COHERENT INC
Form 10-Q
February 10, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended January 2, 2010

or

o	**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	**94-1622541**
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization)	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 January 29, 2010 was 24,646,738.

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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.

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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	
	January 2, 2010	December 27, 2008
Net sales	**$ 122,815**	$ 124,388
Cost of sales	**71,783**	73,999
Gross profit	**51,032**	50,389
Operating expenses:		
Research and development	**15,410**	14,778
Selling, general and administrative	**27,979**	23,628
Impairment of goodwill		19,286
Amortization of intangible assets	**1,961**	1,943
Total operating expenses	**45,350**	59,635
Income (loss) from operations	**5,682**	(9,246)
Other income (expense) (net)	**792**	(4,230)
Income (loss) before income taxes	**6,474**	(13,476)
Provision for income taxes	**2,295**	1,203
Net income (loss)	**$ 4,179**	$ (14,679)
Net income (loss) per share:		
Basic	**$ 0.17**	$ (0.61)
Diluted	**$ 0.17**	$ (0.61)
Shares used in computation:		
Basic	**24,469**	24,145
Diluted	**24,678**	24,145

See Accompanying Notes to Condensed Consolidated Financial Statements

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COHERENT, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited; in thousands, except par value)

	January 2, 2010	October 3, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 199,760**	$ 199,950
Short-term investments	**40,866**	43,685
Accounts receivable net of allowances of $2,150 and $2,147, respectively	**76,136**	74,235
Inventories	**98,924**	97,767
Prepaid expenses and other assets	**51,827**	38,969
Deferred tax assets	**18,948**	28,164
Total current assets	**486,461**	482,770
Property and equipment, net	**100,062**	98,792
Goodwill	**68,916**	66,967
Intangible assets, net	**23,064**	19,738
Other assets	**92,202**	85,337
Total assets	**$ 770,705**	$ 753,604
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term obligations	**$ 21**	$ 9
Accounts payable	**24,359**	21,639
Income taxes payable	**1,617**	1,953
Other current liabilities	**71,911**	62,741
Total current liabilities	**97,908**	86,342
Long-term obligations	**44**	6
Other long-term liabilities	**92,054**	91,685
Commitments and contingencies (Note 11)		
Stockholders equity:		
Common stock, par value $.01 per share:		
Authorized 500,000 shares		
Outstanding 24,644 shares and 24,455 shares, respectively	**246**	244
Additional paid-in capital	**193,096**	188,918
Accumulated other comprehensive income	**77,038**	80,269
Retained earnings	**310,319**	306,140
Total stockholders equity	**580,699**	575,571
Total liabilities and stockholders equity	**$ 770,705**	$ 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)

	Three Months Ended January 2, 2010	Three Months Ended December 27, 2008
Cash flows from operating activities:		
Net income (loss)	$ **4,179**	$ (14,679)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	**5,752**	4,729
Amortization of intangible assets	**1,961**	1,943
Deferred income taxes	**6,921**	(4,859)
Loss on disposal of property and equipment	**100**	155
Stock-based compensation	**1,874**	1,753
Excess tax benefit from stock-based compensation arrangements	**(100)**	(8)
Impairment of goodwill		19,286
Non-cash restructuring and other charges (recoveries)	**230**	(244)
Other non-cash expense (income)	**(32)**	4
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	**(716)**	2,892
Inventories	**1,207**	(875)
Prepaid expenses and other assets	**(8,252)**	(3,482)
Other assets	**(1,089)**	6,722
Accounts payable	**1,752**	(4,826)
Income taxes payable/receivable	**(4,792)**	(4,252)
Other current liabilities	**7,409**	(7,057)
Other long-term liabilities	**1,196**	(6,600)
Net cash provided by (used in) operating activities	**17,600**	(9,398)
Cash flows from investing activities:		
Purchases of property and equipment	**(3,266)**	(8,911)
Proceeds from dispositions of property and equipment	**478**	826
Purchases of available-for-sale securities	**(19,632)**	(14,459)
Proceeds from sales and maturities of available-for-sale securities	**22,506**	4,112
Acquisition of a business	**(15,000)**	
Change in restricted cash		2,521
Net cash used in investing activities	**(14,914)**	(15,911)
Cash flows from financing activities:		
Repayment of capital lease obligations	**(6)**	(2)
Cash overdrafts decrease		(470)
Issuance of common stock under employee stock option and purchase plans	**2,833**	3,543
Net settlement of restricted common stock	**(519)**	
Excess tax benefits from stock-based compensation arrangements	**100**	8
Net cash provided by financing activities	**2,408**	3,079
Effect of exchange rate changes on cash and cash equivalents	**(5,284)**	(6,361)
Net decrease in cash and cash equivalents	**(190)**	(28,591)
Cash and cash equivalents, beginning of period	**199,950**	213,826
Cash and cash equivalents, end of period	$ **199,760**	$ 185,235
Supplemental disclosure of cash flow information:		

