COHERENT INC
Form 10-Q
August 11, 2010

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 July 3, 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 incorporation or organization)	(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 August 06, 2010 was 24,857,339.

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COHERENT, INC.

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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		Nine Months Ended	
	July 3, 2010	**July 4, 2009**	**July 3, 2010**	**July 4, 2009**
Net sales	**$ 166,697**	$ 98,479	**$ 438,669**	$ 328,289
Cost of sales	**92,350**	64,865	**247,677**	204,679
Gross profit	**74,347**	33,614	**190,992**	123,610
Operating expenses:				
Research and development	**18,264**	15,529	**53,162**	45,917
Selling, general and administrative	**31,584**	29,223	**90,727**	80,813
Impairment of goodwill				19,286
Amortization of intangible assets	**2,041**	1,907	**5,958**	5,744
Total operating expenses	**51,889**	46,659	**149,847**	151,760
Income (loss) from operations	**22,458**	(13,045)	**41,145**	(28,150)
Other income (expense):				
Interest and dividend income	**274**	210	**1,712**	2,343
Interest expense	**(159)**	(57)	**(229)**	(166)
Other net	**(300)**	3,176	**616**	(4,678)
Total other income (expense), net	**(185)**	3,329	**2,099**	(2,501)
Income (loss) before income taxes	**22,273**	(9,716)	**43,244**	(30,651)
Provision for (benefit from) income taxes	**7,869**	(2,701)	**16,181**	173
Net income (loss)	**$ 14,404**	$ (7,015)	**$ 27,063**	$ (30,824)
Net income (loss) per share:				
Basic	**$ 0.58**	$ (0.29)	**$ 1.09**	$ (1.27)
Diluted	**$ 0.57**	$ (0.29)	**$ 1.08**	$ (1.27)
Shares used in computation:				
Basic	**25,022**	24,331	**24,732**	24,245
Diluted	**25,438**	24,331	**25,037**	24,245

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)

	July 3, 2010	October 3, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 210,351**	$ 199,950
Restricted cash	**625**	
Short-term investments	**43,656**	43,685
Accounts receivable net of allowances of $1,978 and $2,147, respectively	**98,355**	74,235
Inventories	**99,409**	97,767
Prepaid expenses and other assets	**49,634**	38,969
Deferred tax assets	**20,282**	28,164
Total current assets	**522,312**	482,770
Property and equipment, net	**91,488**	98,792
Goodwill	**67,518**	66,967
Intangible assets, net	**21,660**	19,738
Other assets	**82,369**	85,337
Total assets	**$ 785,347**	$ 753,604
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term obligations	**$ 19**	$ 9
Accounts payable	**31,844**	21,639
Income taxes payable	**1,631**	1,953
Other current liabilities	**98,550**	62,741
Total current liabilities	**132,044**	86,342
Long-term obligations	**37**	6
Other long-term liabilities	**82,288**	91,685
Commitments and contingencies (Note 11)		
Stockholders equity:		
Common stock, par value $.01 per share:		
Authorized 500,000 shares		
Outstanding 24,836 shares and 24,455 shares, respectively	**248**	244
Additional paid-in capital	**196,450**	188,918
Accumulated other comprehensive income	**41,077**	80,269
Retained earnings	**333,203**	306,140
Total stockholders equity	**570,978**	575,571
Total liabilities and stockholders equity	**$ 785,347**	$ 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)

	Nine Months Ended	
	July 3, 2010	**July 4, 2009**
Cash flows from operating activities:		
Net income (loss)	$ **27,063**	$ (30,824)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**16,707**	14,368
Amortization of intangible assets	**5,958**	5,744
Deferred income taxes	**13,922**	(8,074)
Loss on disposal of property and equipment	**451**	496
Stock-based compensation	**6,083**	5,666
Excess tax benefit from stock-based compensation arrangements	**(619)**	(10)
Impairment of goodwill		19,286
Non-cash restructuring and other charges	**1,280**	376
Other non-cash expense	**74**	80
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	**(25,633)**	21,592
Inventories	**(3,405)**	9,283
Prepaid expenses and other assets	**(19,488)**	(14,133)
Other assets	**8**	7,761
Accounts payable	**8,927**	(7,959)
Income taxes payable/receivable	**565**	(720)
Other current liabilities	**37,181**	2,838
Other long-term liabilities	**(735)**	(7,222)
Net cash provided by operating activities	**68,339**	18,548
Cash flows from investing activities:		
Purchases of property and equipment	**(10,117)**	(17,723)
Proceeds from dispositions of property and equipment	**753**	1,603
Purchases of available-for-sale securities	**(99,628)**	(85,642)
Proceeds from sales and maturities of available-for-sale securities	**97,149**	50,364
Acquisition of businesses	**(20,745)**	
Investment in SiOnyx	**(2,000)**	
Change in restricted cash	**(625)**	2,521
Net cash used in investing activities	**(35,213)**	(48,877)
Cash flows from financing activities:		
Short-term borrowings		7
Short-term repayments		(7)
Repayment of capital lease obligations	**(14)**	(6)
Cash overdrafts decrease		(357)
Issuance of common stock under employee stock option and purchase plans	**19,416**	4,674
Repurchase of common stock	**(16,752)**	
Net settlement of restricted common stock	**(1,193)**	1
Excess tax benefits from stock-based compensation arrangements	**619**	10
Net cash provided by financing activities	**2,076**	4,322
Effect of exchange rate changes on cash and cash equivalents	**(24,801)**	(5,488)
Net increase (decrease) in cash and cash equivalents	**10,401**	(31,495)

