

NANOMETRICS INC  
Form 10-Q  
July 24, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

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

For the quarterly period ended June 27, 2015

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 0-13470

NANOMETRICS INCORPORATED  
(Exact name of registrant as specified in its charter)  
Delaware  
(State or other jurisdiction of incorporation or organization)

94-2276314  
(I.R.S. Employer Identification Number)

1550 Buckeye Drive  
Milpitas, California  
(Address of principal executive offices)  
Registrant's telephone number, including area code: (408) 545-6000

95035  
(Zip Code)

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

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As of July 17, 2015, there were 24,160,666 shares of common stock, \$0.001 par value, issued and outstanding.

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NANOMETRICS INCORPORATED  
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FOR THE QUARTER ENDED JUNE 27, 2015

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## PART I — FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

NANOMETRICS INCORPORATED  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands except share and per share amounts)

(Unaudited)

	June 27, 2015	December 27, 2014
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$26,421	\$34,676
Marketable securities	48,368	49,286
Accounts receivable, net of allowances of \$214 and \$253, respectively	44,441	26,121
Inventories	41,539	35,105
Inventories-delivered systems	1,574	1,912
Prepaid expenses and other	6,842	9,289
Deferred income tax assets	1,427	1,457
Total current assets	170,612	157,846
Property, plant and equipment, net	47,541	49,633
Goodwill	9,590	10,494
Intangible assets, net	2,886	4,294
Deferred income tax assets	387	410
Other assets	541	559
Total assets	\$231,557	\$223,236
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$13,358	\$10,199
Accrued payroll and related expenses	9,457	8,700
Deferred revenue	10,555	10,021
Other current liabilities	8,221	8,265
Income taxes payable	1,039	1,017
Total current liabilities	42,630	38,202
Deferred revenue	1,479	2,591
Income taxes payable	751	701
Deferred tax liabilities	1,007	926
Other long-term liabilities	1,226	1,279
Total liabilities	47,093	43,699
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 3,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, \$0.001 par value, 47,000,000 shares authorized: 24,059,033 and 23,813,729, respectively, issued and outstanding	24	24
Additional paid-in capital	254,143	251,396
Accumulated deficit	(65,214)	(69,114)
Accumulated other comprehensive income (loss)	(4,489)	(2,769)
Total stockholders' equity	184,464	179,537

Total liabilities and stockholders' equity	\$231,557	\$223,236
See Notes to Condensed Consolidated Financial Statements		

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NANOMETRICS INCORPORATED  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Net revenues:				
Products	\$38,937	\$39,224	\$77,275	\$82,504
Service	9,692	8,805	21,730	17,101
Total net revenues	48,629	48,029	99,005	99,605
Costs of net revenues:				
Cost of products	19,872	19,789	39,863	41,428
Cost of service	5,036	4,655	11,410	9,769
Amortization of intangible assets	457	677	1,089	1,351
Total costs of net revenues	25,365	25,121	52,362	52,548
Gross profit	23,264	22,908	46,643	47,057
Operating expenses:				
Research and development	8,157	9,373	16,316	17,687
Selling	7,029	6,681	14,145	14,054
General and administrative	5,544	6,001	11,310	12,339
Amortization of intangible assets	25	107	64	215
Restructuring charge	—	—	58	—
Total operating expenses	20,755	22,162	41,893	44,295
Income from operations	2,509	746	4,750	2,762
Other income (expense):				
Interest income	46	10	56	24
Interest expense	(83)	(96)	(165)	(196)
Other income, net	(311)	(84)	393	168
Total other income (expense), net	(348)	(170)	284	(4)
Income before income taxes	2,161	576	5,034	2,758
Provision (benefit) for income taxes	817	(12)	1,134	575
Net income	\$1,344	\$588	\$3,900	\$2,183
Net income per share:				
Basic	\$0.06	\$0.02	\$0.16	\$0.09
Diluted	\$0.06	\$0.02	\$0.16	\$0.09
Weighted average shares used in per share calculation:				
Basic	24,020	23,939	23,943	23,825
Diluted	24,285	24,220	24,260	24,217

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Net income	\$1,344	\$588	\$3,900	\$2,183
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	(18	) 174	(1,745	) 385
Net change on unrealized gains on available-for-sale investments	(4	) 8	25	8
Other comprehensive income (loss)	(22	) 182	(1,720	) 393
Comprehensive income	\$1,322	\$770	\$2,180	\$2,576

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended	
	June 27, 2015	June 28, 2014
Cash flows from operating activities:		
Net income	\$3,900	\$2,183
Reconciliation of net income to net cash used in operating activities:		
Depreciation and amortization	4,555	4,814
Stock-based compensation	2,982	3,410
Loss on disposal of fixed assets	501	28
Inventory write-down	1,298	1,527
Deferred income taxes	136	490
Changes in fair value of contingent payments to Zygo Corporation	93	66
Changes in assets and liabilities:		
Accounts receivable	(19,030	) (1,909
Inventories	(8,442	) (3,830
Inventories-delivered systems	339	6,543
Prepaid expenses and other	2,735	1,251
Accounts payable, accrued and other liabilities	4,283	(2,961
Deferred revenue	(579	) (14,978
Income taxes payable	72	(1,203
Net cash used in operating activities	(7,157	) (4,569
Cash flows from investing activities:		
Sales of marketable securities	2,383	—
Maturities of marketable securities	15,836	17,620
Purchases of marketable securities	(17,561	) (19,479
Purchases of property, plant and equipment	(1,043	) (3,813
Net cash used in investing activities	(385	) (5,672
Cash flows from financing activities:		
Payments to Zygo Corporation related to acquisition	(417	) (261
Proceeds from sale of shares under employee stock option plans and purchase plan	2,500	4,201
Taxes paid on net issuance of stock awards	(1,015	) (664
Repurchases of common stock	(1,721	) —
Net cash (used in) provided by financing activities	(653	) 3,276
Effect of exchange rate changes on cash and cash equivalents	(60	) 187
Net decrease in cash and cash equivalents	(8,255	) (6,778
Cash and cash equivalents, beginning of period	34,676	44,765
Cash and cash equivalents, end of period	\$26,421	\$37,987
Supplemental disclosure of non-cash investing activities:		
Transfer of inventory to property, plant and equipment, net	\$1,103	\$617
See Notes to Consolidated Financial Statements		



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NANOMETRICS INCORPORATED  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Note 1. Nature of Business and Basis of Presentation

Description of Business – Nanometrics Incorporated (“Nanometrics” or the “Company”) and its wholly-owned subsidiaries design, manufacture, market, sell and support optical critical dimension (“OCD”), thin film and overlay dimension metrology and inspection systems used primarily in the manufacturing of semiconductors, solar photovoltaics (“solar PV”) and high-brightness LEDs (“HB-LED”), as well as by customers in the silicon wafer and data storage industries. Nanometrics’ metrology systems precisely measure a wide range of film types deposited on substrates during manufacturing to control manufacturing processes and increase production yields in the fabrication of integrated circuits. The Company’s OCD technology is a patented critical dimension measurement technology that is used to precisely determine the dimensions on the semiconductor wafer that directly control the resulting performance of the integrated circuit devices. The thin film metrology systems use a broad spectrum of wavelengths, high-sensitivity optics, proprietary software, and patented technology to measure the thickness and uniformity of films deposited on silicon and other substrates as well as their chemical composition. The overlay metrology systems are used to measure the overlay accuracy of successive layers of semiconductor patterns on wafers in the photolithography process. Nanometrics’ inspection systems are used to find defects on patterned and unpatterned wafers at nearly every stage of the semiconductor production flow. The corporate headquarters of Nanometrics is located in Milpitas, California.

Basis of Presentation – The accompanying condensed consolidated financial statements (“financial statements”) have been prepared on a consistent basis with the audited consolidated financial statements as of December 27, 2014, and include all normal recurring adjustments necessary to fairly state the information set forth therein. All significant intercompany accounts and transactions have been eliminated in consolidation.

The financial statements have been prepared in accordance with the regulations of the United States Securities and Exchange Commission (“SEC”) for interim periods in accordance with S-X Article 10, and, therefore, omit certain information and footnote disclosure necessary to present the statements in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The operating results for interim periods are not necessarily indicative of the operating results that may be expected for the entire year. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended December 27, 2014, which were included in the Company’s Annual Report on Form 10-K filed with the SEC on February 25, 2015.

Fiscal Period – The Company uses a 52/53 week fiscal year ending on the last Saturday of the calendar year. All references to the quarter refer to Nanometrics’ fiscal quarter. The fiscal quarters presented herein consist of 13 weeks.

Use of Estimates – The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ materially from those estimates. Estimates are used for, but not limited to, revenue recognition, the provision for doubtful accounts, the provision for excess, obsolete, or slow moving inventories, valuation of intangible and long-lived assets, warranty accruals, income taxes, valuation of stock-based compensation, and contingencies.

Revenue Recognition – The Company derives revenue from the sale of process control metrology and inspection systems (“product revenue”) as well as spare part sales, billable service, service contracts, and upgrades (together “service revenue”). Upgrades are a group of parts and/or software that change the existing configuration of a product

and are included in service revenue. They are distinguished from product revenue, which consists of complete, advanced process control metrology and inspection systems (the “system(s)”). Nanometrics’ systems consist of hardware and software components that function together to deliver the essential functionality of the system. Arrangements for sales of systems often include defined customer-specified acceptance criteria.

In summary, the Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price is fixed or determinable, and collectability is reasonably assured.

