. Monti has served as Senior Vice President, Display Solutions since February 2007, and served as Vice President, Worldwide Sales and Marketing from July 1999 to January 2007. Prior to that, Mr. Monti was Vice President, Sales, Service and Marketing for Radiometric Corporation from 1998 to 1999. From 1984 to 1998, Mr. Monti held various positions for Honeywell Measurx including Vice President, Sales, Service and Marketing. Mr. Monti ceased to be an employee of ZYGO on April 3, 2009.

Carl A. Zanoni – age 67 – Senior Vice President, Technology

Dr. Zanoni has served as Senior Vice President, Technology since November 2001. Previously, he served as our Vice President, Technology from June 1998 to November 2001, and Vice President, Research, Development and Engineering from April 1992 to June 1998. Dr. Zanoni is a co-founder of our company and is also a director. Mr. Zanoni ceased to be an employee of ZYGO on February 27, 2009.

William H. Bacon – age 58 – Vice President, Corporate Quality and Support Services

Mr. Bacon has served as Vice President, Corporate Quality and Support Services since March 2003. Previously, he served as our Vice President, Manufacturing from April 2002 to March 2003, Vice President, Metrology Manufacturing from April 2000 to April 2002, and Vice President, Corporate Quality from January 1996 to April 2000. From November 1993 to January 1996, Mr. Bacon was Director of Total Quality and also served as Manager of Instrument Manufacturing from June 1987 to November 1993.

David J. Person – age 60 – Vice President, Human Resources

Mr. Person has served as Vice President, Human Resources since September 1998. Previously, he served in a number of senior human resource management positions with Digital Equipment Corporation from 1972 to September 1998.

Under the By-laws, executive officers serve for a term of one year and until their successors are chosen and qualified unless earlier removed.

Item 1A. Risk Factors

We are subject to numerous known and unknown risks, many of which are described below and elsewhere in this Annual Report. Any of the events described below could have a material adverse effect on our business, financial condition and results of operations. Additional risks and uncertainties that we are not aware of, or that we currently deem to be immaterial, could also impact our business and results of operations.

We are dependent on the semiconductor industry which, as a whole, is volatile.

Our business is significantly dependent on capital expenditures and component requirements for manufacturers in the semiconductor industry. This industry is cyclical and has historically experienced periods of oversupply, resulting in significantly reduced demand for capital equipment, including the products manufactured and marketed by us. For the foreseeable future, our operations will continue to be dependent on the capital expenditures in this industry, which in turn is largely dependent on the market demand in the semiconductor markets.

We have been dependent on sales to one large customer; the loss of this customer or expected near-term reduction in orders from this customer would materially affect our sales.

During fiscal 2008, 2007, and 2006, sales to Canon, our largest customer in those periods, accounted for 19%, 27%, and 36% of our net sales, respectively. We expect that sales to Canon will continue to represent a significant, yet declining, percentage of our net sales for the near future. Canon is an original investor in our company, the owner at June 30, 2008 of approximately 7% of our outstanding shares of common stock, and is a distributor of certain of our products in the Japanese market. A reduction or delay in orders from this customer, including reductions or delays due to market, economic, or competitive conditions in the industries in which we or our customer serves, could have a material adverse effect upon our results of operations. Our customers, including Canon, generally do not enter into long-term agreements obligating them to purchase our products.

Our substantial international sales are subject to risk.

We sell our products internationally, primarily to customers in Japan and throughout the Pacific Rim. Net sales to customers outside the United States accounted for approximately 52%, 61%, and 65% of our net sales in each of the fiscal years ended June 30, 2008, 2007, and 2006, respectively, and are expected to continue to account for a substantial percentage of our net sales.

International sales and foreign operations are subject to inherent risks. These risks include the economic conditions in these various foreign countries and their trading partners, political instability, longer payment cycles, greater difficulty in accounts receivable collection, compliance with foreign laws, changes in regulatory requirements, tariffs or other barriers, difficulties in obtaining export licenses, staffing and managing foreign operations, exposure to currency exchange fluctuations, transportation delays, and potentially adverse tax consequences.

Our sales and costs are negotiated and paid primarily in U.S. dollars. However, changes in the values of foreign currencies relative to the value of the U.S. dollar can render our products comparatively more expensive to the extent locally produced alternative products are available. Such conditions could negatively affect international sales of our products and foreign operations, as would changes in the general economic conditions in those markets. For our sales that are based in local currency, we are exposed to foreign exchange fluctuations from the time customers are invoiced in local currency until collection occurs. For fiscal 2008, approximately 24% of our sales were denominated in foreign currencies. We hedge certain intercompany transactions by entering into forward contracts to reduce the impact of adverse fluctuations on earnings associated with foreign currency exchange rate changes. We do not enter into any derivative transactions for speculative purposes. These contracts are entered into for periods consistent with the currency transaction exposures, generally three to nine months. Generally, any gains and losses on the fair value of these contracts are expected to be largely offset by gains and losses on the underlying transactions. There can be no assurance that risks inherent in international sales and foreign operations will not have a material adverse effect on our results of operations in the future.

Acquisitions may entail certain operational and financial risks.

Our growth strategy includes expanding our products and services, and we may seek acquisitions to strategically expand our business. We regularly review potential acquisitions of businesses, technologies, or products complementary to our business and periodically engage in discussions regarding such possible acquisitions. Acquisitions involve numerous risks, including some or all of the following: substantial cash expenditures and capital investments; potentially dilutive issuance of equity securities; incurrence of debt and contingent liabilities; amortization of certain intangible assets; difficulties in assimilating the operations and products of the acquired companies; diverting our management's attention away from other business concerns; risks of entering markets in which we have limited or no direct experience; the inability to manage the growth expected for various acquisitions; potential loss of key employees of the acquired companies in the process of integrating personnel with disparate business backgrounds; and combining different corporate cultures.

We cannot assure you that any acquisition, including the acquisition of the Solvision, Inc. assets which generated losses in fiscal 2008, will result in long-term benefits to us or that our management will be able to effectively manage the acquired businesses. We may also incorrectly judge the value or worth of an acquired company or business. We have in the past disposed or divested ourselves of several companies or lines of business that previously were acquired by us, at a significant net loss to us.

Our quarterly operating results fluctuate and may continue to fluctuate in the future.

Our quarterly and annual operating results have varied in the past and may vary significantly in the future depending on factors such as: budgeting cycles of our customers; the size, timing, and recognition of revenue from significant orders; increased competition; our ability to develop innovative products; the timing of new product releases by us or our competitors; market acceptance of our products; changes in our and our competitors' pricing policies; changes in operating expenses and personnel changes; the effect of our acquisitions and consequent integration; changes in our business strategy; and general economic factors.

Due to these and other factors, we believe that quarter-to-quarter comparisons of our operating results may not be meaningful. You should not rely on our results for one quarter as any indication of our future performance. In future periods, our operating results may be below the expectations of public market analysts or investors. If this occurs, the price of our common stock would likely decrease.

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 or of capital expenditures in the semiconductor and industrial markets. Because all of the components of our budgeting and forecasting are dependent on estimates of spending within these markets, the prevailing economic uncertainty renders estimates of future revenue and expenses even more difficult than usual to make.

Our scheduled backlog may not result in future sales.

We schedule the production of our systems based in part upon order backlog. Due to possible customer changes in delivery schedules and cancellations of orders, our backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. There can be no assurance that amounts included in our backlog will ultimately result in future sales. We have experienced push-outs and cancellations in the semiconductor capital equipment and electro-optics sectors. A reduction in backlog during any particular period, or the failure of our backlog to result in future sales could adversely affect our results of operations.

Our lengthy sales cycle could affect our manufacturing schedule and cause us to incur expenses without realizing sales.

Our lengthy and variable qualification and sales cycle makes it difficult to predict the timing of a sale or whether a sale will be made, which may cause us to have excess manufacturing capacity or inventory and negatively affect our operating results. As is typical in the industry, our customers generally expend significant efforts in evaluating and qualifying our products and manufacturing process. This evaluation and qualification process frequently results in a lengthy sales cycle, typically ranging from three to six months and sometimes longer. While our customers are evaluating our products and before they place an order with us, we may incur

substantial sales, marketing, and research and development expenses, expend significant management efforts, increase manufacturing capacity and order long-lead-time supplies prior to receiving an order. Even after this evaluation process, it is possible that a potential customer will not purchase our products. In addition, product purchases are frequently subject to unplanned processing and other delays, particularly with respect to larger customers for which our products represent a very small percentage of their overall purchase activity.

If we increase capacity and order supplies in anticipation of an order that does not materialize, our gross margins may be negatively impacted, and we may have to carry or write off excess inventory. Even if we receive an order, the additional manufacturing capacity that we add to service the customer's requirements may be underutilized in a subsequent quarter. Either situation could cause our results of operations to be adversely affected. Our long sales cycles also may cause our revenues and operating results to vary significantly and unexpectedly from quarter to quarter.

We face risks associated with manufacturing forecasts.

If we fail to predict our manufacturing requirements accurately, we could incur additional costs or experience manufacturing delays, which could cause us to lose orders or customers and result in lower net sales. We currently use a rolling 12-month forecast based primarily on our anticipated product orders and our product order history to help determine our requirements for components and materials. It is very important that we accurately predict both the demand for our products and the lead-time required to obtain the necessary components and raw materials. Lead times for materials and components that we order vary significantly and depend on factors such as the specific supplier, the size of the order, contract terms, and demand for each component at a given time. If we underestimate our requirements, we may have inadequate manufacturing capacity or inventory, which could interrupt manufacturing of our products and result in delays in shipments and net sales. If we overestimate our requirements, we could have excess inventory of parts. In addition, delays in the manufacturing of our products could cause us to lose orders or customers.

Our stock price may fluctuate significantly due to a variety of risks.

We believe that factors such as the announcement of new products or technologies by us or our competitors, market conditions in the semiconductor and industrial markets, and quarterly fluctuations in financial results are expected to cause the market price of our common stock to vary substantially. Further, our net sales or results of operations in future quarters may be below the expectations of public market securities analysts and investors. In such event, the price of the common stock would likely decline. In addition, historically the stock market has experienced price and volume fluctuations that have particularly affected the market prices for many high technology companies and which often have been unrelated to the operating performance of such companies. The market volatility may adversely affect the market price of shares of our common stock. Furthermore, our common stock trading price may be more susceptible to market fluctuations due to the relatively small public float and trading volume of our stock.

We operate in a highly competitive industry.

We face competition from a number of companies in all our markets, many of which have greater manufacturing and marketing capabilities, and greater financial, technological, and personnel resources. In addition, we compete with the internal development efforts of our current and prospective customers, some of which may attempt to become vertically integrated. Our competitors can be expected to continue to improve the design and performance of their products and to introduce new products with competitive price/performance characteristics. Competitive pressures may necessitate price reductions, which can adversely affect results of operations. Although we believe that we have certain technical and other advantages over some of our competitors, maintaining such advantages will require a continued high level of investment by our company in research and development and sales, marketing, and service. There can be no assurance that we will have sufficient resources to continue to make such investments or that we will be able to make the technological advances necessary to maintain such competitive advantages. In addition, due to historical relationships and possible prior investments by potential customers in competitive product lines, it may be more difficult for us to realize upon certain of our growth strategies and initiatives. There can be no assurance that the basis of competition in the industries in which we compete will not shift.

Our inability to anticipate and keep pace with rapidly changing technological developments in the markets in which we operate could have a material adverse effect on our business.

The market for our products is characterized by rapidly changing technology. Our future success will continue to depend upon our ability to enhance our current products and to develop and introduce new products that keep pace with technological developments and evolving industry standards, respond to changes in customer requirements, and achieve market acceptance. 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. With continuing advances in technology, potential product advancements require an increasing allocation of resources, including potentially more resources than we then would have available.

We commit significant financial and personnel resources on a continuous basis to redesign and enhance our instruments, systems, and components and upgrade our proprietary software technology incorporated in our products. Any failure by us to anticipate or respond adequately to technological developments and customer requirements, or any significant delays in product development or introduction, could have a material adverse effect on our business and impact our close relationships with customers. This could have an impact on customers' willingness to share proprietary information about their requirements and participate in collaborative efforts with us. There can be no assurance that our customers will continue to provide us with timely access to such information, that we will be successful in developing and marketing new products and services or product and service enhancements on a timely basis, or respond effectively to technological changes or new product announcements by others. In addition, there can be no assurance the new products and services or product enhancements, if any, which we developed will achieve market acceptance.

We may be unable to enforce or defend our ownership and use of proprietary technology.

Our success is heavily dependent upon our proprietary technology. There can be no assurance that the steps taken by us to protect our proprietary technology will be adequate to prevent misappropriation of our technology by third parties or will be adequate under the laws of some foreign countries, which may not protect our proprietary rights to the same extent as do laws of the United States. In addition, there remains the possibility that others will "reverse engineer" our products in order to determine their method of operation and introduce competing products or that others will develop competing technology independently. Any such adverse circumstances could have a material adverse effect on our results of operations.

Our business depends on management and technical personnel who are in great demand.

Our success depends in large part upon the continued services of many of our highly skilled personnel involved in management, research, development and engineering, sales and marketing, manufacturing, and support and upon our ability to attract and retain additional highly qualified employees. Our employees may voluntarily terminate their employment with us at any time. Competition for these individuals from a variety of employers, including our competitors and companies in computer or technology-related industries, at times is intense. We cannot assure you that we will be able to retain our existing personnel or attract and retain additional personnel.

We are exposed to significant delays and additional costs if we do not receive adequate or timely supplies of raw materials and other supplies upon which we depend.

