

MKS INSTRUMENTS INC  
Form 10-K  
February 26, 2019  
Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**Form 10-K**

(MARK ONE)

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

**For the fiscal year ended December 31, 2018**

**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 0-23621**

**MKS INSTRUMENTS, INC.**

*(Exact Name of Registrant as Specified in Its Charter)*

**Massachusetts**

*(State or other Jurisdiction of*

*Incorporation or Organization)*

**2 Tech Drive, Suite 201, Andover, Massachusetts**

*(Address of Principal Executive Offices)*

**04-2277512**

*(IRS Employer*

*Identification No.)*

**01810**

*(Zip Code)*

**(978) 645-5500**

*(Registrant's Telephone Number, including area code)*

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of class</b>	<b>Name of exchange on which registered</b>
Common Stock, no par value	NASDAQ Global Select Market

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company  Emerging growth company   
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with or any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Aggregate market value of the voting and non-voting common equity held by nonaffiliates of the registrant as of June 30, 2018 based on the closing price of the registrant's common stock on such date as reported by the Nasdaq Global Select Market: \$5,217,380,580.

Number of shares outstanding of the issuer's common stock, no par value, as of February 19, 2019: 54,197,726

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement for MKS Annual Meeting of Stockholders to be held on May 8, 2019 are incorporated by reference into Part III of this Form 10-K.



**Table of Contents****TABLE OF CONTENTS****PART I**

Item 1.	<u>Business</u>	2
Item 1A.	<u>Risk Factors</u>	9
Item 1B.	<u>Unresolved Staff Comments</u>	31
Item 2.	<u>Properties</u>	32
Item 3.	<u>Legal Proceedings</u>	33
Item 4.	<u>Mine Safety Disclosures</u>	34

**PART II**

Item 5.	<u>Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	35
Item 6.	<u>Selected Financial Data</u>	37
Item 7.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	39
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	64
Item 8.	<u>Financial Statements and Supplementary Data</u>	66
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	127
Item 9A.	<u>Controls and Procedures</u>	127
Item 9B.	<u>Other Information</u>	128

**PART III**

Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	129
Item 11.	<u>Executive Compensation</u>	129
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	129
Item 13.	<u>Certain Relationships and Related Transactions and Director Independence</u>	129
Item 14.	<u>Principal Accountant Fees and Services</u>	129

**PART IV**

Item 15.	<u>Exhibits and Financial Statement Schedules</u>	130
Item 16.	<u>Form 10-K Summary</u>	134
<b><u>SIGNATURES</u></b>		136

---

**Table of Contents**

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act and Section 21E of the Securities Exchange Act. When used herein, the words believe, anticipate, plan, expect, estimate, intend, may, see, will, would and similar expressions are intended to identify forward-looking statements although forward-looking statements contain these identifying words. These forward-looking statements reflect management's current opinions and are subject to certain risks and uncertainties that could cause actual results to differ materially from those stated or implied. MKS assumes no obligation to update this information. Risks and uncertainties include, but are not limited to, those discussed in the section entitled Risk Factors of this annual report on Form 10-K.

**PART I**

**Item 1. Business**

MKS Instruments, Inc. (MKS or the Company) was founded in 1961 as a Massachusetts corporation. We are a global provider of instruments, subsystems and process control solutions that measure, monitor, deliver, analyze, power and control critical parameters of advanced manufacturing processes to improve process performance and productivity. Our products are derived from our core competencies in pressure measurement and control, flow measurement and control, gas and vapor delivery, gas composition analysis, residual gas analysis, leak detection, control technology, ozone generation and delivery, RF & DC power, reactive gas generation, vacuum technology, lasers, photonics, sub-micron positioning, vibration control, and optics. We also provide services relating to the maintenance and repair of our products, installation services and training.

**Recent Events**

**Acquisition of Electro Scientific Industries, Inc.**

On February 1, 2019, we completed our previously announced acquisition of Electro Scientific Industries, Inc., an Oregon corporation (ESI), pursuant to the Agreement and Plan of Merger (the ESI Merger). ESI is an innovator in laser-based manufacturing solutions for micro-machining applications. Micro-machining applications are used extensively in the manufacture of mobile devices, electronic components, thin film devices and semiconductor packaging. At the effective time of the ESI Merger and pursuant to the terms and conditions of the Agreement and Plan of Merger, each share of ESI's common stock issued and outstanding as of immediately prior to the effective time of the ESI Merger was converted into the right to receive \$30.00 per share in cash, without interest and subject to deduction for any required withholding tax. We paid to the former ESI stockholders aggregate consideration of approximately \$1 billion, excluding related transaction fees and expenses. We funded the payment of the aggregate consideration with a combination of our available cash on hand and proceeds from our term loan facility described below.

In connection with the completion of the ESI Merger, we entered into an amendment (Amendment No. 5) to our Term Loan Credit Agreement with Barclays Bank PLC as administrative agent and collateral agent, that provided additional tranche B-5 term loan commitment in the principal amount of \$650.0 million, which we used to partially fund the ESI Merger.

Also, in connection with the completion of the ESI Merger, we terminated our \$50.0 million asset-based credit agreement with Deutsche Bank AG New York Branch as administrative and collateral agent, and we entered into an asset-based credit agreement with Barclays Bank PLC, as administrative agent and collateral agent, that provides senior secured revolving credit financing of up to \$100.0 million, subject to a borrowing base limitation.

---

## **Table of Contents**

### **Other Dispositions and Acquisitions**

#### **Sale of Data Analytics Solutions Business**

In April 2017, we completed the sale of our Data Analytics Solutions business for total proceeds of \$72.5 million, net of cash sold and recorded a pre-tax gain of \$74.9 million. This business, which had net revenues in 2016 of \$12.7 million and was included in our Vacuum & Analysis segment, was no longer a part of our long-term strategic objectives. The business did not qualify as a discontinued operation as this sale did not represent a strategic shift in our business, nor did the sale have a major effect on our operations. Therefore, the results of operations for all periods are included in our income from operations. The assets and liabilities of this business have not been reclassified or segregated in the consolidated balance sheet or consolidated statements of cash flows as the amounts were immaterial.

#### **Acquisition of Newport Corporation**

On April 29, 2016, we completed our acquisition of Newport Corporation ( Newport ) pursuant to an Agreement and Plan of Merger dated as of February 22, 2016 (the Newport Merger ). At the effective time of the Newport Merger, each share of Newport s common stock issued and outstanding as of immediately prior to the effective time of the Newport Merger was converted into the right to receive \$23.00 in cash, without interest and subject to deduction for any required withholding tax. We paid to the former Newport stockholders aggregate consideration of approximately \$905 million, excluding related transaction fees and expenses, and repaid approximately \$93 million of Newport s U.S. indebtedness outstanding as of immediately prior to the effective time of the Newport Merger. We funded the payment of the aggregate consideration with a combination of our available cash on hand of approximately \$240 million and the proceeds from the senior secured term loan facility in the principal amount of \$780 million (see Note 13 to Notes to Consolidated Financial Statements in Item 8 of this Annual Report on Form 10-K).

Newport was a global supplier of advanced-technology products and systems to customers in the scientific research and defense/security, microelectronics, life and health sciences and industrial manufacturing markets.

#### **Reportable Segments**

Effective April 29, 2016, in conjunction with our acquisition of Newport, we changed the structure of our reportable segments based upon our organizational structure and how our Chief Operating Decision Maker utilizes information provided to allocate resources and make decisions. Our two reportable segments are the Vacuum & Analysis segment and the Light & Motion segment. The Vacuum & Analysis segment represents primarily the legacy MKS business and the Light & Motion segment represents the remaining legacy Newport business. With the acquisition of ESI, we will be adding a third segment.

The Vacuum & Analysis segment provides a broad range of instruments, components and subsystems which are derived from our core competencies in pressure measurement and control, flow measurement and control, gas and vapor delivery, gas composition analysis, residual gas analysis, leak detection, control technology, ozone generation and delivery, RF & DC power, reactive gas generation and vacuum technology. The Light & Motion segment provides a broad range of instruments, components and subsystems which are derived from our core competencies in lasers, photonics, sub-micron positioning, vibration control, and optics.

We group our products into six product groups based upon the similarity of the product function, type of product and manufacturing processes. These six groups are: Analytical and Controls Solutions Products; Power, Plasma and Reactive Gas Solutions Products; Vacuum Solutions Products; Photonics Products; Optics Products; and Laser Products. The Analytical and Controls Solutions Products, the Power, Plasma and Reactive Gas Solutions Products and the Vacuum Solutions Products are included in the Vacuum & Analysis segment and the Photonics Products, Optics Products and Laser Products are included in the Light & Motion segment.

## **Table of Contents**

For further information on our segments, see Note 19 to the Notes to the Consolidated Financials contained in this Annual Report on Form 10-K.

### **Where You Can Find More Information**

We file reports, proxy statements and other documents with the Securities and Exchange Commission ( SEC ). Our SEC filings are available to you on the SEC 's internet site at <http://www.sec.gov>.

Our website is <http://www.mksinst.com>. We are not including the information contained in our website as part of, or incorporating it by reference into, this annual report on Form 10-K. We make available free of charge through our internet site our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act ), as soon as reasonably practicable after we electronically file such materials with, or furnish them to, the SEC.

### **Markets and Applications**

Since our inception, we have focused on satisfying the needs of our customers by establishing long-term collaborative relationships. We have a diverse base of customers and our primary served markets are manufacturers of capital equipment for semiconductor manufacturing, industrial technologies, life and health sciences, as well as research and defense. Approximately 55%, 57% and 56% of our net revenues for the years 2018, 2017 and 2016, respectively, were from sales to semiconductor capital equipment manufacturers and semiconductor device manufacturers.

Approximately 45%, 43% and 44% of our net revenues in the years 2018, 2017 and 2016, respectively, were from advanced manufacturing applications. These include, but are not limited to, industrial technologies, life and health sciences, as well as research and defense.

A significant portion of our net revenues are from sales to customers in international markets. For the years 2018, 2017 and 2016, international net revenues accounted for approximately 51%, 50% and 48% of our total net revenues, respectively. A significant portion of our international net revenues were in South Korea, Japan, Germany and Israel. We expect that international revenues will continue to account for a significant percentage of total net revenues for the foreseeable future, and that in particular, the proportion of our sales to Asian customers will continue to increase, due in large part to our acquisition of ESI, as approximately ninety percent of ESI 's customers are located in Asia. Long-lived assets, located in the United States, were \$147 million, \$125 million and \$123 million as of December 31, 2018, 2017 and 2016, respectively, excluding goodwill and intangibles and long-term tax-related accounts. Long-lived assets, located outside of the United States, were \$77 million, \$78 million, and \$78 million as of December 31, 2018, 2017 and 2016, respectively, excluding goodwill and intangibles and long-term tax-related accounts.

### ***Semiconductor Manufacturing Applications***

A significant portion of our sales are derived from products sold to semiconductor capital equipment manufacturers and semiconductor device manufacturers. Our products are used in the major semiconductor processing steps such as depositing thin films of material onto silicon wafer substrates, etching, cleaning, lithography, metrology and inspection.

We anticipate that the semiconductor manufacturing market will continue to account for a substantial portion of our sales. While the semiconductor device manufacturing market is global, major semiconductor capital equipment manufacturers are concentrated in China, Japan, South Korea, Taiwan, and the United States.

## **Table of Contents**

### ***Advanced Markets***

In addition to semiconductor manufacturing, our products are used in the industrial technologies, life and health sciences, as well as research and defense markets.

### ***Industrial Technologies***

Industrial Technologies encompasses a wide range of diverse applications such as glass coating, laser marking, measurement and scribing, natural gas and oil production, environmental monitoring and electronic thin films. Electronic thin films are a primary component of numerous electronic products including flat panel displays, light emitting diodes, solar cells and data storage media.

Industrial Technologies manufacturers are located in developed and developing countries across the globe.

### ***Life and Health Sciences***

Our products for Life and Health Sciences are used in a diverse array of applications including bioimaging, medical instrument sterilization, medical device manufacturing, analytical, diagnostic and surgical instrumentation, consumable medical supply manufacturing and pharmaceutical production. Our Life and Health Sciences customers are located globally.

### ***Research and Defense***

In addition, our products are sold to government, university and industrial laboratories for applications involving research and development in materials science, physical chemistry, photonics, optics and electronics materials. Our products are also sold for monitoring and defense applications including surveillance, imaging and infrastructure protection. Major equipment providers and research laboratories are concentrated in China, Europe, Japan, South Korea, Taiwan and the United States.

## **Product Groups**

### **Vacuum & Analysis Segment**

The Vacuum & Analysis segment includes Analytical and Control Solutions Products; Vacuum Solutions Products; and Power, Plasma and Reactive Gas Solutions Products.

**Analytical and Control Solutions.** Our Analytical and Control Solutions Products include gas analyzers, automation control products, I/O modules, automation software, and precision machined components and electromechanical assemblies.

**Vacuum Solutions.** Our Vacuum Solutions Products consist of two primary product offerings: Pressure and Vacuum Measurement Solutions Products and Materials Delivery Solutions Products.

*Pressure and Vacuum Measurement Solutions Products.* Our Pressure and Vacuum Measurement Solutions Products consist of direct and indirect pressure measurement and integrated process solutions. Each of our pressure measurement and vacuum product lines consist of products that are designed for a variety of pressure ranges and accuracies.

*Materials Delivery Solutions Products.* Our Materials Delivery Solutions Products include flow and valve technologies as well as integrated pressure measurement and control subsystems to provide customers with precise control capabilities that are optimized for a given application.



## **Table of Contents**

**Power, Plasma and Reactive Gas Solutions.** Our Power, Plasma and Reactive Gas Solutions Products include power delivery, plasma and reactive gas products used in semiconductor and other thin film applications and in medical imaging equipment applications.

*Power Delivery Products.* We design and manufacture microwave, direct current and radio frequency power delivery systems as well as radio frequency matching networks and metrology products. In the semiconductor, industrial technologies and other market sectors, our power supplies are used to provide energy to various etching, stripping and deposition processes. Our power amplifiers are also used in medical imaging equipment.

*Plasma and Reactive Gas Products.* We design and manufacture reactive gas products, which create reactive species. A reactive species is an atom or molecule in an unstable state, which is used to facilitate various chemical reactions in the processing of thin films (deposition of films, etching and cleaning of films and surface modifications). A number of different technologies are used to create reactive gas including different plasma technologies and barrier discharge technologies.

## **Light and Motion Segment**

The Light and Motion segment includes Laser Products; Photonics Products; and Optics Products.

**Lasers.** Our Laser Products include lasers and laser-based systems including ultrafast lasers and amplifiers, fiber lasers, diode-pumped solid-state lasers, high-energy pulsed lasers and tunable lasers. In addition to providing a wide range of standard and configured laser products and accessories to our end-user customers, we also work closely with our original equipment manufacturer ( OEM ) customers to develop lasers and laser system designs optimized for their product and technology roadmaps.

**Photonics.** Our Photonics Products include optical components, lens assemblies and vibration isolation solutions as well as three-dimensional non-contact measurement sensors and equipment. We also design, develop and manufacture subsystems and subassemblies that integrate our broad portfolio of products and technologies into solutions that meet the specific application requirements of our OEM and select end-user customers. Our Photonics Products also includes our instruments and motion products which includes high-precision motion stages and controls, hexapods, photonics instruments for measurement and analysis, and production equipment for test and measurement customers.

**Optics.** Our Optics Products include precision optics, thin-film filters and coatings, replicated mirrors and ruled and holographic diffraction gratings.

