

COHERENT INC
Form 10-Q
May 13, 2010
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended April 3, 2010

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: 001-33962

COHERENT, INC.

Delaware
(State or other jurisdiction of
incorporation or organization)

94-1622541
(I.R.S. Employer
Identification No.)

5100 Patrick Henry Drive, Santa Clara, California 95054
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(408) 764-4000**

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares outstanding of registrant's common stock, par value \$.01 per share, on May 7, 2010 was 25,268,766.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements included in or incorporated by reference in this quarterly report, other than statements of historical fact, are forward-looking statements. These statements are generally accompanied by words such as trend, may, will, could, would, should, expect, plan, anticipate, rely, believe, estimate, predict, intend, potential, continue, forecast or other comparable terminology, including without limitation statements made under Future Trends, Our Strategy, discussions regarding our bookings and in Management's Discussion and Analysis of Financial Condition and Results of Operations. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Actual results of Coherent, Inc. (referred to herein as the Company, we, our or Coherent) may differ significantly from those anticipated in these forward-looking statements as a result of various factors, including those discussed in the sections captioned Future Trends, Risk Factors, Key Performance Indicators, as well as any other cautionary language in this quarterly report. All forward-looking statements included in the document are based on information available to us on the date hereof. We undertake no obligation to update these forward-looking statements as a result of events or circumstances or to reflect the occurrence of unanticipated events or non-occurrence of anticipated events.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****COHERENT, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS***(Unaudited; in thousands, except per share data)*

	Three Months Ended		Six Months Ended	
	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009
Net sales	\$ 149,157	\$ 105,422	\$ 271,972	\$ 229,810
Cost of sales	83,544	65,815	155,327	139,814
Gross profit	65,613	39,607	116,645	89,996
Operating expenses:				
Research and development	19,488	15,610	34,898	30,388
Selling, general and administrative	31,164	27,962	59,143	51,590
Impairment of goodwill				19,286
Amortization of intangible assets	1,956	1,894	3,917	3,837
Total operating expenses	52,608	45,466	97,958	105,101
Income (loss) from operations	13,005	(5,859)	18,687	(15,105)
Other income (expense):				
Interest and dividend income	1,290	689	1,438	2,133
Interest expense	(23)	(32)	(70)	(109)
Other net	225	(2,257)	916	(7,854)
Total other income (expense), net	1,492	(1,600)	2,284	(5,830)
Income (loss) before income taxes	14,497	(7,459)	20,971	(20,935)
Provision for income taxes	6,017	1,671	8,312	2,874
Net income (loss)	\$ 8,480	\$ (9,130)	\$ 12,659	\$ (23,809)
Net income (loss) per share:				
Basic	\$ 0.34	\$ (0.38)	\$ 0.51	\$ (0.98)
Diluted	\$ 0.34	\$ (0.38)	\$ 0.51	\$ (0.98)
Shares used in computation:				
Basic	24,704	24,258	24,587	24,202
Diluted	24,996	24,258	24,837	24,202

See Accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents**COHERENT, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS***(Unaudited; in thousands, except par value)*

	April 3, 2010	October 3, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 192,166	\$ 199,950
Short-term investments	72,943	43,685
Accounts receivable net of allowances of \$2,145 and \$2,147, respectively	84,598	74,235
Inventories	99,144	97,767
Prepaid expenses and other assets	52,708	38,969
Deferred tax assets	19,435	28,164
Total current assets	520,994	482,770
Property and equipment, net	94,972	98,792
Goodwill	66,434	66,967
Intangible assets, net	20,740	19,738
Other assets	85,689	85,337
Total assets	\$ 788,829	\$ 753,604
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term obligations	\$ 20	\$ 9
Accounts payable	29,382	21,639
Income taxes payable	2,159	1,953
Other current liabilities	84,972	62,741
Total current liabilities	116,533	86,342
Long-term obligations	39	6
Other long-term liabilities	88,025	91,685
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Common stock, par value \$.01 per share:		
Authorized 500,000 shares		
Outstanding 25,088 shares and 24,455 shares, respectively	250	244
Additional paid-in capital	205,207	188,918
Accumulated other comprehensive income	59,976	80,269
Retained earnings	318,799	306,140
Total stockholders' equity	584,232	575,571
Total liabilities and stockholders' equity	\$ 788,829	\$ 753,604

See Accompanying Notes to Condensed Consolidated Financial Statements.

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COHERENT, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; in thousands)

	Six Months Ended	
	April 3, 2010	April 4, 2009
Cash flows from operating activities:		
Net income (loss)	\$ 12,659	\$ (23,809)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	11,675	9,716
Amortization of intangible assets	3,917	3,837
Deferred income taxes	11,377	(1,583)
Loss on disposal of property and equipment	333	438
Stock-based compensation	3,892	4,178
Excess tax benefit from stock-based compensation arrangements	(482)	(8)
Impairment of goodwill		19,286
Non-cash restructuring and other charges	1,134	167
Other non-cash expense (income)	(11)	34
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(9,699)	13,013
Inventories	2,321	1,867
Prepaid expenses and other assets	(13,294)	(9,514)
Other assets	(176)	10,045
Accounts payable	5,083	(5,743)
Income taxes payable/receivable	(1,482)	(2,025)
Other current liabilities	19,853	(2,396)
Other long-term liabilities	(921)	(9,976)
Net cash provided by operating activities	46,179	7,527
Cash flows from investing activities:		
Purchases of property and equipment	(5,708)	(14,156)
Proceeds from dispositions of property and equipment	244	1,349
Purchases of available-for-sale securities	(82,913)	(44,986)
Proceeds from sales and maturities of available-for-sale securities	53,286	25,434
Acquisition of a business	(15,000)	
Change in restricted cash		2,521
Net cash used in investing activities	(50,091)	(29,838)
Cash flows from financing activities:		
Short-term borrowings		3
Short-term repayments		(3)
Repayment of capital lease obligations	(8)	(4)
Cash overdrafts decrease		20
Issuance of common stock under employee stock option and purchase plans	13,610	3,544
Net settlement of restricted common stock	(1,180)	
Excess tax benefits from stock-based compensation arrangements	482	8
Net cash provided by financing activities	12,904	3,568
Effect of exchange rate changes on cash and cash equivalents	(16,776)	(12,132)
Net decrease in cash and cash equivalents	(7,784)	(30,875)
Cash and cash equivalents, beginning of period	199,950	213,826
Cash and cash equivalents, end of period	\$ 192,166	\$ 182,951

Supplemental disclosure of cash flow information:

Cash paid during the period for:

Interest	\$	54	\$	104
Income taxes	\$	5,538	\$	13,029

Cash received during the period for:

Income taxes	\$	5,006	\$	6,138
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Non-cash investing and financing activities:

Unpaid property and equipment	\$	960	\$	1,492
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See Accompanying Notes to Condensed Consolidated Financial Statements

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COHERENT, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations. These interim condensed consolidated financial statements and notes thereto should be read in conjunction with the Coherent, Inc. (referred to herein as the Company, we, our, us or Coherent) consolidated financial statements and notes thereto filed on Form 10-K for the fiscal year ended October 3, 2009. In the opinion of management, all adjustments necessary for a fair presentation of financial condition and results of operation as of and for the periods presented have been made and include only normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year or any other interim periods presented therein. Our fiscal year ends on the Saturday closest to September 30 and our second fiscal quarters include 13 weeks of operations in fiscal year 2010 and 14 weeks of operations in fiscal year 2009. Fiscal years 2010 and 2009 include 52 and 53 weeks, respectively.

2. RECENT ACCOUNTING STANDARDS

Adoption of New Accounting Pronouncements

In December 2007 the Financial Accounting Standards Board (FASB) revised the authoritative guidance for business combinations. The revised guidance retains the fundamental requirements of the original pronouncement requiring that the purchase method be used for all business combinations, however these rules, (including additional guidance issuance after December 2007), change certain elements of accounting for business combinations such as:

- The acquisition date is the date that the acquirer achieves control.
- Acquisition related costs are recognized separately from the acquisition and recorded as an expense.
- Assets acquired and liabilities assumed in a business combination that arise from contingencies are recognized at fair value if fair value can be reasonably estimated; if fair value cannot be reasonably estimated during the measurement period, the contingent asset or liability is recognized in accordance with the guidance on contingencies.

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We adopted this guidance for acquisitions completed after October 4, 2009, the beginning of our fiscal year 2010. The impact of adoption will be largely dependent on the size and nature of the business combinations completed after the adoption of this statement.

In February 2008, the FASB issued guidance which delayed the effective date regarding fair value measurements and disclosures of nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. We adopted this update for our fiscal year beginning October 4, 2009. The adoption of this standard did not have a material impact on our consolidated financial position, results of operations and cash flows.

In 2008, the FASB issued new requirements regarding the determination of the useful lives of intangible assets and accounting for acquired defensive assets. This guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible; an entity needs to consider its own historical experience adjusted for entity specific factors. In the absence of that experience, an entity shall consider the assumptions that market participants would use about renewal or extension options. Defensive assets should be assigned useful lives based on the period during which the asset would diminish in value. We adopted this guidance for our fiscal year beginning October 4, 2009 and it will be applied prospectively to intangible assets acquired.

In January 2010, the FASB issued an accounting standard update amending the disclosure requirements for financial instruments under fair value. New disclosures required include the amount of significant transfers in and out of levels 1 and 2 fair value measurements and the reasons for the transfers. In addition, the reconciliation for level 3 activity will be required on a gross rather than net basis. The update provides additional guidance related to the level of disaggregation in determining classes of assets and liabilities and disclosures about inputs and valuation techniques. The amendments are effective for annual or interim reporting periods beginning after December 15, 2009, except for the requirement to provide the reconciliation for level 3 activity on a gross basis which will be effective for fiscal years beginning after December 15, 2010. We adopted this guidance for our fiscal quarter beginning January 3, 2010 and it did not have an impact on our consolidated financial position, results of operations and cash flows.

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In April 2010, the FASB issued an accounting standard update defining a milestone and determining what criteria must be met to apply the milestone method of revenue recognition for research or development transactions. The update provides guidance on the criteria which must be met to determine if the milestone method of revenue recognition is appropriate, whether a milestone is substantive and the disclosures that must be made if the method is elected. This standard should be applied on a prospective basis for milestones reached in fiscal years, and interim periods within those years, beginning on or after June 15, 2010, with earlier adoption permitted. If early adoption is elected and the period of adoption is not the beginning of the Company's fiscal year, the amendments should be applied retrospectively from the beginning of the year of adoption. We do not expect this update to have an impact on our consolidated financial position, results of operations and cash flows.