We are dependent on suppliers for raw materials and various electrical, mechanical, and optical supplies. Although we enter, either directly or through our contract manufacturers, into purchase orders with our suppliers based on our forecasts, we do not have any guaranteed supply arrangements with these suppliers. Moreover, as our demand for supplies increases, we may not be able to obtain these supplies in a timely manner. If any relationship with a key supplier is terminated or if a supplier fails or is unable to provide reliable services or equipment and we are unable to reach suitable alternative solutions quickly, we may experience significant delays and additional costs in the manufacturing of our products. If our key suppliers cease manufacturing the supplies we require, if their manufacturing operations are interrupted for any significant amount of time, or if they are unable or unwilling to supply us for any other reason, including capacity constraints, then we may be at least temporarily unable to obtain these supplies, thus exposing us to significant delays and additional costs. Currently

there are only a limited number of companies that are capable of supplying optical materials in the quantity and of the quality we require.

We assemble our FPD systems in Taiwan through a third party. We are dependent on the third party to assemble the systems accurately and on a timely basis. To the extent the quality of work, including any individual unit, causes delays or cancellations in shipments to our customers, our results could be adversely affected.

Our products may contain defects that are undetected until after our products are installed which may lead to a loss of reputation and customers.

Our products are deployed in large and complex systems and may contain defects that are not detected until after our products have been installed, which could damage our reputation and cause us to lose customers. We design some of our products for deployment in large and complex optical networks. Because of the nature of these products, they can only be fully tested for reliability when deployed in networks for long periods of time. Our customers may discover defects in our products only after they have been fully deployed and operated under peak stress conditions. In addition, our products are combined with products from other vendors. As a result, should problems occur, it might be difficult to identify the source of the problem. These conditions increase the risk that we could experience, among other things: loss of customers; damage to our brand reputation; failure to attract new customers or achieve market acceptance; diversion of development and engineering resources; and legal actions by our customers. The occurrence of any one or more of the foregoing factors could cause us to experience losses, incur liabilities, and cause our net sales to decline.

We are subject to environmental laws and regulations and may have liabilities arising from environmental matters.

We are subject to a variety of environmental regulations relating to the use, storage, discharge, and disposal of hazardous chemicals used during our manufacturing processes. Any failure by us to comply with present and future regulations could subject us to future liabilities or the suspension of production. We are aware of certain levels of contamination on our property which are below reportable levels. In addition, we are aware of certain contamination on an adjacent property that we formerly owned. We are unable to determine or reasonably estimate the amount of costs, if any, that we might incur or for which we may potentially be responsible. In addition, environmental regulations could restrict our ability to expand our facilities or could require us to acquire costly equipment or to incur other significant expenses to comply with such regulations.

Our investments in marketable securities may lose their value if economic conditions were to deteriorate.

Our marketable securities represent approximately 13% of our total assets at June 30, 2008. To the extent credit markets tighten, interest rates increase, or other economic conditions influence the liquidity of our marketable securities, the value and liquidity of our marketable securities may be adversely affected. In addition, we may have to record an impairment charge for marketable securities if we determine that an other-than-temporary decline in the fair value of a marketable security has taken place. For fiscal 2008, we have recorded an impairment charge for a marketable security of \$0.3 million.

Item 1B. Unresolved Staff Comments

We have received no written comments regarding our periodic or current reports from the staff of the SEC that were issued 180 days or more preceding the end of our fiscal year 2008 that remain unresolved.

Item 2. Properties

We own our principal manufacturing facility and corporate headquarters, which is located on Laurel Brook Road in Middlefield, Connecticut. This facility consists of one 153,500-square-foot building on approximately 13 acres. The following table sets forth information with respect to our facilities which are used by both of our operating segments, except as identified otherwise below:

<u>Operation/Location</u>	<u>Square Footage</u>		<u>Owned / Leased Expiration Date</u>
	<u>Manufacturing</u>	<u>Total</u>	
Corporate Headquarters, Eastern Regional Sales Office, and Metrology and Optics Manufacturing			
Middlefield, Connecticut	89,000	153,500	Owned
Zygo - Optical Systems			
Tucson, Arizona	14,560	22,560	Leased - 08/31/11
Flat Panel Display Metrology Engineering & Manufacturing			
Delray Beach, Florida	4,286	10,323	Leased - 06/30/09
Zygo - Optical Systems			
Costa Mesa, California	0	13,714	Leased - 10/18/10
Western Regional Sales Office and R&D Center			
Sunnyvale, California	0	7,390	Leased - 10/31/08
Semiconductor Process Metrology Office			
Hillsboro, Oregon	0	6,410	Leased - 03/30/13
Zygo - Laser Technology Metrology (R&D)			
Watsonville, California	0	1,452	Leased - 04/14/11
Office			
Franklin, Massachusetts	0	400	Leased - 06/30/09
Zygo PTE Ltd			
Singapore	0	803	Leased - 01/14/10
Zygo Taiwan			
Sales Office	0	3,961	Leased - 12/31/08
Service Office	0	2,772	Leased - 04/30/09
ZygoLOT			
Germany	0	3,702	Leased - 10/01/08
Zygo KK			
Japan	0	1,053	Leased - 01/31/09
Zygo China			
China	0	1,610	Leased - 08/15/08
Zygo Korea			
Korea	0	1,507	Leased - 04/12/09

<u>Operation/Location</u>	<u>Square Footage</u>		<u>Owned / Leased Expiration Date</u>
	<u>Manufacturing</u>	<u>Total</u>	
Zygo Lamda			
China	3,552	12,206	Leased - 09/16/12
Zygo Canada, Inc.			
Canada	2,447	6,851	Leased - 10/06/08
Machine Vision International, PTE			
Singapore	2,500	10,828	Leased - 04/22/09
Total	<u>116,345</u>	<u>261,042</u>	

Item 3. Legal Proceedings

From time to time, we are subject to certain legal proceedings and claims that arise in the normal course of our business. In the opinion of management, we are not party to any litigation that we believe could have a material adverse effect on our financial condition, results of operation or liquidity.

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

None.

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our shares of common stock are traded over-the-counter and are quoted on the NASDAQ/National Market under the symbol "ZIGO." The following table provides information about the high and low sales prices of the Company's common stock by quarter for fiscal 2008 and 2007.

	<u>Fiscal Year Ended June 30, 2008</u>		<u>Fiscal Year Ended June 30, 2007</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
First quarter	\$14.55	\$11.33	\$17.21	\$12.34
Second quarter	\$13.50	\$10.79	\$17.35	\$12.16
Third quarter	\$12.94	\$10.72	\$17.00	\$14.83
Fourth quarter	\$13.50	\$ 9.76	\$16.55	\$14.20

These over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not necessarily represent actual transactions.

The number of record holders of our common stock at September 2, 2008 was 449. Our closing stock price as of June 30, 2008 was \$9.83.

We have never declared or paid a cash dividend on our capital stock and do not anticipate paying any cash dividends in the foreseeable future.

As previously announced, in August 2007, our Board of Directors authorized the repurchase of up to \$25.0 million of our outstanding common stock. As of June 30, 2008, we have repurchased outstanding common shares having an aggregate market value of \$20.0 million (determined at the time of their respective repurchases). Repurchases occur from time to time as market conditions warrant through transactions in the open market. The share repurchases are effected pursuant to a plan in conformity with Rule 10b5-1 under the Securities Exchange Act of 1934. This rule allows public companies to adopt written, pre-arranged stock trading plans when they do not have material, non-public information in their possession. The adoption of this stock trading plan allows us to repurchase our shares during periods when we otherwise might be prevented from doing so under insider trading laws or because of self-imposed trading blackout periods.

We also at times grant restricted stock awards. These awards generally allow recipients to sell a portion of the stock award back to us, in order to cover tax liabilities resulting from the vesting of the award.

Common stock repurchases under our authorized purchase plan and restricted stock repurchases in connection with the surrender of shares to cover taxes upon vesting in each quarter of fiscal 2008 were as follows:

<u>Period</u>	<u>Total number of shares purchased</u>	<u>Average price paid per share</u>	<u>Total number of shares purchased as part of publicly announced plans or programs</u>	<u>Approximate dollar value of shares that may yet be purchased under the plans or programs (in millions)</u>
July 1, 2007 - September 30, 2007	376,402	\$13.05	376,402	\$20.1
October 1, 2007 - December 31, 2007 . . .	929,156	\$12.19	928,765	\$ 8.8
January 1, 2008 - March 31, 2008	336,302	\$11.34	336,239	\$ 5.0
April 1, 2008 - June 30, 2008	806	\$ 9.83	—	\$ 5.0

Common stock repurchases under our authorized purchase plan and restricted stock repurchases in connection with the surrender of shares to cover taxes upon vesting in the fourth quarter of fiscal year 2008 were as follows:

<u>Period</u>	<u>Total number of shares purchased</u>	<u>Average price paid per share</u>	<u>Total number of shares purchased as part of publicly announced plans or programs</u>	<u>Approximate dollar value of shares that may yet be purchased under the plans or programs (in millions)</u>
April 1, 2008 - April 30, 2008	—	\$0.00	—	\$5.0
May 1, 2008 - May 31, 2008	—	\$0.00	—	\$5.0
June 1, 2008 - June 30, 2008	806	\$9.83	—	\$5.0

PERFORMANCE GRAPH

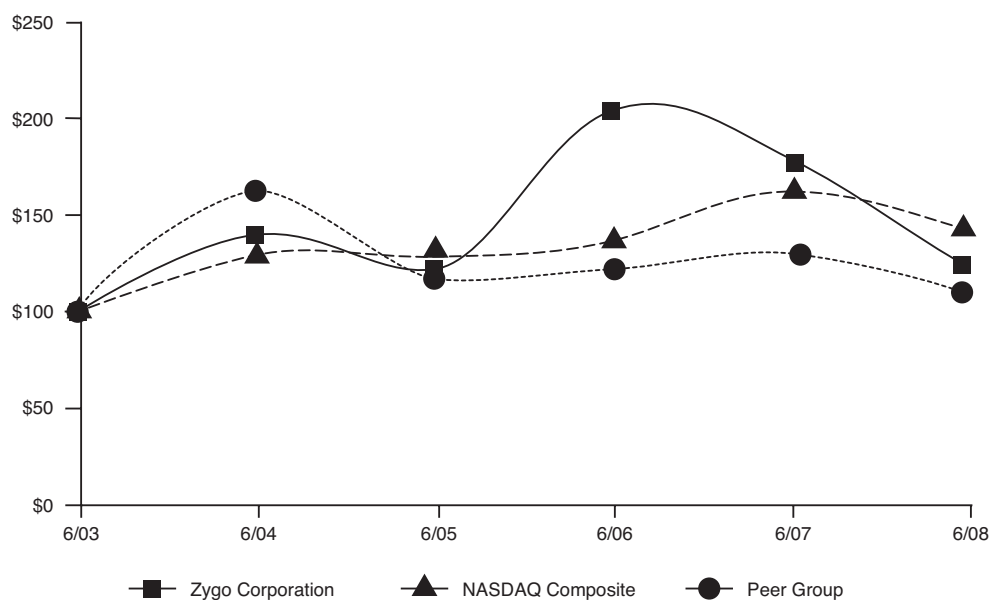
The Stock Price Performance graph below and related information shall not be deemed soliciting material or to be “filed” with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any filing under the Securities Act of 1933, as amended, or under the Securities Exchange Act of 1934, as amended, except to the extent ZYGO specifically incorporates this information by reference.

The graph below compares cumulative total return of our common stock with the cumulative total return of (i) the NASDAQ Composite, and (ii) a group of peer companies weighted to reflect differing market capitalizations. Companies in the peer group are Nanometrics, Inc., Rudolph Technologies, Inc., Veeco Instruments, Inc., II-VI, Incorporated, Mattson Technology, Inc., Semitool, Inc., Photon Dynamics, Inc., Electro Scientific Industries, Inc., GSI Group Inc., and Ultratech, Inc. The peer group consists of issuers selected primarily based on market capitalization and the markets they serve.

	<u>06/30/03</u>	<u>06/30/04</u>	<u>06/30/05</u>	<u>06/30/06</u>	<u>06/30/07</u>	<u>06/30/08</u>
ZYGO CORPORATION	100.00	139.88	122.50	204.88	178.63	122.88
NASDAQ COMPOSITE	100.00	129.09	127.97	136.00	164.15	142.67
PEER GROUP	100.00	162.50	119.30	122.01	129.43	109.36

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Zygo Corporation, The NASDAQ Composite Index And A Peer Group



* \$100 invested on 6/30/03 in stock & index-including reinvestment of dividends.
Fiscal year ending June 30.

Item 6. Selected Financial Data

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 our Consolidated Financial Statements and notes thereto.