Cash and cash equivalents, beginning of period		**199,950**		213,826
Cash and cash equivalents, end of period	**$**	**210,351**	$	182,331
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Interest	**$**	**206**	$	146
Income taxes	**$**	**9,263**	$	17,833
Cash received during the period for:				
Income taxes	**$**	**5,938**	$	8,136
Non-cash investing and financing activities:				
Unpaid property and equipment	**$**	**784**	$	1,182

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 third fiscal quarters include 13 weeks of operations in each fiscal year presented. 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.

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 is being applied prospectively to intangible assets as we make acquisitions.

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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Recently Issued Accounting Pronouncements

In July 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 a significant 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. We will adopt this standard on a prospective basis for revenue arrangements entered into or materially modified in our fiscal year beginning October 3, 2010. We do not expect this update to have a significant impact on our consolidated financial position, results of operations and cash flows.

3. BUSINESS COMBINATIONS

Beam Dynamics, Inc.

On April 29, 2010, we acquired Beam Dynamics, Inc. for $5.9 million in cash as allocated below and $0.3 million in deferred compensation related to an employment contract, which will be recognized in expense as earned. Beam Dynamics manufactures flexible laser cutting tools for the materials processing market. Beam Dynamics has been included in our Commercial Lasers and Components segment.

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

Tangible assets	$	1,132
Goodwill		3,841
Intangible assets:		
Existing technology		2,130
In-process R&D		650
Customer lists		360
Trade name		140
Order backlog		30
Non-compete agreements		10
Liabilities assumed		(2,371)

Total	$	5,922

The goodwill recognized from this acquisition resulted primarily from access to anticipated growth in the laser tool market 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 six years.

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In-process research and development (IPR&D) consists of three development projects that have not yet reached technological feasibility. Acquired IPR&D assets are initially recognized at fair value and are classified as indefinite-lived assets until the successful completion or abandonment of the associated research and development efforts. The value assigned to IPR&D was determined by considering the value of the products under development to the overall development plan, estimating the resulting net cash flows from the projects when completed and discounting the net cash flows to their present value. During the development period, these assets will not be amortized as charges to earnings; instead these assets will be subject to periodic impairment testing. Upon successful completion of the development process for the acquired IPR&D projects, the assets would then be considered finite-lived intangible assets and amortization of the assets will commence.

We expensed $0.2 million of acquisition-related costs as selling, general and administrative expenses in our consolidated statements of operations for the nine months ended July 3, 2010.

Results of operations for the business 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 loss 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.

As of July 3, 2010, we had $0.6 million remaining in an escrow account that will be applied towards remaining closing costs for the acquisition and payments to the shareholders. The amount is included in current restricted cash on our consolidated balance sheet.

StockerYale, Inc.

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 diode (LED) systems and specialty optical fiber products. These assets and liabilities have been included in our Commercial Lasers and Components segment.

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
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.

We expensed $0.2 million of acquisition-related costs incurred as selling, general and administrative expenses in our consolidated statements of operations for the nine months ended July 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.

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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 nine months ended July 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 July 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)	$ 34,279	$	$ 34,279
Certificates of deposit (2)		100,201	100,201
U.S. and international government obligations (3)		89,169	89,169
Corporate notes and obligations (4)		9,089	9,089
Commercial paper (5)		2,999	2,999
Foreign currency contracts (6)		588	588
Total net assets measured at fair value	$ 34,279	$ 202,046	$ 236,325

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

(2) Includes $90,918 recorded in cash and cash equivalents and $9,283 recorded in short-term investments on the Condensed Consolidated Balance Sheet.

(3) Includes $64,885 recorded in cash and cash equivalents and $24,284 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 $1,999 in cash and cash equivalents and $1,000 recorded in short-term investments on the Condensed Consolidated Balance Sheet.

(6) Includes $739 recorded in prepaid expenses and other assets and $151 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.

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(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 forward contracts 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.