For product sales to existing customers, revenue recognition occurs at the time title and risk of loss transfer to the customer, which usually occurs upon shipment from the Company's manufacturing location, if it can be reliably demonstrated

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NANOMETRICS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

that the product has successfully met the defined customer specified acceptance criteria and all other recognition criteria have been met. For initial sales where the product has not previously met the defined customer specified acceptance criteria, product revenues are recognized upon the earlier of receipt of written customer acceptance or expiration of the contractual acceptance period. In Japan, where contractual terms with the customer specify risk of loss and title transfers upon customer acceptance, revenue is recognized upon receipt of written customer acceptance, provided that all other recognition criteria have been met.

The Company warrants its products against defects in manufacturing. Upon recognition of product revenue, a liability is recorded for anticipated warranty costs. On occasion, customers request a warranty period longer than the Company's standard warranty. In those instances where extended warranty services are separately quoted to the customer, the associated revenue is deferred and recognized as service revenue ratably over the term of the contract. The portion of service contracts and extended warranty services agreements that are uncompleted at the end of any reporting period are included in deferred revenue.

As part of its customer services, the Company sells software that is considered to be an upgrade to a customer's existing systems. These standalone software upgrades are not essential to the tangible product's functionality and are accounted for under software revenue recognition rules which require vendor specific objective evidence ("VSOE") of fair value to allocate revenue in a multiple element arrangement. Revenue from upgrades is recognized when the upgrades are delivered to the customer, provided that all other recognition criteria have been met.

Revenue related to spare parts is recognized upon shipment. Revenue related to billable services is recognized as the services are performed. Service contracts may be purchased by the customer during or after the warranty period and revenue is recognized ratably over the service contract period.

Frequently, the Company delivers products and various services in a single transaction. The Company's deliverables consist of tools, installation, upgrades, billable services, spare parts, and service contracts. The Company's typical multi-element arrangements include a sale of one or multiple tools that include installation and standard warranty. Other arrangements consist of a sale of tools bundled with service elements or delivery of different types of services. The Company's tools, upgrades, and spare parts are generally delivered to customers within a period of up to six months from order date. Installation is usually performed soon after delivery of the tool. The portion of revenue associated with installation is deferred based on relative selling price and that revenue is recognized upon completion of the installation. Billable services are billed on a time and materials basis and performed as requested by customers. Under service contract arrangements, services are provided as needed over the fixed arrangement term, which terms can be up to twelve months. The Company does not grant its customers a general right of return or any refund terms and imposes a penalty on orders cancelled prior to the scheduled shipment date.

The Company regularly evaluates its revenue arrangements to identify deliverables and to determine whether these deliverables are separable into multiple units of accounting. The Company allocates the arrangement consideration among the deliverables based on relative selling prices. The Company has established VSOE for some of its products and services when a substantial majority of selling prices falls within a narrow range when sold separately. For deliverables with no established VSOE, the Company uses best estimate of selling price to determine standalone selling price for such deliverable. The Company does not use third party evidence to determine standalone selling price since this information is not widely available in the market as the Company's products contain a significant element of proprietary technology and the solutions offered differ substantially from competitors. The Company has established a process for developing estimated selling prices, which incorporates historical selling prices, the effect of

market conditions, gross margin objectives, pricing practices, as well as entity-specific factors. The Company monitors and evaluates estimated selling price on a regular basis to ensure that changes in circumstances are accounted for in a timely manner.

When certain elements in multiple-element arrangements are not delivered or accepted at the end of a reporting period, the relative selling prices of undelivered elements are deferred until these elements are delivered and/or accepted. If deliverables cannot be accounted for as separate units of accounting, the entire arrangement is accounted for as a single unit of accounting and revenue is deferred until all elements are delivered and all revenue recognition requirements are met.

Derivatives - The Company enters into forward foreign currency contracts that economically hedge the gains and losses generated by the re-measurement of certain recorded assets and liabilities in a non-functional currency and to offset certain operational exposures from the impact of changes in foreign currency exchange rates. Such exposures result from the portion of the Company's operations, assets and liabilities that are denominated in currencies other than the U.S. dollar. These

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NANOMETRICS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

foreign currency exchange contracts are entered into to support transactions made in the normal course of business, and accordingly, are not speculative in nature. The contracts are for periods consistent with the terms of the underlying transactions. Changes in the fair value of these undesignated hedges are recognized in other income (expense), net immediately as an offset to the changes in the fair value of the asset or liability being hedged.

Note 2. Recent Accounting Pronouncements

In January 2015, the Financial Accounting Standards Board ("FASB") issued an accounting standard update which simplifies income statement classification by removing the concept of extraordinary items from the U.S. GAAP. As a result, items that are both unusual and infrequent will no longer be separately reported net of tax after continuing operations. The new standard is effective for the fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted. The Company does not expect any impact on the adoption of this standard on its consolidated financial statements.

In May 2014, the FASB issued an accounting standards update which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In July 2015, the FASB deferred for one year the effective date of the new revenue standard, but early adoption will be permitted. The new standard will be effective for the Company on January 1, 2018. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that the standard will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

In July 2013, the FASB issued an accounting standards update which provides that a liability related to an unrecognized tax benefit would be offset against a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. In situations in which a net operating loss carryforward, a similar tax loss or a tax credit carryforward is not available at the reporting date under the tax law of the jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit will be presented in the financial statements as a liability and will not be combined with deferred tax assets. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The new standard is effective for fiscal years and interim periods beginning after December 15, 2013. The Company adopted this standard during the three months ended March 29, 2014, resulting in a one-time tax benefit of \$0.3 million, a reduction in deferred tax assets of \$0.3 million, and a reduction in long-term income taxes payable of \$0.6 million.

Note 3. Fair Value Measurements and Disclosures, and Financial Instruments

Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard assumes that the transaction to sell the asset or transfer the liability occurs in the principal or most advantageous market for the asset or liability and establishes that the fair value of an asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability.

The Company determines the fair values of its financial instruments based on the fair value hierarchy established in FASB Accounting Standards Codification ("ASC") 820, Fair Value Measurement, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The

classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into the following three levels that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.

Level 3 — Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Such unobservable inputs include an estimated discount rate used in the Company's discounted present

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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

value analysis of future cash flows, which reflects the Company's estimate of debt with similar terms in the current credit markets. As there is currently minimal activity in such markets, the actual rate could be materially different.

The following tables present the Company's assets and liabilities measured at estimated fair value on a recurring basis, excluding accrued interest components, categorized in accordance with the fair value hierarchy (in thousands), as of the following dates:

	June 27, 2015 Fair Value Measurements Using Input Types				December 27, 2014 Fair Value Measurements Using Input Types			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Money market funds	\$1,699	\$—	\$—	\$1,699	\$610	\$—	\$—	\$610
Total cash equivalents	1,699	—	—	1,699	610	—	—	610
Marketable securities:								
U.S. Treasury, U.S. Government and U.S. Government agency debt securities	2,500	20,032	—	22,532	2,497	20,537	—	23,034
Commercial paper, municipal securities and corporate debt securities	—	25,836	—	25,836	—	26,252	—	26,252
Total marketable securities	2,500	45,868	—	48,368	2,497	46,789	—	49,286
Total <sup>(1)</sup>	\$4,199	\$45,868	\$—	\$50,067	\$3,107	\$46,789	\$—	\$49,896
Liabilities:								
Contingent consideration payable	\$—	\$—	\$2,073	\$2,073	\$—	\$—	\$2,397	\$2,397

<sup>(1)</sup> Excludes \$24.7 million and \$34.1 million held in operating accounts as of June 27, 2015 and December 27, 2014, respectively.

The fair values of the marketable securities that are classified as Level 1 in the table above were derived from quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access. The fair value of marketable securities that are classified as Level 2 in the table above were derived from non-binding market consensus prices that were corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques with all significant inputs derived from or corroborated by observable market data. There were no transfers of instruments between Level 1, Level 2 and Level 3 during the financial periods presented.

## Changes in Level 3 liabilities (in thousands)

Fair value at December 27, 2014	\$2,397
Payments made to Zygo Corporation	(417 )
Change in fair value included in earnings	93

Fair value at June 27, 2015

\$2,073

As of June 27, 2015, the Company had liabilities of \$2.1 million resulting from the acquisition of certain assets from Zygo Corporation (“Zygo”), which are measured at fair value on a recurring basis, with changes in fair value recorded in other income (expense), net. Of the \$2.1 million of Zygo liabilities at June 27, 2015, \$1.1 million was a current liability and \$1.0 million was a long-term liability. As of December 27, 2014, the liabilities totaled \$2.4 million of which \$1.4 million was a current liability and \$1.0 million was a long-term liability. The fair values of these liabilities were determined using Level 3

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NANOMETRICS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

inputs applying a discounted cash flow model incorporating assumptions that market participants would use in their estimates of fair value. Some of these assumptions included estimates for discount rate, and timing and the amount of cash flows.

**Derivatives**

The Company uses foreign currency forward contracts to mitigate variability in gains and losses generated from the re-measurement of certain monetary assets and liabilities denominated in foreign currencies. These derivatives are carried at fair value with changes recorded in other income (expense), net in the consolidated statements of operations. Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities. The derivatives have maturities of approximately 30 days.

The loss on settlement of forward foreign currency contracts included in the three and six months ended June 27, 2015, was \$0.1 million, and is included in other income (expense), net, in the consolidated statements of operations.

There were no forward foreign currency contracts entered into in fiscal 2014.