	Fiscal Year Ended June 30,				
	2008	2007	2006	2005	2004
Net sales	\$159,036	\$180,988	\$168,137	\$141,349	\$116,276
Gross profit	\$64,823	\$77,183	\$65,771	\$53,290	\$42,680
% of sales	41%	43%	39%	38%	37%
Earnings from continuing operations	\$1,239	\$15,142	\$14,485	\$9,350	\$4,226
% of sales	1%	8%	9%	7%	4%
Earnings per share from continuing operations:					
Basic	\$0.07	\$0.83	\$0.80	\$0.52	\$0.24
Diluted	\$0.07	\$0.81	\$0.79	\$0.52	\$0.23
Net earnings (loss)	\$1,239	\$15,142	\$14,485	\$8,984	(\$3,429)
Net earnings (loss) per share:					
Basic	\$0.07	\$0.83	\$0.80	\$0.50	(\$0.19)
Diluted	\$0.07	\$0.81	\$0.79	\$0.50	(\$0.19)
Weighted average number of shares:					
Basic	17,295	18,156	18,054	17,950	17,802
Diluted	17,648	18,601	18,367	18,140	18,221
Research, development, and engineering	\$24,275	\$22,038	\$15,901	\$13,377	\$13,011
Capital expenditures	\$6,580	\$10,149	\$7,441	\$9,987	\$7,585
Depreciation and amortization	\$7,478	\$6,519	\$6,214	\$5,880	\$5,717
			June 30,		
	2008	2007	2006	2005	2004
Working capital	\$104,851	\$107,834	\$81,914	\$63,379	\$58,504
Current ratio	5.7	4.3	2.8	2.3	3.5
Total assets	\$190,008	\$211,594	\$206,183	\$190,182	\$156,133
Stockholders’ equity	\$162,946	\$177,777	\$158,938	\$141,153	\$131,352
Price-earnings ratio	140	18	21	20	N/A
Number of employees at year-end	595	575	570	526	476
Sales per employee – average	\$267	\$315	\$295	\$269	\$244
Book value per share	\$9.74	\$9.75	\$8.78	\$7.85	\$7.34
Market price per share at year-end	\$9.83	\$14.29	\$16.39	\$9.80	\$11.19

(Thousands, except for per share, number of employees and ratio amounts)

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operation

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 of America. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses, and related disclosures at the date of our consolidated financial statements. On an on-going basis, management evaluates its estimates and judgments, including those related to bad debts, inventories, marketable securities, share-based compensation, warranty obligations, self-insured healthcare claims, income taxes, and long-lived assets. Management bases its estimates and judgments on historical experience and current market conditions 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. We consider certain accounting policies related to revenue recognition and allowance for doubtful accounts, inventory valuation, valuation of marketable securities, share-based compensation, warranty costs, self-insured health insurance costs, accounting for income 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

We recognize revenue based on guidance provided in SEC Staff Accounting Bulletin (“SAB”) No. 104, “Revenue Recognition” and in accordance with the Emerging Issues Task Force (“EITF”) Issue No. 00-21, “Revenue Arrangements with Multiple Deliverables.” We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, our price is fixed or determinable, and collectibility is reasonably assured. We recognize revenue on our standard products when title passes to the customer upon shipment. While our standard products generally require installation, the installation is considered a perfunctory performance obligation. Standard products do not have customer acceptance criteria. Generally, software is a component of our standard product and, as such, is not separately recognized as revenue. We have standard rights of return which relate to defective products under warranty that we account for as a warranty provision under Statement of Financial Accounting Standards (“SFAS”) No. 5, “Accounting for Contingencies.”

We do not have any price protection agreements or other post shipment obligations. For custom equipment where customer acceptance is part of the sales agreement, revenue is recognized when the customer has accepted the product. In cases where custom equipment does not have customer acceptance as part of the sales agreement, we recognize revenue upon shipment as long as the system meets the specifications as agreed upon with the customer. Certain transactions have multiple deliverables, with the deliverables clearly defined. To the extent that the secondary deliverables are other than perfunctory, we recognize the revenue on each deliverable, if separable, or on the completion of all deliverables, if not separable, all in a manner consistent with SAB No. 104 and EITF 00-21. Standalone software products are recognized as revenue when they are shipped. Revenue generated from development contracts are recorded on a cost-plus basis in the period services are rendered.

Certain customer transactions include payment terms whereby Zygo receives a partial payment of the total order amount prior to the related sale being recognized in its financial statements. These advance payments are included in accrued progress payments in the consolidated balance sheet. Generally, these progress payments relate to orders for custom equipment that require a lengthy build cycle and, in some cases, acceptance by the customer. Zygo may negotiate payment terms with these customers on these particular orders and secure certain payments prior to or on shipment of the equipment. These payments remain in accrued progress payments until Zygo’s applicable revenue recognition criteria have been met.

We maintain 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 from our customer before a shipment is made. If the financial condition of our 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. Our 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 future 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 based on management's estimates 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 our products, and technological obsolescence. Management estimates future product sales and service requirements, and evaluates technological changes and other possible uses to determine if inventory is excess or obsolete. If actual market conditions are different than those projected by management, additional inventory write-downs and loss accruals may be required.

Other Than Temporary Impairment of Marketable Securities

Marketable securities have been primarily classified as held-to-maturity, which requires them to be carried at amortized cost. We also have certain securities that are classified as available-for-sale and trading. Management evaluates the need to record adjustments for impairment of marketable securities on a quarterly basis. Marketable securities with unrealized depreciation in fair value for twelve or more consecutive months and other securities with unrealized losses are reviewed to determine whether the decline in fair value is other than temporary.

Investment ratings, company-specific events, general economic conditions, and other reasons are evaluated in determining if the decline in fair value is other than temporary. If it is judged that a decline in fair value is other than temporary, the marketable security is valued at the current fair value and an impairment charge is reflected in earnings.

Share-Based Compensation

We calculate share-based compensation expense in accordance with SFAS 123(R), "Share-Based Payment (as amended)" using the Black-Scholes option-pricing model to calculate the fair value of share-based awards. The key assumptions for this valuation method include the expected term of an option grant, stock price volatility, risk-free interest rate, dividend yield, and forfeiture rate. The determination of these assumptions is based on past history and future expectations, and is subject to a high level of judgment. To the extent any of the assumptions were to change from year to year, the fair value of new option grants may vary significantly.

Warranty Costs

We provide for the estimated cost of product warranties at the time revenue is recognized. We consider historical warranty costs actually incurred and specifically identified circumstances to establish the warranty liability. The warranty liability is reviewed on a quarterly basis. Should actual costs differ from management's estimates, revisions to the estimated warranty liability would be required. A one percent change in actual costs would have an impact of approximately \$10,000 on our financial condition and results of operations.

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. 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. We record a valuation allowance to reduce our deferred tax assets to an estimated realizable 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 to the valuation allowance, changes in pre-tax income between jurisdictions that have higher or lower tax rates, changes to federal, state, or foreign tax laws, and deductibility of certain costs and expenses by jurisdiction.

We adopted the provisions of FASB Interpretation No. 48 (“FIN 48”), “Accounting for Uncertainty in Income Taxes,” on July 1, 2007. Among other tax guidance, FIN 48 requires applying a “more likely than not” threshold to the recognition and de-recognition of tax positions. As a result of this adoption, we recognized a liability for unrecognized income tax benefits of \$1.5 million, an increase in income tax receivables of \$0.6 million, and a charge of approximately \$0.9 million to the July 1, 2007 retained earnings balance. As of the adoption date, we had gross tax-affected unrecognized tax benefits of \$1.8 million, of which \$1.2 million, if recognized, would affect the effective tax rate. Due to our net operating loss carryforwards, we have accrued no interest and penalties for the unrecognized tax benefits; however, our accounting policy is to recognize interest related to unrecognized tax benefits in interest expense. Penalties, if incurred, would be recognized as a component of income tax expense. In the normal course of business, we provide for uncertain tax positions and adjust our unrecognized tax benefits accordingly. For the year ended June 30, 2008, we recognized an additional liability of \$0.1 million for uncertain tax positions. The total liability for uncertain tax liabilities was \$1.9 million at June 30, 2008. We are not aware of any tax positions that would create a significant adjustment to the unrecognized tax benefits during July 1, 2008 through June 30, 2009.

Valuation of Long-Lived Assets

In accordance with SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” 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, an accumulation of costs for an asset in excess of the amount originally expected, a current period operating loss or cash flow decline combined with a history of operating loss or cash flow uses or a projection that demonstrates continuing losses, and a current expectation that, it’s more likely than not, a long-lived asset will be disposed of at a loss before the end of its estimated useful life.

If one or more of such facts or 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 assets is greater than the estimated future cash flows, the assets are written down to the estimated fair value. We determine the estimated fair value of the assets based on a current market value of the assets. If a current market value is not readily available, a projected discounted cash flow method is applied 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.

Health Insurance

We are self-insured for the majority of our group health insurance. We rely on claims experience in determining an adequate liability for claims incurred, but not reported. To the extent actual claims exceed estimates, we may be required to record additional expense. A one percent change in actual claims would have an impact of approximately \$30,000 on our financial condition and results of operations.

OVERVIEW

Zygo Corporation is a worldwide supplier of optical metrology instruments, precision optics, and electro-optical design and manufacturing services, serving customers in the semiconductor capital equipment and industrial markets. Optical instruments products encompass non-contact optical measurement instruments. Optics products consist of high performance macro-optics components, optical coatings, and optical system assemblies. We conduct the majority of our manufacturing in our 153,500 square foot facility in Middlefield, Connecticut and a 22,560 square foot leased facility in Tucson, Arizona.

On February 28, 2008, we acquired certain assets of Solvision, Inc. (“Solvision”), a Canadian-based company, including the shares of its Singapore subsidiary, for \$4.1 million in cash (net of cash received). In addition, the Company had also loaned to Solvision \$1.5 million of which \$0.9 was recouped as part of the purchase price allocation based on asset values. With this acquisition, we entered the market for in-line inspection of flip chip substrates and IC packaging. Included in the acquisition is the patented FMI technology for rapid 3D inspection. We anticipate that continued development of the FMI head and Flip Chip Substrate equipment will occur in Montreal and that the IC packaging inspection product line will continue to be developed and manufactured in Singapore.

During fiscal 2008, we introduced a multiple application single sensor metrology tool for wafer measurements at 45 nanometers and below. We continued strong growth in the medical sector driven by ophthalmic applications and state of the art dental device design and manufacturing. During the latter half of fiscal 2008, we also formed a majority-owned joint venture in China to develop and assemble products designed for the local market.

During the second quarter of fiscal 2007, we reorganized the business into two operating divisions — Metrology Solutions (Metrology segment) and Optical Systems (Optics segment). Consistent with our new business structure, beginning with our second quarter in fiscal 2007 we reported our segments as Metrology and Optics. Prior to the second quarter of fiscal 2007, our segments were reported as Semiconductor and Industrial.

We believe that within the Metrology segment, the semiconductor market continues to contain our best sales growth opportunities for the future. As such, we are focusing our research and development efforts on specific semiconductor initiatives, most notably in the display and packaging markets. During the past year, we expanded our office in Oregon, which houses our semiconductor process metrology group, to take advantage of opportunities in the semiconductor markets. Additionally, we have expanded our flat panel support infrastructure to support our backlog.

Within our Optics segment, areas of growth continue to be in laser fusion optics and medical based products. During fiscal 2008, our Optics segment received a \$4.4 million initial order for long-range night vision surveillance systems. These systems serve a variety of critical Homeland Security, Department of Defense and Department of Energy applications.

Our backlog at June 30, 2008 was \$72.3 million, an increase of \$0.1 million from June 30, 2007. Orders were \$40.5 million in the fourth quarter of fiscal 2008. Orders for the fourth quarter from the Company’s Metrology segment accounted for 79% of the orders received, with the Optics segment accounting for the remaining 21%. For fiscal 2008, orders were \$159.1 million, a decrease of 8% over fiscal 2007. As we have previously disclosed, orders for our lithography OEM products have experienced a sharp decline but have recently stabilized. We anticipate that the order rate for the lithography OEM products will remain constant for the foreseeable future but at a lower rate than in the past. During the latter half of fiscal 2008, we have seen an increase in display systems orders.

As previously announced, in August 2007, our Board of Directors authorized the repurchase of up to \$25.0 million of our outstanding common stock. As of June 30, 2008, we have repurchased \$20.0 million of our outstanding common shares. Repurchases occur from time to time as market conditions warrant through transactions in the open market. The share repurchases are effected pursuant to a plan in conformity with Rule 10b5-1 under the Securities Exchange Act of 1934. This rule allows public companies to adopt written, pre-arranged stock trading plans when they do not have material, non-public information in their possession. The adoption of this stock trading plan allows us to repurchase our shares during periods when we otherwise might be prevented from doing so under insider trading laws or because of self-imposed trading blackout periods.

RESULTS OF OPERATIONS

Fiscal 2008 Compared with Fiscal 2007

Net Sales

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2008	Net Sales %	June 30, 2007	Net Sales %
Segment				
Metrology	\$105.7	66%	\$132.3	73%
Optics	53.3	34%	48.7	27%
Total	\$159.0	100%	\$181.0	100%

Net sales in the Metrology segment decreased 20% in fiscal 2008 as compared with the prior year. The decrease in net sales of \$26.6 million within the Metrology segment was primarily due to volume decreases in lithography sales of \$24.6 million, display sales of \$10.5 million, and semiconductor sales of \$2.5 million, partially offset by an increase in instrument sales of \$9.0 million and vision systems from the Solvision acquisition of \$2.1 million. The increase in instrument sales was primarily due to a \$5.1 million increase in sales in our Europe region based on volume.

Net sales in the Optics segment increased 9% in fiscal 2008 as compared with the prior year. The increase in net sales of \$4.6 million within the Optics segment was primarily due to an increased volume of laser and precision optics of \$4.8 million, offset by a decrease in contract manufacturing sales, which includes medical components, of \$0.2 million.

Approximately 76% of all fiscal 2008 net sales were denominated in U.S. dollars. Significant changes in the values of foreign currencies relative to the value of the U.S. dollar can influence the sales of our products in export markets, as would changes in the general economic conditions in those markets.

Gross Profit

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2008	Net Sales %	June 30, 2007	Net Sales %
Segment				
Metrology	\$50.5	48%	\$62.2	47%
Optics	14.3	27%	15.0	31%
Total	\$64.8	41%	\$77.2	43%

In fiscal 2008, gross profit as a percentage of net sales in the Metrology segment increased one percentage point as compared with the prior year. Gross profit as a percentage of sales in the Optics segment decreased by four percentage points for fiscal 2008 as compared with the prior year. This decrease was primarily due to shipments in the first half of fiscal 2008 for the initial production run of the helmet mounted display units that resulted in zero margin due to cost over-runs on the initial units.

Selling, General, and Administrative Expenses (“SG&A”)

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2008	Net Sales %	June 30, 2007	Net Sales %
	\$38.5	24%	\$32.9	18%

SG&A in fiscal 2008 as compared with fiscal 2007 increased \$5.6 million primarily due to increases in selling and marketing activities of \$7.0 million, partially offset by a reduction in general and administrative expenses of \$1.4 million. The increase in selling and marketing expenses included an additional \$2.4 million in commission expense, primarily related to instrument sales in Europe, an increase of \$1.5 million related to the planned increased presence in Asia, a \$0.9 million increase in semiconductor sales and marketing efforts, an \$0.8 million increase in optics division sales and marketing efforts, and the incurrence of \$0.6 million in expenses for vision systems for the four month period. The decrease in general and administrative costs was primarily related to a reduction in employee costs of \$3.1 million, including management bonus and employee profit sharing

expense, offset by an increase for vision systems of \$1.0 million for the first four months of operation, and of \$0.8 million related to share-based compensation expense.