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 maturities of 2 months, are as follows (in thousands):

	July 3, 2010	October 3, 2009
Foreign currency hedge contracts		
Purchase		
Euro	**$ 21,688**	$ 22,784
Other currencies	**6,522**	415
Sell	**(8,111)**	(7,779)
Net	**$ 20,099**	$ 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 July 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 nine months ended July 3, 2010 and July 4, 2009 are as follows (in thousands):

	Amount of Gain or (Loss) Recognized in Income on Derivatives	
	Three Months Ended July 3, 2010	Nine Months Ended July 3, 2010
Derivatives not designated as hedging instruments		
Foreign exchange contracts	$ (1,153)	$ (2,164)

	Amount of Gain or (Loss) Recognized in Income on Derivatives	
	Three Months Ended July 4, 2009	Nine Months Ended July 4, 2009
Derivatives not designated as hedging instruments		
Foreign exchange contracts	$ (576)	$ 1,150

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):

	July 3, 2010			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$ 210,976	$	$	$ 210,976
Less: restricted cash	(625)			(625)
	$ 210,351			$ 210,351
Short-term investments:				
Available-for-sale securities:				
Commercial paper	$ 1,000	$	$	$ 1,000
Certificates of deposit	9,283		(1)	9,282
U.S. and international government obligations	24,283	3	(2)	24,284
Corporate notes and obligations	9,075	16	(1)	9,090
Total short-term investments	$ 43,641	$ 19	$ (4)	$ 43,656

	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

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

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During the three and nine months ended July 3, 2010, we received proceeds totaling $7.1 million and $28.4 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 nine months ended July 4, 2009, we received proceeds totaling $20.5 million and $39.1 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.

At July 3, 2010, $0.6 million of cash was restricted for remaining closing costs for the Beam Dynamics acquisition and payments to former shareholders.

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 July 3, 2010.

Corporate notes and obligations: The unrealized losses on our investments in corporate notes and obligations at July 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 were determined to be the same as our operating segments and included 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 nine months ended July 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 July 3, 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	6,421		6,421
Translation adjustments and other	(57)	(5,813)	(5,870)
Balance as of July 3, 2010	$ 6,364	$ 61,154	$ 67,518

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

	July 3, 2010			October 3, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Existing technology	$ 54,901	$ (41,224)	$ 13,677	$ 54,477	$ (39,220)	$ 15,257
Patents	9,075	(8,387)	688	10,440	(8,975)	1,465
Order backlog	4,997	(4,593)	404	5,015	(5,002)	13
Customer lists	8,624	(4,230)	4,394	5,421	(3,763)	1,658
Trade name	3,498	(2,402)	1,096	3,833	(2,488)	1,345
Production know-how	910	(200)	710			
Non-compete agreement	1,559	(1,518)	41	1,590	(1,590)	
In-process research & development	650		650			
Total	$ 84,214	$ (62,554)	$ 21,660	$ 80,776	$ (61,038)	$ 19,738

Amortization expense for intangible assets for the nine months ended July 3, 2010 and July 4, 2009 was $6.0 million and $5.7 million, respectively. At July 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)	$ 2,189
2011	7,259
2012	4,770
2013	3,070
2014	2,024
2015	1,327
Thereafter	1,021
Total	$ 21,660

8. BALANCE SHEET DETAILS

Inventories consist of the following (in thousands):

	July 3, 2010	October 3, 2009
Purchased parts and assemblies	**$ 33,239**	$ 30,945
Work-in-process	**34,550**	30,680
Finished goods	**31,620**	36,142
Total inventories	**$ 99,409**	$ 97,767

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

		July 3, 2010		October 3, 2009
Prepaid and refundable income taxes	**$**	**14,255**	$	22,041
Prepaid expenses and other		**35,379**		16,928
Total prepaid expenses and other assets	**$**	**49,634**	$	38,969

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Other assets consist of the following (in thousands):

		July 3, 2010		October 3, 2009
Assets related to deferred compensation arrangements	**$**	**21,503**	$	21,629
Deferred tax assets		**55,994**		60,819
Other assets		**4,872**		2,889
Total other assets	**$**	**82,369**	$	85,337

On June 8, 2010, we invested $2.0 million in SiOnyx, Inc., a privately-held company focused on shallow junction photonics, used to enhance the performance of light sensing devices used in consumer, industrial, medical and defense related applications using black silicon processing. The investment is included in other assets and is being carried on a cost basis.