The following table summarizes the Company's outstanding derivative instruments on a gross basis as of June 27, 2015:

	Notional Principal (in millions)
Undesignated Hedges:	
Forward Foreign Currency Contracts	\$20.3

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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 4. Cash and Investments

The following tables present cash, cash equivalents, and available-for-sale investments as of the following dates (in thousands):

	June 27, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Cash	\$24,722	\$—	\$—	\$24,722
Cash equivalents:				
Money market funds	1,699	—	—	1,699
Marketable securities:				
Commercial paper	1,799	—	—	1,799
U.S. Treasury securities	2,499	—	—	2,499
U.S. Government agency securities	20,030	5	(3 )	20,032
Municipal securities	3,729	2	(1 )	3,730
Corporate debt securities	20,319	1	(12 )	20,308
Total cash, cash equivalents, and marketable securities	\$74,797	\$8	\$(16 )	\$74,789
	December 27, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Cash	\$34,066	\$—	\$—	\$34,066
Cash equivalents:				
Money market funds	610	—	—	610
Marketable securities:				
Commercial paper	805	—	—	805
U.S. Treasury Securities	2,498	—	(1 )	2,497
U.S. Government agency securities	20,556	1	(19 )	20,538
Municipal securities	3,755	1	(7 )	3,749
Corporate debt securities	21,722	1	(26 )	21,697
Total cash, cash equivalents, and marketable securities	\$84,012	\$3	\$(53 )	\$83,962

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NANOMETRICS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Available-for-sale marketable securities, readily convertible to cash, with maturity dates of 90 days or less are classified as cash equivalents, while those with maturity dates greater than 90 days are classified as marketable securities within short-term assets. All marketable securities as of June 27, 2015 and December 27, 2014, were available-for-sale and reported at fair value based on the estimated or quoted market prices as of the balance sheet date. Unrealized gains or losses, net of tax effect, are recorded in accumulated other comprehensive income (loss) within stockholders' equity. Both the gross unrealized gains and gross unrealized losses for the three and six months ended June 27, 2015 and June 28, 2014 were insignificant and no marketable securities had other than temporary impairment. All marketable securities as of June 27, 2015 and December 27, 2014, had maturity dates of less than two years and were not invested in foreign entities.

Note 5. Accounts Receivable

The Company maintains arrangements under which eligible accounts receivable in Japan are sold without recourse to unrelated third-party financial institutions. These receivables were not included in the consolidated balance sheets as the criteria for sale treatment had been met. The Company pays administrative fees as well as interest ranging from 1.15% to 1.68% based on the anticipated length of time between the date the sale is consummated and the expected collection date of the receivables sold. The Company sold \$3.0 million and \$1.0 million of receivables during the six months ended June 27, 2015 and June 28, 2014, respectively. There were no material gains or losses on the sale of such receivables. There were no amounts due from such third party financial institutions at June 27, 2015 and December 27, 2014.

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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 6. Financial Statement Components

The following tables provide details of selected financial statement components as of the following dates (in thousands):

Condensed Consolidated Balance Sheets Details	At	
	June 27, 2015	December 27, 2014
Inventories:		
Raw materials and sub-assemblies	\$23,676	\$19,463
Work in process	11,003	7,723
Finished goods	6,860	7,919
Inventories	41,539	35,105
Inventories-delivered systems	1,574	1,912
Total inventories	\$43,113	\$37,017
Property, plant and equipment, net <sup>(1)</sup> :		
Land	\$15,572	\$15,572
Building and improvements	19,817	19,641
Machinery and equipment	31,017	29,456
Furniture and fixtures	2,258	2,225
Software	7,965	7,942
Capital in progress	3,554	3,512
Total property, plant and equipment, gross	80,183	78,348
Accumulated depreciation and amortization	(32,642)	(28,715)
Total property, plant and equipment, net	\$47,541	\$49,633
<sup>(1)</sup> Total depreciation and amortization expense for the six months ended June 27, 2015 and June 28, 2014 was \$3.4 million and \$3.2 million, respectively.		
Other current liabilities:		
Accrued warranty	\$3,792	\$2,953
Accrued restructuring	424	997
Accrued professional services	787	778
Fair value of current portion of contingent payments to Zygo Corporation related to acquisition	1,119	1,385
Other	2,099	2,152
Total other current liabilities	\$8,221	\$8,265

## Components of Accumulated Other Comprehensive Income (Loss)

	Foreign Currency Translations	Defined Benefit Pension Plans	Unrealized Income (Loss) on Investment	Accumulated Other Comprehensive Income
Balance as of December 27, 2014	\$(2,604)	\$(134)	\$(31)	\$(2,769)
Current period change	(1,745)	—	25	(1,720)
Balance as of June 27, 2015	\$(4,349)	\$(134)	\$(6)	\$(4,489)

The items above, except for unrealized income (loss) on investment, did not impact the Company's income tax provision. The amounts reclassified from each component of accumulated other comprehensive income into income statement line items were insignificant.



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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 7. Goodwill and Intangible Assets

The following table summarizes the activity in the Company's goodwill during the six months ended June 27, 2015 (in thousands):

Balance as of December 27, 2014	\$10,494	
Foreign currency movements	(904	)
Balance as of June 27, 2015	\$9,590	

Finite-lived intangible assets are recorded at cost, less accumulated amortization. Finite-lived intangible assets as of June 27, 2015 and December 27, 2014 consisted of the following (in thousands):

	June 27, 2015		
	Adjusted cost	Accumulated amortization	Net carrying amount
Developed technology	\$16,278	\$(13,632	) \$2,646
Customer relationships	9,380	(9,380	) —
Brand names	1,927	(1,852	) 75
Patented technology	2,252	(2,087	) 165
Trademark	80	(80	) —
Total	\$29,917	\$(27,031	) \$2,886
	December 27, 2014		
	Adjusted cost	Accumulated amortization	Net carrying amount
Developed technology	\$16,950	\$(12,991	) \$3,959
Customer relationships	9,461	(9,449	) 12
Brand names	1,927	(1,802	) 125
Patented technology	2,252	(2,054	) 198
Trademark	80	(80	) —
Total	\$30,670	\$(26,376	) \$4,294

The amortization of finite-lived intangibles is computed using the straight-line method. Estimated lives of finite-lived intangibles range from two to ten years. Total amortization expense for the six months ended June 27, 2015 and June 28, 2014 was \$1.2 million and \$1.6 million, respectively.

There were no impairment charges related to intangible assets recorded during the six months ended June 27, 2015 and June 28, 2014.

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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

The estimated future amortization expense of finite intangible assets as of June 27, 2015 is as follows (in thousands):

Fiscal Years	Amounts
2015 (remaining six months)	\$ 792
2016	1,682
2017	206
2018	140
2019	66
Total future amortization expense	\$2,886

## Note 8. Warranties

The Company sells the majority of its products with a 12 months repair or replacement warranty from the date of acceptance or shipment date. The Company provides an accrual for estimated future warranty costs based upon the historical relationship of warranty costs to the cost of products sold. The estimated future warranty obligations related to product sales are recorded in the period in which the related revenue is recognized. The estimated future warranty obligations are affected by the warranty periods, sales volumes, product failure rates, material usage, and labor and replacement costs incurred in correcting a product failure. If actual product failure rates, material usage, labor or replacement costs were to differ from the Company's estimates, revisions to the estimated warranty obligations would be required. For new product introductions where limited or no historical information exists, the Company may use warranty information from other previous product introductions to guide it in estimating its warranty accrual. Components of the warranty accrual, which were included in the accompanying condensed consolidated balance sheets with other current liabilities, were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Balance as of beginning of period	\$3,440	\$3,575	\$2,953	\$3,426
Accruals for warranties issued during period	2,251	1,906	3,953	3,217
Settlements during the period	(1,899 )	(1,997 )	(3,114 )	(3,159 )
Balance as of end of period	\$3,792	\$3,484	\$3,792	\$3,484

## Note. 9. Restructuring

The Company recorded a restructuring charge of approximately \$2.3 million in 2014 and \$0.1 million during the six months ended June 27, 2015, as a result of its decision to consolidate and reorganize certain of its operations, primarily in the U.K. This amount includes charges primarily related to employee severance, other expenses (primarily vendor contract termination costs) and early termination costs of a facility lease due to expire in 2017 in the amounts of \$1.1 million, \$0.4 million and \$0.9 million, respectively. The Company completed this restructuring plan in March 2015, and does not expect any remaining charges related to the decisions made in 2014. Any other related costs will be recognized as incurred. The remaining restructuring reserve will be settled in cash by the end of 2017, upon expiration of the lease.





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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

As of June 27, 2015, the components of the Company's restructuring reserves were included in other current liabilities and were as follows (in thousands):

	Employee severance and benefits	Facility termination costs	Other	Total
Balance as of December 27, 2014	\$383	\$583	\$31	\$997
Charges	45	—	13	58
Cash Payments	(428	) (168	) (35	) (631
Balance as of June 27, 2015	\$—	\$415	\$9	\$424

As of June 28, 2014, the balance of the Company's restructuring reserves was zero.