Cash paid during the period for:				
Interest	**$**	**38**	$	75
Income taxes	**$**	**3,279**	$	10,443
Cash received during the period for:				
Income taxes	**$**	**812**	$	14
Non-cash investing and financing activities:				
Unpaid property and equipment	**$**	**654**	$	1,554

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 first fiscal quarter includes 13 weeks of operations. Fiscal years 2010 and 2009 include 52 and 53 weeks, respectively.

2. RECENT ACCOUNTING STANDARDS

Adoption of New Accounting Pronouncements

In December 2007 the 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.

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.

Recently Issued Accounting Pronouncements

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

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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 and results of operations.

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 preliminary 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
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.

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 quarter ended January 2, 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 months ended January 2, 2010, we did not have any assets or liabilities valued based on Level 3 valuations.

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Financial assets and liabilities measured at fair value as of January 2, 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)	$ 17,227	$	$ 17,227
Certificates of deposit (2)		149,451	149,451
U.S. Treasury and agency obligations (3)		45,875	45,875
Corporate notes and obligations (4)		37	37
Commercial paper (5)		2,150	2,150
Foreign currency contracts (6)		(170)	(170)
Total net assets measured at fair value	$ 17,227	$ 197,343	$ 214,570

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

(2) Includes $148,698 recorded in cash and cash equivalents and $753 recorded in short-term investments on the Condensed Consolidated Balance Sheet.

(3) Includes $5,799 recorded in cash and cash equivalents and $40,076 recorded in short-term investments on the Condensed Consolidated Balance Sheet.

(4) Included in short-term investments on the Condensed Consolidated Balance Sheet.

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

(6) Includes $112 recorded in prepaid expenses and other assets and $282 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):

	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

(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 $38,171recorded 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.

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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.

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):

	January 2, 2010	**October 3, 2009**
Foreign currency hedge contracts		
Purchase	**$ 9,291**	$ 23,199
Sell	**(7,148)**	(7,779)
Net	**$ 2,143**	$ 15,420

The location and fair value amounts of our derivative instruments reported in our Condensed Consolidated Balance Sheets as of January 2, 2010 and October 3, 2009were as follows (in thousands):

	Asset Derivatives January 2, 2010		**Liability Derivatives January 2, 2010**	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives not designated as hedging instruments				
Foreign exchange contracts	Prepaid expenses and other assets	$ 112	Other current liabilities	$ 282

	Asset Derivatives October 3, 2009		**Liability Derivatives October 3, 2009**	
	Balance Sheet Location	**Fair Value**	**Balance Sheet Location**	**Fair Value**
Derivatives not designated as hedging instruments				
Foreign exchange contracts	Prepaid expenses and other assets	$ 217	Other current liabilities	$ 221

The location and amounts of non-designated derivative instruments gains and losses in the Condensed Consolidated Statements of Operations for the three months ended January 2, 2010 are as follows (in thousands):

	Location of Gain (Loss) Recognized in Income on Derivatives	Amount of (Loss) Recognized in Income on Derivatives Three Months Ended January 2, 2010
Derivatives not designated as hedging instruments		
Foreign exchange contracts	Other income (expense)	$ (31)