Research, Development, and Engineering Expenses (“RD&E”)

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2008	Net Sales %	June 30, 2007	Net Sales %
	\$24.3	15%	\$22.0	12%

The increase in RD&E costs in fiscal 2008 was primarily related to increased spending on semiconductor initiatives of \$1.7 million, display solutions of \$1.0 million and vision systems of \$0.9 million, and within the optics division of \$0.5 million. These RD&E cost increases were partially offset by a decrease of \$1.7 million in our precision positioning systems and instruments business. We continue to focus and build on our semiconductor initiatives as one of our core areas of expected future growth.

Income Tax Expense

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2008	Tax Rate %	June 30, 2007	Tax Rate %
	\$1.5	37%	\$9.1	36%

The overall tax rate increased by one percentage point when compared with the prior year primarily due to the repeal of the deduction attributable to the Extraterritorial Income Exclusion (“EIE”) on December 31, 2006.

Net Earnings

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2008	Sales %	June 30, 2007	Sales %
	\$1.2	1%	\$15.1	8%

Net earnings in fiscal 2008 decreased by 92% as compared with the prior year. Net earnings per diluted share were \$0.07 for fiscal 2008, as compared with \$0.81 per diluted share for fiscal 2007. The decreased earnings were primarily the result of decreased net sales in precision positioning systems, display solutions, and semiconductor solutions and increased SG&A and R&D expenses due to additional spending within instruments, the semiconductor initiatives and the inclusion of Solvision operating expenses, which are reflected in our results for the last four months of the fiscal year.

Backlog

Backlog at June 30, 2008 totaled \$72.3 million, an increase of \$0.1 million, from June 30, 2007. The year-end fiscal 2008 backlog consisted of \$44.9 million, or 62%, in the Metrology segment and \$27.4 million, or 38%, in the Optics segment. Orders for fiscal 2008 totaled \$159.1 million. Orders by segment for fiscal 2008 consisted of \$121.0 million, or 76%, in the Metrology segment and \$38.1 million, or 24%, in the Optics segment. We enter fiscal 2009 with a strong display solutions backlog. As we have previously disclosed, orders for our lithography OEM products have experienced a sharp decline but have recently stabilized. We anticipate that the order rate for the lithography OEM products will remain constant for the foreseeable future but at a lower rate than in the past.

Fiscal 2007 Compared with Fiscal 2006

Net Sales

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2007	Net Sales %	June 30, 2006	Net Sales %
Segment				
Metrology	\$132.3	73%	\$125.9	75%
Optics	48.7	27%	42.2	25%
Total	\$181.0	100%	\$168.1	100%

Net sales in the Metrology segment increased 5% in fiscal 2007 as compared with the prior year. The increase in net sales of \$6.4 million within the Metrology segment was primarily due to an increase in display sales of \$10.0 million, net sales to our lithography customers of \$9.6 million, and semiconductor sales of \$2.7, partially offset by a decrease in development services revenue of \$15.9 million.

Net sales in the Optics segment increased 15% in fiscal 2007 as compared with the prior year. The increase in net sales of \$6.5 million within the Optics segment was primarily due to an increased volume of optical system assemblies of \$3.4 million and contract manufacturing of \$3.0, which includes medical component sales.

Approximately 79% of all fiscal 2007 net sales were denominated in U.S. dollars. Significant changes in the values of foreign currencies relative to the value of the U.S. dollar can influence the sales of our products in export markets, as would changes in the general economic conditions in those markets.

Gross Profit

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2007	Net Sales %	June 30, 2006	Net Sales %
Segment				
Metrology	\$62.2	47%	\$56.8	45%
Optics	15.0	31%	9.0	21%
Total	\$77.2	43%	\$65.8	39%

Gross profit in the Metrology segment as a percentage of net sales increased by two percentage points in fiscal 2007 as compared with the prior year. The increased gross profit as a percentage of net sales was primarily due to the decrease in development services revenues, which comprised 16% of Metrology revenue in fiscal 2006 and only 3% in fiscal 2007 and which has historically carried margins of 25%-30%. Gross profit in the Optics segment as a percentage of sales increased by ten percentage points for fiscal 2007 as compared with the prior year. This increase was primarily attributable to having a steady order flow within our contract manufacturing operation which increased our efficiency and productivity.

Selling, General, and Administrative Expenses (“SG&A”)

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2007	Net Sales %	June 30, 2006	Net Sales %
	\$32.9	18%	\$31.2	19%

SG&A in fiscal 2007 as compared with fiscal 2006 included increases in sales and marketing of \$1.9 million primarily due to increases in marketing activities of \$0.6 million for our semiconductor products and \$0.5 million for our optical systems solutions. We also incurred additional costs of \$0.6 million as we increased our presence throughout our foreign operations. Administration expenses decreased slightly by \$0.2 million.

Research, Development, and Engineering Expenses (“RD&E”)

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2007	Net Sales %	June 30, 2006	Net Sales %
	\$22.0	12%	\$15.9	9%

The increase in RD&E costs in fiscal 2007 was primarily related to increased spending on our semiconductor initiatives of \$3.1 million, display solutions of \$1.2 million, instrument projects of \$1.4 million, and contract manufacturing projects of \$0.6 million. Semiconductor RD&E contributed to the release, in fiscal 2007, of two new products, the Z3D 7200™ and the UniFire 7900™. Display solution initiatives include developments of new technologies to further enhance our existing product line.

Income Tax Expense

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2007	Tax Rate %	June 30, 2006	Tax Rate %
	<u>\$9.1</u>	<u>36%</u>	<u>\$5.8</u>	<u>28%</u>

Income tax expense in fiscal 2007 increased by 57% as compared with the prior year. The overall tax rate increased by eight percentage points when compared with the prior year. In fiscal 2006, income tax expense included an aggregate tax benefit of \$1.2 million due primarily to the redetermination of our fiscal 2005 and 2004 extraterritorial income exclusion ("EIE").

Net Earnings

<u>(Dollars in millions)</u>	Year Ended			
	June 30, 2007	Sales %	June 30, 2006	Sales %
	<u>\$15.1</u>	<u>8%</u>	<u>\$14.5</u>	<u>9%</u>

Net earnings in fiscal 2007 increased by 4% as compared with the prior year. Net earnings per diluted share were \$0.81 for fiscal 2007, as compared with \$0.79 per diluted share for fiscal 2006. Fiscal 2006 net earnings included a \$0.07 benefit for the effect of the EIE credit related to fiscal 2005 and 2004 of \$1.2 million. The increased earnings were primarily the result of increased net sales and increased gross profits as a percentage of sales which was partially offset by a \$6.1 million increase in RD&E to support our new initiatives.

TRANSACTIONS WITH STOCKHOLDER

Sales to Canon, a stockholder, customer, and distributor of certain of our products in Japan amounted to \$30.7 million (19% of net sales), \$48.1 million (27% of net sales), and \$61.4 million (36% of net sales) for the years ended June 30, 2008, 2007, and 2006, respectively. Selling prices of products sold to Canon are based, generally, on the normal terms customarily given to distributors. Revenues generated from a development contract with Canon were recorded on a cost-plus basis. At June 30, 2008 and 2007, there was in the aggregate, \$3.0 million and \$4.5 million, respectively, of trade accounts receivable from Canon.

In September 2002, we entered into a contract with Canon related to the development of certain interferometers. In March 2004, we signed a preliminary agreement to begin further add-on work; the definitive agreement for this additional work was signed in December 2004. In February 2005, we entered into two additional agreements with Canon related to the development of prototype production tools and accessories. During the twelve months ended June 30, 2007, we recognized revenue of \$4.1 million under the Canon development services contract compared with \$20.0 million for the comparable prior period. Our development services contract with Canon was completed during the third quarter of fiscal 2007.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2008, cash and marketable securities was \$51.0 million, a decrease of \$19.2 million from \$70.2 million at June 30, 2007. The decrease in cash was primarily attributable to \$20.0 million used to fund the repurchase of the company stock and \$5.1 million that was used for the purchase of the Solvision assets. Excluding the purchase of the company stock and the purchase of the Solvision assets, cash and marketable securities would have increased \$6.0 million year-over-year.

Cash flows provided by operating activities were \$14.6 million for fiscal 2008 as compared with \$15.1 million in fiscal 2007. Operating cash flows in fiscal 2008 were impacted primarily by decreased net earnings offset by a decrease in inventories.

Cash flows provided by investing activities for fiscal 2008 were \$14.7 million as compared with cash flows used by investing activities of \$17.8 million in fiscal 2007. Purchases and proceeds of marketable securities

activities were \$20.9 million and \$48.4 million, respectively, in fiscal 2008 and \$38.5 million and \$31.4 million, respectively, in fiscal 2007. Acquisitions of property, plant, and equipment were \$6.6 million in fiscal 2008 as compared with \$10.1 million for fiscal 2007. On February 28, 2008, we acquired certain assets of Solvision, including the shares of its Singapore subsidiary, for \$4.1 million in cash (net of cash received). In addition, the Company had also loaned to Solvision \$1.5 million of which \$0.9 was allocated to the value of assets received.

Cash flows used for financing activities for fiscal 2008 were \$19.9 million as compared with cash flows provided by financing activities of \$0.3 million in fiscal 2007. In August 2007, our Board of Directors approved a stock repurchase program of up to \$25.0 million. We have repurchased \$20.0 million of stock through June 30, 2008.

Although cash requirements will fluctuate during the fiscal year, management believes that cash generated from operations, together with the liquidity provided by existing cash balances and borrowing capability, will be sufficient to satisfy our liquidity requirements for at least the next 12 months. There were no borrowings outstanding under our \$3.0 million bank line of credit agreement at June 30, 2008 and 2007. The agreement contains certain financial covenants which, among others, relate to debt service and consolidated debt ratios.

CONTRACTUAL OBLIGATIONS

The following table summarizes our significant contractual obligations at June 30, 2008, and the effect such obligations are expected to have on our liquidity and cash flows in future periods.

	Payments Due By Period (Dollars in millions)				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating leases	\$4.7	\$1.8	\$2.6	\$0.3	\$ —
Purchase obligations	1.3	1.3	—	—	—
Total	<u>\$6.0</u>	<u>\$3.1</u>	<u>\$2.6</u>	<u>\$0.3</u>	<u>\$ —</u>

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. We have not guaranteed any obligations of a third party.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

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, changes in the investment grade of marketable securities, 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 institutional money market funds (which may include commercial paper, certificates of deposit, and U.S. treasury securities), government agency securities, and corporate bonds. Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly on our short-term instruments. The table below presents investment amounts and related weighted average interest rates by year of maturity for our investment portfolio.

Fair value of investments as of June 30, 2008 maturing in:
(Dollars in millions)

	2009	2010	Thereafter
Marketable securities			
Fixed rate investments	\$17.7	\$5.1	\$1.3
Weighted average interest rate	4.2%	5.5%	4.7%

On June 30, 2008, the Company had variable interest rate money market accounts valued at \$11.7 million.

Marketable Securities Fair Market Value Sensitivity

At June 30, 2008, our investment portfolio included auction rate securities of \$1.3 million of which \$0.3 million is believed to have risk exposure in sub-prime markets. We have reviewed, along with our investment advisor, current investment ratings, company specific events, and general economic conditions in determining whether there is a significant decline in fair value that is other than temporary. To the extent we determine that a decline in fair value is other than temporary, the marketable security will be valued at the then current fair value and an impairment charge will be reflected in earnings. In addition, if the investment grades of the securities decline, liquidity in the market may be restricted or the market value of the security may decline. There also is the possibility that, if credit limits tighten significantly, the issuer may not have access to the capital markets to pay off the securities at the time of maturity.

Exchange Rate Sensitivity

Approximately 76% of our fiscal 2008 net sales were denominated in U.S. dollars. At June 30, 2008, our backlog included orders in U.S. dollars of \$62.8 million, or 87% of the total backlog. Substantially all of our 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 sales of our products in export markets as would changes in the general economic conditions in those markets. For our sales that are based in local currency, we are exposed to foreign exchange fluctuations from the time customers are invoiced in local currency until collection occurs.

We enter into forward contracts to reduce the impact of adverse fluctuations on earnings associated with foreign currency exchange rate changes. We do not enter into any derivative transactions for speculative purposes. These forward contracts are entered into for periods consistent with the currency transaction exposures, generally three to nine months. Any gains and losses on the fair value of these contracts would largely offset corresponding losses and gains on the underlying transactions. The majority of our foreign currency transactions and foreign operations are denominated in the Euro and Japanese yen. In the absence of a substantial increase in sales orders in currencies other than U.S. dollars, we believe a 5% appreciation or depreciation of the U.S. dollar against the Euro and yen would have an immaterial impact on our consolidated financial position and results of operations.

Item 8. Financial Statements and Supplementary Data

Financial statements and supplementary data required pursuant to this item begin on Page F-1 of this Annual Report.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, carried out an evaluation, as of the end of the period covered by this report, of the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based upon their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of such period, our disclosure controls and procedures were effective in recording, processing, summarizing and reporting on a timely basis information required to be disclosed by us in the reports that we file or submit under the Exchange Act and were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our internal controls over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Report of Management on Zygo Corporation's Internal Control Over Financial Reporting

We, as members of management of Zygo Corporation (the "Company"), are responsible for establishing and maintaining adequate internal control over financial reporting, as such term is identified in Exchange Act Rule 13a-15(f). The Company's internal control over financial reporting is a process designed to provide reasonable assurance to the Company's management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Under the supervision and with the participation of management, including our principal executive and financial officers, we assessed the Company's internal control over financial reporting as of June 30, 2008, based on criteria for effective internal control over financial reporting established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, we concluded that the Company maintained effective internal control over financial reporting as of June 30, 2008 based on the specified criteria.