## **Customers**

We sell our products to thousands of customers worldwide, in a wide range of end markets. Our largest customers include leading semiconductor capital equipment manufacturers such as Applied Materials, Inc. and Lam Research Corporation. Revenues from our top ten customers accounted for approximately 41%, 43% and 39% of net revenues for the years 2018, 2017 and 2016, respectively. Applied Materials, Inc. accounted for 12%, 13% and 14% and Lam Research Corporation accounted for 11%, 12% and 11% of our net revenues for the years 2018, 2017 and 2016, respectively.

## **Sales, Marketing, Service and Support**

Our worldwide sales, marketing, service and support organization is critical to our strategy of maintaining close relationships with semiconductor capital equipment and device manufacturers and manufacturers of advanced applications. We market and sell our products and services through our global direct sales organization, an international network of independent distributors and sales representatives, our websites and product catalogs. As of December 31, 2018, we had 475 sales employees worldwide, located in the United States, United

## **Table of Contents**

Kingdom, China, Japan, Israel, South Korea, Germany, France, Taiwan, Singapore, Netherlands and Italy. We maintain a marketing staff that identifies customer requirements, assists in product planning and specifications, and focuses on future trends in semiconductor and other markets.

As semiconductor device manufacturers have become increasingly sensitive to the significant costs of system downtime, they have required that suppliers offer comprehensive local repair, field service and customer support. Manufacturers require close support to enable them to repair, modify, upgrade and retrofit their equipment to improve yields and adapt new materials or processes. To meet these market requirements, we provide technical support from offices located in China, Germany, Japan, South Korea, Singapore, Taiwan, the United Kingdom, Israel and the United States. We provide repair and calibration services at internal service depots and authorized service providers located worldwide. We typically provide warranties for periods ranging from one to three years, depending upon the type of product, with the majority of our products ranging from one to two years. We typically provide warranty on our repair services for periods ranging from 90 days to up to one year, depending upon the type of repair.

## **Research and Development**

Our products incorporate sophisticated technologies to measure, monitor, deliver, analyze, power and control complex semiconductor and advanced manufacturing processes, thereby enhancing uptime, yield and throughput for our customers. Our products have continuously advanced as we strive to meet our customers' evolving needs. We have developed, and continue to develop, new products to address industry trends, such as the shrinking of integrated circuit critical dimensions and technology inflections, and, in the flat panel display and solar markets, the transition to larger substrate sizes, which require more advanced process control technology. In addition, we have developed, and continue to develop, products that support the migration to new classes of materials, ultra-thin layers, and 3D structures that are used in small geometry manufacturing. We involve our marketing, engineering, manufacturing and sales personnel in the development of new products in order to reduce the time to market for new products. Our employees also work closely with our customers' development personnel, helping us to identify and define future technical needs on which to focus research and development efforts. We support research at academic institutions targeted at advances in materials science and semiconductor process development.

As of December 31, 2018, we had 663 research and development employees, primarily located in the United States, France and Israel. Our research and development expenses were \$135.7 million, \$132.6 million and \$110.6 million for the years 2018, 2017 and 2016, respectively. Our research and development efforts include numerous projects, none of which are individually material, and generally have a duration of 3 to 30 months depending upon whether the product is an enhancement of existing technology or a new product. Our current initiatives include projects to enhance the performance characteristics of older products, to develop new products and to integrate various technologies into subsystems.

## **Manufacturing**

Our manufacturing facilities are located in Austria, China, France, Germany, Israel, Italy, South Korea, Mexico, Romania, the United Kingdom and the United States. Manufacturing activities include the assembly and testing of components and subassemblies, which are integrated into our products. We outsource some of our assembly work. We purchase a wide range of electronic, optical, mechanical and electrical components, some of which are designed to our specifications. We consider our lean manufacturing techniques and responsiveness to customers' significantly fluctuating product demands to be a competitive advantage. As of December 31, 2018, we had 3,109 manufacturing-related employees, located primarily in North America (United States) and Asia (primarily China and Israel).

## **Backlog**

At December 31, 2018, our backlog of unfilled orders for all products and services was \$400 million, compared to \$464 million at December 31, 2017. The decrease in backlog of \$64 million in 2018 compared to

## **Table of Contents**

2017 is primarily attributed to a decrease in business levels throughout our company in the second half of 2018. As of December 31, 2018, approximately \$391 million of our consolidated backlog was scheduled to be shipped on or before December 31, 2019. In general, we schedule production of our products based upon our customers' delivery requirements. Our lead times are very short, as a large portion of our orders are received and shipped within 90 days. While backlog is calculated on the basis of firm orders, orders may be subject to cancellation or delay, in many cases, by the customer with limited or no penalty. Our backlog at any particular date, therefore, is not necessarily indicative of actual sales which may be generated for any succeeding period. Historically, our backlog levels have fluctuated based upon the ordering patterns of our customers and changes in our manufacturing capacity.

## **Competition**

The market for our products is highly competitive. Principal competitive factors include:

historical customer relationships;

product quality, performance and price;

breadth of product line;

manufacturing capabilities; and

customer service and support.

Although we believe that we compete favorably with respect to these factors, there can be no assurance that we will continue to do so.

We encounter substantial competition in most of our product lines, although no single competitor competes with us across all product lines. Certain of our competitors may have greater financial and other resources than we do. In some cases, competitors are smaller than we are, but are well established in specific product niches.

For example, Advanced Energy Industries, Inc. offers products that compete with our power delivery and reactive gas generator products. Hitachi Ltd. and Horiba Ltd. products compete with our product line of mass flow controllers. Inficon, Inc. offers products that compete with our vacuum measurement and gas analysis products and our vacuum gauging products. Nor-Cal Products, Inc. and VAT, Inc. offer products that compete with our vacuum components.

Ametek, Inc. offers products that compete with our optics and photonics products. Coherent, Inc. offers products that compete with our lasers and photonics instruments. Excelitas Technologies Corp. offers products that compete with our laser and optics products. IDEX Corporation offers products that compete with our lasers, optics, and photonics subsystems. IPG Photonics, Inc. offers products that compete with our laser products. Jenoptik AG offers products that compete with our laser, optics, and photonics products. PI miCos GmbH offers products that compete with our photonics products. Thorlabs, Inc. offers products that compete with our optics, lasers and photonics products. Trumpf Group offers products that compete with our laser products.

## **Patents and Other Intellectual Property Rights**

We rely on a combination of patent, copyright, trademark and trade secret laws and license agreements to establish and protect our proprietary rights. As of December 31, 2018, we owned 510 U.S. patents and 984 foreign patents that expire at various dates through 2038. As of December 31, 2018, we had 82 pending U.S. patent applications. Foreign counterparts of certain U.S. applications have been filed or may be filed at the appropriate time.

We require each of our employees, including our executive officers, to enter into standard agreements pursuant to which the employee agrees to keep confidential all of our proprietary information and to assign to us all inventions while they are employed by us.



## **Table of Contents**

### **Employees**

As of December 31, 2018, we employed 4,851 persons. We believe that our ongoing success depends upon our continued ability to attract and retain highly skilled employees. Outside of the United States, there are certain countries where our employees are represented by works council or trade unions, as is common practice or required by law. We believe that our employee relations are good.

### **Item 1A. Risk Factors**

The following describes certain risks we face in our business. Additional risks that we do not yet know of or that we currently believe are immaterial may also impair our business. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this report and our other filings with the Securities and Exchange Commission.

***Our business depends substantially on capital spending in the semiconductor industry, which is characterized by periodic fluctuations that may cause a reduction in demand for our products.***

Approximately 55%, 57% and 56% of our net revenues for the years 2018, 2017 and 2016, respectively, were from sales to semiconductor capital equipment manufacturers and semiconductor device manufacturers. While our acquisition of Newport Corporation, ( Newport ) in 2016, has reduced our concentration of customers in these markets and we expect some additional reduction as a result of our February 2019 acquisition of Electro Scientific Industries, Inc. ( ESI ), we anticipate that sales to such customers will continue to account for a substantial portion of our net revenues. Our business depends upon the capital expenditures of semiconductor device manufacturers, which in turn depends upon the demand for semiconductors.

The semiconductor industry is characterized by rapid technological change, frequent product introductions, changing customer requirements and evolving industry standards. Because our customers face uncertainties with regard to the growth and requirements of these markets, their products and components may not achieve, or continue to achieve, anticipated levels of market acceptance. If our customers are unable to deliver products that gain market acceptance, it is likely that these customers will not purchase our products or will purchase smaller quantities of our products. We often invest substantial resources in developing our products and subsystems in advance of significant sales of these products and subsystems to such customers. A failure on the part of our customers' products to gain market acceptance, or a failure of the semiconductor market to sustain current sales levels or to grow would have a significant negative effect on our business, financial condition and results of operations.

The semiconductor industry has historically been characterized by cyclical variations in product supply and demand. These sometimes sudden and severe cycles may result from a number of factors, including overall consumer and industrial spending and demand for electronic products that drive manufacturer production, as well as the manufacturer's capacity utilization, timing of new product introductions and demand for customers' products, inventory levels relative to demand and access to affordable capital. The timing, severity and duration of these market cycles are difficult to predict, and we may not be able to respond effectively to these cycles. The cyclicity of the semiconductor market is demonstrated by the changes in sales to semiconductor capital equipment and device manufacturers in past years. For example, our sales to semiconductor capital equipment manufacturers and semiconductor device manufacturers increased compared to the prior year by 4%, 52% and 29% in 2018, 2017 and 2016, respectively. While we experienced strong sales to these customers during the first half of 2018, we saw moderation in capital spending in the semiconductor capital equipment industry in the third and fourth quarters of 2018 with a similar effect on our semiconductor-related revenue, and we expect that to continue into the first half of 2019. The 52% increase in 2017, compared to 2016, was mainly attributable to an increase in volume from our semiconductor customers and from the full year effect of net sales from Newport, which we acquired in April 2016.

## **Table of Contents**

During semiconductor market downturns, periods of overcapacity have resulted in rapid and significantly reduced demand for our products, which may result in lower gross margins due to reduced absorption of manufacturing overhead, as our ability to rapidly and effectively reduce our cost structure in response to such downturns is limited by the fixed nature of many of our expenses in the near term. Further, our ability to reduce our long-term expenses is constrained by our need to continue our investment in next-generation product technology and to support and service our products. In addition, due to the relatively long manufacturing lead times for some of the products and subsystems we sell to this market, we may incur expenditures or purchase raw materials or components for products we are unable to sell. Accordingly, downturns in the semiconductor capital equipment market may materially harm our business, financial condition and operating results. Conversely, when upturns in this market occur, we may have difficulty rapidly and effectively increasing our manufacturing capacity to meet sudden increases in customer demand. If we fail to do so, we may lose business to our competitors and our relationships with our customers may be harmed. In addition, many semiconductor manufacturers have operations and customers in Asia, a region that in past years has experienced serious economic problems including currency devaluations, debt defaults, lack of liquidity and recessions.

*The acquisition of ESI involves numerous risks, including the inability to effectively integrate ESI's business and operations or realize the expected benefits from the acquisition, which could materially harm our operating results.*

Our February 2019 acquisition of ESI has increased our product offerings, end markets, and number of employees and facilities. ESI's products and certain of its technology, markets and customer base are significantly different from our historical experience. Combining our businesses could make it more difficult to maintain relationships with customers, employees or suppliers. Integrating ESI's business and operations with ours will require significant management attention, efforts and expenditures, and we may not be able to achieve the integration in an effective, complete, timely or cost-efficient manner.

Potential risks related to our acquisition of ESI include our ability to:

expand our financial and management controls and reporting systems and procedures to integrate and manage ESI;

integrate our information technology systems to enable the management and operation of the combined business;

realize expected synergies and cost savings resulting from the acquisition;

maintain and improve ESI's operations while integrating our combined manufacturing organization;

avoid lost revenue due to customer confusion, alienation or misinformation regarding the transaction, and retain and expand ESI's customer base while aligning our sales efforts;

avoid lost revenue resulting from the distraction or confusion of our personnel as a consequence of the acquisition and ongoing integration efforts;

identify and retain key ESI personnel;

recognize and capitalize on anticipated product sales and technology enhancement opportunities presented by our combined businesses;

adequately familiarize ourselves with ESI's products and technology and certain of its markets and customer base such that we can manage ESI's business effectively; and

successfully integrate our respective corporate cultures such that we achieve the benefits of acting as a unified company. Other potential risks related to our acquisition of ESI include:

the assumption of unknown or contingent liabilities, or other unanticipated events or circumstances; and

---

**Table of Contents**

the potential to incur or record significant cash or non-cash charges or write down the carrying value of intangible assets and goodwill obtained in the ESI acquisition, which could adversely impact our cash flow or lower our earnings in the period or periods for which we incur such charges or write down such assets.

Further, some very significant customers of our laser and motion products compete with ESI. ESI will initially remain a separate division from our Light & Motion segment that supplies these laser and motion products, and we have implemented internal measures intended to segregate competitively sensitive information that we receive from these customers from our ESI business, however, these customers may choose to source their laser and motion products from alternate suppliers, which could result in a potentially significant loss of revenue for our laser and motion business.

If we are unable to successfully or timely integrate the operations of ESI's business into our business, we may be unable to realize the revenue growth, synergies and other anticipated benefits resulting from the acquisition and our business could be adversely affected. Additionally, we have incurred and will continue to incur transaction-related costs, including legal, regulatory and other costs associated with implementing integration plans, including facilities and systems consolidation costs and employment-related costs. Although we expect that the elimination of duplicative costs, as well as the realization of other efficiencies related to the integration of the businesses, should allow us to offset transaction and integration-related costs over time, this net benefit may not be achieved in the near term, or at all. Further, we may not realize the expected benefits from the acquisition. ESI's business and operations may not achieve the anticipated revenues and operating results. We may in the future choose to close or divest certain sectors of ESI, which could require us to record losses and/or spend cash relating to such closures or divestitures. Any of the foregoing risks could materially harm our business, financial condition and results of operations.

***The terms of our term loan credit facility and asset-based revolving credit facility impose significant financial obligations and risks upon us, limit our ability to take certain actions, and could discourage a change in control.***

In February 2019, we amended our existing term loan credit facility and obtained a new revolving credit facility in connection with financing our acquisition of ESI. The term loan credit facility, as amended, provided us with additional senior secured financing in the principal amount of \$650 million as of February 1, 2019, with a term of seven years. Together with this additional financing, we have \$998 million in total outstanding debt as of February 1, 2019. The revolving credit facility provides us with senior secured financing of up to \$100 million, subject to a borrowing base limitation.

Our indebtedness under these credit facilities has increased our interest expense and could have the effect, among other things, of reducing the funds available to flexibly respond to changing business and economic conditions. Our indebtedness could also reduce funds available for working capital, capital expenditures, acquisitions and other general corporate purposes and may create competitive disadvantages relative to other companies with lower debt levels. If we do not achieve the expected benefits from the acquisition, or if the financial performance of the combined company does not meet current expectations, then our ability to service our indebtedness may be adversely impacted.

A significant portion of the amounts outstanding under the credit facilities bear interest at variable interest rates. Although we hedge some of that exposure, if interest rates increase, variable rate debt will create higher debt service requirements, which could adversely affect our cash flows. In addition, our credit ratings could affect the cost and availability of future borrowings and, accordingly, our cost of capital. Our ratings of our indebtedness reflect each nationally recognized statistical rating organization's opinion of our financial strength, operating performance and ability to meet our debt obligations. There can be no assurance that we will achieve a particular rating or maintain a particular rating in the future. Moreover, we may be required to raise substantial additional financing to fund working capital, capital expenditures, acquisitions or other general corporate



**Table of Contents**

requirements. Our ability to arrange additional financing or refinancing will depend on, among other factors, our financial position and performance, as well as prevailing market conditions and other factors beyond our control. There can be no assurance that we will be able to obtain additional financing or refinancing on terms acceptable to us or at all.