In September 2009, the FASB amended revenue recognition guidance for arrangements with multiple deliverables. This standard modifies the revenue recognition guidance for arrangements that involve the delivery of multiple elements, such as product, software, services or support, to a customer at different times as part of a single revenue generating transaction and provides principles and application guidance to determine whether multiple deliverables exist, how the individual deliverables should be separated and how to allocate the revenue in the arrangement among those separate deliverables. The standard also expands the disclosure requirements for multiple deliverable revenue arrangements. This standard should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with earlier application permitted. Alternatively, an entity can elect to adopt this standard on a retrospective basis. We are currently evaluating the potential impact and timing of the adoption of this update on our consolidated financial position, results of operations and cash flows.

3. BUSINESS COMBINATION

On October 13, 2009, we acquired all the assets and certain liabilities of StockerYale, Inc. (StockerYale)'s laser module product line in Montreal and its specialty fiber product line in Salem, New Hampshire for \$15.0 million in cash. StockerYale designs, develops and manufactures low power laser modules, light emitting (LED) systems and specialty optical fiber products. These assets and liabilities have been included in our Commercial Lasers and Components segment.

We adopted the new authoritative guidance on business combinations during the first quarter of fiscal 2010 and the acquisition was accounted for in accordance with this guidance; therefore, the tangible and intangible assets acquired were recorded at fair value on the acquisition date.

Our allocation of the purchase price is as follows (in thousands):

Tangible assets	\$	9,770
Goodwill		2,580
Intangible assets:		
Existing technology		610
Production know-how		910
Customer lists		3,170
Non-compete agreements		60

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Order backlog		600
Liabilities assumed		(2,700)
Total	\$	15,000

The goodwill recognized from this acquisition resulted primarily from anticipated increases in market share and synergies of combining these entities and was included in our Commercial Lasers and Components segment. None of the goodwill from this purchase is deductible for tax purposes.

Goodwill, which represents the excess of the purchase price over the fair value of tangible and identified intangible assets acquired, is not being amortized but will be reviewed annually for impairment, or more frequently if impairment indicators arise, in accordance with authoritative guidance. The identifiable intangible assets are being amortized over their respective useful lives of one to seven years.

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In accordance with authoritative guidance, we expensed \$0.2 million of acquisition-related costs incurred as selling, general and administrative expenses in our consolidated statements of operations for the six months ended April 3, 2010.

Results of operations for the acquired product lines have been included in our consolidated financial statements subsequent to the date of acquisition, and have not been presented on a pro forma basis as the revenue and income from operations are not material to our consolidated results. Pro forma results of operations in accordance with authoritative guidance for prior periods have not been presented because the effect of the acquisition was not material to our prior period consolidated financial results.

4. FAIR VALUES**Cash Equivalents and Marketable Securities**

We measure our cash equivalents and marketable securities at fair value. The fair values of our financial assets and liabilities are determined using quoted market prices of identical assets or quoted market prices of similar assets from active markets. Level 1 valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 valuations are obtained from quoted market prices in active markets involving similar assets. Level 3 valuations would be based on unobservable inputs to a valuation model and include our own data about assumptions market participants would use in pricing the asset or liability based on the best information available under the circumstances. As of and during the three and six months ended April 3, 2010, we did not have any assets or liabilities valued based on Level 3 valuations and we had no assets or liabilities that transferred in or out of Level 1 or Level 2 valuation.

Financial assets and liabilities measured at fair value as of April 3, 2010 are summarized below (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Total Fair Value
Money market fund deposits (1)	\$ 14,860	\$	\$ 14,860
Certificates of deposit (2)		83,261	83,261
U.S. and international government obligations (3)		131,460	131,460
Corporate notes and obligations (4)		9,171	9,171
Commercial paper (5)		2,999	2,999
Foreign currency contracts (6)		(464)	(464)
Total net assets measured at fair value	\$ 14,860	\$ 226,427	\$ 241,287

(1) Included in cash and cash equivalents on the Condensed Consolidated Balance Sheet.

(2) Includes \$67,528 recorded in cash and cash equivalents and \$15,733 recorded in short-term investments on the Condensed Consolidated Balance Sheet.

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- (3) Includes \$85,170 recorded in cash and cash equivalents and \$46,290 recorded in short-term investments on the Condensed Consolidated Balance Sheet.
- (4) Included in short-term investments on the Condensed Consolidated Balance Sheet.
- (5) Includes \$1,250 in cash and cash equivalents and \$1,749 recorded in short-term investments on the Condensed Consolidated Balance Sheet.
- (6) Includes \$1 recorded in prepaid expenses and other assets and \$465 recorded in other current liabilities on the Condensed Consolidated Balance Sheet.

Financial assets and liabilities measured at fair value as of October 3, 2009 are summarized below (in thousands):

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	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Total Fair Value
Money market fund deposits (1)	\$ 16,481	\$	\$ 16,481
Certificates of deposit (2)		143,886	143,886
U.S. Treasury and agency obligations (3)		47,770	47,770
Corporate notes and obligations (4)		51	51
Commercial paper (5)		8,598	8,598
Foreign currency contracts (6)		(4)	(4)
Total net assets measured at fair value	\$ 16,481	\$ 200,301	\$ 216,782

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- (1) Included in cash and cash equivalents on the Condensed Consolidated Balance Sheet.
- (2) Includes \$141,423 recorded in cash and cash equivalents and \$2,463 recorded in short-term investments on the Condensed Consolidated Balance Sheet.
- (3) Includes \$9,599 recorded in cash and cash equivalents and \$38,171 recorded in short-term investments on the Condensed Consolidated Balance Sheet.
- (4) Included in short-term investments on the Condensed Consolidated Balance Sheet.
- (5) Includes \$5,598 recorded in cash and cash equivalents and \$3,000 recorded in short-term investments on the Condensed Consolidated Balance Sheet.
- (6) Includes \$217 recorded in prepaid expenses and other assets and \$221 recorded in other current liabilities on the Condensed Consolidated Balance Sheet.

5. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

All derivatives, whether designated in hedging relationships or not, are recorded on the condensed consolidated balance sheet at fair value. We enter into foreign exchange forwards to minimize the risks of foreign currency fluctuation of specific assets and liabilities on the balance sheet; these are not designated as hedging instruments.

We maintain operations in various countries outside of the United States and have foreign subsidiaries that manufacture and sell our products in various global markets. The majority of our sales are transacted in U.S. dollars. However, we do generate revenues in other currencies, primarily the Euro and the Japanese Yen. As a result, our earnings and cash flows are exposed to fluctuations in foreign currency exchange rates. We attempt to limit these exposures through financial market instruments. We utilize derivative instruments, primarily forward contracts with maturities of two months or less, to manage our exposure associated with anticipated cash flows and net asset and liability positions denominated in foreign currencies. Gains and losses on the forward contracts are mitigated by gains and losses on the underlying instruments. We do not use derivative financial instruments for speculative or trading purposes. If a financial counterparty to any of our hedging arrangements experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency hedge, we may experience material financial losses.

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For derivative instruments that are not designated as hedging instruments, gains and losses are recognized in other income (expense).

The outstanding U.S. Dollar notional amounts of hedge contracts, with maximum maturity of 2 months, are as follows (in thousands):

	April 3, 2010	October 3, 2009
Foreign currency hedge contracts		
Purchase		
Euro	\$ 22,570	\$ 22,784
Other currencies	2,075	415
Sell	(7,711)	(7,779)
Net	\$ 16,934	\$ 15,420

The fair value of our derivative instruments are included in prepaid expenses and other assets and in other current liabilities in our Condensed Consolidated Balance Sheets; such amounts were not material as of April 3, 2010 and October 3, 2009.

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The amounts of non-designated derivative instruments' gains and losses in the Condensed Consolidated Statements of Operations for the three months and six months ended April 3, 2010 and April 4, 2009 are as follows (in thousands):

	Amount of Gain or (Loss) Recognized in Income on Derivatives			
	Three Months Ended		Six Months Ended	
	April 3, 2010		April 3, 2010	
Derivatives not designated as hedging instruments				
Foreign exchange contracts	\$	(980)	\$	(1,011)

	Amount of Gain or (Loss) Recognized in Income on Derivatives			
	Three Months Ended		Six Months Ended	
	April 4, 2009		April 4, 2009	
Derivatives not designated as hedging instruments				
Foreign exchange contracts	\$	(1,417)	\$	(1,726)

6. SHORT-TERM INVESTMENTS

We consider all highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents. Investments classified as available-for-sale are reported at fair value with unrealized gains and losses, net of related income taxes, recorded as a separate component of other comprehensive income (OCI) in stockholders' equity until realized. Interest and amortization of premiums and discounts for debt securities are included in interest income. Gains and losses on securities sold are determined based on the specific identification method and are included in other income (expense).

Cash, cash equivalents and short-term investments consist of the following (in thousands):

	Cost Basis	April 3, 2010		Fair Value
		Unrealized Gains	Unrealized Losses	
Cash and cash equivalents	\$ 192,167	\$	\$ (1)	\$ 192,166
Short-term investments:				
Available-for-sale securities:				
Commercial paper	\$ 1,749	\$	\$	\$ 1,749
Certificates of deposit	15,732			15,732
U.S. and international government obligations	46,271	24	(4)	46,291
Corporate notes and obligations	9,121	54	(4)	9,171
Total short-term investments	\$ 72,873	\$ 78	\$ (8)	\$ 72,943

October 3, 2009

Cost Basis	Fair Value
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			Unrealized Gains		Unrealized Losses	
Cash and cash equivalents	\$	199,949	\$	1	\$	199,950
Short-term investments:						
Available-for-sale securities:						
Commercial paper	\$	3,000	\$		\$	3,000
Certificates of deposit		2,451		12		2,463
U.S. Treasury and agency obligations		38,152		19		38,171
Corporate notes and obligations		53			(2)	51
Total short-term investments	\$	43,656	\$	31	\$	(2) \$ 43,685

Substantially all of our available-for-sale investments in debt securities as of April 3, 2010 and October 3, 2009 were due in less than one year.