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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):

	January 2, 2010			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$ 199,758	$ 2	$	$ 199,760
Short-term investments:				
Available-for-sale securities:				
Commercial paper	$	$	$	$
Certificates of deposit	750	2		752
U.S. Treasury and agency obligations	40,008	73	(4)	40,077
Corporate notes and obligations	38		(1)	37
Total short-term investments	$ 40,796	$ 75	$ (5)	$ 40,866

	October 3, 2009			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
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

The amortized cost and estimated fair value of available-for-sale investments in debt securities as of January 2, 2010 and October 3, 2009 classified as short-term investments on our consolidated balance sheet were as follows (in thousands):

	January 2, 2010		October 3, 2009	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in less than 1 year	$ 40,006	$ 40,077	$ 41,151	$ 41,171
Due in 1 to 5 years				
Due in 5 to 10 years				
Due beyond 10 years	38	37	54	51
Total investments in available-for-sale debt securities	$ 40,044	$ 40,114	$ 41,205	$ 41,222

During the first fiscal quarter of 2010, we received proceeds totaling $8.7 million from the sale of available-for-sale securities and realized gross losses of less than $0.1 million. During the first fiscal quarter of 2009, we received proceeds totaling $1.1 million from the sale of available-for-sale securities and realized gross losses of less than $0.1 million.

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The following table shows the gross unrealized losses and fair values of our investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by the investment category and length of time that the individual securities have been in a continuous unrealized loss position at January 2, 2010 and October 3, 2009 (in thousands):

	January 2, 2010					
Description of	Less Than 12 Months		12 Months or Greater		Total	
Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency obligations	$ 11,550	$ (4)	$	$	$ 11,550	$ (4)
Corporate notes and obligations			37	(1)	37	(1)
Total	$ 11,550	$ (4)	$ 37	$ (1)	$ 11,587	$ (5)

	October 3, 2009					
Description of	Less Than 12 Months		12 Months or Greater		Total	
Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency obligations	$ 2,990	$	$	$	$ 2,990	$
Corporate notes and obligations			52	(2)	52	(2)
Total	$ 2,990	$	$ 52	$ (2)	$ 3,042	$ (2)

U.S. Treasury and agency obligations: There were no unrealized losses on these investments.

Corporate notes and obligations: The unrealized losses on our investments in corporate notes and obligations at January 2, 2010 and October 3, 2009 relate to a $0.1 million investment. The credit ratings of the investments in the notes and obligations range from AAA to A (S&P and Moody s) and therefore the decline in the market value is 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.

The non-cash impairment of goodwill of $19.3 million was recorded in the three months ended December 27, 2008.

During the three months ended January 2, 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.

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The changes in the carrying amount of goodwill by segment for the period from October 3, 2009 to January 2, 2010 are as follows (in thousands):

	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		(631)	(631)
Balance as of January 2, 2010	$ 2,580	$ 66,336	$ 68,916

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

	January 2, 2010			October 3, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Existing technology	$ 54,829	$ (40,280)	$ 14,549	$ 54,477	$ (39,220)	$ 15,257
Patents	10,309	(9,072)	1,237	10,440	(8,975)	1,465
Order backlog	5,544	(5,002)	542	5,015	(5,002)	13
Customer lists	8,555	(3,961)	4,594	5,421	(3,763)	1,658
Trade name	3,782	(2,533)	1,249	3,833	(2,488)	1,345
Production know-how	910	(63)	847			
Non-compete agreement	1,640	(1,594)	46	1,590	(1,590)	
Total	$ 85,569	$ (62,505)	$ 23,064	$ 80,776	$ (61,038)	$ 19,738

Amortization expense for intangible assets for the three months ended January 2, 2010 and December 27, 2008 was $2.0 million and $1.9 million, respectively. At January 2, 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)	$ 5,982
2011	6,355
2012	4,338
2013	2,525
2014	1,668
2015	1,252
Thereafter	944
Total	$ 23,064

8. BALANCE SHEET DETAILS

Inventories consist of the following (in thousands):