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

		July 3, 2010		October 3, 2009
Accrued payroll and benefits	**$**	**30,089**	$	19,967
Deferred income		**14,456**		14,424
Reserve for warranty		**12,205**		10,211
Accrued expenses and other		**9,539**		9,918
Other taxes payable		**23,206**		4,361
Accrued restructuring charges		**2,752**		1,652
Customer deposits		**6,303**		2,208
Total other current liabilities	**$**	**98,550**	$	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 our St. Louis site was completed in the fourth quarter of fiscal 2009. The closure of our Finland site was scheduled for completion by the end of fiscal 2010, but we decided to delay the closure by one to two quarters 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 for the third quarter and first nine 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 nine months of fiscal 2010 and 2009 (in thousands):

	Severance Related	Facilities-related Charges	Other Restructuring Costs	Total
Balance at September 27, 2008	$ 2,581	$ 19	$ 987	$ 3,587
Provisions	7,674	3,142	3,179	13,995
Payments and other	(8,615)	(2,804)	(3,428)	(14,847)
Balance at July 4, 2009	$ 1,640	$ 357	$ 738	$ 2,735
Balance at October 3, 2009	$ 488	$ 357	$ 807	$ 1,652
Provisions	1,420	17	2,335	3,772
Payments and other	(312)	(309)	(2,051)	(2,672)
Balance at July 3, 2010	$ 1,596	$ 65	$ 1,091	$ 2,752

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 $1.6 million at July 3, 2010 is expected to result in cash expenditures through the first or second 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.

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

	Nine Months Ended	
	July 3, 2010	**July 4, 2009**
Beginning balance	**$ 10,211**	$ 13,214
Additions related to current period sales	**14,219**	9,571
Warranty costs incurred in the current period	**(11,919)**	(11,701)
Accruals resulting from acquisition	**160**	
Adjustments to accruals related to prior period sales	**(466)**	(269)
Ending balance	**$ 12,205**	$ 10,815

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

	July 3, 2010	October 3, 2009
Long-term taxes payable	**$ 46,443**	$ 51,483
Deferred compensation	**21,854**	22,723
Deferred tax liabilities	**6,254**	9,651
Deferred income	**1,731**	2,109
Asset retirement obligations liability	**1,332**	1,342
Other long-term liabilities	**4,674**	4,377
Total other long-term liabilities	**$ 82,288**	$ 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 $15.1 million of foreign lines of credit as of July 3, 2010. At July 3, 2010, we had used $1.9 million of these available foreign lines of credit. These credit facilities were used in Europe during the third fiscal quarter of 2010 as guarantees. In addition, our domestic line of credit includes a $40 million unsecured revolving credit account with Union Bank of California. The 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 July 3, 2010.

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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 nine months ended July 3, 2010 and July 4, 2009 were estimated using the following weighted-average assumptions:

	Employee Stock Option Plans				Employee Stock Purchase Plan			
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Expected life in years	4.5	5.6	4.6	4.2	0.5	0.5	0.5	0.5
Expected volatility	35.2%	48.0%	33.0%	48.0%	30.9%	55.9%	34.2%	46.7%
Risk-free interest rate	2.0%	2.7%	2.0%	2.0%	0.2%	0.5%	0.2%	1.0%
Expected dividends								
Weighted average fair value per share	$ 11.41	$ 9.43	$ 8.27	$ 8.95	$ 8.09	$ 6.22	$ 6.63	$ 6.72

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 nine months ended July 3, 2010 and July 4, 2009 (in thousands):

	Three Months Ended		Nine Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Cost of sales	$ 233	$ 200	$ 708	$ 660
Research and development	309	249	862	683
Selling, general and administrative	1,650	1,039	4,834	4,260
Income tax benefit	(602)	(120)	(1,422)	(1,110)
	$ 1,590	$ 1,368	$ 4,982	$ 4,493

During the three and nine months ended July 3, 2010, $0.2 million and $0.7 million was capitalized into inventory for all stock plans, $0.2 million and $0.7 million was amortized to cost of sales and $0.3 million remained in inventory at July 3, 2010. During the three and nine months ended July 4, 2009, $0.2 million and $0.6 million, respectively, for all stock plans was capitalized into inventory, $0.2 million and $0.7 million, respectively, was amortized to cost of sales and $0.3 million remained in inventory at July 4, 2009. Management has made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

At July 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 $12.0 million, net of estimated forfeitures of $1.6 million. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 1.4 years and will be adjusted for subsequent changes in estimated forfeitures.

At July 3, 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 nine months of fiscal 2010 and fiscal 2009, we recorded an immaterial amount of excess tax benefits as cash flows from financing activities.