During the three and six months ended April 3, 2010, we received proceeds totaling \$12.6 million and \$21.3 million, respectively, from the sale of available-for-sale securities and realized gross gains of less than \$0.1 million and \$0.1 million, respectively. During the three and six months ended April 4, 2009, we received proceeds totaling \$18.6 million and \$19.7 million, respectively, from the sale of available-for-sale securities and realized gross gains of less than \$0.1 million and \$0.1 million, respectively.

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U.S. Treasury and agency and international government obligations: The unrealized losses on our investments in U.S. Treasury and agency and international government obligations were caused by interest rate increases. Because the Company has the ability and intent to hold those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at April 3, 2010.

Corporate notes and obligations: The unrealized losses on our investments in corporate notes and obligations at April 3, 2010 and October 3, 2009 are attributable to change in interest rates and not credit quality.

7. GOODWILL AND INTANGIBLE ASSETS

During the three months ended December 27, 2008, our stock price declined substantially, which combined with expectations of declines in forecasted operating results due to the slowdown in the global economy, led the Company to conclude that a triggering event for review for potential goodwill impairment had occurred. Accordingly, as of December 27, 2008, we performed an interim goodwill impairment evaluation. Goodwill is tested for impairment first by comparing each reporting unit's fair value to its respective carrying value. If such comparison indicates a potential impairment, then the impairment is determined as the difference between the recorded value of goodwill and its fair value. The performance of this test is a two-step process.

Step 1 of the impairment test involves comparing the fair values of the applicable reporting units with their aggregate carrying values, including goodwill. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, we perform Step 2 of the goodwill impairment test to determine the amount of impairment loss. Step 2 of the goodwill impairment test involves comparing the fair value of the affected reporting unit's goodwill against the carrying value of that goodwill.

The reporting units we evaluated for goodwill impairment have been determined to be the same as our operating segments and include Commercial Lasers and Components (CLC) and Specialty Lasers and Systems (SLS). We determined the fair value of our reporting units for the Step 1 test using a weighting of the Income (discounted cash flow), Market and Transaction approach valuation methodologies. Management completed and reviewed the results of the Step 1 analysis and concluded that a Step 2 analysis was required only for the CLC reporting unit. Our preliminary analysis indicated that the entire balance of the goodwill in the CLC reporting unit at that date was impaired and we recorded a non-cash goodwill impairment charge of \$19.3 million in the first quarter of fiscal 2009. During the three months ended April 4, 2009, we completed the Step 2 analysis for the CLC reporting unit at December 27, 2008 and determined that the entire balance of goodwill in the CLC reporting unit at that date was impaired. The estimated fair value of our SLS reporting unit exceeded its carrying value so no further impairment analysis was required for this reporting unit.

During the six months ended April 3, 2010, we noted no indications of impairment or triggering events to cause us to review goodwill for potential impairment. We will conduct our annual goodwill testing during the fourth fiscal quarter.

The changes in the carrying amount of goodwill by segment for the period from October 3, 2009 to April 3, 2010 are as follows (in thousands):

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	Commercial Lasers and Components		Specialty Lasers and Systems		Total
Balance as of October 3, 2009	\$		\$	66,967	\$ 66,967
Additions		2,580			2,580
Translation adjustments and other		(57)		(3,056)	(3,113)
Balance as of April 3, 2010	\$	2,523	\$	63,911	\$ 66,434

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Components of our amortizable intangible assets are as follows (in thousands):

	April 3, 2010			October 3, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Existing technology	\$ 53,879	\$ (40,791)	\$ 13,088	\$ 54,477	\$ (39,220)	\$ 15,257
Patents	9,739	(8,785)	954	10,440	(8,975)	1,465
Order backlog	5,277	(4,810)	467	5,015	(5,002)	13
Customer lists	8,420	(4,096)	4,324	5,421	(3,763)	1,658
Trade name	3,585	(2,480)	1,105	3,833	(2,488)	1,345
Production know-how	910	(139)	771			
Non-compete agreement	1,597	(1,566)	31	1,590	(1,590)	
Total	\$ 83,407	\$ (62,667)	\$ 20,740	\$ 80,776	\$ (61,038)	\$ 19,738

Amortization expense for intangible assets for the six months ended April 3, 2010 and April 4, 2009 was \$3.9 million and \$3.8 million, respectively. At April 3, 2010, estimated amortization expense for the remainder of fiscal 2010, the next five succeeding fiscal years and all fiscal years thereafter are as follows (in thousands):

	Estimated Amortization Expense
2010 (remainder)	\$ 3,929
2011	6,219
2012	4,246
2013	2,471
2014	1,650
2015	1,252
Thereafter	973
Total	\$ 20,740

8. BALANCE SHEET DETAILS

Inventories consist of the following (in thousands):

	April 3, 2010	October 3, 2009
Purchased parts and assemblies	\$ 32,870	\$ 30,945
Work-in-process	33,488	30,680
Finished goods	32,786	36,142
Inventories	\$ 99,144	\$ 97,767

Prepaid expenses and other assets consist of the following (in thousands):

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	April 3, 2010		October 3, 2009
Prepaid and refundable income taxes	\$	22,798	\$ 22,041
Prepaid expenses and other		29,910	16,928
Total prepaid expenses and other assets	\$	52,708	\$ 38,969

Other assets consist of the following (in thousands):

	April 3, 2010		October 3, 2009
Assets related to deferred compensation arrangements	\$	21,690	\$ 21,629
Deferred tax assets		61,171	60,819
Other assets		2,828	2,889
Total other assets	\$	85,689	\$ 85,337

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Other current liabilities consist of the following (in thousands):

	April 3, 2010	October 3, 2009
Accrued payroll and benefits	\$ 25,945	\$ 19,967
Deferred income	13,509	14,424
Reserve for warranty	10,316	10,211
Accrued expenses and other	11,110	9,918
Other taxes payable	16,964	4,361
Accrued restructuring charges	2,686	1,652
Customer deposits	4,442	2,208
Total other current liabilities	\$ 84,972	\$ 62,741

On April 16, 2008, we announced that we entered into an agreement to sell certain assets of our Auburn Optics (Auburn) manufacturing operation to Research Electro-Optics, Inc. (REO), a privately held optics manufacturing and technology company. We also entered into a strategic supply agreement with REO. REO is providing optical manufacturing capabilities for us, including fabrication and coating of optical components. The transition of the optics manufacturing assets from Auburn to REO was completed in fiscal 2009. The transition has resulted in charges primarily for employee terminations, supplier qualification, moving costs for related equipment, and other exit related costs associated with a plan approved by management.

During fiscal 2008, we consolidated our German DPSS manufacturing into our Lübeck, Germany site. The transfer was completed in the fourth quarter of fiscal 2008. On October 13, 2008, we announced the consolidation of the remainder of our Munich facility into our Göttingen site. The transfer was completed in our third quarter of fiscal 2009. The consolidation and transfers have resulted in charges primarily for employee terminations, other exit related costs associated with a plan approved by management and a grant repayment liability.

During the second quarter of fiscal 2009, we announced our plans to close our facilities in Tampere, Finland and St. Louis, Missouri. The closure of St. Louis site was completed in the fourth quarter of fiscal 2009. The closure of our Finland site is scheduled for completion by the end of fiscal 2010, but we may decide to delay the closure by one quarter due to a significant increase in demand for products manufactured in Finland. These closure plans have resulted in charges primarily for employee termination and other exit related costs associated with a plan approved by management.

Restructuring charges in the first three and six months of fiscal 2010 and 2009 are recorded in cost of sales, research and development and selling, general and administrative expenses in our condensed consolidated statements of operations.

The following table presents our current liability as accrued on our balance sheet for restructuring charges. The table sets forth an analysis of the components of the restructuring charges and payments and other deductions made against the accrual for the first six months of fiscal 2010 and 2009 (in thousands):

Severance Related	Facilities- related Charges	Other Restructuring Costs	Total
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Balance at September 27, 2008	\$	2,581	\$	19	\$	987	\$	3,587
Provisions		5,862		950		2,275		9,087
Payments and other		(5,668)		(607)		(2,645)		(8,920)
Balance at April 4, 2009	\$	2,775	\$	362	\$	617	\$	3,754
Balance at October 3, 2009	\$	488	\$	357	\$	807	\$	1,652
Provisions		964		17		1,492		2,473
Payments and other		(191)		(268)		(980)		(1,439)
Balance at April 3, 2010	\$	1,261	\$	106	\$	1,319	\$	2,686

The current year severance related costs are primarily comprised of severance pay, outplacement services, medical and other related benefits for employees being terminated due to the transition of activities out of Montreal, Canada, and Tampere, Finland. The remaining severance related restructuring accrual balance of approximately \$1.3 million at April 3, 2010 is expected to result in cash expenditures through the fourth quarter of fiscal 2010 or the first quarter of fiscal 2011, if the closure of the Finland facility is extended until the first quarter of fiscal 2011. The other restructuring costs are primarily for a grant repayment liability and other exit related costs associated with a plan approved by management.

We provide warranties on certain of our product sales and allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires us to make estimates of product return rates and expected costs to repair or replace the products under warranty. We currently establish warranty reserves based on historical warranty costs for each product line. The weighted average period covered is approximately 15 months. If actual return rates and/or repair and replacement costs differ significantly from our estimates, adjustments to cost of sales may be required in future periods.

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Components of the reserve for warranty costs during the first six months of fiscal 2010 and 2009 were as follows (in thousands):

	Six Months Ended	
	April 3, 2010	April 4, 2009
Beginning balance	\$ 10,211	\$ 13,214
Additions related to current period sales	6,765	6,178
Warranty costs incurred in the current period	(6,547)	(7,222)
Accruals resulting from acquisition	160	
Adjustments to accruals related to prior period sales	(273)	(532)
Ending balance	\$ 10,316	\$ 11,638

Other long-term liabilities consist of the following (in thousands):

	April 3, 2010	October 3, 2009
Long-term taxes payable	\$ 51,331	\$ 51,483
Deferred compensation	21,732	22,723
Deferred tax liabilities	7,394	9,651
Deferred income	1,886	2,109
Asset retirement obligations liability	1,299	1,342
Other long-term liabilities	4,383	4,377
Total other long-term liabilities	\$ 88,025	\$ 91,685

9. SHORT-TERM BORROWINGS

We have several lines of credit which allow us to borrow in the applicable local currency. We have a total of \$16.1 million of foreign lines of credit as of April 3, 2010. At April 3, 2010, we had used \$2.6 million of these available foreign lines of credit. These credit facilities were used in Europe during the second fiscal quarter of 2010 as guarantees. In addition, our domestic line of credit, which was opened on March 31, 2008, includes a \$40 million unsecured revolving credit account with Union Bank of California. The recently amended agreement will expire on March 31, 2012 and is subject to covenants related to financial ratios and tangible net worth with which we are currently in compliance. No amounts have been drawn upon our domestic line of credit as of April 3, 2010.