Our term loan credit facility, as amended, uses LIBOR as a reference rate for our term loans, such that the interest due pursuant to such loans may be calculated using LIBOR (subject to a stated minimum value). On July 27, 2017, the United Kingdom's Financial Conduct Authority, which regulates LIBOR, announced that it intends to phase out LIBOR by the end of 2021. LIBOR borrowings may become unavailable before that date. It is unclear if at that time LIBOR will cease to exist or if new methods of calculating LIBOR will be established such that it continues to exist after 2021. The future of LIBOR at this time is uncertain. If the method for calculation of LIBOR changes, if LIBOR is no longer available or if lenders have increased costs due to changes in LIBOR, we may have to modify our term loan credit facility, or the loans using LIBOR as a reference rate will convert to the base rate (calculated by reference to the higher of the federal funds effective rate plus 50 basis points or the prime rate, subject to a stated minimum value) which could result in higher interest rates.

The term loan credit facility and the revolving credit facility contain a number of negative covenants that, among other things and subject to certain exceptions, restrict our ability and/or our subsidiaries' ability to:

incur additional indebtedness;

pay certain dividends on our capital stock or redeem, repurchase or retire certain capital stock or certain other indebtedness;

make certain investments, loans and acquisitions;

engage in certain transactions with our affiliates;

sell assets, including capital stock of our subsidiaries;

materially alter the business we conduct;

consolidate or merge;

incur liens; and

engage in sale-leaseback transactions.

These covenants restrict our ability to engage in or benefit from these actions, thereby limiting our flexibility in planning for, or reacting to, changes and opportunities in the markets in which we compete, such as limiting our ability to engage in mergers and acquisitions. This could place us at a competitive disadvantage. If the matters described in our other risk factors result in a material adverse effect on our business, financial condition or results of operations, we may be unable to comply with the terms of our credit facilities or experience an event of default.

The term loan credit agreement and the revolving credit agreement contain customary events of default, including:

failure to make required payments;

failure to comply with certain agreements or covenants;

materially breaching any representation or warranty made or deemed made in connection with the respective credit facility;

failure to pay, or cause acceleration of, certain other indebtedness;

certain events of bankruptcy and insolvency;

---

**Table of Contents**

failure to pay certain judgments; and

a change in control of us.

The amount of cash available to us for repayment of amounts owed under these credit facilities will depend on our usage of our existing cash balances and our operating performance and ability to generate cash flow from operations in future periods, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control. We cannot provide any assurances that we will generate sufficient cash flow from operations to service our debt obligations. Any failure to repay these obligations as they become due would result in an event of default under the credit facilities.

Further, because a change in control of us constitutes an event of default under these credit facilities, this would likely be a deterrent to a potential acquirer, as any potential acquisition would trigger an event of default, unless the lenders agreed to waive such event of default. We cannot guarantee that any such waiver would be obtained.

If an event of default occurs, the lenders may end their obligation to make loans to us under the credit facilities, and may declare any outstanding indebtedness under the credit facilities immediately due and payable. In such case, we would need to obtain additional financing or significantly deplete our available cash, or both, in order to repay this indebtedness. Any additional financing may not be available on reasonable terms or at all, and significant depletion of our available cash could harm our ability to fund our operations or execute our broader corporate objectives. If we were unable to repay outstanding indebtedness following an event of default, then in addition to other available rights and remedies, the lenders could initiate foreclosure proceedings on substantially all of our assets. Any such foreclosure proceedings or other rights and remedies successfully implemented by the lenders in an event of default would have a material adverse effect on our business, financial condition and results of operations.

***Our quarterly operating results have fluctuated, and are likely to continue to vary significantly, which may result in volatility in the market price of our common stock.***

A substantial portion of our shipments occurs shortly after an order is received, and therefore we generally operate with a relatively low level of backlog. As a result, a decrease in demand for our products from one or more customers could occur with limited advance notice and could have a material adverse effect on our results of operations in any particular period. Further, with respect to certain of our business lines, we often recognize a significant portion of net revenues in the last month of each fiscal quarter, due in part to the tendency of some customers to wait until late in a quarter to commit to purchase certain of our products as a result of capital expenditure approvals and budgeting constraints occurring at the end of a quarter, or the hope of obtaining more favorable pricing from a competitor seeking the business. Thus, variations in timing of sales can cause significant fluctuations in our quarterly sales, gross margin and profitability. Orders expected to ship in one period could shift to another period due to changes in the timing of our customers' purchase decisions, rescheduled delivery dates requested by our customers, manufacturing capacity constraints or logistics delays. Our operating results for a particular quarter or year may be adversely affected if our customers, particularly our largest customers, cancel or reschedule orders, or if we cannot fill orders in time due to capacity constraints or unexpected delays in manufacturing, testing, shipping or product acceptance. Also, we base our manufacturing plans on our forecasted product mix. If the actual product mix varies significantly from our forecast, we may not be able to fill some orders, which would result in delays in the shipment of our products and could shift sales to a subsequent period. All of these risks have a disproportionately high impact on our ESI business, which derives substantial revenue from a few significant customers and the sale of a relatively small quantity of products. A significant percentage of our expenses are fixed and based in part on expectations of future net revenues. The inability to adjust spending quickly enough to compensate for any shortfall would magnify the adverse impact of a shortfall in net revenues on our results of operations. Factors that could cause fluctuations in our financial results include:

a worldwide economic slowdown or disruption in the global financial markets;

**Table of Contents**

fluctuations in our customers' capital spending, industry cyclicality (particularly in the semiconductor industry), market seasonality (particularly in the research and defense market), levels of government funding available to our customers (particularly in the life and health sciences and research and defense markets) and other economic conditions within the markets we serve;

the timing of the receipt of orders within a given period and the level of orders from major customers;

demand for our products and the products sold by our customers;

shipment delays;

disruption in sources of supply;

production capacity constraints;

specific features requested by customers;

the timing and level of cancellations and delays of orders in backlog for our products;

the timing of product shipments and revenue recognition within a given quarter;

variations in the mix of products we sell;

changes in our pricing practices or in the pricing practices of our competitors or suppliers;

our timing in introducing new products;

	21.60	92,193	25.88								
Consumer (home equity and other)		27,435	5.21	22,907	4.72	19,914	4.32	20,101	4.45	12,503	3.51
Commercial business loans		20,939	3.98	5,499	1.13	1,538	0.33	0	0.00	1,000	0.28
Total adjustable-rate loans		212,284	40.32	162,043	33.36	121,168	26.29	117,678	26.05	105,696	29.67
Total loans		526,499	100.00%	485,774	100.00%	460,855	100.00%	451,773	100.00%	356,288	100.00%
<i>Less</i>											
Loans in process		2,953		2,771		7,997		4,562		2,814	
Unamortized discounts		289		297		414		547		417	

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

Net deferred loan fees	1,348	1,537	1,948	1,847	1,695
Allowance for losses on loans	3,144	3,273	3,041	2,748	2,340
Total loans receivable, net	\$ 518,765	\$ 477,896	\$ 447,455	\$ 442,069	\$ 349,022

6

The following table illustrates the interest rate sensitivity of HMN's loan portfolio at December 31, 2000. Loans which have adjustable or renegotiable interest rates are shown as maturing in the period during which the contract is due. Scheduled repayments of principal are reflected in the year in which they are scheduled to be paid.

Due During Years Ending December 31,	Real Estate											
	One-to-four family		Multi-family and Commercial		Construction		Consumer		Commercial Business		Total	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
(Dollars in thousands)												
2001(1)	\$ 22,223	7.41%	\$ 6,656	9.60%	\$ 11,777	9.61%	\$ 11,322	10.37%	\$ 20,545	9.54%	\$ 72,523	9.03%
2002	19,388	7.33	5,707	9.17	1,452	9.61	8,181	9.75	5,932	8.99	40,660	8.40
2003	17,429	7.24	8,458	9.44	59	8.58	7,935	9.75	9,176	9.01	43,057	8.51
2004 through 2005	35,319	7.28	14,543	8.74	164	8.75	16,433	9.93	10,078	8.89	76,537	8.34
2006 through 2010	83,024	7.22	17,134	8.20	1,560	8.63	22,363	10.30	1,314	8.58	125,395	7.94
2011 through 2025	119,173	7.33	21,218	9.14	3,826	8.80	4,662	10.49	1,715	8.65	150,594	7.73
2026 and following	16,332	7.89	28	9.50	1,373	8.69	0	0.00	0	0.00	17,733	7.96
	\$ 312,888		\$ 73,744		\$ 20,211		\$ 70,896		\$ 48,760		\$ 526,499	

(1) Includes demand loans, loans having no stated maturity, overdraft loans and education loans.

The total amount of loans due after December 31, 2001 which have predetermined interest rates is \$257.5 million, while the total amount of loans due after such dates which have floating or adjustable interest rates is \$196.5 million.

At December 31, 2000 construction or development loans for one-to-four family dwellings totaled \$9.8 million, multi-family totaled \$5.1 million, and non-residential totaled \$5.3 million.

7

Under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), the aggregate amount of loans that the Bank is permitted to make to any one borrower is generally limited to 15% of unimpaired capital and surplus (25% if the security for such loan has a "readily ascertainable" value or 30% for certain residential development loans). At December 31, 2000, based upon the 15% limitation, the Bank's regulatory limit for loans-to-one borrower was approximately \$7.9 million. However, at December 31, 2000, the largest dollar amount

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

outstanding to one borrower or group of related borrowers was \$7.9 million. The borrowing relationship is secured by a shopping mall located in Winona, Minnesota and other commercial real estate in Rochester, Minnesota. The borrowing relationship was performing in accordance with its terms at December 31, 2000.

The Bank's Mortgage and Consumer Loan Committee is responsible for review and approval of all loans over the FHLMC/FNMA conforming loan dollar limits (the Limit) originated by the Bank which are not sold in the secondary loan market. For the majority of 2000 the Limit was \$275,000, compared to \$240,000 for the majority of 1999. Approval of one member of the Loan Committee is required on all loans ranging from the Limit to \$500,000. Loans greater than \$500,000 must be approved by the Board of Directors of the Bank or its Executive Committee after review and preliminary approval by the Loan Committee. All loans closed each month are reviewed by the Board of Directors at its regularly scheduled meetings.

The Bank's commercial loan officers have the authority to approve loans which meet the guidelines established by the commercial loan policy for loans up to \$250,000. The Bank's Commercial Loan Committee is responsible for reviewing and approving commercial loans which range from \$250,001 to \$4.0 million. Loans exceeding the \$4.0 million must be approved by the Board of Directors.

All of the Bank's lending is subject to its written underwriting standards and to loan origination procedures. Decisions on loan applications are made on the basis of detailed applications and property valuations (consistent with the Bank's appraisal policy) by the Bank's staff appraiser or an independent appraiser. The loan applications are designed primarily to determine the borrower's ability to repay. The more significant items on the application are verified through use of credit reports, financial statements, tax returns and/or confirmations. The Bank also offers the Home Credit Plus Program which relies on the credit score of the loan applicant instead of income, asset and employment verification procedures. The Bank also offers low or alternative documentation underwriting procedures which conform to FNMA underwriting guidelines.

Generally, the Bank requires title insurance on its mortgage loans as well as fire and extended coverage casualty insurance in amounts at least equal to the principal amount of the loan or the value of improvements on the property, depending on the type of loan. The Bank also requires flood insurance to protect the property securing its interest when the property is located in a flood plain.

**One-to-four Family Residential Real Estate Lending.** At December 31, 2000 HMN's one-to-four family real estate loans totaled \$312.9 million, a decline of \$31.8 million compared to \$344.7 million at December 31, 1999 which declined by \$20.8 million, compared to \$365.5 million at December 31, 1998 which declined by \$30.2 million compared to \$395.7 million at December 31, 1997. In order to reduce its interest rate risk the Bank sold 80% of all one-to-four family loans originated during 2000. The Bank converted \$11.1 million of one-to-four family loans into mortgage-backed securities (securitized) and transferred the securities into the securities available for sale portfolio. The Bank also sold another \$5.1 million of one-to-four family loans from the loan portfolio. The impact of the loan securitization and sales when coupled with principal repayments caused the one-to-four family loan portfolio to decline by \$31.8 million during 2000. During 1999 the Bank sold 62% of all one-to-four family mortgage loans originated or refinanced. It converted \$6.9 million of one-to-four family loans into mortgage-backed securities (securitization) and transferred the securities into the securities available for sale portfolio. The Bank also sold another \$10.2 million of one-to-four family loans from the loan portfolio. The impact of the loan securitization and sales when coupled with the principal repayments caused the one-to-four family loan portfolio to decline by \$20.8 million during 1999. During 1998, the Bank securitized and sold \$27.9 million of one-to-four family

8

---

residential loans out of its loan portfolio. It also sold approximately 44% of the Bank's one-to-four family residential loans that were originated or refinanced in 1998. The loan securitization and the loan sales, when coupled with the accelerated prepayments experienced in the loan portfolio during 1998, caused the one-to-four family real estate loan portfolio to decline \$30.2 million from December 31, 1997 to December 31, 1998.

On December 5, 1997 the Bank merged with Marshalltown Financial Corporation ("MFC"). The Loan Portfolio Composition table includes for December 31, 1997, \$62.9 million of one-to-four family residential loans, \$2.3 million of multi-family residential, \$2.1 million of commercial real estate and \$2.6 million of consumer loans which were acquired in the MFC merger.

The GEM loans require payments which increase after the first year. Under the GEM loans, the monthly payments required for the first year are established based on a 30-year amortization schedule. Depending upon the program selected, the payments may increase in the succeeding years by amounts ranging from 0% to 5%. Most of the GEM loans originated by HMN provide for at least three annual payment increases over the first five years of the loan. The increased payments required under GEM loans are applied to principal and have the effect of shortening the term to maturity; the GEM loans do not permit negative amortization. HMN has primarily offered two GEM programs, one with a contractual maturity of approximately 17 years and one with a contractual maturity of approximately 22 years. The GEMs are generally priced based upon loans with similar contractual maturities. The GEMs were popular with consumers who anticipate future increases in income and who desire an amortization schedule of less than 30 years. During 1999 the GEM program was discontinued by HMN. At December 31, 2000, HMN had \$47.8 million of one-to-four family GEM loans, a decrease of \$3.5 million from \$51.3 million at December 31, 1999, compared to a decrease of

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

\$4.9 million from \$56.2 million at December 31, 1998, compared to \$53.3 million at December 31, 1997, and \$48.8 million at December 31, 1996.

In addition to the GEM loan program, HMN offers other conventional fixed-rate one-to-four family loans with maximum terms of up to 30 years. HMN generally sells the majority of new loan originations or refinances with fixed rates and terms to maturity ranging from 15 years to 30 years that are eligible for sale in the secondary market. The interest rates charged on the fixed-rate loan products are generally set based on the FNMA or FHLMC delivery rates, as well as other competitive factors. At December 31, 2000, HMN had \$158.1 million of fixed rate one-to-four family mortgage loans, a decrease of \$29.7 million compared to \$187.8 million at December 31, 1999, a decrease of \$40.0 million compared to \$227.8 million at December 31, 1998, \$256.3 million at December 31, 1997, and \$187.5 million at December 31, 1996.