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Stock Options & Awards Activity

The following is a summary of option activity for our Stock Plans (in thousands, except per share amounts and weighted average 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	476	26.59		
Exercised	(568)	26.71		
Forfeitures	(34)	24.62		
Expirations	(35)	31.95		
Outstanding at July 3, 2010	2,333	$ 29.56	3.9	$ 9,442
Vested and expected to vest at July 3, 2010	2,293	$ 29.63	3.8	$ 9,133
Exercisable at July 3, 2010	1,553	$ 31.83	2.8	$ 2,914

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 1.9 million outstanding options that were in-the-money as of July 3, 2010. The aggregate intrinsic value of options exercised under the Company s stock plans for the three and nine months ended July 3, 2010 were $0.8 million and $2.9 million, respectively, determined as of the date of option exercise. There were no options exercised during the third fiscal quarter of 2009. During the nine months ended July 4, 2009, the aggregate intrinsic value of options exercised under the Company s stock plans was $0.1 million, determined as of the date of option exercise.

The following table summarizes our restricted stock award and restricted stock unit activity for the first nine 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	245	26.73
Vested	(102)	25.90
Forfeited	(16)	23.70
Nonvested stock at July 3, 2010	484	$ 26.21

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.

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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 reviewed and accepted the examination report for the audits of our 2003 and 2004 U.S. federal tax returns and this matter is now closed. 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 the IRS concluding the audits and accepting the examination report. 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. 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.

In the current quarter, the German tax authorities have concluded the audit of our subsidiary in Gottingen for the tax years 1999 through 2001. As a result of the audit settlement, there is a release of income tax reserves under ASC 740, Income Taxes, (formerly FIN 48) net of the tax audit assessment and the amount was not material. The German tax authorities are still conducting an audit of this subsidiary for the tax years 2002 through 2005.

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.

12. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended		**Nine Months Ended**	
	July 3, 2010	**July 4, 2009**	**July 3, 2010**	**July 4, 2009**
Net income (loss)	**$ 14,404**	$ (7,015)	**$ 27,063**	$ (30,824)
Other comprehensive income (loss):				
Translation adjustment	**(18,907)**	13,858	**(39,190)**	(6,740)
Net gain (loss) on derivative instruments, net of taxes	**1**	2	**(8)**	6
Changes in unrealized gains on available-for-sale securities, net of taxes	**7**		**6**	4

Other comprehensive income (loss), net of tax		**(18,899)**		13,860		**(39,192)**		(6,730)
Comprehensive income (loss)	**$**	**(4,495)**	$	6,845	**$**	**(12,129)**	$	(37,554)

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		6
Balance, July 4, 2009	$	(87)
Balance, October 3, 2009	$	(85)
Changes in fair value of derivatives		
Net losses reclassified from OCI		6
Balance, July 3, 2010	$	(79)

Accumulated other comprehensive income (net of tax) at July 3, 2010 is comprised of accumulated translation adjustments of $41.2 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.

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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.

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

	Three Months Ended		Nine Months Ended	
	July 3, 2010	**July 4, 2009**	**July 3, 2010**	**July 4, 2009**
Weighted average shares outstanding basic (1)	**25,022**	24,331	**24,732**	24,245
Dilutive effect of employee stock awards	**416**		**305**	
Weighted average shares outstanding diluted	**25,438**	24,331	**25,037**	24,245
Net income (loss)	**$ 14,404**	$ (7,015)	**$ 27,063**	$ (30,824)
Net income (loss) per basic share	**$ 0.58**	$ (0.29)	**$ 1.09**	$ (1.27)
Net income (loss) per diluted share	**$ 0.57**	$ (0.29)	**$ 1.08**	$ (1.27)

(1) Net of restricted stock

A total of 299,925 and 1,710,047 potentially dilutive securities have been excluded from the dilutive share calculation for the three and nine months ended July 3, 2010, respectively, as their effect was anti-dilutive. As the Company incurred a net loss for the third quarter and first nine 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		Nine Months Ended	
	July 3, 2010	**July 4, 2009**	**July 3, 2010**	**July 4, 2009**

Interest and dividend income	**$ 274**	$ 210	**$ 1,712**	$ 2,343
Interest expense	**(159)**	(57)	**(229)**	(166)
Foreign exchange gain (loss)	**(107)**	503	**(383)**	(801)
Gain (loss) on investments, net	**(341)**	2,259	**819**	(5,761)
Other net	**148**	414	**180**	1,884
Other income (expense), net	**$ (185)**	$ 3,329	**$ 2,099**	$ (2,501)

15. STOCK REPURCHASES

On April 29, 2010, we announced that the Board of Directors had authorized the repurchase of up to $50 million of our common stock. During the quarter ended July 3, 2010, we repurchased and retired 476,910 shares of outstanding common stock at an average price of $35.10 per share for a total of $16.7 million, excluding expenses. Such repurchases were accounted for as a reduction in additional paid in capital. At July 3, 2010, $33.3 million of shares remain authorized for repurchase under our current stock repurchase program. The timing and size of any purchases will be subject to market conditions. The program is authorized for 12 months.