10. STOCK-BASED COMPENSATION**Fair Value of Stock Compensation**

We recognize compensation expense for all share based payment awards based on the fair value of such awards. The expense is recognized on a straight-line basis over the respective requisite service period of the awards.

Determining Fair Value

The fair values of our stock options granted to employees and shares purchased under the Employee Stock Purchase Plan (ESPP) for the three and six months ended April 3, 2010 and April 4, 2009 were estimated using the following weighted-average assumptions:

	Employee Stock Option Plans				Employee Stock Purchase Plan			
	Three Months Ended		Six Months Ended		Three Months Ended		Six Months Ended	
	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009
Expected life in years	5.8	5.6	4.6	4.2	0.5	0.5	0.5	0.5
Expected volatility	33.0%	48.0%	33.0%	48.0%	29.9%	44.1%	35.9%	40.5%
Risk-free interest rate	3.0%	2.1%	2.02%	1.95%	0.2%	1.1%	0.2%	1.3%
Expected dividends								
Weighted average fair value per share	\$ 11.80	\$ 7.27	\$ 8.25	\$ 8.92	\$ 5.88	\$ 6.95	\$ 5.91	\$ 7.06

Table of Contents**Stock Compensation Expense**

The following table shows total stock-based compensation expense and related tax benefits included in the Condensed Consolidated Statements of Operations for the three and six months ended April 3, 2010 and April 4, 2009 (in thousands):

	Three Months Ended		Six Months Ended	
	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009
Cost of sales	256	\$ 177	\$ 475	\$ 461
Research and development	280	239	553	434
Selling, general and administrative	1,514	2,009	3,184	3,220
Income tax benefit	(177)	(453)	(820)	(990)
	\$ 1,873	\$ 1,972	\$ 3,392	\$ 3,125

During the three and six months ended April 3, 2010, \$0.2 million and \$0.4 million was capitalized into inventory for all stock plans, \$0.3 million and \$0.5 million was amortized to cost of sales and \$0.3 million remained in inventory at April 3, 2010. During the three and six months ended April 4, 2009, \$0.3 million and \$0.5 million, respectively, for all stock plans was capitalized into inventory, \$0.2 million and \$0.5 million, respectively, was amortized to cost of sales and \$0.3 million remained in inventory at April 4, 2009. Management has made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

At April 3, 2010, the total compensation cost related to unvested stock-based awards granted to employees under the Company's stock option plans but not yet recognized was approximately \$13.4 million, net of estimated forfeitures of \$1.8 million. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 1.6 years and will be adjusted for subsequent changes in estimated forfeitures.

At April 3, 2010, total compensation cost related to options to purchase common shares under the ESPP but not yet vested was approximately \$0.1 million, which will be recognized over the offering period.

The cash flows resulting from excess tax benefits (tax benefits related to the excess of tax deduction resulting from an employee's exercises of stock options over the stock-based compensation cost recognized for those options) are classified as financing cash flows. During the first six months of fiscal 2010 and fiscal 2009, we recorded an immaterial amount of excess tax benefits as cash flows from financing activities.

Stock Options & Awards Activity

The following is a summary of option activity for our Stock Plans (in thousands, except per share amounts and remaining contractual term in years):

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	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at October 4, 2009	2,494	\$ 29.44		
Granted	473	26.53		
Exercised	(446)	25.91		
Forfeitures	(22)	24.46		
Expirations	(27)	33.50		
Outstanding at April 3, 2010	2,472	\$ 29.52	4.0	\$ 7,985
Vested and expected to vest at April 3, 2010	2,413	\$ 29.63	3.9	\$ 7,586
Exercisable at April 3, 2010	1,674	\$ 31.71	2.9	\$ 2,347

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying options and the quoted price of our common stock at the end of the reporting period. There were approximately 1.1 million outstanding options that were in-the-money as of April 3, 2010. The aggregate intrinsic value of options exercised under the Company's stock plans was \$2.0 million and \$2.1 million for the three and six months ended April 3, 2010, respectively. There were no options exercised during the three months ended April 4, 2009. The aggregate intrinsic value of options exercised was less than \$0.1 million for the six months ended April 4, 2009.

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The following table summarizes our restricted stock award and restricted stock unit activity for the first six months of fiscal 2010 (in thousands, except per share amounts):

	Number of Shares	Weighted Average Grant Date Fair Value per Share
Nonvested stock at October 3, 2009	357	\$ 25.66
Granted	234	25.04
Vested	(101)	25.86
Forfeited	(8)	21.57
Nonvested stock at April 3, 2010	482	\$ 25.38

11. COMMITMENTS AND CONTINGENCIES

We are subject to legal claims and litigation arising in the ordinary course of business, such as product liability, employment or intellectual property claims, including, but not limited to, the matters described below. The outcome of any such matters is currently not determinable. Although we do not expect that such legal claims and litigation will ultimately have a material adverse effect on our consolidated financial position or results of operations, an adverse result in one or more matters could negatively affect our results in the period in which they occur.

Derivative Lawsuit Between February 15, 2007 and March 2, 2007, three purported shareholder derivative lawsuits were filed in the United States District Court for the Northern District of California against certain of the Company's current and former officers and directors. The Company was named as a nominal defendant. The complaints generally alleged that the defendants breached their fiduciary duties and violated the securities laws in connection with the granting of stock options, the accounting treatment for such grants, the issuance of allegedly misleading public statements and stock sales by certain of the individual defendants. On May 30, 2007, these lawsuits were consolidated under the caption *In re Coherent, Inc. Shareholder Derivative Litigation*, Lead Case No. C-07-0955-JF (N.D. Cal.). On June 25, 2007, plaintiffs filed an amended consolidated complaint. The Company's Board of Directors appointed a Special Litigation Committee (SLC) comprised of independent director Sandeep Vij to investigate and evaluate the claims asserted in the derivative litigation and to determine what action(s) should be taken with respect to the derivative litigation. On September 8, 2009, Coherent, Inc., by and through the SLC, plaintiffs, and certain of Coherent's former and current officers and directors filed with the court a Stipulation of Settlement reflecting the terms of a settlement that would resolve all claims alleged in the consolidated complaint.

On September 14, 2009, the United States District Court for the Northern District of California issued an order granting preliminary approval of the settlement of the three purported shareholder derivative lawsuits. On November 20, 2009, the court held a hearing for final approval of the settlement, and on November 24, 2009, the court entered an Order and Final Judgment, which approved the settlement and dismissed the action with prejudice. Following receipt of insurance proceeds and the payment of the plaintiff attorneys' fees and expenses, we received a net cash benefit of \$2.2 million from the settlement on December 11, 2009, which has been recorded in selling general and administrative expenses in the Condensed Consolidated Statement of Operations for the first quarter of fiscal 2010.

Income Tax Audits The Internal Revenue Service (IRS) has concluded the audits of our 2003 and 2004 U.S. federal tax returns. We had previously agreed to various adjustments proposed by the IRS in its Notices of Proposed Adjustments (NOPAs) to these returns and there were no additional adjustments prior to concluding the audits. The IRS has indicated that it may consider an audit of our 2005 and 2006 tax returns. The IRS is also auditing the research and development credits generated in the years 1999 through 2001 and carried forward to future tax years.

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We received a NOPA from the IRS in October 2008 to decrease the amount of research and development credits generated in years 2000 and 2001. We responded to this NOPA and we are disputing the adjustment with the IRS through the appeals process available to us. While we believe that we have adequately provided for any adjustments that may be proposed by the IRS related to these credits, there exists the possibility of a material adverse impact on our results of operations in the event that this issue is resolved unfavorably to us.

The German tax authorities are conducting an audit of our subsidiary in Göttingen for the tax years 1999 through 2005. We believe that we have adequately provided for any adjustments that may be proposed by the German tax authorities.

Table of Contents**12. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

The components of comprehensive loss, net of income taxes, are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009
Net income (loss)	\$ 8,480	\$ (9,130)	\$ 12,659	\$ (23,809)
Other comprehensive loss:				
Translation adjustment	(17,058)	(10,437)	(20,283)	(20,598)
Net gain on derivative instruments, net of taxes	3	2	4	4
Changes in unrealized gains (losses) on available-for-sale securities, net of taxes	(15)		(7)	7
Other comprehensive loss, net of tax	(17,070)	(10,435)	(20,286)	(20,587)
Comprehensive loss	\$ (8,590)	\$ (19,565)	\$ (7,627)	\$ (44,396)

The following summarizes activity in accumulated other comprehensive loss related to derivatives, net of income taxes, held by us (in thousands):

Balance, September 27, 2008	\$ (93)
Changes in fair value of derivatives	
Net losses reclassified from OCI	4
Balance, April 4, 2009	\$ (89)
Balance, October 3, 2009	\$ (85)
Changes in fair value of derivatives	
Net losses reclassified from OCI	5
Balance, April 3, 2010	\$ (80)

Accumulated other comprehensive income (net of tax) at April 3, 2010 is comprised of accumulated translation adjustments of \$60.1 million and a net loss on derivative instruments of \$0.1 million. Accumulated other comprehensive income (net of tax) at October 3, 2009 is comprised of accumulated translation adjustments of \$80.3 million and net loss on derivative instruments of \$0.1 million.

13. EARNINGS PER SHARE

Basic earnings per share is computed based on the weighted average number of shares outstanding during the period, excluding unvested restricted stock. Diluted earnings per share is computed based on the weighted average number of shares outstanding during the period increased by the effect of dilutive employee stock awards, including stock options, restricted stock awards and stock purchase plan contracts, using the treasury stock method.