HMN also offers one-year ARMs at a margin (generally 275 to 375 basis points) over the yield on the Average Monthly One Year U.S. Treasury Constant Maturity Index for terms of up to 30 years. The ARM loans currently offered by HMN allow the borrower to select (subject to pricing) an initial period of one year, three years, or five years between the loan origination and the date the first interest rate change occurs. Generally, the ARMs provide for up to a 200 basis point annual interest rate change cap and a lifetime cap 600 basis points over or under the initial rate. Initial interest rates offered on the ARM loans during 2000 ranged from 100 basis points below the fully indexed loan rate to 100 basis points over the fully indexed loan rate. All borrowers are now qualified for the loan at the fully indexed rate. HMN's originated ARMs do not permit negative amortization of principal, do not contain prepayment penalties and generally are not convertible into fixed-rate loans. See "Delinquencies and Non-Performing Assets." In the past, the Bank offered one-year ARMs with a margin of 200 to 235 basis points over a specified index and an average annual cap of 145 basis points. At December 31, 2000 the one-to-four family ARMs totaled \$107.0 million an increase of \$1.4 million compared to \$105.6 million at December 31, 1999, an increase of \$24.1 million compared to \$81.5 million at December 31, 1998, \$86.1 million at December 31, 1997, and \$85.0 million at December 31, 1996.

HMN has also originated a limited number of fixed-rate loans with terms up to 30 years which are insured by the Federal Housing Authority (FHA), Veterans Administration (VA) and Minnesota Home Finance Administration (MHFA).

9

---

In underwriting one-to-four family residential real estate loans, HMN evaluates the borrower's credit history, ability to make principal, interest and escrow payments, and the value of the property that will secure the loan and debt to income ratios. Properties securing one-to-four family residential real estate loans made by HMN are appraised by independent fee appraisers or by HMN's staff appraiser. HMN originates residential mortgage loans with loan-to-value ratios of up to 95% for owner-occupied homes and up to 70% for non-owner occupied homes; however, private mortgage insurance is generally required to reduce HMN's exposure to 80% or less. HMN generally seeks to underwrite its loans in accordance with secondary market standards.

HMN's residential mortgage loans customarily include due-on-sale clauses giving it the right to declare the loan immediately due and payable in the event that, among other things, the borrower sells or otherwise disposes of the property subject to the mortgage.

**Commercial Real Estate and Multi-Family Lending.** HMN originates permanent commercial real estate and multi-family loans secured by properties located in its market area. It also purchases commercial real estate and multi-family loans originated by other third parties on properties outside of its market area. Commercial real estate loans totaled \$61.7 million at December 31, 2000, an increase of \$17.8 million from \$43.9 million at December 31, 1999, compared to \$29.0 million at December 31, 1998, \$10.6 million at December 31, 1997 and \$7.9 million at December 31, 1996. Multi-family loans totaled \$12.1 million at December 31, 2000, an increase of \$3.6 million from \$8.5 million at December 31, 1999, compared to \$4.7 million at December 31, 1998, compared to \$2.7 million at December 31, 1997.

The commercial real estate and multi-family loan portfolio includes loans secured by motels, hotels, apartment buildings, churches, small office buildings, small business facilities, shopping malls, nursing homes, golf courses, and other non-residential building properties primarily located in the upper midwestern United States.

Permanent commercial real estate and multi-family loans are generally originated for a maximum term of 15 years and may have longer amortization periods with balloon maturity features. The interest rates may be fixed for the term of the loan or have adjustable features which are tied to prime or a treasury index. Commercial real estate and multi-family loans are generally written in amounts of up to 75% of the lesser of the appraised value of the property or the purchase price and generally have a debt service coverage ratio of at least 120%. The debt service coverage is the ratio of net cash from operations before payment of debt to debt service. HMN may originate construction loans secured by commercial or multi-family real estate, or may purchase participation interests in third party originated construction loans secured by commercial or multi-family real estate.

Appraisals on commercial real estate and multi-family real estate properties are performed by independent appraisers prior to the time the loan is made. For transactions less than \$250,000, HMN may use an internal valuation. All appraisals on commercial and multi-family real estate are

reviewed and approved by a commercial loan officer or credit manager. The Bank's underwriting procedures require verification of the borrower's credit history, income and financial statements, banking relationships, references and income projections for the property. All commercial real estate and multi-family loans over \$500,000 must be approved by a majority of the commercial loan committee prior to closing. For commercial real estate and multi-family loans under \$500,000, two authorized loan officer's are required to approve the loan. The commercial loan policy generally requires personal guarantees from the proposed borrowers. An initial on-site inspection is required for all collateral properties for loans with balances in excess of \$250,000. Annual reviews are performed for aggregate commercial lending relationships that exceed \$500,000. The reviews cover financial performance, documentation completeness and accuracy of loan risk ratings.

At December 31, 2000, HMN's two largest commercial real estate loans totaled \$6.2 million and \$4.9 million. The first loan is secured by a shopping mall in Winona, Minnesota and the second loan is secured by an apartment complex in Rochester, Minnesota. Both of these loans were performing at December 31, 2000.

Multi-family and commercial real estate loans generally present a higher level of risk than loans secured by

10

---

one-to-four family residences. This greater risk is due to several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family and commercial real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced (for example, if leases are not obtained or renewed), the borrower's ability to repay the loan may be impaired. At December 31, 2000, HMN did not have any commercial real estate loans or multi-family loans which were 90 days or more delinquent.

**Construction Lending.** HMN makes construction loans to individuals for the construction of their residences and to builders for the construction of one-to-four family residences. It also makes a very limited number of loans to builders for houses built on speculation. Construction loans also include commercial real estate loans. HMN had \$20.2 million of construction loans outstanding at December 31, 2000, an increase of \$4.2 million from \$16.0 million at December 31, 1999, compared to \$15.2 million at December 31, 1998, \$5.7 million at December 31, 1997 and \$3.5 million at December 31, 1996.

Almost all loans to individuals for the construction of their residences are structured as permanent loans. Such loans are made on the same terms as residential loans, except that during the construction phase, which typically lasts up to seven months, the borrower pays interest only. Generally, the borrower also pays a construction fee up to \$800 at the time of origination. Residential construction loans are underwritten pursuant to the same guidelines used for originating residential loans on existing properties.

Construction loans to builders or developers of one-to-four family residences generally carry terms of 1 to 15 years with a construction phase of up to seven months. Such loans generally do not permit the payment of interest from loan proceeds.

Construction loans to owner occupants are generally made in amounts of up to 95% of the lesser of cost or appraised value, but no more than 85% of the loan proceeds can be disbursed until the building is completed. The loan-to-value ratios on loans to builders are limited to 70%. Prior to making a commitment to fund a construction loan, HMN requires an appraisal of the property and financial data and verification of the borrower's income. HMN obtains personal guarantees for substantially all of its construction loans to builders. Personal financial statements of guarantors are also obtained as part of the loan underwriting process. Generally construction loans have been located in HMN's market area.

Construction loans are obtained principally through continued business from builders and developers who have previously borrowed from the Bank, as well as referrals from existing customers and walk-in customers. The application process includes a submission to the Bank of accurate plans, specifications and costs of the project to be constructed. These items are used as a basis to determine the appraised value of the subject property to be built.

At December 31, 2000 construction real estate loans totaled \$20.2 million of which one-to-four family residential loans totaled \$9.8 million, multi-family residential totaled \$5.1 million and construction on commercial real estate totaled \$5.3 million.

The nature of construction loans is such that they are more difficult to evaluate and monitor. The risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value upon completion of the project and the estimated cost (including interest) of the project. If the estimate of value proves to be inaccurate, HMN may be confronted, at or prior to the maturity of the loan, with a project having a value which is insufficient to assure full repayment and/or the possibility of having to make substantial investments to complete and sell the project. Because defaults in repayment may not occur during the construction period it may be difficult to identify problem loans at an early stage. In such cases, HMN may be required to modify the terms of the loan.



---

**Consumer Lending.** HMN originates a variety of different types of consumer loans, including home equity loans (open-ended and closed-ended), education, automobile, home improvement, mobile home, deposit account and other loans for household and personal purposes. At December 31, 2000, consumer loans totaled \$70.9 million, an increase of \$22.7 million from \$48.2 million at December 31, 1999, compared to \$34.8 million at December 31, 1998, \$31.9 million at December 31, 1997 and \$20.9 million at December 31, 1996.

Consumer loan terms vary according to the type and value of collateral, length of contract and creditworthiness of the borrower. HMN's consumer loans are made at fixed and adjustable interest rates, with terms of up to 20 years for secured loans and up to three years for unsecured loans.

HMN's home equity loans are written so that the total commitment amount, when combined with the balance of any other outstanding mortgage liens, may not exceed 100% of the appraised value of the property. The closed-end home equity loans are written with fixed- or adjustable-rates with terms of up to 15 years. The open-end home equity lines are written with an adjustable rate with terms of up to 20 years, a 10 year draw period which requires "interest only" payments and a 10 year repayment period which fully amortizes the outstanding balance. The consumer may access the open-end home equity line either by making a withdrawal at the Bank or writing a check on the home equity line of credit account. HMN's closed ended home equity loans totaled \$28.1 million at December 31, 2000, an increase of \$10.8 million from \$17.3 million at December 31, 1999, compared to \$9.6 million at December 31, 1998, \$7.2 million at December 31, 1997 and \$5.9 million at December 31, 1996. HMN's open-ended home equity lines totaled \$26.9 million at December 31, 2000, an increase of \$4.5 million from \$22.4 million at December 31, 1999, compared to \$19.5 million at December 31, 1998, \$19.5 million at December 31, 1997 and \$11.9 million at December 31, 1996.

The underwriting standards employed by the Bank for consumer loans include a determination of the applicant's payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although creditworthiness of the applicant is of primary consideration, the underwriting process also includes a comparison of the value of the security, if any, in relation to the proposed loan amount. Consumer loans may entail greater credit risk than do residential mortgage loans, particularly in the case of consumer loans which are unsecured or are secured by rapidly depreciable assets, such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. At December 31, 2000, \$142,000 of the consumer loan portfolio was non-performing. There can be no assurance that delinquencies will not increase in the future.

**Commercial Business Lending.** In order to satisfy the demand for financial services available to individuals and businesses in its market area, historically HMN has maintained a portfolio of commercial business loans primarily to small retail operations, small manufacturing concerns and professional firms. More recently HMN has expanded its commercial business loans to include loans collateralized by inventory and/or receivables and leasehold interests on equipment HMN's commercial business loans generally have terms ranging from six months to five years and may have either fixed or variable interest rates. HMN's commercial business loans generally include personal guarantees and are usually, but not always, secured by business assets such as inventory, equipment, leasehold interests in equipment fixtures, real estate and accounts receivables. The underwriting process for commercial business loans includes consideration of the borrower's financial statements, tax returns, projections of future business operations and inspection of the subject collateral, if any. HMN has also purchased participation interests in commercial business loans from third party originators. The underlying collateral for the loans are generally inventory or equipment and generally have repayment periods of less than ten years. Commercial business loans totaled \$48.8 million at December 31, 2000, an increase of \$24.4 million from \$24.4 million at December 31, 1999, compared to \$11.7 million at December 31, 1998, \$5.2 million at December 31, 1997 and \$2.3 million at December 31, 1996.

---

Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her income, and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. As a result, the availability of funds for the repayment of commercial business loans may be substantially dependent on the success of the business itself. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business. At December 31, 2000, \$95,000 of loans in the commercial business loan portfolio were non-performing. There can be no assurance that delinquencies will not increase in the future.

#### **Originations, Purchases and Sales of Loans and Mortgage-Backed and Related Securities**

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

Real estate loans are generally originated by HMN's staff of salaried and commissioned loan officers. Loan applications are taken in all branch offices.

While HMN originates both fixed- and adjustable-rate loans, its ability to originate loans is dependent upon the relative customer demand for loans in its market. Demand for adjustable-rate loans is affected by the interest rate environment. HMN originated for portfolio \$12.5 million of one-to-four family adjustable rate loans during 2000, an increase of \$6.5 million from \$6.0 million for 1999, compared to \$2.3 million for 1998. HMN also originated for portfolio \$2.7 million of fixed rate one-to-four family loans during 2000, a decrease of \$5.5 million from \$8.2 million for 1999, compared to \$44.4 million for 1998.

During the past two years HMN has focused its portfolio loan origination efforts on commercial real estate, commercial business and consumer loans because the loans generally have terms to maturity and adjustable interest rate characteristics which are generally more beneficial to HMN than single family fixed-rate conventional loans. HMN originated \$112.0 million of commercial real estate, commercial business and consumer loans (which excludes commercial real estate loans in construction or development) during the year ended December 31, 2000, an increase of \$7.2 million from originations of \$104.8 million for 1999, compared to originations of \$88.6 million for 1998.

In order to supplement loan demand in HMN's market area and geographically diversify its loan portfolio, HMN purchases real estate loans from selected sellers, with yields based upon current market rates. HMN carefully reviews and underwrites all loans to be purchased to ensure that they meet HMN's underwriting standards. The seller generally continues to service the purchased loans. HMN purchased \$20.6 million of loans during 2000, a decrease of \$49.0 million from \$69.6 million during 1999, compared to \$71.0 million for 1998. The majority of the purchased one-to-four family loans have interest rates that are fixed for a one, three or five year period and then adjust annually thereafter or were 15 year fixed-rate loans. The commercial real estate and commercial business loans purchased have terms and interest rates that are similar in nature to HMN's originated commercial and business portfolio. All purchased loans are reviewed to determine that each loan meets certain underwriting requirements. Refer to Note 4 of the Notes to Consolidated Financial Statements in the Annual Report for more information on purchased loans.

HMN has substantial holdings of mortgage-backed and related securities which are held, depending on the investment intent, in the "available for sale" portfolio. HMN purchased \$2.1 million of mortgage-backed securities during 2000, a decrease of \$18.3 million from purchases of \$20.4 million for 1999, compared to \$113.8 million in purchases for 1998. HMN sold \$30.0 million of mortgage-backed securities during the year ended December 31, 2000, a decrease of \$700,000 from sales of \$29.3 million for 1999, compared to sales of \$96.5 million for 1998. See "Investment Activities."

13

The following table shows the loan and mortgage-backed and related securities origination, purchase, acquisition, sale and repayment activities of HMN for the periods indicated.