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16. 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 discrete to the period. Our estimated effective tax rate for the three months and nine months ended July 3, 2010 was 35.3% and 37.4%, respectively. Our effective tax rates for the three months and nine months ended July 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, adjustments related to remitted foreign earnings and losses of a foreign subsidiary for which no tax benefit may be available. These amounts are partially offset by the benefit of foreign tax credits, a release of income tax reserves under ASC 740 net of tax audit assessments, 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 July 3, 2010, the total amount of gross unrecognized tax benefits was $53.3 million, of which $31.1 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.

Our policy is to include interest and penalties related to unrecognized tax benefits within the provision for income taxes. As of July 3, 2010, the total amount of gross interest and penalties accrued was $6.6 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 reviewed and accepted the examination report for the audits of our 2003 and 2004 U.S. federal tax returns and this matter is now closed. There were 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 and 2001, respectively, 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 740and this amount is not material.

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 has carried 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 July 3, 2010, our condensed consolidated balance sheet included net deferred tax assets, before valuation allowance, of approximately $75.5 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 $6.8 million reported as of July 3, 2010. We intend to maintain the valuation allowance until sufficient positive evidence exists to support reversal of the valuation allowance.

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17. 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.

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

	Three Months Ended		Nine Months Ended	
	July 3, 2010	**July 4, 2009**	**July 3, 2010**	**July 4, 2009**
Net sales:				
Commercial Lasers and Components	**$ 58,261**	$ 28,061	**$ 146,856**	$ 96,269
Specialty Laser Systems	**108,411**	70,393	**291,738**	231,945
Corporate and other	**25**	25	**75**	75
Total net sales	**$ 166,697**	$ 98,479	**$ 438,669**	$ 328,289
Income (loss) from operations:				
Commercial Lasers and Components	**$ 3,667**	$ (7,495)	**$ 368**	$ (38,771)
Specialty Laser Systems	**26,802**	2,961	**63,468**	24,586
Corporate and other	**(8,011)**	(8,511)	**(22,691)**	(13,965)
Total income (loss) from operations	**$ 22,458**	$ (13,045)	**$ 41,145**	$ (28,150)

18. SUBSEQUENT EVENTS

On July 21, 2010 we completed the sale of our facility in Tampere, Finland and entered into an agreement to lease back the facility while we complete building adequate buffer stock for the transition of operations from that facility to our facility in Sunnyvale, California. We expect to recognize a loss of approximately $3.5 to $4.0 million on the sale in the fourth fiscal quarter.

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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.

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.

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.

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- **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.

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.

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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.

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 during 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 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.

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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 nine months ended July 3, 2010, we noted no indications of impairment or triggering events to cause us to review goodwill for potential impairment.

At July 3, 2010, we had $67.5 million of goodwill, $91.5 million of property and equipment and $21.7 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 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.

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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.

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 has carried back losses incurred in fiscal 2009 in accordance with this new legislation and this tax law change has had minimal financial statement impact.

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KEY PERFORMANCE INDICATORS

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			
	July 3, 2010	July 4, 2009	Change	% Change
		(Dollars in thousands)		
Bookings	$ 180,570	$ 88,647	$ 91,923	103.7%
Net sales Commercial Lasers and Components	$ 58,261	$ 28,061	$ 30,200	107.6%
Net sales Specialty Lasers and Systems	$ 108,411	$ 70,393	$ 38,018	54.0%
Gross profit as a percentage of net sales Commercial Lasers and Components	38.4%	25.7%	12.7%	49.4%
Gross profit as a percentage of net sales Specialty Lasers and Systems	48.1%	37.8%	10.3%	27.2%
Research and development as a percentage of net sales	11.0%	15.8%	(4.8)%	(30.4)%
Income (loss) before income taxes	$ 22,273	$ (9,716)	$ 31,989	329.2%
Net cash provided by operating activities	$ 22,160	$ 11,021	$ 11,139	101.1%
Days sales outstanding in receivables	53.1	68.7	(15.6)	(22.7)%
Annualized inventory turns	3.7	2.4	1.3	54.2%
Capital spending as a percentage of net sales	2.6%	3.6%	(1.0)%	(27.8)%

	Nine Months Ended			
	July 3, 2010	July 4, 2009	Change	% Change
		(Dollars in thousands)		
Bookings	$ 503,477	$ 285,809	$ 217,668	76.2%
Net sales Commercial Lasers and Components	$ 146,856	$ 96,269	$ 50,587	52.5%
Net sales Specialty Lasers and Systems	$ 291,738	$ 231,945	$ 59,793	25.8%
Gross profit as a percentage of net sales Commercial Lasers and Components	36.5%	26.4%	10.1%	38.3%
Gross profit as a percentage of net sales Specialty Lasers and Systems	47.3%	42.5%	4.8%	11.3%
Research and development as a percentage of net sales	12.1%	14.0%	(1.9)%	(13.6)%
Income (loss) before income taxes	$ 43,244	$ (30,651)	$ 73,895	241.1%
Net cash provided by operating activities	$ 68,339	$ 18,548	$ 49,791	268.4%
Capital spending as a percentage of net sales	2.3%	5.4%	(3.1)%	(57.4)%

Definitions and analysis of these performance indicators are as follows:

Bookings

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 three quarters of fiscal 2010, led by a significant increase in the microelectronics market. Third fiscal quarter bookings increased 103.7% from the same quarter one year ago, with increases in all four markets.