## Note 10. Line of Credit and Debt Obligations

Line of Credit - On May 30, 2014, the Company amended its revolving line of credit facility (i) to extend the maturity date of such facility by two years to May 30, 2016, and (ii) to increase the minimum amount available to borrow to \$12.0 million. The instrument governing the line of credit facility includes certain financial covenants regarding tangible net worth. The revolving line of credit agreement includes a provision for the issuance of commercial or standby letters of credit by the bank on behalf of the Company. The value of all letters of credit outstanding reduces the total line of credit available. The revolving line of credit is collateralized by a blanket lien on all of the Company's domestic assets excluding intellectual property and real estate. The minimum borrowing interest rate is 3.00% per annum. Borrowing is limited to the lesser of (a) \$12.0 million plus the borrowing base, or (b) \$20.0 million. The total borrowing base available as of June 27, 2015 was \$18.8 million. As of June 27, 2015, the Company was not in breach of any restrictive covenants in connection with this line of credit. There were no outstanding amounts drawn on this facility as of June 27, 2015. Although management has no current plans to request advances under this credit facility, the Company may use the proceeds of any future borrowing for general corporate purposes, future acquisitions or expansion of the Company's business.

## Note 11. Commitments and Contingencies

Intellectual Property Indemnification Obligations – The Company will, from time to time, in the normal course of business, agree to indemnify certain customers, vendors or others against third party claims that the Company's products, when used for their intended purpose(s), or the Company's intellectual property, infringe the intellectual property rights of such third parties or other claims made against parties with whom it enters into contractual relationships. It is not possible to determine the maximum potential amount of liability under these indemnification obligations due to the limited history of prior indemnification claims and the unique facts and circumstances that are likely to be involved in each particular claim. Historically, the Company has not made payments under these obligations and believes that the estimated fair value of these agreements is immaterial. Accordingly, no liabilities have been recorded for these obligations in the accompanying condensed consolidated balance sheets as of June 27, 2015 and December 27, 2014.

## Note 12. Earnings Per Share

The Company presents both basic and diluted earnings per share on the face of its condensed consolidated statements of operations. Basic net income per share excludes the effect of potentially dilutive shares and is computed by dividing earnings by the weighted-average number of shares of common stock outstanding for the period. Diluted earnings per share is computed using the weighted-average number of shares of common stock outstanding for the period plus the effect of all dilutive securities representing potential shares of common stock outstanding during the period.

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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

A reconciliation of the share denominator of the basic and diluted net income per share computations for three and six months ended June 27, 2015 and June 28, 2014 is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Weighted average common shares outstanding used in basic earnings per share calculation	24,020	23,939	23,943	23,825
Potential dilutive common stock equivalents, using treasury stock method	265	281	317	392
Weighted average shares used in diluted earnings per share calculation	24,285	24,220	24,260	24,217

## Note 13. Stockholders' Equity and Stock-Based Compensation

## Options and ESPP Awards

The fair value of each option award is estimated on the grant date using the Black-Scholes valuation model and the assumptions noted in the following table. The expected lives of options granted were calculated using the simplified method allowed by the SAB 107. The risk-free rates were based on the U.S Treasury rates in effect during the corresponding period of grant. The expected volatility was based on the historical volatility of the Company's stock price. The dividend yield reflects that the Company has not paid any cash dividends since inception and does not intend to pay any cash dividends in the foreseeable future.

	Three Months Ended		Six Months Ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Stock Options:				
Expected life	—	4.6 years	—	4.6 years
Volatility	—	52.0%	—	54.9%
Risk free interest rate	—	1.56%	—	1.54%
Dividends	—	—	—	—
Employee Stock Purchase Plan:				
Expected life	0.5 years	0.5 years	0.5 years	0.5 years
Volatility	37.2%	32.6%	37.2%	32.6%
Risk free interest rate	0.11%	1.00%	0.11%	1.00%
Dividends	—	—	—	—

No stock options were awarded during the six months ended June 27, 2015. The weighted average fair value per share of the stock options awarded in three and six month periods ended June 28, 2014 was \$7.30 and \$8.13, respectively.

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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

A summary of activity of stock options during the six months ended June 27, 2015 is as follows:

	Number of Shares Outstanding (Options)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in Thousands)
Options				
Outstanding at December 27, 2014	1,382,993	\$ 13.92	3.41	\$4,108
Exercised	(152,882 )	10.82		
Cancelled	(30,790 )	16.08		
Outstanding at June 27, 2015	1,199,321	\$ 14.27	2.90	\$3,227
Exercisable at June 27, 2015	997,952	\$ 13.86	2.48	\$3,062

The aggregate intrinsic value in the above table represents the total pretax intrinsic value, based on the Company's closing stock price of \$16.65 as of June 26, 2015, the last trading day of the quarter, which would have been received by the option holders had all option holders exercised their options as of that date. The total intrinsic value of options exercised during the three months ended June 27, 2015 and June 28, 2014 was \$0.3 million and \$0.8 million, respectively, and during the six months ended June 27, 2015 and June 28, 2014 was \$1.1 million and \$2.5 million, respectively.

## Restricted Stock Units ("RSUs")

Time-based RSUs are valued using the market value of the Company's common stock on the date of grant, assuming no expectation of dividends paid.

A summary of activity for RSUs is as follows:

RSUs	Number of RSUs	Weighted Average Fair Value
Outstanding RSUs as of December 27, 2014	563,337	\$17.90
Granted	365,539	16.04
Released	(203,429 )	17.01
Cancelled	(47,592 )	17.31
Outstanding RSUs as of June 27, 2015	677,855	\$17.21

## Market-Based Performance Stock Units ("PSUs")

In March 2015, in addition to granting RSUs that vest on the passage of time only, the Company granted PSUs to an executive. The PSUs will vest in three equal tranches over one, two and three years based on the relative performance of the Company's stock during those periods, compared to a peer group over the same period. If target stock price performance is achieved, 40,000 shares of the Company's common stock will vest, and up to a maximum of 60,000 shares will vest if the maximum stock price performance is achieved for each tranche.

## Valuation of PSUs

On the date of grant, the Company estimated the fair value of PSUs using a Monte Carlo simulation model. The assumptions for the valuation of PSUs are summarized as follows:

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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

	2015 Award
Number of PSUs granted and outstanding as of June 27, 2015	40,000
Grant Date Fair Value Per Share	\$18.35
Weighted-average assumptions/inputs:	
Expected Dividend	—
Range of risk-free interest rates	0.25%-1.1%
Range of expected volatilities for peer group	23%-65%

## Stock-based Compensation Expense

Stock-based compensation expense for all share-based payment awards made to the Company's employees and directors pursuant to the employee stock option and employee stock purchase plans by function were as follows (in thousands):

	For the Three Months Ended		For the Six Months Ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Cost of products	\$60	\$68	\$132	\$129
Cost of service	45	89	91	174
Research and development	215	296	496	636
Selling	393	437	892	863
General and administrative	698	886	1,371	1,608
Total stock-based compensation expense	\$1,411	\$1,776	\$2,982	\$3,410

## Note 14. Income Taxes

The Company accounts for income taxes under the provisions of ASC 740, Accounting for Income Taxes. The Company adjusts its effective tax rate each quarter to be consistent with the estimated annual effective tax rate. The Company also records the tax effect of unusual or infrequently occurring discrete items, including changes in judgment about valuation allowances and effects of changes in tax laws or tax rates, in the interim period in which they occur. The Company's effective tax rate reflects the impact of a portion of its earnings being taxed in foreign jurisdictions as well as a valuation allowance maintained on certain deferred tax assets.

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

	Three Months Ended		Six Months Ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Provision for income taxes	\$817	\$(12)	\$1,134	\$575

The increase in the tax provision for 2015 from 2014 was primarily related to the increased profitability of the Company for the three and six months ended June 27, 2015.

As of June 27, 2015, the Company continues to maintain a valuation allowance against its U.S. and certain foreign deferred tax assets as a result of uncertainties regarding the realization of the asset due to cumulative losses and uncertainty of future taxable income. The Company will continue to assess the realizability of the deferred tax assets in each of the applicable jurisdictions and maintain the valuation allowances until sufficient positive evidence exists to support a reversal. In the event the Company determines that the deferred tax assets are realizable, an adjustment to

the valuation allowance will be reflected in the tax provision for the period such determination is made.

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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

The Company is subject to taxation in the U.S. and various states including California, and foreign jurisdictions including Korea, Japan, Taiwan, and China. Due to tax attribute carry-forwards, the Company is subject to examination for tax years 2003 forward for U.S. tax purposes. The Company is also subject to examination in various states for tax years 2002 forward. The Company is subject to examination for tax years 2007 forward for various foreign jurisdictions.

The Company accrues interest and penalties related to unrecognized tax benefits in its provision for income taxes. The total amount of penalties and interest were not material as of June 27, 2015 and June 28, 2014. During the next twelve months, the Company anticipates increases in its unrecognized tax benefits of approximately \$0.1 million.

## Note 15. Segment, Geographic, Product and Significant Customer Information

The Company has one operating segment, which is the sale, design, manufacture, marketing and support of optical critical dimension and thin film systems. The following tables summarize total net revenues and long-lived assets (excluding intangible assets) attributed to significant countries (in thousands):

	Three Months Ended		Six Months Ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Total net revenues:				
United States	\$ 15,052	13,302	\$ 24,130	20,043
South Korea	7,370	8,373	22,013	24,262
Singapore	10,090	496	12,887	1,079
Taiwan	9,414	6,281	23,842	10,697
China	1,625	9,358	5,626	24,846
Other	5,078	10,219	10,507	18,678
Total net revenues	\$ 48,629	\$ 48,029	\$ 99,005	\$ 99,605
Long-lived tangible assets:		June 27, 2015		December 27, 2014
United States		\$ 45,850		\$ 47,729
Taiwan		1,313		1,473
All Other		378		431
Total long-lived tangible assets		\$ 47,541		\$ 49,633

The following customers accounted for 10% or more of total accounts receivable, net:

	At			
	June 27, 2015	December 27, 2014		
Micron	33	% 24		%
Taiwan Semiconductor Manufacturing Company Limited	20	% 20		%
SK Hynix	10	% ***		
Samsung Electronics Co. Ltd.	***	10		%
Global Foundries	***	10		%

\*\*\* The customer accounted for less than 10% of total accounts receivable, net, as of that period end.