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The following table presents information necessary to calculate basic and diluted earnings (loss) per share (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009
Weighted average shares outstanding basic (1)	24,704	24,258	24,587	24,202
Dilutive effect of employee stock awards	292		250	
Weighted average shares outstanding diluted	24,996	24,258	24,837	24,202
Net income (loss)	\$ 8,480	\$ (9,130)	\$ 12,659	\$ (23,809)
Net income (loss) per basic share	\$ 0.34	\$ (0.38)	\$ 0.51	\$ (0.98)
Net income (loss) per diluted share	\$ 0.34	\$ (0.38)	\$ 0.51	\$ (0.98)

(1) Net of restricted stock

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A total of 1,796,257 and 1,751,554 potentially dilutive securities have been excluded from the dilutive share calculation for the three and six months ended April 3, 2010, respectively, as their effect was anti-dilutive. As the Company incurred a net loss for the second quarter and first six months of fiscal 2009, all potentially dilutive securities from stock options, employee stock purchase plan and restricted stock awards have been excluded from the diluted net loss per share computation as their effects were deemed anti-dilutive.

14. OTHER INCOME (EXPENSE)

Other income (expense) is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009
Interest and dividend income	\$ 1,290	\$ 689	\$ 1,438	\$ 2,133
Interest expense	(23)	(32)	(70)	(109)
Foreign exchange gain (loss)	81	(1,806)	(276)	(1,304)
Gain (loss) on investments, net	97	(1,222)	1,160	(8,020)
Other net	47	771	32	1,470
Other income (expense), net	\$ 1,492	\$ (1,600)	\$ 2,284	\$ (5,830)

15. INCOME TAXES

Income tax expense includes a provision for federal, state and foreign taxes based on the annual estimated effective tax rate applicable to us and our subsidiaries, adjusted for items which are considered discreet to the period. Our estimated effective tax rate for the three months and six months ended April 3, 2010 was 41.5% and 39.6%, respectively. Our effective tax rates for the three months and six months ended April 3, 2010 were both higher than the statutory rate of 35% primarily due to permanent differences related to deemed dividend inclusions under the Subpart F tax rules and adjustments related to remitted foreign earnings. These amounts are partially offset by the benefit of foreign tax credits, income subject to foreign tax rates that are lower than U.S. tax rates, an unrealized gain on life insurance policy investments related to our deferred compensation plan and research and development credits.

Determining the consolidated provision for income taxes, income tax liabilities and deferred tax assets and liabilities involves judgment. We calculate and provide for income taxes in each of the tax jurisdictions in which we operate, which involves estimating current tax exposures as well as making judgments regarding the recoverability of deferred tax assets in each jurisdiction. The estimates used could differ from actual results, which may have a significant impact on operating results in future periods.

As of April 3, 2010, the total amount of gross unrecognized tax benefits was \$57.6 million, of which \$31.7 million, if recognized, would affect our effective tax rate. Our total gross unrecognized tax benefits were classified as other long-term liabilities in the condensed consolidated balance sheets.

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Our policy is to include interest and penalties related to unrecognized tax benefits within the provision for income taxes. As of April 3, 2010, the total amount of gross interest and penalties accrued was \$8.3 million, which is classified as other long-term liabilities in the condensed consolidated balance sheets.

We are subject to taxation and file income tax returns in the U.S. federal jurisdiction and in many state and foreign jurisdictions. For U.S. federal income tax purposes, all years prior to 1999 are closed. The IRS has concluded the audits of our 2003 and 2004 U.S. federal tax returns with no additional adjustments other than those previously agreed to within NOPAs associated with those returns. The statute remains open for these years as there are attributes being carried forward from these years to future years. The IRS is auditing the research and development credits generated in the years 1999 through 2001 and carried forward to future years. We responded to a NOPA issued by the IRS in October 2008 to decrease the amount of research and development credits generated in 2000 and 2001 and we are disputing the proposed adjustment with the IRS through the appeals process available to us. The IRS has also indicated that it may consider an audit of our 2005 and 2006 tax returns. In our major state jurisdiction and our major foreign jurisdiction, the years subsequent to 1998 remain open and could be subject to examination by the taxing authorities.

Management believes that it has adequately provided for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in our tax audits be resolved in a manner not consistent with management's expectations, we could be required to adjust our provision for income tax in the period such resolution occurs. Although timing of the resolution and/or closure of audits is highly uncertain, we do not believe it is reasonably possible that our unrecognized tax benefits would materially change. Within the next 12 months, we anticipate a lapse in the statute of limitations which could result in a release of interest expense accrued under ASC 740, Income Taxes. This amount is not considered significant.

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The Worker, Homeownership and Business Assistance Act of 2009 was enacted on November 6, 2009. Under the Act, businesses with net operating losses for 2008 and 2009 may carry back those losses for up to five years. The Company intends to carry back losses incurred in fiscal 2009 in accordance with this new legislation and this tax law change has minimal financial statement impact.

Deferred Income Taxes

As of April 3, 2010, our condensed consolidated balance sheet included net deferred tax assets, before valuation allowance, of approximately \$78.4 million, which consists of tax credit carryovers, deferred gain on subsidiary stock issuance, accruals and reserves, competent authority offset to transfer pricing tax reserve, employee stock-based compensation expenses, depreciation and amortization, and certain other liabilities. Management periodically evaluates the realizability of our net deferred tax assets based on all available evidence, both positive and negative. The realization of net deferred tax assets is solely dependent on our ability to generate sufficient future taxable income in the applicable jurisdictions during periods prior to the expiration of tax statutes to fully utilize these assets. After evaluating all available evidence, we have determined that it is more likely than not that a portion of the deferred tax assets would not be realized and we have a total valuation allowance of \$6.9 million reported as of April 3, 2010. We intend to maintain the valuation allowance until sufficient positive evidence exists to support reversal of the valuation allowance.

16. SEGMENT INFORMATION

We are organized into two reportable operating segments: Commercial Lasers and Components (CLC) and Specialty Lasers and Systems (SLS). This segmentation reflects the go-to-market strategies for various products and markets. While both segments work to deliver cost-effective solutions, CLC focuses on higher volume products that are offered in set configurations. The product architectures are designed for easy exchange at the point of use such that product service and repairs are generally based upon advanced replacement and depot (i.e., factory) repair. CLC's primary markets include OEM components and instrumentation and materials processing. SLS develops and manufactures configurable, advanced-performance products largely serving the microelectronics and scientific research markets. The size and complexity of many of the SLS products generally require service to be performed at the customer site by factory-trained field service engineers.

We have identified CLC and SLS as operating segments for which discrete financial information is available. Both units have engineering, marketing, product business management and product line management. A small portion of our outside revenue is attributable to projects and recently developed products for which a segment has not yet been determined. The associated direct and indirect costs are presented in the category of Corporate and other, along with other corporate costs as described below.

Our Chief Executive Officer has been identified as the chief operating decision maker (CODM) as he assesses the performance of the segments and decides how to allocate resources to the segments. Income (loss) from operations is the measure of profit and loss that our CODM uses to assess performance and make decisions. Assets by segment are not a measure used to assess the performance of the company by the CODM; therefore we do not report assets by segment internally or in our disclosures. Income (loss) from operations represents the net sales less the cost of sales and direct operating expenses incurred within the operating segments as well as allocated expenses such as shared sales and manufacturing costs. We do not allocate to our operating segments certain operating expenses which we manage separately at the corporate level. These unallocated costs include stock-based compensation and corporate functions (certain research and development, management, finance, legal and human resources) and are included in the results below under Corporate and other in the reconciliation of operating results. Management does not consider unallocated Corporate and other costs in its measurement of segment performance.

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The following table provides net sales and income (loss) from operations for our operating segments (in thousands):

	Three Months Ended		Six Months Ended	
	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009
Net sales:				
Commercial Lasers and Components	\$ 51,514	\$ 30,828	\$ 88,595	\$ 68,208
Specialty Laser Systems	97,618	74,569	183,327	161,552
Corporate and other	25	25	50	50
Total net sales	\$ 149,157	\$ 105,422	\$ 271,972	\$ 229,810
Income (loss) from operations:				
Commercial Lasers and Components	\$ 2,161	\$ (7,508)	\$ (3,299)	\$ (31,276)
Specialty Laser Systems	18,881	7,891	36,667	21,624
Corporate and other	(8,037)	(6,242)	(14,681)	(5,453)
Total income (loss) from operations	\$ 13,005	\$ (5,859)	\$ 18,687	\$ (15,105)

17. SUBSEQUENT EVENTS

On April 29, 2010, we announced that our Board of Directors has authorized the Company to repurchase up to \$50 million of our common stock under a stock repurchase program. The timing and size of any purchases will be subject to market conditions.

On April 30, 2010, we acquired Beam Dynamics for \$6.25 million, excluding transaction fees. The acquisition enhances our application knowledge and development capabilities and provides a pathway to expand our presence in the market for precision laser processing workstations.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**COMPANY OVERVIEW****BUSINESS BACKGROUND**

We are one of the world's leading suppliers of photonics based solutions in a broad range of commercial and scientific research applications. We design, manufacture, service and market lasers and related accessories for a diverse group of customers. Since inception in 1966, we have grown through internal expansion and through strategic acquisitions of complementary businesses, technologies, intellectual property, manufacturing processes and product offerings.

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We are organized into two operating segments: Commercial Lasers and Components (CLC) and Specialty Lasers and Systems (SLS). This segmentation reflects the go-to-market strategies for various products and markets. While both segments deliver cost-effective photonics solutions, CLC focuses on higher volume products that are offered in set configurations. The product architectures are designed for easy exchange at the point of use such that substantially all product service and repairs are based upon advanced replacement and depot (i.e., factory) repair. CLC's primary markets include materials processing and original equipment manufacturer (OEM) components and instrumentation. SLS develops and manufactures configurable, advanced performance products largely serving the microelectronics, OEM components and instrumentation and scientific research and government programs markets. The size and complexity of many of the SLS products require service to be performed at the customer site by factory trained field service engineers.

Income (loss) from operations is the measure of profit and loss that our chief operating decision maker (CODM) uses to assess performance and make decisions. Income (loss) from operations represents the sales less the cost of sales and direct operating expenses incurred within the operating segments as well as allocated expenses such as shared sales and manufacturing costs. We do not allocate to our operating segments certain operating expenses, which we manage separately at the corporate level. These unallocated costs include stock-based compensation and corporate functions (certain advanced research and development, management, finance, legal and human resources) and are included in Corporate and other. Management does not consider unallocated Corporate and other costs in its measurement of segment performance.