		January 2, 2010		October 3, 2009
Purchased parts and assemblies	**$**	**33,314**	$	30,945
Work-in-process		**31,811**		30,680
Finished goods		**33,799**		36,142
Inventories	**$**	**98,924**	$	97,767

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

		January 2, 2010		October 3, 2009
Prepaid and refundable income taxes	**$**	**26,839**	$	22,041
Prepaid expenses and other		**24,988**		16,928
Total prepaid expenses and other assets	**$**	**51,827**	$	38,969

Other assets consist of the following (in thousands):

		January 2, 2010		October 3, 2009
Assets related to deferred compensation arrangements	**$**	**22,598**	$	21,629
Deferred tax assets		**66,699**		60,819
Other assets		**2,905**		2,889
Total other assets	**$**	**92,202**	$	85,337

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

		January 2, 2010		October 3, 2009
Accrued payroll and benefits	**$**	**20,521**	$	19,967
Deferred income		**13,694**		14,424
Reserve for warranty		**9,933**		10,211
Accrued expenses and other		**11,212**		9,918
Other taxes payable		**10,005**		4,361
Accrued restructuring charges		**1,965**		1,652
Customer deposits		**4,581**		2,208
Total other current liabilities	**$**	**71,911**	$	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. 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 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.

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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 three months of fiscal 2010 and 2009 (in thousands):

	Severance Related	Facilities-related Charges	Other Restructuring Costs	Total
Balance at September 27,008	$ 2,581	$ 19	$ 987	$ 3,587
Provisions	2,884	192	1,011	4,087
Payments and other	(2,921)	(27)	(1,383)	(4,331)
Balance at December 27, 2008	$ 2,544	$ 184	$ 615	$ 3,343
Balance at October 3, 2009	$ 488	$ 357	$ 807	$ 1,652
Provisions	434	17	607	1,058
Payments and other	(94)	(235)	(416)	(745)
Balance at January 2, 2010	$ 828	$ 139	$ 998	$ 1,965

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 $0.8 million at January 2, 2010 is expected to result in cash expenditures through the fourth quarter of fiscal 2010. 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.

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

	Three Months Ended	
	January 2, 2010	**December 27, 2008**
Beginning balance	**$ 10,211**	$ 13,214
Additions related to current period sales	**3,082**	3,651
Warranty costs incurred in the current period	**(3,459)**	(4,476)
Accruals resulting from acquisition	**160**	
Adjustments to accruals related to prior period sales	**(61)**	(328)
Ending balance	**$ 9,933**	$ 12,061

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

	January 2, 2010	October 3, 2009
Long-term taxes payable	**$ 51,879**	$ 51,483
Deferred compensation	**23,906**	22,723
Deferred tax liabilities	**8,581**	9,651
Deferred income	**1,992**	2,109
Asset retirement obligations liability	**1,289**	1,342
Other long-term liabilities	**4,407**	4,377
Total other long-term liabilities	**$ 92,054**	$ 91,685

The following table reconciles changes in our asset retirement obligations liability (in thousands):

	Three Months Ended	
	January 2, 2010	December 27, 2008
Beginning balance	**$ 1,679**	$ 1,464
Adjustment to asset retirement obligations recognized	**(49)**	354
Accretion recognized	**20**	27
Changes due to foreign currency exchange	**(29)**	35
Ending balance	**$ 1,621**	$ 1,880

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At January 2, 2010, $332,000 of the asset retirement liability is reported in other current liabilities and $1,289,000 is reported in other long-term liabilities on our condensed consolidated balance sheets. At December 27, 2008, $250,000 of the asset retirement liability is reported in other current liabilities and $1,630,000 is reported in other long-term liabilities on our condensed consolidated balance sheets.