Deloitte & Touche LLP, the independent registered public accounting firm that also audited the Company's consolidated financial statements included in this Form 10-K, audited the operating effectiveness of internal control over financial reporting and issued their attestation report which is included on page F-2.

Zygo Corporation

September 15, 2008

By: /s/ J. Bruce Robinson
J. Bruce Robinson
Chairman and Chief Executive Officer

September 15, 2008

By: /s/ Walter A. Shephard
Walter A. Shephard
Vice President, Finance, Chief Financial Officer,
and Treasurer

Item 9B. Other Information

None.

ZYGO CORPORATION AND CONSOLIDATED SUBSIDIARIES
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
Zygo Corporation
Middlefield, Connecticut

We have audited the accompanying consolidated balance sheets of Zygo Corporation and subsidiaries (the "Company") as of June 30, 2008 and 2007 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2008. We also have audited the Company's internal control over financial reporting as of June 30, 2008, based on the criteria established in "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Report of Management on Zygo Corporation's Internal Control Over Financial Reporting (Item 9A). Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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, 2008 and 2007 and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2008, based on the criteria established in "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As discussed in Notes 1, 12 and 14 to the consolidated financial statements, the Company adopted Financial Accounting Standards Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109", on July 1, 2007 and Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment", on July 1, 2005.

Deloitte & Touche LLP
Hartford, Connecticut
September 12, 2008

CONSOLIDATED BALANCE SHEETS
(Thousands of dollars, except share amounts)

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 26,421	\$ 17,826
Marketable securities (note 3)	17,639	29,453
Receivables, net of allowance for doubtful accounts of \$349 and \$333, respectively (notes 2, 4 and 16)	31,036	32,476
Inventories (notes 2 and 5)	37,542	43,048
Prepaid expenses	2,230	2,240
Income tax receivable (note 14)	241	—
Deferred income taxes (note 14)	12,143	15,077
Total current assets	<u>127,252</u>	<u>140,120</u>
Marketable securities (note 3)	6,963	22,879
Property, plant, and equipment, net (notes 2 and 6)	36,371	36,349
Deferred income taxes (note 14)	8,904	5,700
Intangible assets, net (notes 2 and 7)	9,522	6,110
Other assets	996	436
Total assets	<u>\$190,008</u>	<u>\$211,594</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 7,955	\$ 8,720
Accrued progress payments	5,226	8,770
Accrued salaries and wages	4,156	9,056
Other accrued expenses (note 9)	5,032	4,637
Deferred income taxes	32	1,103
Total current liabilities	<u>22,401</u>	<u>32,286</u>
Long-term income tax payable	1,973	—
Other long-term liabilities	844	555
Minority interest	1,844	976
Commitments and contingencies (notes 9 and 10)		
Stockholders' equity (notes 12, 13 and 14):		
Common stock, \$.10 par value per share:		
40,000,000 shares authorized;		
18,824,670 shares issued (18,692,478 in 2007);		
16,732,399 shares outstanding (18,242,192 in 2007)	1,882	1,869
Additional paid-in capital	152,663	148,844
Retained earnings	32,514	32,194
Accumulated other comprehensive income:		
Currency translation effects	1,316	205
Net unrealized loss on marketable securities (note 3)	(39)	—
	<u>188,336</u>	<u>183,112</u>
Less treasury stock, at cost; 2,092,271 common shares (450,286 in 2007) .	25,390	5,335
Total stockholders' equity	<u>162,946</u>	<u>177,777</u>
Total liabilities and stockholders' equity	<u>\$190,008</u>	<u>\$211,594</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Thousands except per share amounts)

	Fiscal Year Ended June 30,		
	2008	2007	2006
Net sales:			
Products	\$159,036	\$176,937	\$148,123
Development services	<u>—</u>	<u>4,051</u>	<u>20,014</u>
	<u>159,036</u>	<u>180,988</u>	<u>168,137</u>
Cost of goods sold:			
Products	94,213	100,835	88,119
Development services	<u>—</u>	<u>2,970</u>	<u>14,247</u>
	<u>94,213</u>	<u>103,805</u>	<u>102,366</u>
Gross profit	64,823	77,183	65,771
Selling, general, and administrative expenses	38,501	32,876	31,125
Research, development, and engineering expenses	<u>24,275</u>	<u>22,038</u>	<u>15,901</u>
Operating profit	<u>2,047</u>	<u>22,269</u>	<u>18,745</u>
Other income:			
Interest income	2,367	2,990	2,119
Miscellaneous income (expense), net	<u>(235)</u>	<u>(9)</u>	<u>262</u>
Total other income	<u>2,132</u>	<u>2,981</u>	<u>2,381</u>
Earnings from operations before income tax expense and minority interest	4,179	25,250	21,126
Income tax expense (note 14)	(1,542)	(9,132)	(5,849)
Minority interest	<u>(1,398)</u>	<u>(976)</u>	<u>(792)</u>
Net earnings	<u>\$ 1,239</u>	<u>\$ 15,142</u>	<u>\$ 14,485</u>
Basic - Earnings per share:	\$ 0.07	\$ 0.83	\$ 0.80
Diluted - Earnings per share:	\$ 0.07	\$ 0.81	\$ 0.79
Weighted average number of shares:			
Basic	<u>17,295</u>	<u>18,156</u>	<u>18,054</u>
Diluted	<u>17,648</u>	<u>18,601</u>	<u>18,367</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Thousands of dollars)

	Total	Compre- hensive Income (Loss)	Retained Earnings	Accumulated Other Compre- hensive Income (Loss)	Common Stock	Treasury Stock	Paid-In Capital
Balance at July 1, 2005	\$141,153		\$ 2,567	\$ (80)	\$1,842	\$ (5,287)	\$142,111
Comprehensive income:							
Net earnings	14,485	<u>\$14,485</u>	14,485				
Other comprehensive income (loss), net of tax:							
Unrealized loss on marketable securities	(13)	(13)					
Foreign currency translation effect ..	186	<u>186</u>					
Other comprehensive (loss)		<u>173</u>		173			
Comprehensive income		<u><u>\$14,658</u></u>					
Non-cash compensation charges							
related to stock options	1,698						1,698
Employee stock purchase	492				5		487
Exercise of employee stock options and related tax effect	<u>937</u>				<u>8</u>		<u>929</u>
Balance at June 30, 2006	158,938		17,052	93	1,855	(5,287)	145,225
Comprehensive income:							
Net earnings	15,142	<u>\$15,142</u>	15,142				
Other comprehensive income (loss), net of tax:							
Unrealized loss on marketable securities	(19)	(19)					
Foreign currency translation effect ..	131	<u>131</u>					
Other comprehensive income		<u>112</u>		112			
Comprehensive income		<u><u>\$15,254</u></u>					
Non-cash compensation charges							
related to stock options	2,189						2,189
Employee stock purchase	323				2		321
Repurchase of company stock	(48)					(48)	
Exercise of employee stock options and related tax effect	<u>1,121</u>				<u>12</u>		<u>1,109</u>
Balance at June 30, 2007	177,777		32,194	205	1,869	(5,335)	148,844
Comprehensive income:							
Net earnings	1,239	<u>\$ 1,239</u>	1,239				
Other comprehensive income, net of tax:							
Unrealized loss on marketable securities	(39)	(39)					
Foreign currency translation effect	1,111	<u>1,111</u>					
Other comprehensive income		<u>1,072</u>		1,072			
Comprehensive income		<u><u>\$ 2,311</u></u>					
Non-cash compensation charges							
related to stock options	2,921						2,921
Employee stock purchase	267				2		265
Restricted stock vesting and related tax effect	<u>(88)</u>				<u>4</u>	<u>(6)</u>	<u>(86)</u>
Exercise of employee stock options and related tax effect	726				7		719
Adjustment recorded upon adoption of FIN 48 (note 14)	(919)		(919)				
Repurchase of company stock	<u>(20,049)</u>					<u>(20,049)</u>	
Balance at June 30, 2008	<u><u>\$162,946</u></u>		<u><u>\$32,514</u></u>	<u><u>\$1,277</u></u>	<u><u>\$1,882</u></u>	<u><u>\$(25,390)</u></u>	<u><u>\$152,663</u></u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Thousands of dollars)

	Fiscal Year Ended June 30,		
	2008	2007	2006
Cash provided by operating activities:			
Net earnings	\$ 1,239	\$ 15,142	\$ 14,485
Adjustments to reconcile net earnings to cash provided by operating activities:			
Depreciation and amortization	7,478	6,519	6,214
Loss on disposal of assets	70	190	266
Deferred income taxes	(379)	6,606	3,836
Impairment of marketable securities	291	—	—
Compensation cost related to share-based payment arrangements	2,921	2,189	1,698
Excess tax benefits from share-based payment arrangements	(43)	(190)	(128)
Minority interest	1,398	976	792
Other	764	111	5
Changes in operating accounts, excluding the effect of acquisition:			
Receivables	3,505	1,833	(5,438)
Inventories	8,931	(4,964)	(3,959)
Prepaid expenses	(136)	(138)	20
Accounts payable, accrued expenses, and taxes payable	(11,462)	(13,193)	(1,773)
Net cash provided by operating activities	<u>14,577</u>	<u>15,081</u>	<u>16,018</u>
Cash provided by (used for) investing activities:			
Additions to property, plant, and equipment	(6,580)	(10,149)	(7,441)
Purchase of marketable securities	(20,934)	(38,546)	(31,336)
Additions to intangibles and other assets	(716)	(490)	(816)
Issuance of note receivable	(559)	—	—
Investments and acquisitions, excluding cash acquired	(5,079)	—	—
Proceeds from the maturity of marketable securities	48,388	31,402	22,000
Proceeds from the formation of the joint venture and sale of other assets	222	24	9
Net cash provided by (used for) investing activities	<u>14,742</u>	<u>(17,759)</u>	<u>(17,584)</u>
Cash provided by (used for) financing activities:			
Dividend payments to minority interest	(751)	(1,287)	(622)
Employee stock purchase	267	323	492
Excess tax benefits from share-based payment arrangements	43	190	128
Repurchase of company stock	(20,049)	(48)	—
Restricted stock vesting and related tax benefits	(88)	—	—
Exercise of employee stock options	726	1,121	937
Net cash provided by (used for) financing activities	<u>(19,852)</u>	<u>299</u>	<u>935</u>
Effect of exchange rate changes on cash and cash equivalents	(872)	(113)	—
Net increase (decrease) in cash and cash equivalents	8,595	(2,492)	(631)
Cash and cash equivalents, beginning of year	17,826	20,318	20,949
Cash and cash equivalents, end of year	<u>\$ 26,421</u>	<u>\$ 17,826</u>	<u>\$ 20,318</u>

Supplemental Cash flow information:

Cash paid for income taxes were \$1,375, \$3,272, and \$1,316 in fiscal 2008, 2007, and 2006, respectively.

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years Ended June 30, 2008, 2007, and 2006

(Dollars in thousands, except for per share amounts)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Operations and Principles of Consolidation

Zygo Corporation is a worldwide supplier in optical metrology instruments, precision optics, and electro-optical design and manufacturing services, serving customers in the semiconductor capital equipment and industrial markets. The accompanying consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (U.S. "GAAP") and include the accounts of Zygo Corporation and its subsidiaries ("ZYGO," "we," "us," "our" or "Company"). All transactions and accounts with the subsidiaries have been eliminated from the consolidated financial statements. Minority interest related to our ownership interests of less than 100% is reported as minority interest in subsidiaries in the consolidated balance sheets. The minority ownership interest of our earnings, net of tax, is reported as minority interest in the consolidated statements of operations.

Translation of Foreign Currency Financial Statements

ZYGO's reporting currency is the U.S. dollar. The functional currency of the majority of our foreign subsidiaries is their local currency and, as such, amounts included in the consolidated statements of operations are translated at the weighted-average exchange rates for the period. Assets and liabilities are translated at period-end exchange rates and resulting foreign exchange translation adjustments are recorded in the consolidated balance sheets as a component of accumulated other comprehensive income (loss).

Foreign Currency Transactions

Monetary assets and liabilities denominated in currencies other than the functional currency are remeasured into their respective functional currencies at exchange rates in effect at the balance sheet date. The resulting exchange gain or loss is included in our consolidated statements of operations as miscellaneous income (expense), net.

Cash and Cash Equivalents

We consider 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

We consider investments in securities with maturities at the date of purchase in excess of three months as marketable securities. Marketable securities consist primarily of corporate and government agency securities. Securities held by us at June 30, 2008 and 2007 were classified as held-to-maturity, available-for-sale, and trading. The held-to-maturity investments are recorded at amortized cost. The available-for-sale investments are recorded at fair value and adjusted through stockholders' equity. Trading investments are recorded at fair value and adjusted through the statement of operations.

Inventories

Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market. Obsolete inventory or inventory in excess of management's estimated future usage is written down to its estimated market value, if less than its cost.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Maintenance and repairs are charged to expense as incurred. Management evaluates, on an ongoing basis, the carrying value of our property, plant, and equipment and makes adjustments when impairments are identified. Depreciation is based on the estimated useful lives of the various classes of assets and is computed using the straight-line method.

Intangible Assets

Intangible assets include patents, trademarks, license agreements and customer lists. The cost of intangible assets is amortized on a straight-line basis, over estimated useful lives ranging from 5-17 years.

Valuation of Long-Lived Assets

In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” 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 considered important, which could trigger an 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, an accumulation of costs for an asset in excess of the amount originally expected, a current period operating loss or cash flow decline combined with a history of operating losses or cash flow uses or a projection that demonstrates continuing losses, and a current expectation that, it is more likely than not, a long-lived asset will be disposed of at a loss before the end of its estimated useful life.