<i>(Dollars in thousands)</i>	Year Ended December 31,		
	2000	1999	1998
<b>LOANS HELD FOR INVESTMENT</b>			
<i>Originations by type:</i>			
<i>Adjustable-rate:</i>			
Real estate one-to-four family	\$ 12,479	5,965	2,328
multi-family	160	818	0
commercial	7,953	12,336	5,388
construction or development	28,727	10,171	787
Non-real estate consumer	20,374	17,481	15,689
commercial business	20,681	16,671	176
Total adjustable-rate	90,374	63,442	24,368
<i>Fixed-rate:</i>			
Real estate one-to-four family	2,698	8,240	44,413
multi-family	738	2,597	1,694

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

		Year Ended December 31,		
		2019	2018	2017
	commercial	8,194	15,791	16,882
	construction or development	4,502	9,544	10,626
Non-real estate	consumer	36,706	23,267	13,100
	commercial business	18,062	19,305	37,672
Total fixed-rate		70,900	78,744	124,387
Total loans originated		161,274	142,186	148,755
<i>Purchases:</i>				
Real estate	one-to-four family	10,133	47,975	58,512
	multi-family	0	0	8,571
	commercial	2,045	10,673	1,172
	construction or development	4,750	6,793	0
Non-real estate	commercial business	3,671	4,123	2,731
Total loans purchased		20,599	69,564	70,986
<i>Sales and repayments:</i>				
Real estate	one-to-four family	0	0	5,878
	commercial	0	685	650
Non-real estate	consumer	207	246	238
Total sales		207	931	6,766
Loans securitized and transferred to securities		11,129	6,925	27,953
Transfers to loans held for sale		5,081	10,187	52,295
Principal repayments		126,425	163,691	106,824
Total reductions		142,842	181,734	193,838
Decrease in other items, net		1,694	(5,097)	(20,517)
Net increase		\$ 40,725	24,919	5,386

14

**LOANS HELD FOR SALE**

*Originations by type:*

Adjustable-rate:

Real estate	one-to-four family	\$ 1,724	837	826
	multi-family	0	0	0
	commercial	0	0	0
	construction or development	0	0	0
Non-real estate	consumer	0	0	0
	commercial business	0	0	0
Total adjustable-rate		1,724	837	826

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

<b>Fixed-rate:</b>				
Real estate	one-to-four family	58,928	66,065	111,639
	multi-family	0	0	0
	commercial	0	0	0
	construction or development	1,240	485	0
Non-real estate	consumer	0	0	0
	commercial business	0	0	0
Total fixed-rate		60,168	66,550	111,639
Total loans originated		61,892	67,387	112,465
<b>Purchases:</b>				
Real estate	one-to-four family	51,826	93,177	65,199
	multi-family	0	0	0
	commercial	0	0	0
	construction or development	0	0	0
Non-real estate	consumer	0	0	0
	commercial business	0	0	0
Total loans purchased		51,826	93,177	65,199
<b>Sales and repayments:</b>				
Real estate	one-to-four family	104,815	179,770	173,007
	multi-family	0	0	0
	commercial	0	0	0
	construction or development	0	0	0
Non-real estate	consumer	0	0	0
	commercial business	0	0	0
Total sales		104,815	179,770	173,007
Transfers to (from) loans held for investment		(5,081)	(10,187)	(6,165)
<b>Principal repayments</b>				
Total reductions		109,896	169,583	166,842
<b>Increase (decrease) in other items, net</b>				
Net increase (decrease)		\$ 3,822	(9,019)	10,822

15

**MORTGAGE-BACKED AND RELATED SECURITIES**

Loans securitized and transferred to securities	\$	11,129	6,925	27,953
<b>Purchases:</b>				
Mortgage-backed securities:(1)				
Adjustable-rate		0	0	0
Fixed-rate		0	0	1,766
CMOs and REMICs:				

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

Adjustable-rate	2,112	0	76,174
Fixed-rate	0	20,385	35,839
Total purchases	2,112	20,385	113,779
<b>Sales:</b>			
Mortgage-backed securities:(1)			
Adjustable-rate	3,776	6,913	24,955
Fixed-rate	1,674	1,143	46,432
CMOs and REMICs:			
Adjustable-rate	6,425	17,466	13,765
Fixed-rate	18,149	3,815	11,366
Total sales	30,024	29,337	96,518
<b>Principal repayments:</b>			
Decrease in other items, net	(8,615)	(40,342)	(38,003)
Net increase (decrease)	\$ (25,398)	(42,369)	7,211

(1) Consists of pass-through securities.

**Delinquencies and Non-Performing Assets**

**Delinquency Procedures.** When a borrower fails to make a required payment on a loan, HMN attempts to cure the delinquency by contacting the borrower. A late notice is sent on all loans over 16 days delinquent. Additional written and verbal contacts may be made with the borrower between 30 and 60 days after the due date. If the loan is contractually delinquent 90 days, HMN usually sends a 30-day demand letter to the borrower and, after the loan is contractually delinquent 120 days, institutes appropriate action to foreclose on the property. If foreclosed, the property is sold at a sheriff's sale and may be purchased by HMN. Delinquent consumer loans are generally handled in a similar manner. HMN's procedures for repossession and sale of consumer collateral are subject to various requirements under state consumer protection laws.

Real estate acquired by HMN as a result of foreclosure or by deed in lieu of foreclosure is classified as real estate in judgement for six months to one year and thereafter as real estate owned until it is sold. When property is acquired or expected to be acquired by foreclosure or deed in lieu of foreclosure, it is recorded at the lower of cost or estimated fair value, less the estimated cost of disposition. After acquisition, all costs incurred in maintaining the property are expensed. Costs relating to the development and improvement of the property, however, are capitalized to the extent of fair value less disposition cost.

16

The following table sets forth HMN's loan delinquencies by type, by amount and by percentage of type at December 31, 2000.

(Dollars in thousands)	Loans Delinquent For:								
	60-89 Days			90 Days and Over			Total Delinquent Loans		
	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category	Number	Amount	Percent of Loan Category
	8	\$ 703	0.22%	14	\$ 1,830	0.58%	22	\$ 2,533	0.81%

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

Loans Delinquent For:

One-to-four family real estate									
Multi-family	0	0	0.00	0	0	0.00	0	0	0.00
Commercial	0	0	0.00	0	0	0.00	0	0	0.00
Construction or development	0	0	0.00	0	0	0.00	0	0	0.00
Consumer	17	155	0.22	31	142	0.20	48	297	0.42
Commercial business	2	45	0.09	2	50	0.10	4	95	0.19
<b>Total</b>	<b>27</b>	<b>\$ 903</b>	<b>0.17%</b>	<b>47</b>	<b>\$ 2,022</b>	<b>0.38%</b>	<b>74</b>	<b>\$ 2,925</b>	<b>0.56%</b>

**Classification of Assets.** Federal regulations require that each savings institution classify its own assets on a regular basis. In addition, in connection with examinations of savings institutions, the Office of Thrift Supervision (OTS) and FDIC examiners have authority to identify problem assets and, if appropriate, require them to be classified. There are three classifications for problem assets: Substandard, Doubtful and Loss. Substandard assets have one or more defined weaknesses and are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Doubtful assets have the weaknesses of Substandard assets, with the additional characteristics that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. An asset classified as Loss is considered uncollectible and of such little value that continuance as an asset on the balance sheet of the institution is not warranted. Assets classified as Substandard or Doubtful require the institution to establish prudent general allowances for loan losses. If an asset or portion thereof is classified as Loss, the institution must either establish specific allowances for loan losses in the amount of 100% of the portion of the asset classified as Loss, or charge off such amount. If an institution does not agree with an examiner's classification of an asset, it may appeal this determination to the District Director of the OTS. On the basis of management's review of its assets, at December 31, 2000, the Bank had classified a total of \$1,386,000 of its loans and other assets as follows:

Real Estate

(Dollars in thousands)	One-to-Four Family	Construction or Development	Commercial and Multi-Family	Consumer	Commercial Business	Total
Substandard	\$ 1,180	0	0	88	64	1,332
Doubtful	0	0	0	0	0	0
Loss	0	0	0	54	0	54
<b>Total</b>	<b>\$ 1,180</b>	<b>0</b>	<b>0</b>	<b>142</b>	<b>64</b>	<b>1,386</b>

The Bank's classified assets consist of the non-performing loans and loans and other assets of concern discussed herein. As of the date hereof, these asset classifications are materially consistent with those of the OTS and FDIC.

**Non-Performing Assets.** Loans are reviewed quarterly and any loan whose collectibility is doubtful is placed on non-accrual status. Loans are placed on nonaccrual status when either principal or interest is 90 days or more past due, unless, in the judgment of management, the loan is well collateralized and in the process of collection. Interest accrued and unpaid at the time a loan is placed on non-accrual status is charged against interest income. Subsequent payments are either applied to the outstanding principal balance or recorded as interest income,

depending on the assessment of the ultimate collectibility of the loan. Restructured loans include the Bank's troubled debt restructurings (which involved forgiving a portion of interest or principal on any loans or making loans at a rate materially less than the market rate). Foreclosed assets include assets acquired in settlement of loans. The following table sets forth the amounts and categories of non-performing assets in the Bank's portfolio.

December 31,

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

<i>(Dollars in thousands)</i>	2000	1999	1998	1997	1996
<b>Non-accruing loans:</b>					
Real estate:					
One-to-four family	\$ 775	165	317	177	235
Commercial real estate	0	0	73	79	83
Consumer	142	177	86	7	7
Commercial business	95	0	0	0	13
Total	1,012	342	476	263	338
<b>Accruing loans delinquent 90 days or more:</b>					
One-to-four family	405	476	312	365	0
Consumer	0	0	0	37	0
Total	405	476	312	402	0
<b>Restructured loans:</b>					
Multi-family	0	0	0	0	0
<b>Foreclosed assets:</b>					
Real estate:					
One-to-four family	195	0	18	142	23
Total	195	0	18	142	23
Total non-performing assets	\$ 1,612	818	806	807	361
Total as a percentage of total assets	0.23%	0.12%	0.12%	0.12%	0.07%
Total non-performing loans	\$ 1,417	\$ 818	\$ 788	\$ 665	\$ 338
Total as a percentage of total loans receivable, net	0.27%	0.17%	0.18%	0.15%	0.10%

For the year ended December 31, 2000, gross interest income which would have been recorded had the non-accruing loans been current in accordance with their original terms amounted to \$88,366. The amounts that were included in interest income on such loans during 2000 were \$39,073.

Total non-performing assets were \$1,612,000 at December 31, 2000, an increase of \$794,000, compared to \$818,000 at December 31, 1999, \$806,000 at December 31, 1998, \$807,000 at December 31, 1997, and \$361,000 at December 31, 1996. Non-performing assets had the following activity during 2000: charge-offs of \$8,000, transfers in of \$1,128,000 and transfers out due to performance of \$326,000. Non-performing assets had the following activity during 1999: sales of \$18,000, transfers in of \$423,000 and transfers out due to performance of \$393,000. Non-performing assets had the following activity during 1998: sales of \$142,000, transfers in of \$389,000 and transfers out due to performance of \$248,000. Non performing assets had the following activity during 1997: sales of \$42,000, charge-offs of \$35,000, payments of \$80,000, and net transfers to non-performing assets of \$603,000. The increase in non-performing assets from 1999 to 2000 is primarily the result of a one-to-four family purchased loan totaling \$381,000 and four commercial loans totaling \$95,000 that were behind on their payments by more than 90 days and the foreclosure of a one-to-four family mortgage totaling \$195,000.

**Other Loans of Concern.** In addition to the non-performing assets set forth in the table above, as of December 31, 2000 there were \$733,210 of loans with known information about the possible credit problems of the borrowers or the cash flows of the secured properties that have caused management to have concerns as to the ability of the borrowers to comply with present loan repayment terms which may result in the future inclusion of such items in the non-performing asset categories.

Management has considered the Bank's non-performing and "of concern" assets in establishing its allowance for loan losses.

**Allowance for losses on loans.** The following table sets forth an analysis of the Bank's allowance for loan losses for the year ended:

<i>(Dollars in thousands)</i>	<b>2000</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>	<b>1996</b>
Balance at beginning of year	\$ 3,273	3,041	2,748	2,341	2,191
MFC allowance for losses acquired	0	0	0	122	0
Provision for losses	180	240	310	300	300
<b>Charge-offs</b>					
Real estate:					
One-to-four family	0	(1)	(2)	(4)	0
Multi-family	0	0	0	0	(88)
Consumer	(59)	(9)	(17)	(7)	(1)
Commercial business	(253)	0	0	(12)	(61)
Total charge-offs	(312)	(10)	(19)	(23)	(150)
<b>Recoveries</b>					
Consumer	3	2	0	0	0
Commercial business	0	0	2	8	0
Total recoveries	3	2	2	8	0
Net charge-offs	(309)	(8)	(17)	(15)	(150)
Balance at end of year	\$ 3,144	3,273	3,041	2,748	2,341
Ratio of net charge-offs during the year to average loans outstanding during the year	0.06%	0.00%	0.00%	0.01%	0.05%
Ratio of allowance for losses on loans to total non-performing loans, at end of year	221.87%	400.29%	385.79%	413.17%	691.84%

The distribution of the Bank's allowance for losses on loans at the dates indicated is summarized as follows:

		<b>December 31,</b>									
		<b>2000</b>		<b>1999</b>		<b>1998</b>		<b>1997</b>		<b>1996</b>	
<i>(Dollars in thousands)</i>	<b>Amount</b>	<b>Percent of Loans in Each Category to Total Loans</b>	<b>Amount</b>	<b>Percent of Loans in Each Category to Total Loans</b>	<b>Amount</b>	<b>Percent of Loans in Each Category to Total Loans</b>	<b>Amount</b>	<b>Percent of Loans in Each Category to Total Loans</b>	<b>Amount</b>	<b>Percent of Loans in Each Category to Total Loans</b>	



# Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

December 31,

<b>Real Estate:</b>															
One-to-four family	\$	302	59.43%	\$	527	70.95%	\$	544	79.31%	\$	560	87.58%	\$	496	90.19%
Multi-family		111	2.30		133	1.75		142	1.02		80	0.60		8	0.08
Commercial		802	11.71		533	9.04		797	6.29		198	2.34		113	2.22
Construction or development		408	3.84		231	3.30		455	3.29		172	1.27		104	0.98
Consumer		414	13.47		674	9.93		546	7.55		527	7.05		473	5.87
<b>Commercial business</b>															
Unallocated		665	9.25		291	5.03		328	2.54		46	1.16		29	0.66
		442	0.00		884	0.00		229	0.00		1,165	0.00		1,118	0.00
<b>Total</b>	<b>\$</b>	<b>3,144</b>	<b>100.00%</b>	<b>\$</b>	<b>3,273</b>	<b>100.00%</b>	<b>\$</b>	<b>3,041</b>	<b>100.00%</b>	<b>\$</b>	<b>2,748</b>	<b>100.00%</b>	<b>\$</b>	<b>2,341</b>	<b>100.00%</b>

20

The allowance for losses on loans is established through a provision for losses on loans charged to earnings based on management's evaluation of the risk inherent in its entire loan portfolio and changes in the nature and volume of its loan activity. Such evaluation, which includes a review of all loans of which full collectibility may not be reasonably assured, considers specific occurrences, general and local economic conditions, loan portfolio composition, historical and local experience and other factors that warrant recognition in providing for an adequate allowance for loan losses. In determining the general reserves under these policies, historical charge-offs and recoveries, changes in the mix and levels of the various types of loans, the general level of non-performing assets and the anticipated net realizable values, the current loan portfolio and current economic conditions are considered. The Bank also requires additional reserves for all classified loans.

While management believes that it uses the best information available to determine the allowance for losses on loans, unforeseen market conditions could result in adjustments to the allowance for losses on loans, and net earnings could be significantly affected, if circumstances differ substantially from the assumptions used in making the final determination. Refer to Management's Discussion and Analysis on Allowances for Loan and Real Estate Losses and Non-performing Assets in the Annual Report.

## Investment Activities

HMN and the Bank utilize the available for sale securities portfolio in virtually all aspects of asset/liability management strategy. In making investment decisions, the Investment-Asset/Liability Committee considers, among other things, the yield and interest rate objectives, the credit risk position and the projected cash flow requirements.

The Bank must maintain minimum levels of investments that qualify as liquid assets under OTS regulations. Liquidity may increase or decrease depending upon the availability of funds and comparative yields on investments in relation to the return on loans. Cash flow projections are regularly reviewed and updated to assure that adequate liquidity is maintained. At December 31, 2000, the Bank's liquidity ratio (liquid assets as a percentage of net withdrawable savings deposits and current borrowings) was 16.4%. The Bank's level of liquidity is a result of management's asset/liability strategy. See "Regulation Liquidity."

**Securities.** Federally chartered savings institutions have the authority to invest in various types of liquid assets, including United States Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, certain bankers' acceptances, repurchase agreements and federal funds. Subject to various restrictions, federally chartered savings institutions may also invest their assets in commercial paper, investment grade corporate debt securities and mutual funds whose assets conform to the investments that a federally chartered savings institution is otherwise authorized to make directly.

The investment strategy of HMN and the Bank has been directed toward a mix of high-quality assets (primarily government and agency obligations) with short and intermediate terms to maturity. At December 31, 2000, HMN did not own any investment securities of a single issuer which exceeded 10% of HMN's stockholder's equity other than U.S. government or federal agency obligations.