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MARKET APPLICATIONS

Our products address a broad range of applications that we group into the following markets: Microelectronics, Scientific Research and Government Programs, OEM Components and Instrumentation and Materials Processing.

OUR STRATEGY

We strive to develop innovative and proprietary products and solutions that meet the needs of our customers and that are based on our core expertise in lasers and optical technologies. In pursuit of our strategy, we intend to:

- **Leverage our technology portfolio and application engineering to lead the proliferation of photonics into broader markets** We will continue to identify opportunities in which our technology portfolio and application engineering can be used to offer innovative solutions and gain access to new markets. We plan to utilize our expertise to expand into new markets, such as laser based processing development tools for solar manufacturing and high power materials processing solutions.
- **Optimize our leadership position in existing markets** There are a number of markets where we have historically been at the forefront of technological development and product deployment and from which we have derived a substantial portion of our revenues. We plan to optimize our financial returns from these markets.
- **Maintain and develop additional strong collaborative customer and industry relationships** We believe that the Coherent brand name and reputation for product quality, technical performance and customer satisfaction will help us to further develop our loyal customer base. We plan to maintain our current customer relationships and develop new ones with customers who are industry leaders and work together with these customers to design and develop innovative product systems and solutions as they develop new technologies.
- **Develop and acquire new technologies and market share** We will continue to enhance our market position through our existing technologies and develop new technologies through our internal research and development efforts, as well as through the acquisition of additional complementary technologies, intellectual property, manufacturing processes and product offerings.
- **Streamline our manufacturing structure and improve our cost structure** We will focus on optimizing the mix of products that we manufacture internally and externally. We will utilize vertical integration where our internal manufacturing process is considered proprietary and seek to leverage external sources when the capabilities and cost structure are well developed and on a path towards commoditization.

- **Focus on long-term improvement of adjusted EBITDA expressed as a percentage of net sales** We define adjusted EBITDA as earnings before interest, taxes, depreciation, amortization, stock compensation expenses and certain other non-operating income and expense items. Key initiatives to reach our goals for EBITDA improvements include our program of consolidating manufacturing locations, rationalizing our supply chain and selective outsourcing of certain manufacturing operations.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the SEC. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We have identified the following as the items that require the most significant judgment and often involve complex estimation: revenue recognition, accounting for long-lived assets (including goodwill and intangible assets), inventory valuation, warranty reserves, stock-based compensation and accounting for income taxes.

Revenue Recognition

We recognize revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists, the product has been delivered or the service has been rendered, the price is fixed or determinable and collection is probable. Revenue from product sales is recorded when all of the foregoing conditions are met and risk of loss and title passes to the customer. Our products typically include a warranty and the estimated cost of product warranty claims (based on historical experience) is recorded at the time the sale is recognized. Sales to customers are generally not subject to any price protection or return rights.

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The vast majority of our sales are made to OEMs, distributors, resellers and end-users in the non-scientific market. Sales made to these customers do not require installation of the products by us and are not subject to other post-delivery obligations, except in occasional instances where we have agreed to perform installation or provide training. In those instances, we defer revenue related to installation services or training until these services have been rendered. We allocate revenue from multiple element arrangements to the various elements based upon relative fair values.

Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected. Failure to obtain anticipated orders due to delays or cancellations of orders could have a material adverse effect on our revenue. In addition, pressures from customers to reduce our prices or to modify our existing sales terms may have a material adverse effect on our revenue in future periods.

Our sales to distributors, resellers and end-user customers typically do not have customer acceptance provisions and only certain of our sales to OEM customers have customer acceptance provisions. Customer acceptance is generally limited to performance under our published product specifications. For the few product sales that have customer acceptance provisions because of higher than published specifications, (1) the products are tested and accepted by the customer at our site or by the customer's acceptance of the results of our testing program prior to shipment to the customer, or (2) the revenue is deferred until customer acceptance occurs.

Sales to end-users in the scientific market typically require installation and, thus, involve post-delivery obligations; however our post-delivery installation obligations are not essential to the functionality of our products. We defer revenue related to installation services until completion of these services.

For most products, training is not provided; therefore, no post-delivery training obligation exists. However, when training is provided to our customers, it is typically priced separately and recognized as revenue after these services have been provided.

Long-Lived Assets and Goodwill

We evaluate long-lived assets and amortizable intangible assets whenever events or changes in business circumstances or our planned use of assets indicate that their carrying amounts may not be fully recoverable or that their useful lives are no longer appropriate. Reviews are performed to determine whether the carrying values of assets are impaired based on comparison to the undiscounted expected future cash flows identifiable to such long-lived and amortizable intangible assets. If the comparison indicates that impairment exists, the impaired asset is written down to its fair value.

We have determined that our reporting units are the same as our operating segments as each constitutes a business for which discrete financial information is available and for which segment management regularly reviews the operating results. We make this determination in a manner consistent with how the operating segments are managed. Based on this analysis, we have identified two reporting units which are our reportable segments: CLC and SLS.

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Goodwill is tested for impairment on an annual basis and between annual tests in certain circumstances, and written down when impaired (see Note 7 in the Notes to Condensed Consolidated Financial Statements). We perform our annual impairment tests at the beginning of the fourth quarter of each fiscal year using the opening balance sheet as of the first day of the fourth quarter, with any resulting impairment recorded in the fourth quarter of the fiscal year.

During the first quarter of fiscal 2009, our stock price declined substantially which, combined with expectations of declines in forecasted operating results due to the slowdown in the global economy, led the Company to conclude that a triggering event for review for potential goodwill impairment had occurred. Accordingly, as of December 27, 2008, we performed an interim goodwill impairment evaluation. Goodwill is tested for impairment by comparing the respective fair value with the respective carrying value of the reporting unit. If such comparison indicates a potential impairment, then the impairment is determined as the difference between the recorded value of goodwill and its fair value. The performance of this test is a two-step process.

Step 1 of the impairment test involves comparing the fair values of the applicable reporting units with their aggregate carrying values, including goodwill. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, we perform Step 2 of the goodwill impairment test to determine the amount of impairment loss. Step 2 of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit's goodwill against the carrying value of that goodwill.

We rely on the following three valuation approaches to determine the fair value of both of our reporting units. (1) The Income approach utilizes the discounted cash flow model to provide an estimation of fair value based on the cash flows that a business expects to generate. These cash flows are based on forecasts developed internally by management which are then discounted at an after tax rate of return required by equity and debt market participants of a business enterprise. This rate of return or cost of capital is weighted based on the capitalization of comparable companies. (2) The Market approach determines fair value by comparing the reporting units

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to comparable companies in similar lines of business that are publicly traded. Total Enterprise Value (TEV) multiples such as TEV to revenues and TEV to earnings (if applicable) before interest and taxes of the publicly traded companies are calculated. These multiples are then applied to the reporting unit's operating results to obtain an estimate of fair value. (3) The Transaction approach estimates the fair value of the reporting unit based on market prices in actual transactions. A comparison is done between the reporting units and other similar businesses. TEV multiples for revenue and earnings as noted in the Market approach above are calculated from the comparable companies and then applied to the reporting unit's operating results to obtain an estimate of fair value. Each of these three approaches captures aspects of value in each reporting unit. The Income approach captures our expected future performance, the Market approach captures how investors view the reporting units through other competitors; and, the Transaction approach captures value through transactions for sales of similar types of companies. We believe these valuation approaches are proven valuation techniques and methodologies for our industry and are widely accepted by investors.

We weighted each of these approaches equally as none are perceived by us to deliver any greater indication of value than the other. The sensitivity analysis performed by management determined that by changing the weighting placed on the three approaches, the result of the Step 1 test for both reporting units was not affected.

The valuation analysis requires significant judgments and estimates to be made by management in particular related to the forecast. The assumed growth rates and gross margins as well as period expenses were determined based on internally developed forecasts considering our future plans. The assumptions used were management's best estimates based on projected results and market conditions as of the date of testing. In order to test the sensitivity of these fair values, management further reviewed other scenarios relative to these assumptions to see if the resulting impact on fair values would have resulted in a different Step 1 conclusion for the CLC and SLS reporting units.

Based on these forecast scenarios, the fair value of both reporting units was re-calculated. In addition, this sensitivity analysis applied more conservative assumptions with regard to control premiums as well as multipliers used in the Market approach and the Transaction approach. In each of the sensitivity analyses performed, the CLC reporting unit failed and the SLS reporting unit passed. None of the outcomes of the sensitivity analyses performed would have impacted our Step 1 conclusions or the non-cash impairment charge for goodwill of \$19.3 million recorded in the first quarter of fiscal 2009.

Sensitivity was also applied to the discount rate used in the Income approach for both the CLC and SLS reporting units. At December 27, 2008, the discount rate for the CLC reporting unit could have been reduced by more than 40% and still resulted in a failure. For the SLS reporting unit, the discount rate could have been increased by more than 40% and still resulted in no impairment.

During the second quarter of fiscal 2009, our expectations of declines in forecasted operating results due to the slowdown in the global economy and the further declines in our stock price led us to conclude that a triggering event for review for potential goodwill impairment had occurred. Accordingly, as of April 4, 2009, we performed an interim goodwill impairment evaluation. This interim impairment evaluation utilized the same valuation techniques used in our impairment valuation in the first quarter of fiscal 2009. A similar sensitivity analysis was also done at April 4, 2009 where we determined that the discount rate used in the Income approach for the SLS reporting unit could have been increased by approximately 20% and still resulted in no impairment. Based on the results of our Step 1 analysis, we determined that no additional goodwill impairment was indicated.

During the six months ended April 3, 2010, we noted no indications of impairment or triggering events to cause us to review goodwill for potential impairment.

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At April 3, 2010, we had \$66.4 million of goodwill, \$95.0 million of property and equipment and \$20.7 million of purchased intangible assets on our condensed consolidated balance sheet.

It is reasonably possible that the estimates of anticipated future net revenue, the remaining estimated economic life of the products and technologies, or both, could differ from those used to assess the recoverability of these assets. In addition, if the price of our common stock were to significantly decrease combined with any other adverse change in market conditions, thus indicating that the underlying fair value of our reporting units or other long-lived assets may have decreased, we may be required to assess the recoverability of such assets in the period such circumstances are identified. In that event, additional impairment charges or shortened useful lives of certain long-lived assets may be required.