If any such facts or circumstances exist, the carrying value of long-lived assets are evaluated 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 assets is greater than the estimated future cash flows, the assets are written down to the estimated fair value. The estimated fair value of the assets is based on a current market value of the assets. If a current market value is not readily available, a projected discounted cash flow method is applied 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.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred 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 tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by valuation allowances if it is determined that it is more likely than not that the deferred tax asset will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

On July 1, 2008, ZYGO adopted the provisions of FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109” (“FIN 48”). We apply a more likely than not threshold to the recognition and de-recognition of tax benefits. The calculation of the tax liabilities involves dealing with uncertainties in the application of complex tax regulations in a multitude of jurisdictions across our global operations. We also recognize potential liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on an estimate of whether it is more likely than not additional taxes will be due.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue Recognition

We recognize revenue based on guidance provided in Securities and Exchange Commission (“SEC”) Staff Accounting Bulletin (“SAB”) No. 104, “Revenue Recognition,” and in accordance with Emerging Issues Task Force (“EITF”) Issue No. 00-21, “Revenue Arrangements with Multiple Deliverables.” We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, our price is fixed or determinable, and collectibility is reasonably assured. We recognize revenue on our standard products when title passes to the customer upon shipment. While our standard products generally require installation, the installation is considered a perfunctory performance obligation. The standard products do not have customer acceptance criteria. Generally, software is a component of our standard product and, as such, is not separately recognized as revenue. Standalone software products are recognized as revenue when they are shipped. We have standard rights of return that we account for as a warranty provision under SFAS No. 5, “Accounting for Contingencies.” We do not have any price protection agreements or other post shipment obligations. For custom equipment where customer acceptance is part of the sales agreement, revenue is recognized when the customer has accepted the product. In cases where custom equipment does not have customer acceptance as part of the sales agreement, we recognize revenue upon shipment, as long as the system meets the specifications as agreed upon with the customer. Certain transactions have multiple deliverables, with the deliverables clearly defined. To the extent that the secondary deliverables are other than perfunctory, we recognize the revenue on each deliverable, if separable, or on the completion of all deliverables, if not separable. Revenue generated from development contracts are recorded on a cost-plus basis in the period services are rendered.

Certain customer transactions include payment terms whereby Zygo receives a partial payment of the total order amount prior to the related sale being recognized in its financial statements. These advance payments are included in accrued progress payments in the consolidated balance sheet. Generally, these progress payments relate to orders for custom equipment that require a lengthy build cycle and, in some cases, acceptance by the customer. Zygo may negotiate payment terms with these customers on these particular orders and secure certain payments prior to or on shipment of the equipment. These payments remain in accrued progress payments until Zygo’s applicable revenue recognition criteria have been met.

Research, Development and Engineering

Research and development costs are expensed as incurred. For fiscal 2008, 2007, and 2006, we expensed \$20,350, \$16,791, and \$12,696 of research and development expense. Reimbursements from customers for research and development costs are recorded as offsets to the expenses. In fiscal 2007 and 2006, reimbursements totaled \$170 and \$1,176, respectively. There were no reimbursed research and development costs in fiscal 2008.

Earnings Per Share

Basic and diluted earnings per share are calculated in accordance with SFAS No. 128, “Earnings Per Share.”

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

	<u>June 30, 2008</u>	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Weighted average shares outstanding	17,294,973	18,155,627	18,053,596
Dilutive effect of stock options and restricted stock	353,090	445,675	313,470
Diluted weighted average shares outstanding	<u>17,648,063</u>	<u>18,601,302</u>	<u>18,367,066</u>

For fiscal 2008, 2007, and 2006, 1,165,069, 808,665, and 782,712, respectively, of the Company’s outstanding stock options and restricted stock awards (“Stock Grants”) were excluded from the calculation of diluted earnings per share because they were antidilutive.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Share-Based Compensation

We have two share-based compensation plans, which are described in Note 12. We account for share-based compensation in accordance with SFAS 123(R), "Share-Based Payment (as amended)." SFAS No. 123(R) eliminates the alternative to use the intrinsic value method of accounting that was provided in SFAS No. 123, which generally resulted in no compensation expense recorded in the financial statements related to the issuance of equity awards to employees and directors to the extent issued at fair market value. SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. SFAS No. 123(R) establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all companies to apply a fair-value-based measurement method in accounting generally for all share-based payment transactions with employees. SFAS 123(R) does not require the recording of compensation expense in periods prior to the date of adoption.

Share-based compensation expense for the fiscal year ended June 30, 2008 was \$2,921, with a related tax benefit of \$1,052. This increased cost of sales by \$239, selling, general, and administration by \$2,340, and research, development, and engineering by \$342. Share-based compensation expense for the fiscal year ended June 30, 2007 was \$2,189, with a related tax benefit of \$788. This increased cost of sales by \$244, selling, general, and administration by \$1,497, and research, development, and engineering by \$448. Share-based compensation expense for the fiscal year ended June 30, 2006 was \$1,698, with a related tax benefit of \$608. This increased cost of sales by \$419, selling, general, and administration by \$1,023, and research, development, and engineering by \$256.

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 payable, and accrued expenses approximate fair value because they are short-term in nature.

Use of Estimates

Management 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 U.S. GAAP. On an ongoing basis, management evaluates its estimates and judgments, including those related to allowances for bad debts, reserves for excess and obsolete inventories, impairments and recoverability of long-lived assets, share-based compensation, income taxes, and warranty obligations. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements

In April 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") No. FAS 142-3, "Determination of the Useful Life of Intangible Assets". The final FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, "Goodwill and Other Intangible Assets". The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. We are in the process of evaluating the impact FSP 142-3 will have on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133" ("SFAS 161"). Statement 161 requires disclosures of how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Statement 161 is effective for our fiscal year beginning July 1, 2009, with early

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

adoption permitted. We are in the process of evaluating the impact of SFAS 161 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51" ("SFAS 160"). SFAS 160 requires that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated balance sheets within equity, but separate from the parent's equity. Furthermore, the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of operations. The provisions of SFAS 160 are effective for our fiscal year beginning July 1, 2009. We are in the process of evaluating the impact of SFAS 160 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" ("SFAS 141R"). SFAS 141R offers specific guidance on how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquirer, and goodwill acquired or any bargain purchase gains. The provisions of SFAS 141R are effective for our fiscal year beginning July 1, 2009. We are in the process of evaluating the impact of SFAS 141R on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS 159"). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, with unrealized gains and losses related to these financial instruments reported in earnings at each subsequent reporting date. The provisions of SFAS 159 are effective for our fiscal year beginning July 1, 2008. We do not expect the impact of SFAS 159 to be material on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for our fiscal year beginning July 1, 2008. We do not expect the impact of SFAS 157 to be material on our consolidated financial statements.

NOTE 2: ACQUISITION

On February 28, 2008 we acquired certain assets of Solvision, Inc. ("Solvision"), a Canadian-based company, including the shares of its Singapore subsidiary for \$5,079, net of cash received under the purchase method of accounting. This amount represents \$4,138 of cash and \$941 representing the value of assets received for the forgiveness of a \$1.5 million note extended to Solvision. The remaining balance of \$559 of the note was charged to bad debt expense. This acquisition allowed us to enter the market for in-line inspection of flip chip substrates and packaged integrated circuits. Included in the acquisition is the patented Fast Moiré Interferometer ("FMI") technology for rapid 3D inspection. This acquisition was integrated into the Metrology segment. The results of operations of this acquisition have been included the consolidated statement of operations commencing on February 28, 2008.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 2: ACQUISITION (Continued)

The following is a preliminary purchase price allocation based on the estimated fair values of the assets acquired and liabilities assumed as of the date of acquisition:

Cash	\$ 102
Deposits	12
Accounts receivable	589
Inventory	2,034
Property and equipment	670
Customer relationships	1,290
Technology	<u>2,046</u>
Total assets	6,743
Less: Liabilities assumed	1,238
Deferred tax liability	<u>324</u>
Total	<u>\$5,181</u>

The following disclosure presents certain information regarding the Company's acquired intangible assets as of June 30, 2008. All acquired intangible assets are being amortized over their estimated useful lives, as indicated below, with no estimated residual values:

Acquired Intangible Assets	Weighted Average Amortization Period	Gross Carrying Amount at February 28, 2008	Effect of Foreign Exchange	Accumulated Amortization	Net Balance at June 30, 2008
Customer relationships	7 Years	\$1,290	\$ (9)	\$ (60)	\$1,221
Technology	7 Years	<u>2,046</u>	<u>(16)</u>	<u>(96)</u>	<u>1,934</u>
Total		<u>\$3,336</u>	<u>\$(25)</u>	<u>\$(156)</u>	<u>\$3,155</u>

The following unaudited pro forma condensed financial information shows the results of operations for the years ended June 30, 2008 and 2007 as though the acquisition of the Solvision, Inc. assets had occurred at the beginning of each respective fiscal year. The proforma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time:

	Year Ended June 30,	
	2008	2007
Net sales	\$161,585	\$186,561
Income (loss) before extraordinary items, discontinued operations, and the cumulative effect of an accounting change	\$ (1,422)	\$ 8,562
Net income (loss)	\$ (1,422)	\$ 8,562
Earnings per share amounts:		
Basic - Earnings (loss) per share	\$ (0.08)	\$ 0.47
Diluted - Earnings (loss) per share	\$ (0.08)	\$ 0.46

As of June 30, 2008, the purchase price allocation has not been completed. This is due to ongoing efforts to finalize the valuation related to certain of the assets acquired. There were no contingent payments, options, or commitments contained in the acquisition agreement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 3: MARKETABLE SECURITIES

Marketable securities consisted primarily of corporate and government agency securities for fiscal 2008 and 2007. The Company classifies these securities as held-to-maturity, trading, or available-for-sale.

Dividend and interest income is recognized when earned. Straight-line amortization related to discounts and premiums on the purchase of marketable securities is recorded in interest income. Realized gains and losses are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

The amortized cost, gross unrealized gains and losses, and fair value of held-to-maturity securities at June 30, 2008 and 2007 were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
At June 30, 2008				
Corporate, federal, state and local municipal bonds	<u>\$22,695</u>	<u>\$103</u>	<u>\$ (51)</u>	<u>\$22,747</u>
At June 30, 2007				
Corporate, federal, state and local municipal bonds	<u>\$52,332</u>	<u>\$ 4</u>	<u>\$(202)</u>	<u>\$52,134</u>

At June 30, 2008, all held to maturity securities consisted of corporate bonds.

At June 30, 2007, \$38,318 consisted of corporate bonds, \$9,914 consisted of federal government bonds, and \$4,100 consisted of state and local municipal bonds.

The cost, gross unrealized gains and losses, and fair value of available-for-sale securities, consisting of auction rate securities, at June 30, 2008 were as follows:

	<u>Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
At June 30, 2008				
Corporate and local municipal bonds	<u>\$ 1,600</u>	<u>\$ —</u>	<u>\$(330)</u>	<u>\$ 1,270</u>

Trading securities consist of a mutual fund investment corresponding to elections made in our deferred compensation program. The cost, gross unrealized gains and losses, and fair value of trading securities at June 30, 2008 were as follows:

	<u>Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
At June 30, 2008				
Mutual fund	<u>\$ 682</u>	<u>\$ —</u>	<u>\$ (45)</u>	<u>\$ 637</u>

Maturities of investment securities classified as held-to-maturity at June 30, 2008 and 2007 were as follows:

	<u>June 30, 2008</u>		<u>June 30, 2007</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Due within one year	<u>\$17,639</u>	<u>\$17,668</u>	<u>\$29,453</u>	<u>\$29,366</u>
Due after one year through five years . . .	<u>5,056</u>	<u>5,079</u>	<u>22,879</u>	<u>22,768</u>
	<u><u>\$22,695</u></u>	<u><u>\$22,747</u></u>	<u><u>\$52,332</u></u>	<u><u>\$52,134</u></u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 3: MARKETABLE SECURITIES (Continued)

Maturities of investment securities classified as available-for-sale at June 30, 2008 and 2007 were as follows:

	June 30, 2008		June 30, 2007	
	Cost	Fair Value	Cost	Fair Value
Due within one year	\$ —	\$ —	\$ —	\$ —
Due after one year	<u>1,600</u>	<u>1,270</u>	—	—
	<u>\$1,600</u>	<u>\$1,270</u>	<u>\$ —</u>	<u>\$ —</u>

The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at June 30, 2008 and 2007.

	Fiscal Year 2008				Total	
	Less than 12 months		More than 12 months		Market Value	Gross Unrealized Losses
	Market Value	Gross Unrealized Losses	Market Value	Gross Unrealized Losses		
Corporate and other	\$6,154	\$(25)	\$1,245	\$(65)	\$7,399	\$(90)
US Government Agencies	—	—	—	—	—	—
	<u>\$6,154</u>	<u>\$(25)</u>	<u>\$1,245</u>	<u>\$(65)</u>	<u>\$7,399</u>	<u>\$(90)</u>

	Fiscal Year 2007				Total	
	Less than 12 months		More than 12 months		Market Value	Gross Unrealized Losses
	Market Value	Gross Unrealized Losses	Market Value	Gross Unrealized Losses		
Corporate and other	\$17,938	\$(53)	\$15,098	\$(127)	\$33,036	\$(180)
US Government Agencies	9,396	(18)	496	(4)	9,892	(22)
	<u>\$27,334</u>	<u>\$(71)</u>	<u>\$15,594</u>	<u>\$(131)</u>	<u>\$42,928</u>	<u>\$(202)</u>

In determining whether investment holdings are other than temporarily impaired, we consider the nature, cause, severity, and duration of the impairment. We and our investment advisors use analyst reports, credit ratings and other items as part of our review. We recognized an other-than-temporary impairment on one available-for-sale auction rate security during fiscal 2008 resulting in a loss of \$291 which was recorded in the statements of operations as part of miscellaneous income (expense).