The Bank invests a portion of its liquid assets in interest-earning overnight deposits of the Federal Home Loan Bank of Des Moines ("FHLB") and various money market mutual funds. Other investments include high grade medium-term (up to three years) corporate debt securities,

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

medium-term federal agency notes, and a variety of other types of mutual funds which invest in adjustable-rate, mortgage-backed securities, asset-backed securities, repurchase agreements and U.S. Treasury and agency obligations. HMN invests in the same type of investment securities as the Bank and also invests in taxable and tax exempt municipal obligations and corporate equities such as preferred and common stock. See Note 3 of the Notes to Consolidated Financial Statements in the Annual Report for additional information regarding HMN's securities portfolio.

21

The following table sets forth the composition of HMN's securities portfolio, excluding mortgage-backed and related securities, at the dates indicated.

	December 31,											
	2000				1999				1998			
	Amortized Cost	Adjusted To	Market Value	% of Total	Amortized Cost	Adjusted To	Market Value	% of Total	Amortized Cost	Adjusted To	Market Value	% of Total
<i>(Dollars in thousands)</i>												
Securities available for sale:												
U.S. government and agency obligations	\$ 35,216	(1,206)	34,010	37.59%	\$ 39,298	(1,691)	37,607	40.34%	\$ 17,379	12	17,391	25.11%
U.S. Treasury obligations	1,482	(2)	1,480	1.64	3,984	(42)	3,942	4.23				
Municipal obligations	1,104	(6)	1,098	1.21	1,532	(4)	1,528	1.64	2,901	(5)	2,896	4.18
Corporate debt	16,235	(501)	15,734	17.39	19,695	(276)	19,419	20.83	4,232	(3)	4,229	6.10
Corporate equity(1)	8,587	(768)	7,819	8.64	8,587	(1,440)	7,147	7.67	8,271	(296)	7,975	11.51
Stock of federal agencies(1)	3,768	(82)	3,686	4.07	3,768	(711)	3,057	3.28	5,874	114	5,988	8.64
Subtotal	66,392		63,827	70.54	76,864		72,700	77.99	38,657		38,479	55.54
FHLB stock	12,245		12,245	13.53	11,470		11,470	12.30	9,838		9,838	14.20
Total investment securities and FHLB stock	78,637		76,072	84.07	88,334		84,170	90.29	48,495		48,317	69.74
Average remaining life of investment securities excluding FHLB stock	4.3 years				4.6 years				4.5 years			
Other Interest-earning Assets:												
Cash equivalents	14,417		14,417	15.93	9,051		9,051	9.71	20,961		20,961	30.26
Total	\$ 93,054		90,489	100.00%	\$ 97,385		93,221	100.00%	\$ 69,456		69,278	100.00%
Average remaining life or term to repricing of investment securities and other interest-earning assets, excluding FHLB stock	3.7 years				4.2 years				3.2 years			

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

(1) Average life assigned to corporate equity holdings and stock of federal agencies is five years.

22

The composition and maturities of the securities portfolio, excluding FHLB stock, mortgage-backed and other related securities, are indicated in the following table.

December 31, 2000								
(Dollars in thousands)	1 Year or Less	After 1 through 5 Years	After 5 through 10 Years	Over 10 Years	No Stated Maturity	Total Securities		
	Amortized Cost	Amortized Cost	Amortized Cost	Amortized Cost	Amortized Cost	Amortized Cost	Adjusted To	Market Value
Securities available for sale:								
U.S. government securities	\$ 0	20,037	0	15,179	0	35,216	(1,206)	34,010
U.S. Treasuries	1,482	0	0	0	0	1,482	(2)	1,480
Municipal obligations	0	0	1,104	0	0	1,104	(6)	1,098
Corporate debt	4,511	11,724	0	0	0	16,235	(501)	15,734
Corporate equity	0	0	0	0	8,587	8,587	(768)	7,819
Stock of federal agencies	0	0	0	0	3,768	3,768	(82)	3,686
Total stock	\$ 5,993	31,761	1,104	15,179	12,355	66,392		63,827
Weighted average yield(1)	6.78%	6.39%	8.58%	6.40%	5.08%	6.22%		

(1) Yields are computed on a tax equivalent basis.

23

**Mortgage-Backed and Related Securities.** In order to supplement loan production (particularly those of interest rate sensitive loans) and achieve its asset/liability management goals, HMN invests in mortgage-backed and related securities. All of the mortgage-backed and related securities owned by HMN are issued, insured or guaranteed either directly or indirectly by a federal agency or are rated "AA" or higher. HMN had \$75.4 million of mortgage-backed and related securities all classified as available for sale at December 31, 2000, a decrease of \$25.4 million from \$100.8 million at December 31, 1999, compared to \$143.1 million at December 31, 1998.

The contractual maturities of the mortgage-backed and related securities portfolio without any prepayment assumptions at December 31, 2000 is as follows:

(Dollars in thousands)	5 Years or Less	5 to 10 Years	10 to 20 Years	Over 20 Years	December 31, 2000 Balance Outstanding
------------------------	-----------------	---------------	----------------	---------------	---------------------------------------

Securities available for sale:						
Federal Home Loan Mortgage Corporation	\$	0	358	2,099	1,863	4,320
Federal National Mortgage Association		0	0	0	259	259
Government National Mortgage Association		7	0	74	0	81
Other mortgage-backed securities		0	0	0	0	0
Collateralized Mortgage Obligations		0	2,367	6,112	62,241	70,720
<b>Total</b>	<b>\$</b>	<b>7</b>	<b>2,725</b>	<b>8,285</b>	<b>64,363</b>	<b>75,380</b>
 Weighted average yield		9.00%	6.20%	6.69%	7.87%	7.68%

At December 31, 2000, HMN did not have any non-agency mortgage-backed or related securities in excess of 10% of its stockholders' equity.

CMOs are securities derived by reallocating the cash flows from mortgage-backed securities or pools of mortgage loans in order to create multiple classes, or tranches, of securities with coupon rates and average lives that differ from the underlying collateral as a whole. The terms to maturity of any particular tranche is dependent upon the prepayment speed of the underlying collateral as well as the structure of the particular CMO. Although a significant proportion of HMN's CMOs are in tranches which have been structured (through the use of cash flow priority and "support" tranches) to give somewhat more predictable cash flows, the cash flow and hence the value of CMOs is subject to change.

At December 31, 2000, HMN had \$58.2 million invested in CMOs which have floating interest rates that change either monthly or quarterly, compared to \$68.0 million at December 31, 1999 and \$94.5 million at December 31, 1998.

Refer to Management's Discussion and Analysis Market Risk in the Annual Report for information on changes in market value of the mortgage-backed or related securities under different rate shock environments.

Mortgage-backed and related securities can serve as collateral for borrowings and, through sales and repayments, as a source of liquidity. In addition, mortgage-backed and related securities available for sale can be sold to respond to changes in economic conditions.

## Sources of Funds

**General.** The Bank's primary sources of funds are deposits, payments (including prepayments) of loan principal, interest earned on loans and securities, repayments of securities, borrowings and other funds provided from operations.

**Deposits.** The Bank offers a variety of deposit accounts having a wide range of interest rates and terms. The Bank's deposits consist of passbook, negotiable order of withdrawal (NOW), money market, non-interest bearing checking and certificate accounts (including individual retirement accounts) to retail consumers and commercial business accounts. The Bank relies primarily on competitive pricing policies and customer service to attract and retain these deposits.

The variety of deposit accounts offered by the Bank has allowed it to be competitive in obtaining funds and to respond with flexibility to changes in consumer demand. As customers have become more interest rate conscious, the Bank has become more susceptible to short-term fluctuations in deposit flows. The Bank manages the pricing of its deposits in keeping with its asset/liability management, profitability and growth objectives. Based on its experience, the Bank believes that its passbook and NOW accounts are relatively stable sources of deposits. However, the ability of the Bank to attract and maintain certificate deposits, and the rates paid on these deposits, has been and will continue to be significantly affected by market conditions.

The following table sets forth the savings flows at the Bank during the periods indicated.

(Dollars in thousands)	Year Ended December 31,		
	2000	1999	1998

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

Year Ended December 31,

Opening balance	\$ 400,382	433,869	467,348
Deposits	785,319	667,957	536,135
Withdrawals	(780,460)	(716,263)	(588,662)
Interest credited	16,450	14,819	19,048
Ending balance	421,691	400,382	433,869
Net increase (decrease)	\$ 21,309	(33,487)	(33,479)
Percent increase (decrease)	5.32%	(7.72)%	(7.16)%

25

The following table sets forth the dollar amount of savings deposits in the various types of deposit programs offered by the Bank as of December 31:

	2000		1999		1998	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
<i>(Dollars in thousands)</i>						
<b>Transactions and Savings Deposits(1):</b>						
Non-interest checking	\$ 12,923	3.07%	\$ 7,706	1.92%	\$ 13,187	3.04%
NOW Accounts 1.00%(2)	33,068	7.84	25,896	6.47	25,459	5.87
Passbook Accounts 2.00%(3)	32,742	7.76	34,470	8.61	35,766	8.24
Money Market Accounts 3.96%(4)	34,427	8.16	31,821	8.00	29,419	6.78
Total Non-Certificates	\$ 113,160	26.83%	\$ 99,893	25.00%	\$ 103,831	23.93%
<b>Certificates:</b>						
2.00 - 2.99%	\$ 244	0.06%	\$ 201	0.05%	\$ 0	0.00%
3.00 - 3.99%	15,884	3.77	16,408	4.10	1,943	0.45
4.00 - 4.99%	38,420	9.11	88,176	22.02	87,582	20.19
5.00 - 5.99%	52,714	12.50	151,827	37.92	160,630	37.02
6.00 - 6.99%	159,765	37.89	43,875	10.96	78,273	18.04
7.00 - 7.99%	41,504	9.84	2	0.00	1,342	0.31
8.00 - 8.99%	0	0.00	0	0.00	264	0.06
9.00 - 9.99%	0	0.00	0	0.00	4	0.00
10.00% and over	0	0.00	0	0.00	0	0.00
Total Certificates	308,531	73.17	300,489	75.05	330,038	76.07
Total Deposits	\$ 421,691	100.00%	\$ 400,382	100.00%	\$ 433,869	100.00%

(1) Reflects rates paid on transaction and savings deposits at December 31, 2000.

(2) The rate on NOW Accounts for 1999 and 1998 was 1.00%.

Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

(3) The rate on Passbook Accounts for 1999 and 1998 was 2.00%.

(4) The rate on Money Market Accounts for 1999 was 3.41% and 1998 was 3.19%.

26

The following table shows rate and maturity information for the Bank's certificates of deposit as of December 31, 2000.

<i>(Dollars in thousands)</i>	<b>2.00- 2.99%</b>	<b>3.00- 3.99%</b>	<b>4.00- 4.99%</b>	<b>5.00- 5.99%</b>	<b>6.00- 6.99%</b>	<b>7.00- 7.99%</b>	<b>8.00- 8.99%</b>	<b>9.00- 9.99%</b>	<b>Total</b>	<b>Percent of Total</b>
Certificate accounts maturing in quarter ending:										
March 31, 2001	34	5,556	7,843	11,507	28,018	847	0	0	53,805	17.44
June 30, 2001	137	3,460	5,308	10,103	33,958	576	0	0	53,542	17.35
September 30, 2001	17	2,088	5,120	7,012	12,661	5,173	0	0	32,071	10.39
December 31, 2001	15	4,412	3,425	3,733	38,838	12,144	0	0	62,567	20.28
March 31, 2002	13	4	3,535	2,288	40,982	11,664	0	0	58,486	18.96
June 30, 2002	6	5	2,640	824	1,955	254	0	0	5,684	1.84
September 30, 2002	6	58	2,532	535	797	731	0	0	4,659	1.51
December 31, 2002	1	251	2,113	349	1,201	4	0	0	3,919	1.27
March 31, 2003	1	6	302	1,514	782	0	0	0	2,605	0.84
June 30, 2003	0	39	512	1,280	42	0	0	0	1,873	0.61
September 30, 2003	5	0	1,387	1,801	111	0	0	0	3,304	1.07
December 31, 2003	3	0	1,110	3,329	193	0	0	0	4,635	1.50
Thereafter	6	5	2,593	8,439	227	10,111	0	0	21,381	6.94
<b>Total</b>	<b>\$ 244</b>	<b>15,884</b>	<b>38,420</b>	<b>52,714</b>	<b>159,765</b>	<b>41,504</b>	<b>0</b>	<b>0</b>	<b>308,531</b>	<b>100.00%</b>
<b>Percent of total</b>	<b>0.08%</b>	<b>5.15%</b>	<b>12.45%</b>	<b>17.09%</b>	<b>51.78%</b>	<b>13.45%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>100.00%</b>	

27

The following table indicates the amount of the Bank's certificates of deposit and other deposits by time remaining until maturity as of December 31, 2000.

<i>(Dollars in thousands)</i>	<b>Maturity</b>				<b>Total</b>
	<b>3 Months or Less</b>	<b>Over 3 to 6 Months</b>	<b>Over 6 to 12 Months</b>	<b>Over 12 Months</b>	
Certificates of deposit less than \$100,000	\$ 44,192	47,268	85,889	86,000	263,349
Certificates of deposit of \$100,000 or more	5,388	4,584	7,750	20,545	38,267
Public funds less than \$100,000(1)	0	95	0	0	95
Public funds of \$100,000 or more(1)	4,225	1,595	1,000	0	6,820
<b>Total certificates of deposit</b>	<b>\$ 53,805</b>	<b>53,542</b>	<b>94,639</b>	<b>106,545</b>	<b>308,531</b>
Passbook of \$100,000 or more	\$ 1,149	0	0	0	1,149
Accounts of \$100,000 or more	10,762	6,179	8,750	20,545	46,236

- (1) Deposits from governmental and other public entities.

For additional information regarding the composition of the Bank's deposits, see Note 11 of the Notes to Consolidated Financial Statements in the Annual Report. For additional information on certificate maturities and the impact on HMN's liquidity see Liquidity starting on page 23 of the Annual Report.

**Borrowings.** The Bank's other available sources of funds include advances from the FHLB and other borrowings. As a member of the FHLB, the Bank is required to own capital stock in the FHLB and is authorized to apply for advances from the FHLB. Each FHLB credit program has its own interest rate, which may be fixed or variable, and range of maturities. The FHLB may prescribe the acceptable uses for these advances, as well as limitations on the size of the advances and repayment provisions. Consistent with its asset/liability management strategy, the Bank has utilized FHLB advances from time to time to extend the term to maturity of its liabilities. Also, the Bank has used FHLB borrowings to fund loan demand and other investment opportunities and to offset deposit outflows. At December 31, 2000, the Bank had \$221.9 million of FHLB advances outstanding. On such date, the Bank had a collateral pledge arrangement with the FHLB of Des Moines pursuant to which the Bank may borrow up to an additional \$27.1 million for liquidity purposes. See Note 12 of the Notes to Consolidated Financial Statements in the Annual Report.

At December 31, 2000, HMN had an undrawn \$2.5 million revolving line of credit with Wells Fargo Bank Minnesota, N.A. The credit line matures September 30, 2001 and floats at the Federal Funds rate plus 250 basis points. See Note 13 of the Notes to Consolidated Financial Statements in the Annual Report.

28

The following table sets forth the maximum month-end balance and average balance of FHLB advances and the revolving line of credit ("Other Borrowings") for the periods indicated.

	Year Ended December 31,		
	2000	1999	1998
<i>(Dollars in thousands)</i>			
<b>Maximum Balance:</b>			
FHLB advances and Other Borrowings	\$ 244,900	230,900	194,579
FHLB short-term borrowings and Other Borrowings	67,000	60,500	46,893
<b>Average Balance:</b>			
FHLB advances and Other Borrowings	232,862	197,861	172,232
FHLB short-term borrowings and Other Borrowings	50,708	28,614	32,145

The following table sets forth certain information as to the Bank's FHLB advances at the dates indicated.