Inventory Valuation

We record our inventory at the lower of cost (computed on a first-in, first-out basis) or market. We write-down our inventory to its estimated market value based on assumptions about future demand and market conditions. Inventory write-downs are generally recorded within guidelines set by management when the inventory for a device exceeds 12 months of its demand and when individual parts have been in inventory for greater than 12 months. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required which could materially affect our future results of operations. Due to

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rapidly changing forecasts and orders, additional write-downs for excess or obsolete inventory, while not currently expected, could be required in the future. In the event that alternative future uses of fully written down inventories are identified, we may experience better than normal profit margins when such inventory is sold. Differences between actual results and previous estimates of excess and obsolete inventory could materially affect our future results of operations. We write-down our demonstration inventory by amortizing the cost of demonstration inventory over a twenty month period starting from the fourth month after such inventory is placed in service.

Warranty Reserves

We provide warranties on certain of our product sales and allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires us to make estimates of product return rates and expected costs to repair or replace the products under warranty. We currently establish warranty reserves based on historical warranty costs for each product line. The weighted average warranty period covered is approximately 15 months. If actual return rates and/or repair and replacement costs differ significantly from our estimates, adjustments to cost of sales may be required in future periods.

Stock-Based Compensation

We account for stock-based compensation using the fair value of the awards granted. We estimate the fair value of stock options granted using the Black Scholes Merton model. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. We amortize the fair value of stock options on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. We value restricted stock units using the intrinsic value method. We amortize the value of restricted stock units on a straight-line basis over the restriction period. See Note 10 Stock-Based Compensation for a description of our stock-based employee compensation plans and the assumptions we use to calculate the fair value of stock-based employee compensation.

Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income tax provision (benefit) in each of the jurisdictions in which we operate. This process involves estimating our current income tax provision (benefit) together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets.

We record a valuation allowance to reduce our deferred tax assets to an amount that more likely than not will be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the allowance for the deferred tax assets would increase income in the period such determination was made. Likewise, should we determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the valuation allowance for the deferred tax assets would be charged to income in the period such determination was made.

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We evaluate our need for reserves for our uncertain tax positions using a two-step approach. The first step, recognition, occurs when we conclude (based solely on the technical aspects of the matter) that a tax position is more likely than not to be sustained upon examination by a taxing authority. The second step, measurement, is only considered after step one has been satisfied and measures any tax benefit at the largest amount that is deemed more likely than not to be realized upon ultimate settlement of the uncertainty. These determinations involve significant judgment by management. Tax positions that fail to qualify for initial recognition are recognized in the first subsequent interim period that they meet the more likely than not standard or when they are resolved through negotiation or litigation with factual interpretation, judgment and certainty. Tax laws and regulations themselves are complex and are subject to change as a result of changes in fiscal policy, changes in legislation, evolution of regulations and court filings. Therefore, the actual liability for U.S. or foreign taxes may be materially different from our estimates, which could result in the need to record additional tax liabilities or potentially to reverse previously recorded tax liabilities.

The Worker, Homeownership and Business Assistance Act of 2009 was enacted on November 6, 2009. Under the Act, businesses with net operating losses for 2008 and 2009 may carry back those losses for up to five years. The Company intends to carry back losses incurred in fiscal 2009 in accordance with this new legislation and this tax law change has minimal financial statement impact.

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The following is a summary of some of the quantitative performance indicators (as defined below) that may be used to assess our results of operations and financial condition:

	Three Months Ended		Change	% Change
	April 3, 2010	April 4, 2009		
	(Dollars in thousands)			
Bookings	\$ 164,512	\$ 93,843	\$ 70,669	75.3%
Net sales Commercial Lasers and Components	\$ 51,514	\$ 30,828	\$ 20,686	67.1%
Net sales Specialty Lasers and Systems	\$ 97,618	\$ 74,569	\$ 23,049	30.9%
Gross profit as a percentage of net sales Commercial Lasers and Components	40.0%	22.7%	17.3%	76.2%
Gross profit as a percentage of net sales Specialty Lasers and Systems	46.3%	44.0%	2.3%	5.2%
Research and development as a percentage of net sales	13.1%	14.8%	(1.7)%	(11.5)%
Income (loss) before income taxes	\$ 14,497	\$ (7,459)	\$ 21,956	294.4%
Net cash provided by operating activities	\$ 28,579	\$ 16,925	\$ 11,654	68.9%
Days sales outstanding in receivables	51.0	69.4	(18.4)	(26.5)%
Annualized inventory turns	3.4	2.3	1.1	46.3%
Capital spending as a percentage of net sales	1.6%	5.0%	(3.4)%	(68.0)%

	Six Months Ended		Change	% Change
	April 3, 2010	April 4, 2009		
	(Dollars in thousands)			
Bookings	\$ 322,906	\$ 197,162	\$ 125,744	63.8%
Net sales Commercial Lasers and Components	\$ 88,595	\$ 68,208	\$ 20,387	29.9%
Net sales Specialty Lasers and Systems	\$ 183,327	\$ 161,552	\$ 21,775	13.5%
Gross profit as a percentage of net sales Commercial Lasers and Components	35.2%	26.7%	8.5%	31.8%
Gross profit as a percentage of net sales Specialty Lasers and Systems	46.8%	44.5%	2.3%	5.2%
Research and development as a percentage of net sales	12.8%	13.2%	(0.4)%	(3.0)%
Income (loss) before income taxes	\$ 20,971	\$ (20,935)	\$ 41,906	200.2%
Net cash provided by operating activities	\$ 46,179	\$ 7,527	\$ 38,652	513.5%
Capital spending as a percentage of net sales	2.1%	6.2%	(4.1)%	(66.1)%

Definitions and analysis of these performance indicators are as follows:

Bookings

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Bookings represent orders expected to be shipped within 12 months and services to be provided pursuant to service contracts. While we generally have not experienced a significant rate of cancellation, bookings are generally cancelable by our customers without substantial penalty and, therefore, we cannot assure all bookings will be converted to net sales.

Fiscal 2009 began with weak bookings, particularly in the microelectronics and OEM components and instrumentation markets that were most impacted by the decline in consumer confidence and spending. In the second quarter of fiscal 2009, the business environment remained challenging, with continued declines in bookings due to drops in consumer confidence in the microelectronics and OEM components and instrumentation markets partially offset by improvements in the scientific and materials processing markets. The third quarter of fiscal 2009 continued to be impacted by macroeconomic conditions, with the largest impact felt in the microelectronics market. All four of our markets showed signs of recovery, with increases in bookings during the fourth quarter of fiscal 2009, led by significant increases in the microelectronics and scientific markets.

All four of our markets continued to show signs of recovery in the first two quarters of fiscal 2010, led by a significant increase in the microelectronics market. Second fiscal quarter bookings increased 75.3% from the same quarter one year ago, with increases in all four markets.

Microelectronics

Microelectronics bookings, which set a new Company record, increased 163% compared to the same quarter one year ago and increased 8% from record bookings in the first quarter of fiscal 2010.

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Bookings for semiconductor capital equipment rose significantly compared to the first quarter of fiscal 2010 and a year ago as utilization rates and capital equipment spending trended upward. Demand has been increasing for service, legacy and new products across all applications.

Orders for advanced packaging applications have more than doubled compared to a year ago and increased more than 28% sequentially with all three submarkets microvias, direct imaging and silicon singulation and scribing contributing. There appears to be three factors fueling this growth: sustained growth in the smartphone market, growth in the light-emitting diode (LED) television market, which relies on high density interconnect (HDI) printed circuit boards (PCB), and general PCB production expansion in China.

The flat panel display market is very strong as we have secured another multi-unit order valued at approximately \$13.5 million for use in organic light-emitting diode (OLED) production on netbook and laptop displays. Each unit consists of a Vyper laser, the highest power excimer laser commercially available, and projection optics. Per customer request, these units are scheduled for delivery in fiscal 2011. The next phase of development will be for manufacturing OLED televisions larger than 40 inches, which will require another step-up in laser power and projection optics.

The solar market remains very active for us. In addition to shipping the first set of Equinox solar production tools, we are engaged with a variety of customers on future deployments and we expect to receive additional new tool orders in the third quarter of fiscal 2010.

Materials Processing

Materials processing orders increased 71% compared to the same quarter one year ago and increased 38% from the first quarter of fiscal 2010.

Marking and engraving customers increased their orders for the third consecutive quarter to support increased demand from consumer products applications. While China was the leading source of growth, U.S. and European customers also have increased order rates, with this trend benefitting all power product categories.

Our customer and application development work in the high power market with the E-1000 CO2 laser is progressing well and customer feedback has been positive. First revenue shipments of the E-1000 CO2 laser will occur in the third quarter of fiscal 2010 as planned.

OEM Components and Instrumentation

OEM Components and Instrumentation orders increased 67% compared to the same quarter one year ago and were flat from the first quarter of fiscal 2010.

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Conditions are starting to improve in the medical OEM market as evidenced by a rise in elective ophthalmic and aesthetic procedures. This should lead to a replacement cycle in established markets and new system investments in emerging markets. Our excimer lasers used in refractive surgery and our CO₂ and OPSL lasers for aesthetic applications should be the main beneficiaries of this trend. Our efforts in non-refractive procedures including photocoagulation and photodisruption using OPSL lasers are progressing well and are in-line with expectations.

Several factors are influencing demand in the instrumentation market. There is a trend towards higher power lasers for use in microscopy and high speed cytometry, which plays to the power scalability of our OPSL portfolio. Similarly, wavelength flexibility, another core strength of our OPSL products, is becoming more and more critical as customers develop new test protocols. Finally, beam shaping is gaining traction to enhance detection sensitivity and represents an opportunity to deliver higher level subassemblies into this market.

Graphic arts applications are also exhibiting early signs of recovery for lasers used in the computer-to-plate, flexographic and screen printing, which is consistent with a general market recovery. Within the display arena, we are enjoying a strong competitive advantage through our OPSL products.

Scientific and Government Programs

Scientific and government programs orders increased 6% compared to the same quarter one year ago, but decreased 14% from the first quarter of fiscal 2010.