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## NANOMETRICS INCORPORATED

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

The following customers accounted for 10% or more of total net revenues:

	Three Months Ended		Six Months Ended			
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014		
Micron	32	% ***	19	% ***		
Taiwan Semiconductor Manufacturing Company Limited	17	% 11	% 20	% ***		
SK Hynix	10	% 18	% 12	% 13	%	
Samsung Electronics Co. Ltd.	***	16	% 20	% 35	%	
Intel Corporation	***	18	% ***	16	%	
Global Foundries	***	15	% ***	***		

\*\*\* The customer accounted for less than 10% of total net revenues during the period.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. The statements contained in this document that are not purely historical are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding future periods, financial results, revenues, margins, growth, customers, tax rates, product performance, and the impact of accounting rules on our business and the future implications of our statements regarding goals, strategy, and similar terms. We may identify these statements by the use of words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "may," "might," "plan," "project," "will," and other similar expressions. All forward-looking statements included in document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements, except as may otherwise be required by law.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain risks, uncertainties and changes in circumstances, many of which may be difficult to predict or beyond our control, including those factors referenced in Part II, Item 1A, Risk Factors, and elsewhere in this document, and in Part I, Item 1A, Risk Factors, in our Annual Report on Form 10-K for the fiscal year ended December 27, 2014. In particular our results could vary significantly based on: changes in customer and industry spending; rate and extent of changes in product mix; adoption of new products; timing of orders, shipments, and acceptance of products; our ability to secure volume supply agreements; and general economic conditions. In evaluating our business, investors should carefully consider these factors in addition to any other risks and uncertainties set forth elsewhere. The occurrence of the events described in the risk factors and elsewhere in this report as well as other risks and uncertainties could materially and adversely affect our business, operating results and financial condition. While management believes that the discussion and analysis in this report is adequate for a fair presentation of the information presented, we recommend that you read this discussion and analysis in conjunction with (i) our audited consolidated financial statements and notes thereto for the fiscal year ended December 27, 2014, which were included in our 2014 Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on February 25, 2015, and (ii) our other filings with the SEC.

We are an innovator in the field of metrology and inspection systems for semiconductor manufacturing and other industries. Our systems are designed to precisely monitor optical critical dimensions and film thickness that are necessary to control the manufacturing process and to identify defects that can affect production yields and performance.

Principal factors that impact our revenue growth include capital expenditures by manufacturers of semiconductors to increase capacity and to enable their development of new technologies, and our ability to improve market share. The increasing complexity of the manufacturing processes for semiconductors is an important factor in the demand for our innovative metrology systems, as are the adoption of optical critical dimension ("OCD") metrology across fabrication processes, immersion lithography and multiple patterning, new types of thin film materials, advanced packaging strategies and wafer backside inspection, and the need for improved process control to drive process efficiencies. Our strategy is to continue to innovate organically as well as to evaluate strategic acquisitions to address business challenges and opportunities.

Our revenues are primarily derived from product sales but are also derived from customer service and system upgrades for the installed base of our products. For the six months ended June 27, 2015, we derived 78% of our total net revenues from product sales and 22% of our total net revenues from services and upgrades.

Overview

Together with our subsidiaries, we are a leading provider of advanced, high-performance process control metrology and inspection systems used primarily in the fabrication of integrated circuits, high-brightness LEDs ("HB-LED"), discrete components and hard disk drive components. Our automated and integrated systems address numerous process control applications, including critical dimension and film thickness measurement, device topography, defect

inspection, and analysis of various other film properties such as optical, electrical and material characteristics. Our process control solutions are deployed throughout the fabrication process, from front-end-of-line substrate manufacturing, to high-volume production of semiconductors and other devices, to advanced wafer-scale packaging applications. Our systems enable device manufacturers to improve yields, increase productivity and lower their manufacturing costs.

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### Nanometrics Products

We offer a diverse line of systems to address the broad range of process control requirements of the semiconductor manufacturing industry. In addition, we believe that our engineering expertise, strategic acquisitions, supplier alliances and short-cycle production strategies enable us to develop and offer advanced process control solutions that, in the future, should address industry advancement and trends.

#### Automated Systems

Our automated systems primarily consist of fully automated metrology systems that are employed in high-volume semiconductor production environments, as well as in research and development ("R&D") and pilot production. The Atlas<sup>®</sup> II, Atlas II+, Atlas XP/Atlas XP+ and Atlas-M represent our line of high-performance metrology systems providing optical critical dimension ("OCD"), thin film metrology and wafer stress for transistor and interconnect metrology applications. The OCD technology is supported by our NanoCD<sup>®</sup> suite of solutions including our NanoDiffract<sup>®</sup> software and NanoGen<sup>™</sup> scalable computing engine that enables visualization, modeling, and analysis of complex structures. The UniFire<sup>™</sup> system enables users to measure multiple parameters at any given process step in the advanced packaging process flow for critical dimension, overlay, and topography applications. Our SPARK<sup>™</sup> defect inspection system, offers ultra-fast inspection of patterned and unpatterned semiconductor wafers.

#### Integrated Systems

Our integrated metrology ("IM") systems are installed directly onto wafer processing equipment to provide near real-time measurements for improved process control and maximum throughput. Our IM systems are sold directly to end customers and through OEM channels. The IMPULSE<sup>®</sup> system is our latest metrology platform for OCD, and thin film metrology, and has been successfully qualified on numerous OEM platforms. Our 90x0 system is qualified for OEM and direct sales supporting thin film and OCD applications. Our NanoCD suite of solutions is sold in conjunction with our IMPULSE<sup>®</sup> and legacy 90x0 systems. Our Trajectory<sup>®</sup> system provides in-line measurement of layers in thin film thickness and composition in semiconductor applications.

#### System Platform

The Lynx<sup>®</sup> platform enables cluster metrology factory automation for improved cost of ownership to our customers by combining our Atlas<sup>®</sup> II+ and IMPULSE<sup>®</sup>, UniFire metrology and SPARK inspection systems in configurations to provide high throughput, reduced footprint systems for leading 300mm wafer metrology applications including OCD and thin film process control.

#### Materials Characterization

Our materials characterization products include systems that are used to monitor the physical, optical, electrical and material characteristics of discrete electronic industry, HB-LED, solar PV, compound semiconductor, strained silicon and silicon-on-insulator ("SOI") devices, including composition, crystal structure, layer thickness, dopant concentration, contamination and electron mobility.

Our Imperia<sup>™</sup> is a photoluminescence ("PL") full wafer imaging and mapping system designed for high-volume compound semiconductor metrology applications including power control and photonics applications adding significant inspection and substrate metrology capability to the established PL fleet. The RPMBlue<sup>™</sup> is our latest PL mapping system designed specifically for the HB-LED market, and is complemented by the RPMBlue-FS, enabling a breadth of research and development configurability. We sell Fourier-Transform Infrared ("FTIR") automated and manual systems in the QS2200/3300 and QS1200 respectively. The FTIR systems are spectrometers designed for non-destructive wafer analysis for various applications. The NanoSpec<sup>®</sup> line, including the NanoSpec II, supports thin film measurement across all applications in both low volume production and research applications.

We are continually working to strengthen our competitive position by developing new technologies and products in our market segment. We have expanded our product offerings to address growing applications within the semiconductor manufacturing and adjacent industries. In continuance of our goals, we have:

• Introduced new products, applications, and upgrades in every core product line and primary market served;

• Diversified our product line and served markets through acquisitions, such as: the 2006 acquisition of Accent Optical Technologies, Inc., a supplier of overlay and thin film metrology and process control systems; the 2008 acquisition of Tevet Process Control Technologies ("Tevet"), an integrated metrology supplier; the 2009 acquisition of the UniFire<sup>™</sup>



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product line from Zygo Corporation; and the 2011 acquisition of Nanda Technologies GmbH, a supplier of high sensitivity, high throughput defect inspection systems;

Continued development of new measurement and inspection technologies for advanced fabrication processes; and

Researched and developed innovative applications of existing technology to new market opportunities within the solar PV, HB-LED, discrete device, and data storage industries.

Important Themes and Significant Trends

The semiconductor equipment industry is characterized by cyclical growth. Changing trends in the semiconductor industry continue to drive the need for metrology as a major component of device manufacturing. These trends include:

**Proliferation of Optical Critical Dimension Metrology across Fabrication Processes.** Our customers use photolithographic processes to create patterns on wafers. Critical dimensions must be carefully controlled during this process. In advanced node device definition, additional monitoring of thickness and profile dimensions on these patterned structures at CMP, Etch, and Thin Film processing is driving broader OCD adoption. Our proprietary OCD systems can provide the critical process control of these circuit dimensions that is necessary for successful manufacturing of these state-of-the-art devices. Nanometrics OCD technology is broadly adopted across NAND, DRAM, and logic semiconductor manufacturing processes.

**Development of 3D Transistor Architectures.** Our end customers continue to improve device density and performance by scaling front-end-of-line transistor architectures. Many of these designs, including FinFET transistors and 3D-NAND, have buried features and high aspect ratio stacked features that enable improved performance and density. The advanced designs require additional process control to manage the complex shapes and materials properties, driving additional applications for both OCD and our UniFire systems.