	December 31,		
	2000	1999	1998
<i>(Dollars in thousands)</i>			
FHLB short-term borrowings and Other Borrowings	\$ 38,000	60,500	17,500
Weighted average interest rate of FHLB short-term borrowings and Other Borrowings	6.79%	5.67%	5.38%

#### Service Corporations of the Bank

As a federally chartered savings bank, the Bank is permitted by OTS regulations to invest up to 2% of its assets in the stock of, or loans to, service corporation subsidiaries, and may invest an additional 1% of its assets in service corporations where such additional funds are used for inner-city or community development purposes. In addition to investments in service corporations, federal institutions are permitted to invest an unlimited amount in operating subsidiaries engaged solely in activities in which a federal savings bank may engage directly.

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

Osterud Insurance Agency, Inc. (OAI), a Minnesota corporation, was organized in 1983. OAI operated as an insurance agency until 1986 when its assets were sold. OAI remained inactive until 1993 when it began offering credit life insurance, annuity products and mutual fund products to the Bank's customers and others. OAI recorded net income of \$31,400 for the year ended December 31, 2000.

MSL Financial Corporation (MSL) was acquired in the MFC merger. MSL offered annuity products to MFC customers and also has an investment in FHLMC preferred stock. On April 30, 1999, MSL was liquidated and \$151,000 of assets and \$3,100 of liabilities were transferred to the Bank.

### Competition

The Bank faces strong competition both in originating real estate loans and in attracting deposits. Competition in originating loans comes primarily from mortgage bankers, commercial banks, credit unions and other savings institutions, which also make loans secured by real estate located in the Bank's market area and through internet banking operations which are throughout the continental United States. The Bank competes for loans principally on the basis of the interest rates and loan fees it charges, the types of loans it originates and the quality of services it provides to borrowers.

Competition for deposits is principally from money market and mutual funds, securities firms, commercial banks

29

---

and other savings institutions located in the same communities and through internet banking operations which are throughout the continental United States. The ability of the Bank to attract and retain deposits depends on its ability to provide an investment opportunity that satisfies the requirements of investors as to rate of return, liquidity, risk, convenient locations and other factors. The Bank competes for these deposits by offering a variety of deposit accounts at competitive rates, convenient business hours and a customer oriented staff.

HFMS faces strong competition both in originating one-to-four family residential real estate loans and purchasing one-to-four family loans from third party originators for resale in the secondary market. HFMS currently competes primarily in Minnesota and the states surrounding Minnesota with Wells Fargo Home Mortgage, Principal Residential Mortgage, Inc. and many other purchasers of loan located in the Minneapolis-St. Paul metropolitan area and the numerous communities surrounding the metropolitan area. HFMS competes for the one-to-four family loan originations based upon interest rates and fees it charges to prospective borrowers. HFMS competes for the purchase of loans primarily based upon the price it pays for loans including the servicing release premium it pays plus the fees it charges for services provided to its customers.

### Other Corporations Owned by HMN

During 2000 HMN had two other wholly owned subsidiaries, HMN Mortgage Services, Inc. (MSI) and Security Finance Corporation (SFC). On January 23, 2001 all of the stock of MSI was sold to Home Federal Savings Bank and on January 31, 2001 it was merged into Home Federal Mortgage Services LLC. HFMS operates a mortgage banking and mortgage brokerage facility located in Brooklyn Park, Minnesota. Brooklyn Park is located in the Minneapolis/St. Paul Metropolitan area. HFMS's primary function is to originate and/or purchase single family residential loans for resale on the secondary market to FNMA, FHLMC or other third parties. It also, from time to time, purchases mortgage servicing rights from other lenders. SFC invests in commercial loans and commercial real estate loans located throughout the United States which were originated by third parties. During 2000 SFC sold the majority of its investments and loans to the Bank and has discontinued purchasing loans.

### Employees

At December 31, 2000, HMN had a total of 151 full-time equivalent employees. None of the employees of HMN or its subsidiaries are represented by any collective bargaining unit. Management considers its employee relations to be good.

## REGULATION

### Regulation And Supervision



The banking industry is highly regulated. HMN, as a savings and loan holding company, is subject to regulation by the Office of Thrift Supervision (OTS). The Bank, a federal savings bank, is subject to extensive regulation and examination by the OTS, which is the Bank's primary federal regulator. The Federal Deposit Insurance Corporation (FDIC) also has limited authority to regulate the Bank. Subsidiaries of HMN and the Bank are also subject to state regulation and/or licensing in connection with certain insurance or mortgage banking activities. HMN and the Bank are subject to numerous laws and regulations. These laws and regulations impose restrictions on activities, set minimum capital requirements, impose lending and deposit restrictions and establish other restrictions. References in this section to applicable statutes and regulations are brief and incomplete summaries only. You should consult the statutes and regulations for a full understanding of the details of their operation.

### **Holding Company Regulation**

If a holding company owns more than one savings association, it is a multiple savings and loan holding company (SLHC); if it owns only one savings association, it is a unitary SLHC. HMN is a unitary savings and loan holding company. The Home Owners Loan Act (HOLA) generally limits multiple SLHCs and their non-association

30

---

subsidiaries to traditional savings association activities and services and to activities authorized for bank holding companies. Unitary SLHCs, in the past, have not been subject to restrictions on the activities that could be conducted by holding companies. See "Recent Developments" for more on unitary SLHCs.

*Acquisitions by Savings and Loan Holding Companies.* Acquisition of a savings institution or a savings and loan holding company is generally subject to OTS approval and the public must have an opportunity to comment on the proposed acquisition. Without prior approval from the OTS, HMN may not acquire more than 5% of the voting stock of any savings institution that is not one of its subsidiaries.

*Annual Reporting; Examinations.* Under HOLA and OTS regulations HMN, as a savings and loan holding company, must file periodic reports with the OTS. In addition, HMN must comply with OTS recordkeeping requirements. HMN is subject to holding company examination by the OTS. The OTS may take enforcement action if the activities of a savings and loan holding company constitute a serious risk to the financial safety, soundness or stability of a subsidiary savings association.

*Commonly Controlled Depository Institutions; Affiliate Transactions.* Depository institutions are "commonly controlled" if they are controlled by the same holding company or if one depository institution controls another depository institution. HMN controls the Bank. The FDIC has authority to require FDIC-insured banks and savings associations to reimburse the FDIC for losses it incurs in connection either with the default of a "commonly controlled" depository institution or with the FDIC's provision of assistance to such an institution.

The Bank, as a holding company subsidiary that is a depository institution, is subject to both qualitative and quantitative limitations on transactions with HMN and its other subsidiaries. See "Federal Restrictions on Transactions with Affiliates" below.

*Capital Adequacy.* HMN is not subject to any regulatory capital requirements, the Bank is subject to various capital requirements. See "Capital Requirements" below.

### **Bank Regulation**

As a federally-chartered savings association, the Bank is subject to regulation and supervision by the OTS. Federal statutes empower federal savings institutions, such as the Bank, to conduct, subject to various conditions and limitations, business activities that include: accepting deposits and paying interest on them; making loans on residential and other real estate; making a limited amount of consumer loans; making a limited amount of commercial loans; investing in corporate obligations, government debt securities, and other securities; and offering various trust and banking services to their customers.

OTS regulations further delineate such institutions' lending and investment powers. Savings associations are expected to conduct lending activities in a prudent, safe and sound manner. OTS regulations set aggregate limits on certain types of loans including commercial loans and consumer loans. OTS regulations also establish limits on loans to a single borrower. As of December 31, 2000, the Bank's loan limit to one borrower was approximately \$7.9 million. Federal savings institutions generally may not invest in noninvestment-grade debt securities. Federal savings institutions may establish subsidiaries to conduct any activity the institution is authorized to conduct and may establish service corporation subsidiaries for limited preapproved activities.

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

*Qualified Thrift Lender Test.* Savings associations, including the Bank, must be qualified thrift lenders ("QTL"). A savings association generally satisfies the QTL test if at least 65% of a specified asset base consists of things such as loans to small businesses, credit card loans; and certain assets related to domestic residential real estate. Savings associations may qualify as QTLs in other ways. Savings associations that do not qualify as QTLs are subject to significant restrictions on their operations. As of December 31, 2000, the Bank met the QTL test.

31

---

*OTS Assessments.* HOLA authorizes the OTS to charge assessments to recover the costs of examining savings associations and their affiliates. The assessment is done semi-annually. The OTS bases the assessment on three factors: 1) asset size; 2) condition; and 3) complexity of the institution. The Bank's OTS assessment for the year ended December 31, 2000, was approximately \$130,000.

*Federal Restrictions on Transactions with Affiliates.* All banks and savings institutions are subject to affiliate and insider transaction rules applicable to member banks of the Federal Reserve System set forth in Sections 23A, 23B, 22(g) and 22(h) of the Federal Reserve Act, as well as such additional limitations as the institution's primary federal regulator may adopt. These provisions prohibit or limit a savings institution from extending credit to, or entering into certain transactions with affiliates, principal stockholders, directors and executive officers of the savings institution and its affiliates. For these purposes, the term "affiliate" generally includes a holding company such as HMN and any company under common control with the savings institution. Section 23A limits transactions with any one affiliate to 10% of the bank's capital and surplus. In addition, the federal law governing unitary savings and loan holding companies prohibits the Bank from making any loan to any affiliate whose activity is not permitted for a subsidiary of a bank holding company. This law also prohibits the Bank from making any equity investment in any affiliate that is not its subsidiary.

*Restrictions on Subsidiary Savings Institution Dividends.* Federal law limits the ability of a depository institution, such as, the Bank to pay dividends or make other capital distributions. Associations (such the Bank) that are subsidiaries of a savings and loan holding company must file a notice with the OTS at least 30 days before the proposed declaration of a dividend or approval of the proposed capital distribution by its board of directors. In addition, a savings association must obtain prior approval from the OTS if it fails to meet certain regulatory conditions. In March of 2000, the Bank received notification from the OTS that subject to certain restrictions (which could only be calculated at the time of distribution) a dividend from the Bank to HMN of \$3.0 million could be paid during 2000 without violating the dividend limitations mentioned above.

### **FDIC Insurance**

The FDIC insures the deposits of the Bank. The FDIC administers two separate deposit insurance funds, the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). The BIF is a deposit insurance fund for commercial banks and some state-chartered savings banks. The SAIF is a deposit insurance fund for most savings associations. The Bank is a member of the SAIF.

The FDIC has established a risk-based system for setting deposit insurance assessments. Under the risk-based assessment system, an institution's insurance assessments vary according to the level of capital the institution holds and the degree to which it is the subject of supervisory concern. In addition, regardless of the potential risk to the insurance fund, federal law requires the FDIC to establish assessment rates that will maintain each insurance fund's ratio of reserves to insured deposits at \$1.25 per \$100. Both funds currently exceed this reserve ratio. During 2000, the assessment rate for both SAIF and BIF deposits ranged from zero to 0.27% of covered deposits. The Bank qualified for the lowest rate on SAIF deposits in 2000. Accordingly, the Bank did not pay any deposit insurance assessments in 2000.

In addition to deposit insurance assessments, the FDIC is authorized to collect assessments against insured deposits to be paid to the Finance Corporation (FICO) to service FICO debt incurred in the 1980s. The FICO assessment rate is adjusted quarterly.

Before 2000, the FICO assessment rate for SAIF-insured deposits was significantly higher than the rate for BIF-insured deposits. The average annual assessment rate in 1999 was approximately 6 cents per \$100 of SAIF-insured deposits. Beginning in 2000, the annualized rate is estimated to be approximately 2.5 cents per \$100 of insured deposits. In 2000 the Bank paid an assessment of approximately \$83,000.

32

---

### **Capital Requirements**

Since 1989 the federal bank regulators, including the OTS, have had a risk-based capital framework in place. The regulators use a combination of risk-based guidelines and leverage ratios to evaluate capital adequacy.

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

The following table sets forth the current regulatory requirement for capital ratios for savings associations as compared with our capital ratios at December 31, 2000:

	Core or Tier 1 Capital to Adjusted Total Assets	Tangible Capital to Adjusted Total Assets	Core or Tier 1 Capital to Risk- Weighted Assets	Total Capital to Risk-Weighted Assets
Regulatory Minimum	3.00%(1)	1.50%	4.00%	8.00%
The Bank's Actual	7.07	7.07	11.19	11.88

(1)

Most savings associations are required to maintain a leverage ratio of 4.00% or more.

### Capital Categories and Prompt Corrective Action

The Federal Deposit Insurance Corporation Improvement Act ("FDICIA") created a statutory framework that increased the importance of meeting applicable capital requirements. FDICIA established five capital categories: (1) well-capitalized; (2) adequately capitalized; (3) undercapitalized; (4) significantly undercapitalized; and (5) critically undercapitalized.

An institution's category depends upon where its capital levels are in relation to relevant capital measures, which include a risk-based capital measure, a leverage ratio capital measure, and certain other factors. The federal banking agencies (including the OTS) adopted regulations that implement this statutory framework. Under these regulations, an institution is treated as well-capitalized if its ratio of total capital to risk-weighted assets is 10.00% or more, its ratio of core capital to risk-weighted assets is 6.00% or more, its ratio of core capital to adjusted total assets (leverage ratio) is 5.00% or more, and it is not subject to any federal supervisory order or directive to meet a specific capital level. In order to be adequately capitalized, an institution must have a total risk-based capital ratio of not less than 8.00%, a Tier 1 risk-based capital ratio of not less than 4.00%, and a leverage ratio of not less than 4.00%. Any institution that is neither well capitalized nor adequately capitalized will be considered undercapitalized. The activities in which a depository institution may engage and regulatory responsibilities of federal banking regulators vary depending upon whether an institution is well-capitalized, adequately capitalized or under capitalized. Under capitalized institutions are subject to various restrictions such as limitations on dividends and growth. The Bank currently is considered well capitalized.

### Other Regulations and Examination Authority

The FDIC has adopted regulations to protect the deposit insurance funds and depositors, including regulations governing the deposit insurance of various forms of accounts. Federal regulation of depository institutions is intended for the protection of depositors (and the BIF and the SAIF), and not for the protection of stockholders or other creditors. In addition, a provision in the Omnibus Budget Reconciliation Act of 1993 requires that in any liquidation or other resolution of any FDIC-insured depository institution, claims for administrative expenses of the receiver and for deposits in U.S. branches (including claims of the FDIC as subrogee of the insured institution) shall have priority over the claims of general unsecured creditors.

33

The OTS may sanction any OTS-regulated bank that does not operate in accordance with OTS regulations, policies and directives. The FDIC has additional authority to terminate insurance of accounts, after notice and hearing, upon a finding that the insured institution is or has engaged in any unsafe or unsound practice that has not been corrected, is operating in an unsafe or unsound condition, or has violated any applicable law, regulation, rule, or order of or condition imposed by the FDIC.

### Federal Home Loan Bank ("FHLB") System

The Bank is a member of the FHLB, which is one of the 12 regional Federal Home Loan Banks ("FHB"), that administers the home financing credit function of savings associations. Each FHB serves as a reserve or central bank for its members within its assigned region. It is funded primarily from proceeds derived from the sale of consolidated obligations of the FHB System. It makes loans to members (i.e., advances) in accordance with policies and procedures established by the board of directors of the FHB. These policies and procedures are subject to the regulation and oversight of the Federal Housing Financing Board. All advances from the FHLB are required to be fully secured by sufficient collateral as determined by the FHB. Long-term advances are required to be used for residential home financing and small business and agricultural loans.