Microelectronics

Microelectronics bookings increased 235% compared to the same quarter one year ago and increased 2% from record bookings in the second quarter of fiscal 2010.

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Bookings for semiconductor capital equipment reflect the broader trend in the market and have increased more than 200% compared to the same quarter a year ago. Given the product mix, part of the demand will relieve short-term integrated circuit shortages. We are also taking orders for advanced nodes to support new products, which should continue into fiscal 2011.

Advanced packaging orders increased more than 60% sequentially and 250% compared to the prior year period. The activity in the light-emitting diode (LED) market has been strong and we believe approximately ten new fabs will be opening this year to satisfy demand for LED televisions and lighting. We have also secured several key design wins for silicon singulation and scribing, which will contribute to future bookings and revenues. The continued growth in mobile communications and computing (i.e., smartphones) is driving orders for via drilling, while overall consumer electronics growth is benefitting laser sales to direct imaging applications.

Orders for flat panel display (FPD) manufacturing were lower following a record-setting second quarter of fiscal 2010, but we remain optimistic about the customer demand for our product offerings in this space. The number of small format active-matrix organic light-emitting diodes (AMOLED)s used in smartphones have grown by more than 50% in the past year and are poised for more growth. Our excimer laser annealing systems were used to produce the overwhelming majority of these displays. Despite the success of OLEDs, LCDs remain a force in the marketplace due to products like Apple s® iPhone and iPad . The continued adoption of these and similar products will require further capacity buildouts. We also provide lasers used to make light guide panels for LED TVs, to seal OLED displays, to create touchscreen sensitivity, and different solutions to cut glass. These applications accounted for the bulk of our FPD bookings in the third quarter of fiscal 2010.

Our first set of Equinox solar tools have been installed and are in production mode. We have engaged with other customers and have received the first development tool orders.

Materials Processing

Materials processing orders increased 120% compared to the same quarter one year ago and increased 20% from the second quarter of fiscal 2010.

Low end marking and engraving utilizing CO_2 lasers led the materials processing recovery over the last few quarters. This trend continued in the third quarter of fiscal 2010 for the textile and leather market. We are now seeing the first signs of recovery in high-end marking and engraving with China accounting for much of this growth through direct sales or imports.

We have not yet seen signs of sustainable recovery in the macro market. Nonetheless, we have made inroads with our newly released E-1000 CO_2 laser. We have delivered lasers that will be used for 3D, robotic cutting of automotive interiors, which is a sizable market. The combination of performance and footprint was pivotal in capturing this opportunity. We are also fielding strong interest from flatbed cutting customers that constitute another large market.

We completed the Beam Dynamics acquisition in April and the move of those operations to our Santa Clara facility was finished in July 2010. We are starting to take orders and look forward to bringing this innovative and cost-effective solution to the broader market.

OEM Components and Instrumentation

OEM Components and Instrumentation orders increased 81% compared to the same quarter one year ago and increased 30% from the second quarter of fiscal 2010.

The continued increase in elective ophthalmic and aesthetic procedures led to higher orders in the third quarter of fiscal 2010 for both lasers used in refractive surgery and lasers for non-refractive ophthalmology. We are also monitoring some new techniques that hold promise to improve treatment of certain eye diseases including diabetic retinopathy, a disease that is on the rise around the world. If these techniques work, they would represent a significant breakthrough in photocoagulation therapy.

The life sciences market is enjoying significant investment, especially in Asia, which has led to a meaningful increase in instrumentation bookings. The underlying product trends are favoring higher power/higher ASP lasers that are differentiated compared to competitive offerings. We are also seeing greater interest in beam shaping optics that enhance detection sensitivity, thereby boosting performance.

Scientific and Government Programs

Scientific and government programs orders increased 15% compared to the same quarter one year ago, but decreased 3% from the second quarter of fiscal 2010.

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With stimulus funds nearly exhausted, scientific bookings are reverting to pre-stimulus levels. Some stimulus money remains in the U.S., but it does not appear to be targeted at laser applications. Orders for Chameleon lasers led all major product categories as biological imaging continued to attract research funding, especially within Asia. Recognizing this trend, we have been working with various partners to add tunable light sources to Chameleon and other ultrafast lasers that extend the spectrum of available colors. This is enabling researchers to study new phenomena.