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After a very strong first quarter of fiscal 2010, second quarter bookings continued to be strong, particularly in demand for high-end ultrafast amplifiers for the applied physics and physical chemistry communities. Orders also reflected increased adoption of our OPS-based Verdi G Series products. While biological imaging remains a cornerstone of the research market, orders for Chameleon lasers eased following two record setting quarters.

The second quarter of fiscal 2010 marked the end of committed stimulus funds in Germany and Japan, although Germany continues to invest in R&D at higher than average rates. In the U.S., it appears that a majority of the stimulus funds have been deployed with the balance to be completed by the end of September 2010.

Net Sales

Net sales include sales of lasers, related accessories and service contracts. Net sales for the second fiscal quarter increased 67.1% in our CLC segment and increased 30.9% in our SLS segment from the same quarter one year ago. Net sales for the first six months of fiscal 2010 increased 29.9% in our CLC segment and increased 13.5% in our SLS segment from the same period one year ago. For a more complete description of the reasons for changes in net sales refer to the Results of Operations section of this quarterly report.

Gross Profit as a Percentage of Net Sales

Gross profit as a percentage of net sales (gross profit percentage) is calculated as gross profit for the period divided by net sales for the period. Gross profit percentage in the second quarter increased from 22.7% to 40.0% in our CLC segment and increased from 44.0% to 46.3% in our SLS segment from the same quarter one year ago. Gross profit percentage for the first six months of fiscal 2010 increased from 26.7% to 35.2% in our CLC segment and increased from 44.5% to 46.8% in our SLS segment from the same period one year ago. For a more complete description of the reasons for changes in gross profit refer to the Results of Operations section of this quarterly report.

Research and Development as a Percentage of Net Sales

Research and development as a percentage of net sales (R&D percentage) is calculated as research and development expense for the period divided by net sales for the period. Management considers R&D percentage to be an important indicator in managing our business as investing in new technologies is a key to future growth. R&D percentage decreased to 13.1% from 14.8% in our second fiscal quarter and to 12.8% from 13.2% for the first six months of fiscal 2010 compared to the same periods one year ago. For a more complete description of the reasons for changes in R&D spending refer to the Results of Operations section of this quarterly report.

Net Cash Provided by Operating Activities

Net cash provided by operating activities shown on our Condensed Consolidated Statements of Cash Flows primarily represents the excess or shortfall of cash collected from billings to our customers and other receipts over cash paid to our vendors for expenses and inventory purchases to run our business. We believe that cash flows from operations is an important performance indicator because cash generation over the long term is essential to maintaining a healthy business and providing funds to help fuel growth. For a more complete description of the reasons for changes in Net Cash Provided by Operating Activities refer to the Liquidity and Capital Resources section of this quarterly report.

Days Sales Outstanding in Receivables

We calculate days sales outstanding (DSO) in receivables as net receivables at the end of the period divided by net sales during the period and then multiplied by the number of days in the period, using 90 days for quarters. DSO in receivables indicates how well we are managing our collection of receivables, with lower DSO in receivables resulting in more cash flow availability. The more money we have tied up in receivables, the less money we have available for research and development, acquisitions, expansion, marketing and other activities to grow our business. Our DSO in receivables for the second quarter of fiscal 2010 decreased 18.4 days from the same quarter one year ago primarily due to significantly improved collections, particularly in Asia and Europe.

Annualized Inventory Turns

We calculate annualized inventory turns as the cost of sales during the quarter multiplied by four and then divided by net inventories at the end of the period. This indicates how well we are managing our inventory levels, with higher inventory turns resulting in more cash flow availability and a higher return on our investments in inventory. The more money we have tied up in inventory, the less money we have available for research and development, acquisitions, expansion, marketing and other activities to grow our business. Our annualized inventory turns for the second quarter of fiscal 2010 increased 1.1 from the same quarter one year ago primarily due to increased sales volumes and reduced inventories due to site consolidations, increase in outsourcing and other inventory reduction programs.

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Capital Spending as a Percentage of Net Sales

Capital spending as a percentage of net sales (capital spending percentage) is calculated as capital expenditures for the period divided by net sales for the period. Capital spending percentage indicates the extent to which we are expanding or improving our operations, including investments in technology. Management monitors capital spending levels as this assists management in measuring our cash flows, net of capital expenditures. Our capital spending percentage decreased to 1.6% for the second quarter from 5.0% in the second quarter of fiscal 2009 and to 2.1% from 6.2% for the first six months of fiscal 2010 primarily due to higher sales volumes and the purchase of assets in support of a more effective business model for our semiconductor business and building investments related to our facilities consolidation and relocation programs in fiscal 2009. We expect spending in the second half of fiscal 2010 to return to a normal spending rate of 3.0% to 3.5% of net sales.

SIGNIFICANT EVENTS

During the three months ended December 27, 2008, our stock price declined substantially, which combined with expectations of declines in forecasted operating results due to the slowdown in the global economy, led the Company to conclude that a triggering event for review for potential goodwill impairment had occurred. Accordingly, as of December 27, 2008, we performed an interim goodwill impairment evaluation. The performance of this test is a two-step process. Management reviewed the results of the Step 1 analysis and concluded that a Step 2 analysis was required only for the CLC reporting unit. Our preliminary analysis indicated that the entire balance of the goodwill in the CLC reporting unit at that date was impaired and we recorded a non-cash goodwill impairment charge of \$19.3 million in the first quarter of fiscal 2009. During the three months ended April 4, 2009, we completed the Step 2 analysis for the CLC reporting unit at December 27, 2008 and determined that the entire balance of goodwill in the CLC reporting unit at that date was impaired. The estimated fair value of our SLS reporting unit exceeded its carrying value so no further impairment analysis was required for this reporting unit. During the six months ended April 3, 2010, we noted no indications of impairment or triggering events to cause us to review goodwill for potential impairment.

We initiated the planning phase of a multiyear project, with a targeted completion date of September 2010, to exit our epitaxial growth facility in Tampere, Finland and establish enhanced capabilities in Sunnyvale, California. We may decide to delay the closure by one quarter due to a significant increase in demand for our products manufactured in Finland. We completed the consolidation of the remainder of our Munich facility into our Göttingen site during the third quarter of fiscal 2009. During the second quarter of fiscal 2009, we substantially completed the transition of our optics manufacturing assets from Auburn, California to REO, and announced that we would be exiting our facility in St. Louis, Missouri. We completed the exit from St. Louis, Missouri in the fourth quarter of fiscal 2009.

On October 13, 2009, we acquired all the assets and certain liabilities of StockerYale's laser module product line in Montreal and its specialty fiber product line in Salem, New Hampshire for \$15.0 million in cash. StockerYale designs, develops and manufactures low power laser modules, light emitting diode (LED) systems and specialty optical fiber products. These assets and liabilities have been included in our Commercial Lasers and Components segment.

On April 30, 2010, we acquired Beam Dynamics for \$6.25 million, excluding transaction fees. The acquisition enhances our application knowledge and development capabilities and provides a pathway to expand our presence in the market for precision laser processing workstations.

Table of Contents**RESULTS OF OPERATIONS****CONSOLIDATED SUMMARY**

The following table sets forth, for the periods indicated, the percentage of total net sales represented by the line items reflected in our condensed consolidated statements of operations:

	Three Months Ended		Six Months Ended	
	April 3, 2010	April 4, 2009	April 3, 2010	April 4, 2009
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	56.0%	62.4%	57.1%	60.8%
Gross profit	44.0%	37.6%	42.9%	39.2%
Operating expenses:				
Research and development	13.1%	14.8%	12.8%	13.2%
Selling, general and administrative	20.9%	26.5%	21.7%	22.4%
Impairment of goodwill	%	%	%	8.4%
Amortization of intangible assets	1.3%	1.8%	1.4%	1.7%
Total operating expenses	35.3%	43.1%	35.9%	45.7%
Income (loss) from operations	8.7%	(5.5)%	7.0%	(6.5)%
Other income (net)	1.0%	(1.5)%	0.8%	(2.5)%
Income (loss) before income taxes	9.7%	(7.0)%	7.8%	(9.0)%
Provision for income taxes	4.0%	1.6%	3.1%	1.3%
Net income (loss)	5.7%	(8.6)%	4.7%	(10.3)%

Net income for the second quarter of fiscal 2010 was \$8.5 million (\$0.34 per diluted share) including \$1.0 million of after-tax restructuring costs and \$1.9 million of after-tax stock-related compensation expense. Net loss for the second quarter of fiscal 2009 was \$9.1 million (\$0.38 per share) including \$4.5 million of after-tax restructuring costs, a \$2.7 million tax expense due to a recently enacted change in state tax law, \$2.0 million of after-tax stock-related compensation expense and \$0.4 million of after-tax costs related to litigation resulting from our internal stock option investigation. Net income for the first six months of fiscal 2010 was \$12.7 million (\$0.51 per diluted share) including \$1.8 million of after-tax restructuring costs, \$3.4 million of after-tax stock-related compensation expense and \$1.4 million net after-tax benefit related to a receipt from the settlement of litigation resulting from our internal stock option investigation. Net loss for the first six months of fiscal 2009 was \$23.8 million (\$0.98 per share) including a charge for goodwill impairment of \$19.3 million, \$7.1 million of after-tax restructuring costs, \$3.1 million of after-tax stock-related compensation expense, a \$2.7 million tax expense due to a recently enacted change in state tax law and \$0.6 million of after-tax costs related to litigation resulting from our internal stock option investigation.

NET SALES**Market Application**

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The following tables set forth, for the periods indicated, the amount of net sales and their relative percentages of total net sales by market application (dollars in thousands):

	April 3, 2010		Three Months Ended		April 4, 2009	
	Amount	Percentage of total net sales	Amount	Percentage of total net sales	Amount	Percentage of total net sales
Consolidated:						
Microelectronics	\$ 52,653	35.3%	\$ 25,721	24.4%		
OEM components and instrumentation	38,871	26.1%	30,940	29.4%		
Materials processing	19,819	13.3%	15,852	15.0%		
Scientific and government programs	37,814	25.3%	32,909	31.2%		
Total	\$ 149,157	100.0%	\$ 105,422	100.0%		

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	Six Months Ended		Six Months Ended	
	April 3, 2010	Percentage of total net sales	April 4, 2009	Percentage of total net sales
	Amount		Amount	
Consolidated:				
Microelectronics	\$ 91,741	33.7%	\$	