**Adoption of Advanced Packaging Processes.** Our customers use photolithography, etching, metallization and wafer thinning to enable next generation advanced packaging solutions for semiconductor devices. These new packaging techniques lead to increased functionality in smaller, less expensive form factors. Advanced packages can be broken down into high density flip chip or bump packages that increase pin density allowing for more complex I/O on advanced CPU parts. Similar or different devices can be stacked at the wafer level using a Through Silicon Via (“TSV”) process. The TSV process enables high density small form factor parts, being primarily driven by mobile consumer products (e.g. cellular telephones with integrated CMOS camera sensors). Increasingly advanced packaging technologies are being adopted by our end customers.

**Adoption of New Types of Thin Film Materials.** The need for ever increasing device circuit speed coupled with lower power consumption has pushed semiconductor device manufacturers to begin the replacement of traditional aluminum etch back interconnect flows, as well as conventional gate dielectric materials, with new materials and processes that are driving broader adoption of thin film and OCD metrology systems. To achieve greater semiconductor device speed, manufacturers have adopted copper in Logic/IDM and it is now proliferating in next generation DRAM and Flash nodes. Additionally, to achieve improved transistor performance in logic devices and higher cell densities in memory devices, new materials including high dielectric constant (or high-k) gate materials are increasingly being substituted for traditional silicon-oxide gate dielectric materials. High-k materials comprise complex thin films including layers of hafnium oxide and a bi-layer of thin film metals. Our advanced metrology and inspection solutions are required for control of process steps, which are critical to enable the device performance improvements that these new materials allow.

**Need for Improved Process Control to Drive Process Efficiencies.** Competitive forces influencing semiconductor device manufacturers, such as price-cutting and shorter product life cycles, place pressure on manufacturers to rapidly achieve production efficiency. Device manufacturers are using our integrated and automated systems throughout the fabrication process to ensure that manufacturing processes scale rapidly, are accurate and can be repeated on a consistent basis.

Increased Customer Concentration. Our market is characterized by continued consolidation in the customer base. Our largest customer accounted for 20% and 35% of our total net revenues in the six months ended June 27, 2015 and June 28, 2014, respectively.

#### Critical Accounting Policies

The preparation of our financial statements conforms to accounting principles generally accepted in the United States of America, which requires management to make estimates and judgments in applying our accounting policies that have an important impact on our reported amounts of assets, liabilities, revenue, expenses and related disclosures at the date of our financial statements. On an ongoing basis, management evaluates its estimates including those related to bad debts, inventory valuations, warranty obligations, impairment and income taxes. Management bases its estimates and judgments on historical

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experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from management's estimates. There were no significant changes in our critical accounting policies during the six months ended June 27, 2015. Please refer to Please refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in our Annual Report on Form 10-K for the fiscal year ended December 27, 2014 for a complete discussion of our critical accounting policies.

## Recent Accounting Pronouncements

See Note 2 of the Unaudited Condensed Consolidated Financial Statements for a description of recent accounting pronouncements, including the respective dates of adoption and effects or anticipated effects on our results of operations and financial condition.

## Results of Operations

## Net Revenues

Our net revenues comprised the following product lines (in thousands, except percentages):

	Three Months Ended				Six Months Ended					
	June 27, 2015	June 28, 2014	Change		June 27, 2015	June 28, 2014	Change			
Automated systems	\$29,326	\$33,456	\$(4,130)	(12.3 )%	\$59,832	\$67,339	\$(7,507)	(11.1 )%		
Integrated systems	6,178	2,853	3,325	116.5 %	10,903	9,775	1,128	11.5 %		
Materials characterization systems	3,433	2,915	518	17.8 %	6,540	5,390	1,150	21.3 %		
Total product revenue	38,937	39,224	(287 )	(0.7 )%	77,275	82,504	(5,229 )	(6.3 )%		
Service	9,692	8,805	887	10.1 %	21,730	17,101	4,629	27.1 %		
Total net revenues	\$48,629	\$48,029	\$600	1.2 %	\$99,005	\$99,605	\$(600 )	(0.6 )%		

For the three months ended June 27, 2015, as compared to the same period in 2014, the increase in net revenues was due to an increase in service revenue, primarily driven by upgrades, partially offset by a decrease in product revenue.

The decrease in product revenues was attributable to a lower level of sales of our Automated Systems (principally Atlas™ ) which declined by \$4.1 million largely offset by a \$3.3 million increase in sales of Integrated Systems (principally IMPULSE®) and a \$0.5 million increase in Material Characterization sales. Service revenue increased by \$0.9 million in the three months ended June 27, 2015 principally due to an increase in upgrade revenue as a result of higher demand for upgrades of installed tools during the second quarter of 2015.

For the six months ended June 27, 2015, as compared to the same period in 2014, the decrease in net revenues was due to a decrease in product revenue largely offset by an increase in service revenue, primarily driven by upgrades.

The net decrease in product revenues was attributable to sales of our Automated Systems (principally Atlas™ ) which declined by \$7.5 million partially offset by a \$1.1 million increase in Integrated Systems sales (principally IMPULSE®) and a \$1.2 million increase in Materials Characterization sales . Service revenue increased by \$4.6 million in the six months ended June 27, 2015 principally due to an increase in upgrade revenue as a result of higher demand for upgrades of installed tools.

Upgrades tend to fluctuate from quarter to quarter based on availability of new functionality from upgrades and customer production cycles, which determine when customers purchase available upgrades.

With a significant portion of the world's semiconductor manufacturing capacity located in Asia, a substantial portion of our revenues continue to be generated in that region. Although sales to customers within individual countries of that region will vary from time to time, we expect that a substantial portion of our revenues will continue to be generated in Asia.

## Gross margin



Our gross margin breakdown was as follows:

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	Three Months Ended		Six Months Ended		
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014	
Product	47.8	% 47.8	% 47.0	% 48.1	%
Service	48.0	% 47.1	% 47.5	% 42.9	%

The calculation of product gross margin includes both cost of products and amortization of intangibles.

Gross margin on product revenue remained unchanged in the three months ended June 27, 2015 as compared to the same period in 2014, despite lower revenues, primarily due to favorable factory overhead absorption. The increase in gross margin on our services business of 0.9 percentage points in the three months ended June 27, 2015 as compared to the same period in 2014, was due principally to an increase in upgrade revenues, which typically have higher margins than core service revenue.

The decrease in gross margin on product revenue of 1.1 percentage points in the six months ended June 27, 2015 as compared to the same period in 2014, was due primarily to the unfavorable impact of lower product revenues against fixed costs, such as fixed overhead and other product and manufacturing related period costs. The increase in gross margin on our services business of 4.6 percentage points in the six months ended June 27, 2015 as compared to the same period in 2014, was due principally to an increase in upgrade revenues, which typically have higher margins than core service revenue.

## Operating expenses

Our operating expenses comprised the following categories (in thousands, except percentages):

	Three Months Ended			Six Months Ended			
	June 27, 2015	June 28, 2014	Change	June 27, 2015	June 28, 2014	Change	
Research and development	\$8,157	\$9,373	\$(1,216 ) (13.0 )%	\$16,316	\$17,687	\$(1,371 ) (7.8 )%	
Selling	7,029	6,681	348 5.2 %	14,145	14,054	91 0.6 %	
General and administrative	5,544	6,001	(457 ) (7.6 )%	11,310	12,339	(1,029 ) (8.3 )%	
Amortization of intangible assets	25	107	(82 ) (76.6 )%	64	215	(151 ) (70.2 )%	
Restructuring charge	—	—	— NM*	58	—	58 NM*	
Total operating expenses	\$20,755	\$22,162	\$(1,407 ) (6.1 )%	\$41,893	\$44,295	\$(2,402 ) (5.4 )%	

\*NM = not meaningful

## Research and development

The decrease in research and development costs of \$1.2 million or 13.0% in the three months ended June 27, 2015 compared to the same period in 2014, related primarily to decreased spending for material expenses and related expenses associated with R&D investments for our next generation Automated and Integrated systems.

The decrease in research and development costs of \$1.4 million or 7.8% in the six months ended June 27, 2015 compared to the same period in 2014, related primarily decreased spending for material expenses and related expenses associated with R&D investments for our next generation Automated and Integrated systems and a decrease in headcount resulting from the shutdown of our UK operations in the second half of 2014.

Investments in research and development personnel and associated projects are part of our strategy to ensure our products remain competitive and meet customers' needs.

Selling

The increase in selling expenses in the three and six months ended June 27, 2015 compared to the same periods in 2014, was primarily due to an increase in amortization of demonstration tools and third party commissions, offset in part by a decrease in travel and related expenses.

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## General and administrative

The decrease in general and administrative expenses in the three and six months ended June 27, 2015 compared to the same periods in 2014, was primarily due to lower headcount and the decrease in consulting expenditures from the comparable 2014 period when our new ERP system had just been implemented.

## Amortization of intangible assets

Amortization of intangible assets included in operating expenses in the three and six months ended June 27, 2015 compared to the same periods in 2014, decreased as a result of the reduction in amortization due to intangible assets that became fully amortized in the prior and current year.

## Restructuring charge

We recorded a restructuring charge of \$0.1 million in the six months ended June 27, 2015 related to our efforts to improve operating efficiencies. We completed the restructuring plan in March 2015, and do not expect any remaining charges related to the decisions made in 2014. No restructuring charges were recorded in the three months ended June 27, 2015. Other related costs, if any, are expected to be recognized as incurred. There were no comparable charges in the comparable periods in 2014.