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

As a member, the Bank is required to purchase and maintain stock in the FHLB of Des Moines. As of December 31, 2000, the Bank had \$12.2 million in FHLB stock, which was in compliance with this requirement. In past years, the Bank has received dividends on its FHLB stock. Over the past five calendar years such dividends have averaged approximately 6.7%.

### **Federal Reserve Regulation**

Under Federal Reserve Board regulations, the Bank is required to maintain reserves against transaction accounts (primarily interest-bearing and non-interest-bearing checking accounts). Because reserves must generally be maintained in cash or in non-interest-bearing accounts, the effect of the reserve requirements is to increase an institution's cost of funds. These regulations generally require that the Bank maintain reserves against net transaction accounts. The reserve levels are subject to adjustment by the Federal Reserve Board. A savings bank, like other depository institutions maintaining reservable accounts, may, under certain conditions, borrow from the Federal Reserve Bank discount window.

Numerous other regulations promulgated by the Federal Reserve Board affect the business operations of the Bank. These include regulations relating to equal credit opportunity, electronic fund transfers, collection of checks, truth in lending, truth in savings and availability of funds.

### **Community Reinvestment Act**

The Community Reinvestment Act (CRA) requires financial institutions regulated by the federal financial supervisory agencies to ascertain and help meet the credit needs of their delineated communities, including low-to moderate-income neighborhoods within those communities, while maintaining safe and sound banking practices. The regulatory agency assigns one of four possible ratings to an institution's CRA performance and is required to make public an institution's rating and written evaluation. The four possible ratings of meeting community credit needs are outstanding, satisfactory, needs improvement and substantial noncompliance. The Bank's last CRA exam was December 10, 1999 and the Bank received a "satisfactory" rating.

Under regulations that apply to all CRA performance evaluations after July 1, 1997, many factors play a role in assessing a financial institution's CRA performance. The institution's regulator must consider its financial capacity and size, legal impediments, local economic conditions and demographics, including the competitive environment in which it operates. The evaluation does not rely on absolute standards, and the institutions are not required to perform specific activities or to provide specific amounts or types of credit. The Bank maintains a CRA statement for public viewing, as

34

---

well as an annual CRA highlights document. These documents describe the Bank's credit programs and services, community outreach activities, public comments and other efforts to meet community credit needs.

### **Recent Developments**

In November 1999, the President signed into law the Gramm-Leach-Bliley Act, or GLB Act, which significantly changed the regulatory structure and oversight of the financial services industry. The GLB Act revises the Bank Holding Company Act of 1956 (BHC Act) and the Home Owners Loan Act (HOLA) and repeals the affiliation provisions of the Glass-Steagall Act of 1933, permitting a qualifying holding company, called a financial holding company, to engage in a full range of financial activities, including banking, insurance, and securities activities, as well as merchant banking and additional activities that are "financial in nature" or "incidental" to such financial activities. Savings and loan holding companies are similarly authorized to engage in activities that are financial in nature. The GLB Act thus provides expanded financial affiliation opportunities for existing holding companies and permits various non-bank financial services providers to acquire banks and thrifts by allowing holding companies to engage in activities such as securities underwriting, and underwriting and brokering of insurance products. The GLB Act also expands passive investments by financial holding companies in any type of company, financial or nonfinancial, through merchant banking and insurance company investments. In order for a bank holding company to qualify as a financial holding company, its subsidiary depository institutions must be "well-capitalized" and "well-managed" and have at least a "satisfactory" Community Reinvestment Act rating.

The GLB Act reforms the regulatory framework of the financial services industry. Under the GLB Act, financial holding companies are subject to primary supervision by the Federal Reserve Board and savings and loan holding companies are subject to supervision by the OTS. Current federal and state regulators of financial holding company regulated subsidiaries such as insurers, broker-dealers, investment companies and banks generally retain their jurisdiction and authority. In order to implement its underlying purposes, the GLB Act preempts state laws restricting the establishment of financial affiliations authorized or permitted under the GLB Act, subject to specified exceptions for state insurance regulators. With regard to securities laws, the GLB Act removes the current blanket exemption for banks from the broker-dealer registration requirements under the Securities Exchange Act of 1934, amends the Investment Company Act of 1940 with respect to bank common trust fund and mutual fund activities, and amends the Investment Advisers Act of 1940 to require registration of banks that act as

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

investment advisers for mutual funds. The GLB Act also includes provisions concerning subsidiaries of banks, permitting a national bank to engage in most financial activities through a financial subsidiary, provided that the bank and its depository institution affiliates meet certain qualification requirements relating to capital, management, total assets, subordinated debt, capital, risk management, and affiliate transactions.

The GLB Act adopts a number of provisions relating to capitalization, membership, corporate governance and other measures designed to modernize the Federal Home Loan Bank System. The GLB Act also restricts the powers of new unitary savings and loan association holding companies. Unitary savings and loan holding companies that are "grandfathered," i.e., unitary savings and loan holding companies in existence or with applications filed with the OTS on or before May 4, 1999, such as HMN, retain their authority under the prior law. All other unitary savings and loan holding companies are limited to financially related activities. The GLB Act prohibits non-financial companies from acquiring grandfathered unitary savings and loan holding companies. HMN is unable to predict the impact of the GLB Act on its operations at this time.

35

### ITEM 2. PROPERTIES

The following table sets forth information concerning the main office and each branch office of HMN at December 31, 2000. The Bank uses all properties listed below except for the mortgage banking/brokerage office which is used by HFMS. At December 31, 2000, HMN's premises had an aggregate net book value of approximately \$6.4 million.

Location	Year Acquired	Owned or Leased
<i>Corporate Office:</i>		
101 North Broadway Spring Valley, Minnesota	1975	Owned
<i>Full Service Branches:</i>		
715 North Broadway Spring Valley, Minnesota	1998	Owned
201 Oakland Avenue West Austin, Minnesota	1960	Owned
Crossroads Shopping Center Rochester, Minnesota	1962	Owned
4th & Center(1) Winona, Minnesota	1973	Owned
175 Center Street Winona, Minnesota	1998	Owned
208 South Walnut LaCrescent, Minnesota	1975	Owned
1110 6th St., NW Rochester, Minnesota	1982	Owned
143 West Clark Street Albert Lea, Minnesota	1993	Owned
303 W. Main St. Marshalltown, Iowa	1997	Owned
119 W. High St. Toledo, Iowa	1997	Leased
29 S. Center St.	1997	Owned

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

<b>Location</b>	<b>Year Acquired</b>	<b>Owned or Leased</b>
Marshalltown, Iowa		
111 S. Broadway, Suite 200 Rochester, MN	2000	Leased
<i>Mortgage Banking/Brokerage Office:</i>		
7101 Northland Circle, Suite 105 Brooklyn Park, Minnesota	1997	Leased

- (1) The property previously was used by the Bank and is currently being held for sale.

36

### ITEM 3. LEGAL PROCEEDINGS

From time to time, the Bank and HMN are involved as plaintiff or defendant in various legal proceedings arising in the normal course of its business. While the ultimate outcome of these various legal proceedings cannot be predicted with certainty, it is the opinion of management that the resolution of these legal actions should not have a material effect on HMN's consolidated financial condition or results of operations.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

## PART II

### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED SECURITY HOLDER MATTERS

The information on pages 22, 45, 56 and the back cover page of the Annual Report to Security Holders for the year ended December 31, 2000 is incorporated herein by reference.

### ITEM 6. SELECTED FINANCIAL DATA

The information on page 11 of the Annual Report to Security Holders for the year ended December 31, 2000 is incorporated herein by reference.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information on pages 12 through 28 of the Annual Report to Security Holders for the year ended December 31, 2000 is incorporated herein by reference.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The information on pages 24 through 26 of the Annual Report to Security Holders for the year ended December 31, 2000 is incorporated herein by reference.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The information on pages 29 through 56 of the Annual Report to Security Holders for the year ended December 31, 2000 is incorporated herein by reference.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

37

---

**PART III**

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

The information regarding directors on pages 4 through 6 and the information regarding beneficial ownership reporting compliance on pages 19 and 20 of the Registrant's definitive Proxy Statement dated March 23, 2001 is incorporated herein by reference.

**Executive Officers of the Registrant Who Are Not Directors**

Officers are elected annually by the Board of Directors of HMN and the Bank. The business experience of each executive officer of HMN and the Bank who is not also a director of HMN is set forth below.

*Dwain C. Jorgensen.* Mr. Jorgensen, age 52, is Senior Vice President Operations of HMN and the Bank. Mr. Jorgensen has held such positions with the Bank since 1998. Prior to such time, he served as Vice President, Controller and Chief Accounting Officer of HMN and the Bank from 1989 to 1998. From 1983 to 1989, Mr. Jorgensen was an Assistant Vice President and Operations Officer with the Bank.

**ITEM 11. EXECUTIVE COMPENSATION**

The information on pages 8 through 13 of the Registrant's definitive Proxy Statement dated March 23, 2001 is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The information on pages 1, 2, 3, and 4 of the Registrant's definitive Proxy Statement dated March 23, 2001 is incorporated herein by reference.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information on page 13 of the Registrant's definitive Proxy Statement dated March 23, 2001 is incorporated herein by reference.

38

---

**PART IV**

**ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K**

(a) Financial Statements, Financial Statement Schedules and Exhibits

1. Financial Statements

The following information appearing in the Registrant's Annual Report to Security Holders for the year ended December 31, 2000, is incorporated by reference in this Form 10-K Annual Report as Exhibit 13.

Annual Report Section	Pages in 2000 Annual Report
Five Year Consolidated Financial Highlights	11
Consolidated Balance Sheets December 31, 2000 and 1999	29
Consolidated Statements of Income Each of the Years in the Three-Year Period Ended December 31, 2000	30
Consolidated Statements of Comprehensive Income Each of the Years in the Three-Year Period Ended December 31, 2000	30
Consolidated Statement of Stockholders' Equity Each of the Years in the Three-Year Period Ended December 31, 2000	31
Consolidated Statements of Cash Flows Each of the Years in the Three-Year Period Ended December 31, 2000	32
Notes to Consolidated Financial Statements	33 - 52
Independent Auditors' Report	53
Selected Quarterly Financial Data	54 - 55
Other Financial Data	56
Common Stock Price Information	56

2. Financial Statement Schedules

All financial statement schedules have been omitted as information is not required under the related instructions, is not applicable or has been included in the Notes to Consolidated Financial Statements.

39

3. Exhibits

Regulation S-K Exhibit Number	Document	Reference to Prior Filing or Exhibit Number Attached Hereto	Sequential Page Numbering Where Attached Exhibits Are Located in This Form 10-K
2	Agreement and Plan of Merger dated July 1, 1997	1*	Not applicable



Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

Regulation S-K Exhibit Number	Document	Reference to Prior Filing or Exhibit Number Attached Hereto	Sequential Page Numbering Where Attached Exhibits Are Located in This Form 10-K
3	Amended and Restated Certificate of Incorporation	2*	Not applicable
	Amended and Restated By-laws	3*	Not applicable
4	Form of Common Stock Certificate	4*	Not applicable
10.1	Employment Agreement for Mr. Weise dated June 29, 1994	5*	Not applicable
	Extension of Employment Contract		Not applicable
	Second Extension of Employment Contract	6*	Not applicable
	Third Extension of Employment Contract	7*	Not applicable
	Fourth Extension of Employment Contract	8*	Not applicable
		9*	
10.2a	Employment Agreement for Mr. Gardner dated June 29, 1994	5*	Not applicable
	Extension of Employment Contract		
	Second Extension of Employment Contract	6*	Not applicable
	Third Extension of Employment Contract	7*	Not applicable
	Fourth Extension of Employment Contract	8*	Not applicable
		9*	Not applicable
10.2b	Early Retirement Agreement for Mr. Gardner dated October 24, 2000	10.2b	Filed electronically
10.3a	Change in Control Agreement for Mr. McNeil dated as of November 1, 2000	10.3a	Filed electronically
10.3b	Employment Agreement for Mr. McNeil dated as of November 1, 2000	10.3b	Filed electronically
10.4a	Change in Control Agreement for Mr. Johnson dated as of November 1, 2000	10.4a	Filed electronically
10.4b	Employment Agreement for Mr. Johnson dated as of November 1, 2000	10.4b	Filed electronically
10.5	Directors Deferred Compensation Plan	5*	Not applicable
10.6	Amended and Restated HMN Financial, Inc. Recognition and Retention Plan dated July 29, 1998	10*	Not applicable
10.7	Amended and Restated HMN Financial, Inc. Stock Option and Incentive Plan dated July 29, 1998	10*	Not applicable

40

11	Statement re: Computation of per share earnings	11	Filed electronically
13	Annual Report to Security Holders	13	Filed electronically

## Edgar Filing: MKS INSTRUMENTS INC - Form 10-K

21	Subsidiaries of Registrant	21	Filed electronically
23	Consent of KPMG LLP dated March 28, 2001	23	Filed electronically

---

Management contract of compensatory arrangement.

- 1\*  
Incorporated by reference to the same numbered exhibit to the Company's Current Report on Form 8-K dated July 1, 1997, filed on July 10, 1997.
- 2\*  
Incorporated by reference to the same numbered exhibit to the Company's Quarterly Report on Form 10-Q for the period ended March 31, 1998 (File No. 0-24100).
- 3\*  
Incorporated by reference to the same numbered exhibit to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 1997 (File No. 0-24100).
- 4\*  
Incorporated by reference to the same numbered exhibit to the Company's Registration Statement on Form S-1 dated April 1, 1994 (File No. 33-77212).
- 5\*  
Incorporated by reference to the same numbered exhibit to the Company's Annual Report on Form 10-K for the period ended December 31, 1994 (File No. 0-24100).
- 6\*  
Incorporated by reference to the same numbered exhibit to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1997 (File No. 0-24100).
- 7\*  
Incorporated by reference to the same numbered exhibit to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1998 (File No. 0-24100).
- 8\*  
Incorporated by reference to the same numbered exhibit to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1999 (File No. 0-24100).
- 9\*  
Incorporated by reference to the same numbered exhibit to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2000 (File No. 0-24100).
- 10\*  
Incorporated by reference to the same numbered exhibit to the Company's Quarterly Report on Form 10-Q for the period ended September 30, 1998 (File No. 0-24100).
- (b)  
The Company filed the following reports on Form 8-K during the fourth quarter of 2000:
1.  
On October 24, 2000, under Item 5, containing a press release declaring a dividend and announcing the appointment of the Company's Chairman, President and Chief Financial Officer.



10.2b	Early Retirement Agreement for Mr. Gardner	Filed electronically
10.3a	Change in Control Agreement for Mr. McNeil	Filed electronically
10.3b	Employment Agreement for Mr. McNeil	Filed electronically
10.4a	Change in Control Agreement for Mr. Johnson	Filed electronically
10.4b	Employment Agreement for Mr. Johnson	Filed electronically
11	Statement re: Computation of per share earnings	Filed electronically
13	Annual Report to Security Holders	Filed electronically
21	Subsidiaries of Registrant	Filed electronically
23	Consent of KPMG LLP dated March 28, 2001	Filed electronically

QuickLinks

TABLE OF CONTENTS

PART I

ITEM 1. BUSINESS

General

Lending Activities

Investment Activities

Sources of Funds

Service Corporations of the Bank

Competition

Other Corporations Owned by HMN

Employees

REGULATION

ITEM 2. PROPERTIES

ITEM 3. LEGAL PROCEEDINGS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED SECURITY HOLDER MATTERS

ITEM 6. SELECTED FINANCIAL DATA

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Executive Officers of the Registrant Who Are Not Directors

ITEM 11. EXECUTIVE COMPENSATION

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

SIGNATURES

INDEX TO EXHIBITS