NOTE 4: RECEIVABLES

At June 30, 2008 and 2007, receivables were as follows:

	June 30, 2008	June 30, 2007
Trade	<u>\$30,816</u>	\$31,033
Other	<u>569</u>	<u>1,776</u>
	<u>31,385</u>	32,809
Allowance for doubtful accounts	<u>(349)</u>	<u>(333)</u>
	<u>\$31,036</u>	<u>\$32,476</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 5: INVENTORIES

At June 30, 2008 and 2007, inventories were as follows:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Raw materials and manufactured parts	\$17,049	\$20,268
Work in process	14,763	17,115
Finished goods	<u>5,730</u>	<u>5,665</u>
	<u>\$37,542</u>	<u>\$43,048</u>

Inventories were reduced by reserves for excess and obsolete items of \$4,602 and \$4,363 as of June 30, 2008 and 2007, respectively.

NOTE 6: PROPERTY, PLANT, AND EQUIPMENT

At June 30, 2008 and 2007, property, plant, and equipment, at cost, were as follows:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>	Estimated Useful Life (Years)
Land	\$ 615	\$ 615	—
Building and improvements	17,270	17,085	15-40
Machinery, equipment, and office furniture	62,940	56,395	3-8
Leasehold improvements	903	795	1-5
Construction in progress	<u>2,050</u>	<u>5,231</u>	—
	<u>83,778</u>	80,121	
Less accumulated depreciation	<u>(47,407)</u>	<u>(43,772)</u>	
	<u>\$ 36,371</u>	<u>\$ 36,349</u>	

Depreciation expense for the fiscal years ended June 30, 2008, 2007, and 2006 was \$7,008, \$6,246, and \$5,734, respectively.

NOTE 7: INTANGIBLE ASSETS

Intangible assets, at cost, at June 30, 2008 and 2007 were as follows:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>	Estimated Useful Life (Years)
Patents and trademarks	\$ 8,106	\$ 7,504	5-17
Customer relationships and technology	<u>3,311</u>	—	7
	<u>11,417</u>	7,504	
Accumulated amortization	<u>(1,895)</u>	<u>(1,394)</u>	
Total	<u>\$ 9,522</u>	<u>\$ 6,110</u>	

Intangible amortization expense for the fiscal years ended June 30, 2008, 2007 and 2006 was \$570, \$322, and \$362, respectively. Intangible amortization expense is estimated to be approximately \$890 in fiscal 2009 and approximately \$900 annually in fiscal 2010-2013. Amortization expense related to patents and trademarks is included in cost of goods sold in the consolidated statements of operations. Amortization expense related to customer relationships and technology is included in selling, general and administrative expense in the consolidated statements of operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 8: BANK LINE OF CREDIT

We have a \$3,000 unsecured bank line of credit agreement bearing interest at our choice of either the prime rate (5.00% at June 30, 2008) or the one month LIBOR rate plus a variable interest rate of 1.0% to 2.5%, based on a pricing grid related to a certain debt ratio, adjusted quarterly. The agreement contains certain financial covenants which, among others, relate to debt service and consolidated debt ratios. The line of credit is available through January 31, 2009. At June 30, 2008 and 2007, no amounts were outstanding under the bank line of credit.

NOTE 9: WARRANTY LIABILITY

A limited warranty is provided on our products for periods typically ranging from 3 to 24 months and allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires management to make estimates of product return rates and expected costs to repair or replace products under warranty. If actual return rates or repair and replacement costs, or both, differ significantly from management's estimates, adjustments to recognize additional expense may be required.

The following is a reconciliation of the beginning and ending balances of our accrued warranty liability, which is included in the "other accrued expenses" line item in the consolidated balance sheets:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Beginning balance	\$ 1,552	\$ 1,660
Reductions for payments made	(1,012)	(1,566)
Changes in accruals related to warranties issued in the current period	1,810	2,293
Changes in accrual related to pre-existing warranties	<u>(1,087)</u>	<u>(835)</u>
Ending balance	<u>\$ 1,263</u>	<u>\$ 1,552</u>

NOTE 10: COMMITMENTS AND CONTINGENCIES

From time to time, we are subject to certain legal proceedings and claims that arise in the normal course of our business. In the opinion of management, we are not party to any litigation that we believe could have a material adverse effect on our financial condition, results of operation or liquidity.

We lease certain manufacturing equipment and facilities under operating leases, some of which include cost escalation clauses, expiring on various dates through fiscal 2013. Total lease expense, net, charged to operations was \$1,844, \$1,363, and \$1,663, in fiscal 2008, 2007, 2006, respectively. At June 30, 2008, the minimum future lease commitments under noncancellable leases payable over the remaining lives of the leases are as follows:

Year ending June 30,	Minimum Future Lease Commitments
2009	\$1,837
2010	1,243
2011	872
2012	446
2013	<u>290</u>
Total minimum lease payments	<u>\$4,688</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 11: PROFIT-SHARING PLAN

We maintain a deferred profit-sharing plan under which substantially all full-time employees are eligible to participate. The profit-sharing plan consists of a cash distribution and a 401(k) program. Profit-sharing cash distributions are determined annually at the discretion of the Board of Directors. We also maintain 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 60% of their compensation, as defined. We contribute to the 401(k) program based on matching up to 4% of an employee's contributions. Under the Employee Stock Ownership Program, we may, at the discretion of the Board of Directors, contribute our own stock or contribute cash to purchase our own stock. The purchased stock's fair market value cannot exceed the maximum amount of employee stock ownership credit as determined under Section 416 of the Internal Revenue Code. Our contribution expenses related to the plans for the years ended June 30, 2008, 2007, and 2006, amounted to \$1,035, \$3,630, and \$2,847, respectively.

NOTE 12: SHARE-BASED COMPENSATION PLANS

Share-Based Compensation Plans

ZYGO has two share-based compensation plans. The Zygo Corporation 2002 Equity Incentive Plan ("2002 Plan") permits the granting of stock options to purchase shares of common stock and the granting of restricted stock up to a total of 3,300,000 shares. The exercise price per share of common stock covered by an option may not be less than the par value per share on the date of grant, and in the case of an incentive stock option, the exercise price may not be less than the market value per share on the date of grant. These options generally vest over a four year period at a rate of 25% each year. Generally, restricted stock awards have 50% of their restrictions lapse after three years and the remaining 50% lapse after four years. The 2002 Plan will expire on August 27, 2012. Pursuant to the terms of the 2002 Plan, the Board of Directors may also amend the 2002 Plan to authorize the grant of other types of equity-based awards, without further action by our stockholders. Options issued to non-employee directors are now issued under this plan. As part of director's compensation for services to our company, non-employee directors are granted 5,000 restricted shares, which vest after one year, on an annual basis and each new non-employee director will be granted options to purchase 16,000 shares of common stock on his or her first day of service, at the market value per share on the date of grant. These options will vest over a four year period at a rate of 25% each year.

The Zygo Corporation Amended and Restated Non-Employee Director Stock Option Plan ("Director Plan") permits the granting of non-qualified options to purchase a total of 620,000 shares (adjusted for stock splits) of common stock at prices not less than the market value of the stock on the date of grant. Under the terms of the Director Plan, as amended on September 24, 1999, each new non-employee director (other than a person who was previously an employee of ZYGO or any of our subsidiaries) was 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 was granted an option to purchase 3,000 shares of common stock on an annual basis. All options were fully exercisable on the date of grant and had a 10-year term. The Director Plan, as amended, will expire on November 17, 2009. The Company ceased granting options under this plan in fiscal 2003 and does not intend to grant further options under the Director Plan.

On June 26, 2001, the Board of Directors granted a warrant to purchase 25,000 shares of our common stock to the Zetetic Institute, a non-profit organization that provides assistance to us 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 vested in equal annual increments over the four-year period following the date of grant. The warrant will expire in fiscal 2011.

We use the Black-Scholes option-pricing model to calculate the fair value of stock option awards. The key assumptions for this valuation method include the expected term of the option, stock price volatility, risk-free interest rate, dividend yield, exercise price, and forfeiture rate. Under the assumptions indicated below, the weighted-average fair value of stock option grants for fiscal 2008, 2007, and 2006 were \$4.99, \$6.23, and \$5.41,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 12: SHARE-BASED COMPENSATION PLANS (Continued)

respectively. The table below indicates the key assumptions used in the option valuation calculations for options granted in fiscal 2008, 2007, and 2006, and a discussion of our methodology for developing each of the assumptions used in the valuation model:

	Fiscal Years Ended June 30,		
	2008	2007	2006
Term	4.0 Years	4.1 Years	4.1 Years
Volatility	45.7%	52.1%	52.9%
Dividend yield	0.0%	0.0%	0.0%
Risk-free interest rate	2.5-4.2%	4.7-4.8%	3.9-4.4%
Forfeiture rate	11.0%	10.7%	10.6%

Term – This is the period of time over which the options granted are expected to remain outstanding. Options granted have a maximum term of ten years. An increase in the expected term will increase compensation expense.

Volatility – This is a measure of the amount by which a price has fluctuated or is expected to fluctuate. Volatilities are based on implied volatilities from traded options of ZYGO’s shares and historical volatility of ZYGO’s shares. An increase in the expected volatility will increase compensation expense.

Risk-Free Interest Rate – This is the U.S. Treasury rate for the week of the grant having a term equal to the expected term of the option. An increase in the risk-free interest rate will increase compensation expense.

Dividend Yield – We did not make any dividend payments during the last five fiscal years and we have no plans to pay dividends in the foreseeable future. An increase in the dividend yield will decrease compensation expense.

Forfeiture Rate – This is the estimated percentage of options granted that are expected to be forfeited or canceled before becoming fully vested. An increase in the forfeiture rate will decrease compensation expense.

Stock Options

Included in the information below are outstanding options from the Zygo Corporation Amended and Restated Non-Qualified Stock Option Plan which expired in fiscal 2003, to the extent the options remain available for exercise.

The following table summarizes information about our stock options granted under our share-based compensation plans for fiscal 2008, 2007, and 2006.

	June 30, 2008		June 30, 2007		June 30, 2006	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	2,057,766	\$25.80	2,082,636	\$26.03	2,069,175	\$26.95
Granted	125,900	\$12.30	175,000	\$13.47	186,000	\$11.80
Exercised	(69,848)	\$ 8.44	(108,740)	\$ 8.85	(83,340)	\$ 9.07
Expired or cancelled	(55,179)	\$34.05	(91,130)	\$27.75	(89,199)	\$33.20
Options - Outstanding-end of year	<u>2,058,639</u>	<u>\$25.33</u>	<u>2,057,766</u>	<u>\$25.80</u>	<u>2,082,636</u>	<u>\$26.03</u>
Options vested or expected to vest	<u>2,004,989</u>	<u>\$25.68</u>	<u>2,018,558</u>	<u>\$26.05</u>	<u>2,054,698</u>	<u>\$26.25</u>
Options - Exercisable-end of year	<u>1,718,789</u>	<u>\$27.95</u>	<u>1,668,766</u>	<u>\$29.13</u>	<u>1,585,574</u>	<u>\$31.19</u>

At June 30, 2008, outstanding options at the end of the year had an intrinsic value of \$792 with a weighted average remaining contractual life of 4.6 years. At June 30, 2008, options vested or expected to vest at the end of the year had an intrinsic value of \$790 with a weighted average remaining contractual life of 4.5 years. In addition, exercisable options at the end of the year had an intrinsic value of \$760 with a weighted average remaining contractual life of 3.9 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 12: SHARE-BASED COMPENSATION PLANS (Continued)

The following table summarizes information about our stock options granted under our share-based compensation plans as of June 30, 2008.

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding as of June 30, 2008	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable as of June 30, 2008	Weighted Average Exercise Price
\$ 5.20 - \$ 7.80	194,807	4.3	\$ 6.48	194,807	\$ 6.48
\$ 7.90 - \$11.85	705,425	4.9	\$10.01	618,225	\$10.04
\$11.99 - \$17.99	598,763	6.5	\$13.56	346,113	\$14.00
\$18.00 - \$27.00	161,292	3.0	\$19.05	161,292	\$19.05
\$32.09 - \$48.14	30,900	2.2	\$42.67	30,900	\$42.67
\$65.69 - \$98.53	367,452	2.2	\$85.25	367,452	\$85.25
\$ 5.20 - \$98.53	<u>2,058,639</u>	<u>4.6</u>	<u>\$25.33</u>	<u>1,718,789</u>	<u>\$27.95</u>

As of June 30, 2008, there was \$1,411 of total unrecognized compensation cost related to stock options. These costs are expected to be recognized over a weighted average period of 2.37 years.

The total intrinsic value of stock options exercised was \$280, \$778, and \$650 and the total fair value of stock awards vested was \$1,005, 1,267, and 1,925 during the fiscal year ended June 30, 2008, 2007 and 2006, respectively.

Cash received from stock option exercises and the associated tax benefit for the fiscal year ended June 30, 2008 was \$690.

Restricted Stock

The following table summarizes information about restricted stock awards granted under share-based compensation plans for the fiscal years ended June 30, 2008, 2007, and 2006:

	June 30, 2008		June 30, 2007		June 30, 2006	
	Shares	Weighted Average Fair Value	Shares	Weighted Average Fair Value	Shares	Weighted Average Fair Value
Non vested balance at beginning of year	368,176	\$12.90	148,200	\$11.51	—	\$ —
Granted	327,050	\$12.00	261,450	\$13.92	154,800	\$11.46
Vested	(43,858)	\$16.46	(8,457)	\$16.33	—	\$ —
Forfeited	(16,221)	\$11.86	(33,017)	\$13.86	(6,600)	\$10.40
Non vested balance at end of year	<u>635,147</u>	<u>\$12.23</u>	<u>368,176</u>	<u>\$12.90</u>	<u>148,200</u>	<u>\$11.51</u>

As of June 30, 2008, there was \$5,213 of total unrecognized compensation costs related to restricted stock awards. These costs are expected to be recognized over a weighted average period of 2.4 years.

At June 30, 2008, an aggregate of 1,504,687 shares remained available for future grants under our share-based compensation plans, which cover stock awards and stock options. We issue shares to satisfy stock option exercises and restricted stock awards, as applicable.