## Other income (expense), net

Our other income (expense), net, consisted of the following items (in thousands, except percentages):

	Three Months Ended			Six Months Ended			Change			
	June 27, 2015	June 28, 2014	Change	June 27, 2015	June 28, 2014	Change				
Interest income	\$46	\$10	\$36	360.0	%	\$56	\$24	\$32	133.3	%
Interest expense	(83)	(96)	13	(13.5)	)%	(165)	(196)	31	(15.8)	)%
Other income (expense)	(311)	(84)	(227)	270.2	%	393	168	225	133.9	%
Total other income (expense), net	\$(348)	\$(170)	\$(178)	104.7	%	\$284	\$(4)	\$288	NM*	

As compared to the same periods in 2014, other expense increased by \$0.2 million for the three months ended June 27, 2015, and other income increased by \$0.2 million in the six months ended June 27, 2015. These changes were principally due to the revaluation of intercompany balances based on fluctuations in foreign exchange rates relative to the U.S. dollar.

## Provision for income taxes

We recorded a tax provision of \$0.8 million and a benefit of \$12,000 in three months ended June 27, 2015 and June 28, 2014, respectively, and a tax provision of \$1.1 million and \$0.6 million in six months ended June 27, 2015 and June 28, 2014, respectively. The increase in the tax provision for 2015 from 2014 was primarily related to increased profitability for the three and six months ended June 27, 2015.

As of June 27, 2015, we continue to maintain a valuation allowance against our U.S. and certain foreign deferred tax assets as a result of uncertainties regarding the realization of the asset due to cumulative losses and uncertainty of future taxable income. We will continue to assess the realizability of the deferred tax assets in each of the applicable jurisdictions and maintain the valuation allowances until sufficient positive evidence exists to support a reversal. In the event we determine that the deferred tax assets are realizable, an adjustment to the valuation allowance will be reflected in the tax provision for the period such determination is made.

We are subject to taxation in the U.S. and various states including California, and foreign jurisdictions including Korea, Japan, Taiwan, and China. Due to tax attribute carry-forwards, we are subject to examination for tax years

2003 forward for U.S. tax purposes. We are also subject to examination in various states for tax years 2002 forward. We are subject to examination for tax years 2007 forward for various foreign jurisdictions. We accrue interest and penalties related to unrecognized tax benefits in our provision for income taxes. The total amount of penalties and interest were not material as of June 27, 2015 and June 28, 2014. During the next twelve months, we anticipate increases in its unrecognized tax benefits of approximately \$0.1 million.

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## Liquidity and Capital Resources

The following tables present selected financial information and statistics as of June 27, 2015 and December 27, 2014 and for the six months ended June 27, 2015 and June 28, 2014 (in millions):

	As of	
	June 27, 2015	December 27, 2014
Cash, cash equivalents and marketable securities	\$74.8	\$84.0
Working capital	\$128.0	\$119.6
	Six Months Ended	
	June 27, 2015	June 28, 2014
Cash used in operating activities	\$(7.2)	\$(4.6)
Cash used in investing activities	\$(0.4)	\$(5.7)
Cash (used in) provided by financing activities	\$(0.7)	\$3.3

We believe our existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy our working capital needs, capital asset purchases, outstanding commitments and other liquidity requirements associated with our existing operations over the next twelve months.

During the six months ended June 27, 2015, cash used in operating activities of \$7.2 million was a result of \$3.9 million of net income, non-cash adjustments to net income of \$9.6 million and a net change in operating assets and liabilities of \$20.6 million. Changes to operating assets and liabilities were generally driven by the timing of customer payments for accounts receivable, the timing of inventory purchases and the timing of vendor payments. Cash used in investing activities of \$0.4 million during the six months ended June 27, 2015, consisted primarily of cash used to acquire property, plant and equipment of \$1.0 million, partially offset by cash provided by sales and maturities of marketable securities, net of purchases, of \$0.6 million. Cash used in financing activities of \$0.7 million during the six months ended June 27, 2015 consisted primarily of cash used to repurchase common stock of \$1.7 million, royalty and other payments to Zygo of \$0.4 million, and cash paid for taxes on net issuance of stock awards of \$1.0 million, partially offset by \$2.5 million in proceeds from the issuance of common stock from the employee stock purchase program and the exercise of stock options. As we move away from issuing stock options to employees, we anticipate that cash provided by the proceeds from the issuance of common stock may continue to decrease, and the cash paid on net issuance of stock awards to increase.

During the six months ended June 28, 2014, cash used in operating activities of \$4.6 million was a result of \$2.2 million of net income, non-cash adjustments to net income of \$10.3 million and a net change in operating assets and liabilities of \$17.1 million. Changes to operating assets and liabilities were generally driven by the timing of customer payments for accounts receivable, the timing of inventory purchases and the timing of vendor payments. Cash used in investing activities of \$5.7 million during the six months ended June 28, 2014 consisted primarily of cash used for purchases of marketable securities, net of maturities, of \$1.9 million, and cash used to acquire property, plant and equipment of \$3.8 million. Cash provided by financing activities of \$3.3 million during the six months ended June 28, 2014 consisted primarily of \$4.2 million in proceeds from the issuance of common stock from the employee stock purchase program and the exercise of stock options, partially offset by cash paid for taxes on net issuance of stock awards of \$0.6 million, and other payments to Zygo of \$0.3 million.

## Debt and Repurchases of Common Stock

Line of Credit - On May 30, 2014, we amended our revolving line of credit facility with Comerica Bank principally (i) to extend the maturity date of such facility by two years to May 30, 2016, and (ii) to increase the minimum amount available to borrow to \$12.0 million.

The instrument governing the line of credit facility includes certain financial covenants regarding tangible net worth. The revolving line of credit agreement includes a provision for the issuance of commercial or standby letters of credit by the bank on our behalf. The value of all letters of credit outstanding reduces the total line of credit available. The revolving line of credit is collateralized by a blanket lien on all of our domestic assets excluding intellectual property

and real estate. The

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minimum borrowing interest rate is 3.00% per annum. Borrowing is limited to the lesser of (a) \$12.0 million plus the borrowing base, or (b) \$20.0 million. The total borrowing available as of June 27, 2015 was \$18.8 million. As of June 27, 2015, we were not in material breach of any restrictive covenants in connection with this line of credit. There were no borrowings against the line of credit during the six months ended June 27, 2015 and June 28, 2014 and there were no outstanding amounts drawn on this facility as of June 27, 2015. Although we have no current plans to request advances under this credit facility, we may use the proceeds of any future borrowing for general corporate purposes, future acquisitions or expansion of our business.

Repurchases of Common Stock - On May 29, 2012, our Board of Directors approved a program to repurchase up to \$20.0 million of our common stock, referred to as the 2012 program.

Stock repurchases under this program may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased is dependent on a variety of factors including price, corporate and regulatory requirements and other market conditions. Shares repurchased and retired for the indicated periods of the applicable repurchase programs with the associated cost of repurchase and amount available for repurchase at the end of the respective periods are as follows (in thousands, except number of shares and weighted average price per share):

	Six Months Ended June 27, 2015
Number of shares of common stock repurchased	111,050
Weighted average price per share	\$15.49
Total cost of repurchase	\$1,721
Amount available for repurchase at end of period	\$4,397
No shares were repurchased in the three months ended June 27, 2015, nor in any comparable period in 2014.	

Business Partnership - On June 17, 2009, we announced a strategic business partnership with Zygo Corporation whereby we have purchased inventory and certain other assets from Zygo Corporation, and the two companies entered into a supply agreement. We will make payments to Zygo Corporation (with an estimated present value of \$2.1 million as of June 27, 2015 and \$2.4 million as of December 27, 2014) over a period of time as acquired inventory is sold and other aspects of the supply agreement are executed. We made royalty and sustaining engineering payments of \$0.4 million and \$0.1 million to Zygo in six months ended June 27, 2015 and June 28, 2014, respectively.

We have evaluated and will continue to evaluate the acquisitions of products, technologies or businesses that are complementary to our business. These activities may result in product and business investments, which may affect our cash position and working capital balances. Some of these activities might require significant cash outlays.

Our principal sources of liquidity are cash and cash equivalents, and marketable securities, cash flow generated from our operations, and, to a lesser extent, borrowings from a line of credit. Our liquidity is affected by many factors, including those that relate to our specific operations and those that relate to the uncertainties of global and regional economies and the sectors of the semiconductor industry which we operate in. Although our cash requirements will fluctuate based on the timing and extent of these factors, we believe our existing cash, cash equivalents and marketable securities and borrowing availability, combined with cash currently projected to be generated from our operations, will be sufficient to meet our liquidity needs through at least the next twelve months.

Off-Balance Sheet Arrangements

As of June 27, 2015, we had no off-balance sheet arrangements or obligations.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our exposure to market risk does not differ materially from that discussed in our Annual Report on Form 10-K for the fiscal year ended December 27, 2014, filed with the SEC on February 25, 2015. However, we cannot give any assurance as to the effect that future changes in interest rates and foreign currency exchange rates will have on our consolidated financial position, results of operations or cash flows.





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## Foreign Currency Risk

Our exposure to foreign currency exchange rate fluctuations arises in part from intercompany balances in which costs are charged between our U.S. headquarters and our foreign subsidiaries. On our consolidated balance sheet these intercompany balances are eliminated and thus no consolidated balances are associated with these intercompany balances; however, since each foreign entity's functional currency is generally its respective local currency, there is exposure to foreign exchange risk on a consolidated basis. Intercompany balances are denominated primarily in U.S. dollars and, to a lesser extent, other local currencies.