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 $16.8 million of foreign lines of credit as of January 2, 2010. At January 2, 2010, we had used $3.6 million of these available foreign lines of credit. These credit facilities were used in Europe during the first 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 January 2, 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 for the three months ended January 2, 2010 and December 27, 2008 were estimated using the following weighted-average assumptions:

	Employee Stock Option Plans Three Months Ended		Employee Stock Purchase Plan Three Months Ended	
	January 2, 2010	**December 27, 2008**	**January 2, 2010**	**December 27, 2008**
Expected life in years	4.5	4.0	0.5	0.5
Expected volatility	33.0%	48.0%	41.3%	44.1%
Risk-free interest rate	2.0%	1.9%	0.2%	1.1%
Expected dividends				
Weighted average fair value per share	$ 8.01	$ 9.10	$ 5.94	$ 6.95

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 months ended January 2, 2010 and December 27, 2008 (in thousands):

	Three Months Ended	
	January 2, 2010	December 27, 2008
Cost of sales	$ 219	$ 283
Research and development	273	195
Selling, general and administrative	1,670	1,212
Income tax benefit	(643)	(537)
	$ 1,519	$ 1,153

During the three months ended January 2, 2010, $0.2 million was capitalized into inventory for all stock plans, $0.2 million was amortized to cost of sales and $0.3 million remained in inventory at January 2, 2010. During the three months ended December 27, 2008, $0.2 million was capitalized into inventory for all stock plans, $0.3 million was amortized to cost of sales and $0.3 million remained in inventory at December 27, 2008. Management has made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

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At January 2, 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 $14.6 million, net of estimated forfeitures of $1.9 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 January 2, 2010, total compensation cost related to options to purchase common shares under the ESPP but not yet vested was approximately $0.4 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 three 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):

	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	443	26.16		
Exercised	(31)	24.94		
Forfeitures	(22)	24.46		
Expirations	(5)	33.01		
Outstanding at January 2, 2010	2,879	$ 29.02	3.7	$ 7,025
Vested and expected to vest at January 2, 2010	2,812	$ 29.11	3.6	$ 6,708
Exercisable at January 2, 2010	2,069	$ 30.77	2.6	$ 2,813

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. There were approximately 1.5 million outstanding options that were in-the-money at January 2, 2010. The aggregate intrinsic value of options exercised under the Company s stock plans was less than $0.1 million for both the three months ended January 2, 2010 and the three months ended December 27, 2008, determined as of the date of option exercise.

The following table summarizes our restricted stock award and restricted stock unit activity for the first three 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	225		26.16
Vested	(52)		23.30
Forfeited	(4)		21.57
Nonvested stock at January 2, 2010	526	$	26.14

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.

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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 is 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 consolidated complaint asserted causes of action for alleged violations of federal securities laws, violations of California securities laws, breaches of fiduciary duty and/or aiding and abetting breaches of fiduciary duty, abuse of control, gross mismanagement, constructive fraud, corporate waste, unjust enrichment, insider selling and misappropriation of information. The consolidated complaint sought, among other relief, disgorgement and damages in an unspecified amount, an accounting, rescission of allegedly improper stock option grants, punitive damages and attorneys fees and costs.

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 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 three months ended January 2, 2010.

Income Tax Audits The Internal Revenue Service (IRS) is conducting an audit of our 2003 and 2004 U.S. federal tax returns. The IRS has issued a number of Notices of Proposed Adjustments (NOPAs) to these returns. Among other items, the IRS has challenged our research and development credits and our extraterritorial income (ETI) exclusion. We have agreed to the various adjustments proposed by the IRS and we believe that we have adequately provided for these exposures and any other items identified by the IRS as a result of the audit of these tax years. As part of its audit of our 2003 and 2004 years, the IRS has requested information related to our stock option investigation and we complied with this request and we will address any issues that are raised in a timely manner. The IRS has also 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. 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.

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12. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended January 2, 2010	Three Months Ended December 27, 2008
Net income (loss)	**$ 4,179**	$ (14,679)
Other comprehensive income (loss):		
Translation adjustment	**(3,225)**	(10,161)
Net gain on derivative instruments, net of taxes	**2**	2
Changes in unrealized gains (losses) on available-for-sale securities, net of taxes	**(8)**	7
Other comprehensive income (loss), net of tax	**(3,231)**	(10,152)
Comprehensive income (loss)	**$ 948**	$ (24,831)

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