NOTE 13: EMPLOYEE STOCK PURCHASE PLAN

ZYGO has a non-compensatory Employee Stock Purchase Plan (“ESPP”). Under the ESPP, employees who elect to participate have the ability to purchase common stock at a 5% 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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 13: EMPLOYEE STOCK PURCHASE PLAN (Continued)

shares of common stock that may be issued under the ESPP is 500,000. At June 30, 2008 and 2007, we had withheld from employees \$144 and \$145, respectively, for the purchases of shares under this plan, and in July 2008 and 2007, we issued approximately 13,072 and 10,325 shares of common stock, respectively.

NOTE 14: INCOME TAXES

Total income tax expense (benefit) for each year is as follows:

	Fiscal Year Ended June 30,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Earnings from operations	\$1,542	\$9,132	\$5,849
Amounts charged to stockholders' equity	(56)	(164)	(229)
	<u>\$1,486</u>	<u>\$8,968</u>	<u>\$5,620</u>

The income tax expense (benefit) for operations listed above were provided on the following pre-tax book income amounts:

	Fiscal Year Ended June 30,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Earnings from operations - U.S.	\$ (959)	\$21,612	\$17,759
Earnings from foreign operations	5,138	3,638	3,367
	<u>\$4,179</u>	<u>\$25,250</u>	<u>\$21,126</u>

The provision (benefit) for income taxes consists of the following:

	Fiscal Year Ended June 30,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Current:			
Federal	\$ 44	\$ 403	\$ 382
State	(201)	325	158
Foreign	2,078	1,626	1,264
	<u>1,921</u>	<u>2,354</u>	<u>1,804</u>
Deferred:			
Federal	(246)	6,411	4,006
State	221	439	118
Foreign	(354)	(72)	(79)
	<u>(379)</u>	<u>6,778</u>	<u>4,045</u>
Total	<u>\$1,542</u>	<u>\$9,132</u>	<u>\$5,849</u>

The total income tax expense differs from the amount computed by applying the applicable U.S. federal income tax rate of 35% in fiscal 2008, 2007, and 2006 to earnings before income taxes for the following reasons:

	Fiscal Year Ended June 30,		
	<u>2008</u>	<u>2007</u>	<u>2006</u>
Computed "expected tax expense"	\$1,463	\$8,837	\$7,394
Increases (reductions) in taxes resulting from:			
State taxes, net of federal income tax benefit	13	497	179
Export tax incentives	—	(372)	(2,034)
Research credit	—	(62)	—
Tax on foreign dividend	—	—	326
Foreign tax differential	(29)	208	(68)
Other, net	95	24	52
	<u>\$1,542</u>	<u>\$9,132</u>	<u>\$5,849</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 14: INCOME TAXES (Continued)

During fiscal 2006, the Company completed a redetermination of its fiscal 2005 and 2004 Extraterritorial Income Exclusion (“EIE”). Due to this redetermination, the Company recorded a tax benefit of \$1,192. The Company’s tax rate for fiscal 2007 was negatively impacted by the repeal of the EIE. The Company claimed a benefit on foreign trading income from foreign sales through December 31, 2006. The Company does not expect any significant tax benefit from the Manufacturing Deduction as provided in IRC Sec. 199 due to its net operating loss carryforward (“NOL”) position. During fiscal 2006, the Company released a foreign tax reserve of \$328 upon the completion of the taxing authorities’ audit in the foreign jurisdiction.

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, 2008 and 2007 are presented below:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Deferred tax assets:		
Accounts receivable	\$ 75	\$ 93
Accrued liabilities and other	1,388	1,497
Inventory valuation	2,908	3,210
Deferred revenue	—	160
Stock option compensation	2,039	1,190
Intangible assets	—	20
Federal, foreign, and state net operating loss carryforwards and credits	20,377	20,321
Contributions	63	33
	<u>26,850</u>	<u>26,524</u>
Less: Valuation allowance	2,105	2,170
Deferred tax asset	<u>24,745</u>	<u>24,354</u>
Deferred tax liabilities:		
Prepaid expenses	(108)	(136)
Property, plant, and equipment	(3,492)	(3,441)
Intangible assets	(277)	—
Deferred tax liability	<u>(3,877)</u>	<u>(3,577)</u>
Net deferred tax asset	<u>\$20,868</u>	<u>\$20,777</u>

The net current deferred tax assets and net non-current deferred tax assets as recorded on the balance sheet as of June 30, 2008 and 2007 are as follows:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
Net current deferrred tax asset	<u>\$12,111</u>	<u>\$15,077</u>
Net noncurrent deferred tax asset	<u>8,757</u>	<u>5,700</u>
Net deferred tax asset	<u>\$20,868</u>	<u>\$20,777</u>

The deferred tax provisions for 2008 and 2007 do not reflect the tax benefit of \$56 and \$164, respectively, resulting from amounts charged to other comprehensive income and paid in capital, from the exercise of employee stock options.

During 2008, the valuation allowance changed primarily due to the generation of additional tax credits that were fully valued, along with the utilization of fully valued net operating losses.

Management believes it is more likely than not that the remaining net deferred tax assets of \$20,868 as of June 30, 2008 will be realized as the results of future operations are expected to generate sufficient taxable income to do so.

At June 30, 2008, our share of the cumulative undistributed earnings of foreign subsidiaries was \$4,318. No provision has been made for U.S. or additional foreign taxes on the undistributed earnings of foreign subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 14: INCOME TAXES (Continued)

because we intend 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, 2008, we have federal, state, and foreign NOL carryforwards of approximately \$29,611, \$20,572, and \$1,716, respectively, and various state and foreign credit carryforwards of \$5,569 and \$110. The federal NOL will expire from fiscal 2023 through fiscal 2025, while the state NOL and credits will expire from fiscal 2013 through fiscal 2025. The foreign NOL will begin to expire in 2014. We also have federal general business credit carryforwards of approximately \$4,911, which are available to reduce federal income taxes, if any, through 2019 and begin to expire in 2012. In addition, the Company also has alternative minimum tax credit carryforwards of approximately \$789, which are available to reduce future federal regular income taxes, if any, over an indefinite period. The Company also has outstanding refunds from R&D tax credits of \$411.

We adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," on July 1, 2007. As a result of this adoption, we recognized a liability for unrecognized income tax benefits of \$1,535, an increase in income tax receivables of \$616, and a charge of approximately \$919 to the July 1, 2007 retained earnings balance. As of the adoption date, we had gross tax-affected unrecognized tax benefits of \$1,784, of which \$1,168, if recognized, would affect the effective tax rate. Due to our net operating loss carryforwards, we have accrued no interest and penalties for the unrecognized tax benefits; however, our accounting policy is to recognize interest related to unrecognized tax benefits in interest expense. Penalties, if incurred, would be recognized as a component of income tax expense. In the normal course of business, we provide for uncertain tax positions and adjust our unrecognized tax benefits accordingly. For the year ended June 30, 2008, we recognized an additional liability of \$88 for uncertain tax positions. The total liability for unrecognized tax benefits was \$1,872 at June 30, 2008. We are not aware of any tax positions that would create a significant adjustment to the unrecognized tax benefits during July 1, 2008 through June 30, 2009.

The following table is a reconciliation of the beginning and ending balances of unrecognized tax benefits:

Unrecognized tax benefits, July 1, 2007	\$1,784
Gross increases - current filing positions	<u>88</u>
Unrecognized tax benefits, June 30, 2008	<u>\$1,872</u>

We are subject to U.S. federal income tax as well as income tax in multiple state and foreign jurisdictions. We are no longer subject to U.S. federal income tax audit or tax adjustments for years prior to June 30, 1997. We are no longer subject to state and foreign income tax audit or tax adjustments for years prior to June 30, 2000 and June 30, 2003, respectively. We are currently not under income tax audit in any jurisdiction.

NOTE 15: SEGMENT REPORTING

During the second quarter of fiscal 2007, we reorganized the business into two operating divisions – Metrology Solutions (Metrology segment) and Optical Systems (Optics segment). Consistent with our new business structure, beginning with the second quarter in fiscal 2007, we reported our segments as Metrology and Optics. The Metrology segment consists of OEM and in-line products primarily for the semiconductor and industrial markets. The Optics segment consists of components and opto-mechanical assemblies primarily for the medical, defense, and aerospace industries, which are included in the industrial market. The chief operating decision-maker uses this information to allocate resources. Prior to the second quarter of fiscal 2007, our segments were reported as Semiconductor and Industrial. Fiscal 2006 segment information has been restated in a manner consistent with our new reporting segments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 15: SEGMENT REPORTING (Continued)

	Fiscal Year Ended June 30,		
	2008	2007	2006
Metrology			
Sales	\$105,700	\$132,264	\$125,880
Gross profit	50,529	62,189	56,818
Gross profit as a % of sales	48%	47%	45%
Optics			
Sales	\$53,336	\$48,724	\$42,257
Gross profit	14,294	14,994	8,953
Gross profit as a % of sales	27%	31%	21%
Total			
Sales	\$159,036	\$180,988	\$168,137
Gross profit	64,823	77,183	65,771
Gross profit as a % of sales	41%	43%	39%

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.

Substantially all of our operating assets, depreciation, and amortization are U.S. based. Sales by geographic area based on shipping destination were as follows:

	Fiscal Year Ended June 30,		
	2008	2007	2006
Americas:			
America	\$ 75,596	\$ 71,330	\$ 58,446
Canada	1,551	—	—
Total Americas	77,147	71,330	58,446
Far East:			
Japan	44,354	66,613	76,595
Pacific Rim	15,202	23,985	18,233
Total Far East	59,556	90,598	94,828
Europe	22,333	19,060	14,863
Total	\$159,036	\$180,988	\$168,137

NOTE 16: TRANSACTIONS WITH STOCKHOLDER

Sales to Canon, Inc., a stockholder representing approximately 7% ownership at June 30, 2008, and Canon Sales Co., Inc., a distributor of certain of our products in Japan and a subsidiary of Canon Inc. (collectively "Canon"), amounted to \$30,711 (19% of net sales), \$48,147 (27% of net sales), and \$61,366 (36% of net sales), for the years ended June 30, 2008, 2007, and 2006, respectively. Substantially all of these sales occurred in the Metrology segment. Selling prices of products sold to Canon are based, generally, on the normal terms given to distributors. Revenues generated from development contracts were recorded on a cost-plus basis.

In September 2002, we entered into a contract with Canon related to the development of certain interferometers. In March 2004, we signed a preliminary agreement to begin further add-on work; the definitive agreement for this additional work was signed in December 2004. In February 2005, we entered into two additional agreements with Canon related to the development of prototype production tools and accessories. Work on these development services was completed during the third quarter of fiscal 2007. During fiscal 2007 and 2006, we recognized revenue in the Metrology segment of \$4,051, and \$20,014, respectively, for the original contract and subsequent add-on work. At June 30, 2008 and 2007, there were, in the aggregate, \$3,032 and \$4,515, respectively, of trade accounts receivable from Canon.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

NOTE 17: HEDGING ACTIVITIES

We enter into foreign currency forward contracts to reduce the impact of adverse fluctuations on earnings associated with foreign currency exchange rate changes. We do not enter into any derivative transactions for speculative purposes. These contracts are not designated as cash flow, fair value, or net investment hedges under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, and therefore, are marked-to-market with changes in fair value recorded to earnings. These contracts are entered into for periods consistent with the currency transaction exposures, generally three to six months. Any gains and losses on the fair value of these contracts would largely offset corresponding losses and gains on the underlying transactions.

As of June 30, 2008, we had twelve foreign currency forward contracts outstanding with notional amount aggregating to \$8,336. Net unrealized (loss) gains recognized from foreign currency forward contracts for fiscal 2008, 2007 and 2006 was (\$161), \$148, and (\$27), respectively, and are included in other income in the consolidated statements of operations. These gains or losses are substantially offset by foreign exchange losses or gains on intercompany balances recorded by our subsidiaries.

NOTE 18: QUARTERLY RESULTS (UNAUDITED)

The following table sets forth certain unaudited quarterly financial data:

	For the Fiscal Year Ended June 30, 2008			
	<u>September 30,</u>	<u>December 31,</u>	<u>March 31,</u>	<u>June 30,</u>
Net sales	<u>\$31,714</u>	<u>\$40,369</u>	<u>\$38,456</u>	<u>\$48,497</u>
Gross profit	<u>\$11,052</u>	<u>\$16,646</u>	<u>\$15,549</u>	<u>\$21,576</u>
Net earnings (loss)	<u>\$ (944)</u>	<u>\$ 1,179</u>	<u>\$ (49)</u>	<u>\$ 1,053</u>
Basic earnings (loss) per share	<u>\$ (0.05)</u>	<u>\$ 0.07</u>	<u>\$ —</u>	<u>\$ 0.06</u>
Diluted earnings (loss) per share	<u>\$ (0.05)</u>	<u>\$ 0.07</u>	<u>\$ —</u>	<u>\$ 0.06</u>
	For the Fiscal Year Ended June 30, 2007			
	<u>September 30,</u>	<u>December 31,</u>	<u>March 31,</u>	<u>June 30,</u>
Net sales	<u>\$41,107</u>	<u>\$44,682</u>	<u>\$48,655</u>	<u>\$46,544</u>
Gross profit	<u>\$17,791</u>	<u>\$19,767</u>	<u>\$20,411</u>	<u>\$19,214</u>
Net earnings	<u>\$ 3,652</u>	<u>\$ 3,714</u>	<u>\$ 3,966</u>	<u>\$ 3,810</u>
Basic earnings per share	<u>\$ 0.20</u>	<u>\$ 0.20</u>	<u>\$ 0.22</u>	<u>\$ 0.21</u>
Diluted earnings per share	<u>\$ 0.20</u>	<u>\$ 0.20</u>	<u>\$ 0.21</u>	<u>\$ 0.20</u>

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