We enter into foreign currency forward exchange contracts to protect against currency exchange risks associated with existing assets and liabilities. A foreign currency forward exchange contract acts as a hedge by increasing in value when underlying assets decrease in value or underlying liabilities increase in value due to changes in foreign exchange rates. Conversely, a foreign currency forward exchange contract decreases in value when underlying assets increase in value or underlying liabilities decrease in value due to changes in foreign exchange rates. These forward contracts are not designated as accounting hedges, so the unrealized gains and losses are recognized in other income, net, in advance of the actual foreign currency cash flows with the fair value of these forward contracts being recorded as accrued liabilities or other current assets.

We do not use forward contracts for trading purposes. Our forward contracts generally have maturities of 30 days or less. We enter into foreign currency forward exchange contracts based on estimated future asset and liability exposures, and the effectiveness of our hedging program depends on our ability to estimate these future asset and liability exposures. Recognized gains and losses with respect to our current hedging activities will ultimately depend on how accurately we are able to match the amount of foreign currency forward exchange contracts with actual underlying asset and liability exposures.

The following table provides information about our foreign currency forward exchange contracts as of June 27, 2015. The information is provided in United States dollar equivalent amounts. The table presents the notional amounts, at contract exchange rates, and the weighted average contractual foreign currency exchange rates expressed as units of the foreign currency per United States dollar, which in some cases may not be the market convention for quoting a particular currency. All of these forward contracts mature during July 2015.

	Notional Principal (in millions)	Contract Price
Forward Contracts		
Korean Won	\$6.8	1,107.1
European Union euro	3.4	1.12
Israeli shekel	3.1	3.75
Singapore dollar	2.8	1.35
Chinese yuan	0.8	6.11
Japanese Yen	3.4	124.27
Total	\$20.3	
Estimated Fair Value	\$20.3	

There were no forward contracts as of December 27, 2014.

We actively monitor our foreign currency risks, but there is no guarantee that our foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchange rates on our results of operations, cash flows and financial position.



#### ITEM 4. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer, Timothy J. Stultz, and our Chief Financial Officer, Jeffrey Andreson, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of June 27, 2015, our disclosure controls and procedures were effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 were (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms; and (ii) accumulated and reported to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely discussions regarding required disclosures.

##### Changes in Internal Control over Financial Reporting

During the quarter ended June 27, 2015, there were no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

##### Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, has designed our disclosure controls and procedures and our internal control over financial reporting to provide reasonable assurances that the controls' objectives will be met. However, management does not expect that disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within Nanometrics have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any system's design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of a system's control effectiveness into future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

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PART II — OTHER INFORMATION

ITEM 1A. RISK FACTORS

Investing in our securities involves a high degree of risk. In assessing these risks, you should carefully consider the information included in or incorporated by reference into this report, including our financial statements and the related notes thereto. You should carefully review and consider all of the risk factors set forth in Part I, “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 27, 2014, filed with the SEC on February 25, 2015. The risks described in our Annual Report on Form 10-K are not the only ones we face. Additional risks and uncertainties that are not currently known to us or that we currently believe are immaterial may also impair our business operations. Our business, operating results and financial conditions could be materially harmed by any of these risks. The trading price of our common stock could decline due to any of these risks and investors may lose all or part of their investment. There have been no material changes in our risk factors from those discussed in our Annual Report on Form 10-K for the fiscal year ended December 27, 2014.

ITEM 6. EXHIBITS

The following exhibits are filed, furnished or incorporated by reference with this Quarterly Report on Form 10-Q:

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Exhibit No.	Description
3.(i)	Certificate of Incorporation
3.1(1)	Certificate of Incorporation of the Registrant
3.(ii)	Bylaws
3.2(2)	Bylaws of the Registrant
10	Material Contracts
10.1(5)	General Severance Benefits and Change in Control Severance Benefits Agreement between Registrant and Timothy J. Stultz, Ph.D., dated May 19, 2015
10.2(6)	General Severance Benefits and Change in Control Severance Benefits Agreement between Registrant and Jeffrey Andreson, dated May 19, 2015
10.3(7)	General Severance Benefits and Change in Control Severance Benefits Agreement between Registrant and S. Mark Borowicz, dated May 19, 2015
10.4(8)	General Severance Benefits and Change in Control Severance Benefits Agreement between Registrant and Kevin Heidrich, dated May 19, 2015
10.5(9)	Form of Indemnification Agreement between the Registrant and each of its directors and executive officers
31	Rule 13a-14(a)/15d-14(a) Certifications
31.1(3)	Certification of Timothy J. Stultz, principal executive officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2(3)	Certification of Jeffrey Andreson, principal financial officer and principal accounting officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Section 1350 Certifications
32.1(3)	Certification of Timothy J. Stultz, principal executive officer of the Registrant, and Jeffrey Andreson, principal financial officer and principal accounting officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101(4)	The following financial statements, formatted in XBRL: (i) Condensed Consolidated Balance Sheets at June 27, 2015, and December 27, 2014, (ii) Condensed Consolidated Statements of Operations for the three and six months ended June 27, 2015 and June 28, 2014, (iii) Condensed Consolidated Statements of Cash Flows for the six months June 27, 2015 and June 28, 2014, and (v) Notes to Unaudited Condensed Consolidated Financial Statements, tagged as blocks of text. The information in Exhibit 101 is “furnished” and not “filed”, as provided in Rule 402 of Regulation S-T.

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101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Incorporated by reference to Exhibit 3.1 filed with the Registrant's Current Report on Form 8-K (File No. 000-13470) filed on October 5, 2006.

(2) Incorporated by reference to Exhibit 3.1 filed with the Registrant's Current Report on Form 8-K (File No. 000-13470) filed on April 12, 2012.

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- (3) Filed herewith.
- (4) Furnished herewith.
- (5) Incorporated by reference to Exhibit 10.1 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on May 22, 2015.
- (6) Incorporated by reference to Exhibit 10.2 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on May 22, 2015.
- (7) Incorporated by reference to Exhibit 10.3 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on May 22, 2015.
- (8) Incorporated by reference to Exhibit 10.4 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on May 22, 2015.
- (9) Incorporated by reference to Exhibit 10.1 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on February 20, 2013.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NANOMETRICS INCORPORATED  
(Registrant)

By: /S/ JEFFREY ANDRESON  
Jeffrey Andreson  
Chief Financial Officer  
(Duly Authorized and Principal Financial Officer)

Dated: July 24, 2015

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EXHIBIT INDEX

Exhibit No.	Description
3.(i)	Certificate of Incorporation
3.1(1)	Certificate of Incorporation of the Registrant
3.(ii)	Bylaws
3.2(2)	Bylaws of the Registrant
10	Material Contracts
10.1(5)	General Severance Benefits and Change in Control Severance Benefits Agreement between Registrant and Timothy J. Stultz, Ph.D., dated May 19, 2015
10.2(6)	General Severance Benefits and Change in Control Severance Benefits Agreement between Registrant and Jeffrey Andreson, dated May 19, 2015
10.3(7)	General Severance Benefits and Change in Control Severance Benefits Agreement between Registrant and S. Mark Borowicz, dated May 19, 2015
10.4(8)	General Severance Benefits and Change in Control Severance Benefits Agreement between Registrant and Kevin Heidrich, dated May 19, 2015
10.5(9)	Form of Indemnification Agreement between the Registrant and each of its directors and executive officers
31	Rule 13a-14(a)/15d-14(a) Certifications
31.1(3)	Certification of Timothy J. Stultz, principal executive officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2(3)	Certification of Jeffrey Andreson, principal financial officer and principal accounting officer of the Registrant, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Section 1350 Certifications
32.1(3)	Certification of Timothy J. Stultz, principal executive officer of the Registrant, and Jeffrey Andreson, principal financial officer and principal accounting officer of the Registrant pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101(4)	The following financial statements, formatted in XBRL: (i) Condensed Consolidated Balance Sheets at June 27, 2015, and December 27, 2014, (ii) Condensed Consolidated Statements of Operations for the three and six months ended June 27, 2015 and June 28, 2014, (iii) Condensed Consolidated Statements of Cash Flows for the six months June 27, 2015 and June 28, 2014, and (v) Notes to Unaudited Condensed Consolidated Financial Statements, tagged as blocks of text. The information

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101.INS**	is Exhibit 101 is “furnished” and not “filed”, as provided in Rule 402 of Regulation S-T. XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Incorporated by reference to Exhibit 3.1 filed with the Registrant’s Current Report on Form 8-K (File

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No. 000-13470) filed on October 5, 2006.

(2) Incorporated by reference to Exhibit 3.1 filed with the Registrant's Current Report on Form 8-K (File No. 000-13470) filed on April 12, 2012.

(3) Filed herewith.

(4) Furnished herewith.

(5) Incorporated by reference to Exhibit 10.1 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on May 22, 2015.

(6) Incorporated by reference to Exhibit 10.2 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on May 22, 2015.

(7) Incorporated by reference to Exhibit 10.3 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on May 22, 2015.

(8) Incorporated by reference to Exhibit 10.4 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on May 22, 2015.

(9) Incorporated by reference to Exhibit 10.1 filed with the Registrant's Current Report on Form 8-K (file No. 000-13470) filed on February 20, 2013.