Net Sales

Net sales include sales of lasers, related accessories and service contracts. Net sales for the third fiscal quarter increased 107.6% in our CLC segment and increased 54.0% in our SLS segment from the same quarter one year ago. Net sales for the first nine months of fiscal 2010 increased 52.5% in our CLC segment and increased 25.8% 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 third quarter increased from 25.7% to 38.4% in our CLC segment and increased from 37.8% to 48.1% in our SLS segment from the same quarter one year ago. Gross profit percentage for the first nine months of fiscal 2010 increased from 26.4% to 36.5% in our CLC segment and increased from 42.5% to 47.3% 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 11.0% from 15.8% in our third fiscal quarter and to 12.1% from 14.0% for the first nine 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 working capital 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 third quarter of fiscal 2010 decreased 15.6 days from the same quarter one year ago primarily due to significantly improved collections, particularly in Japan and Europe, and fewer longer term receivables in Japan.

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 working capital 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 third quarter of fiscal 2010 increased by 1.3 from the same quarter one year ago primarily due to increased sales volumes and reduced inventories due to site consolidations, increases 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 2.6% for the third quarter from 3.6% in the third quarter of fiscal 2009 and to 2.3% from 5.4% for the first nine months of fiscal 2010 primarily due to higher sales volumes net of 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.

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 nine months ended July 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 decided to delay the closure by one to two quarters 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 29, 2010 we announced that our Board of Directors authorized the Company to repurchase up to $50 million of our common stock under a stock repurchase program. In the third quarter of fiscal 2010, we repurchased and retired 476,910 shares of outstanding common stock for a total of $16.7 million, net of expenses. The timing and size of any purchases will be subject to cash balances and general business and market conditions. The program is authorized for 12 months.

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. These assets and liabilities have been included in our Commercial Lasers and Components segment.

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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		Nine Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Net sales	**100.0%**	100.0%	**100.0%**	100.0%
Cost of sales	**55.4%**	65.9%	**56.5%**	62.3%
Gross profit	**44.6%**	34.1%	**43.5%**	37.7%
Operating expenses:				
Research and development	**11.0%**	15.8%	**12.1%**	14.0%
Selling, general and administrative	**18.9%**	29.7%	**20.7%**	24.6%
Impairment of goodwill	%	%	%	5.9%
Amortization of intangible assets	**1.2%**	1.9%	**1.4%**	1.7%
Total operating expenses	**31.1%**	47.4%	**34.2%**	46.2%
Income (loss) from operations	**13.5%**	(13.3)%	**9.3%**	(8.5)%
Other income (net)	**(0.1)%**	3.4%	**0.6%**	(0.8)%
Income (loss) before income taxes	**13.4%**	(9.9)%	**9.9%**	(9.3)%
Provision for (benefit from) income taxes	**4.8%**	(2.8)%	**3.7%**	0.1%
Net income (loss)	**8.6%**	(7.1)%	**6.2%**	(9.4)%

Net income for the third quarter of fiscal 2010 was $14.4 million ($0.57 per diluted share) including $0.8 million of after-tax restructuring costs and $1.6 million of after-tax stock-related compensation expense. Net loss for the third quarter of fiscal 2009 was $7.0 million ($0.29 per share) including $3.4 million of after-tax restructuring costs, $1.4 million of after-tax stock-related compensation expense and $0.1 million of after-tax costs related to litigation resulting from our internal stock option investigation. Net income for the first nine months of fiscal 2010 was $27.1 million ($1.08 per diluted share) including $2.6 million of after-tax restructuring costs, $5.0 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 nine months of fiscal 2009 was $30.8 million ($1.27 per share) including a charge for goodwill impairment of $19.3 million, $10.4 million of after-tax restructuring costs, $4.5 million of after-tax stock-related compensation expense, a $2.7 million tax expense due to a change in state tax law and $0.7 million of after-tax costs related to litigation resulting from our internal stock option investigation.

NET SALES

Market Application

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):

	Three Months Ended			
	July 3, 2010		July 4, 2009	
	Amount	Percentage of total net sales	Amount	Percentage of total net sales
Consolidated:				
Microelectronics	**$ 69,583**	**41.7%**	$ 30,349	30.8%
OEM components and instrumentation	**40,101**	**24.1%**	25,342	25.8%
Materials processing	**23,317**	**14.0%**	12,644	12.8%
Scientific and government programs	**33,696**	**20.2%**	30,144	30.6%
Total	**$ 166,697**	**100.0%**	$ 98,479	100.0%

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	Nine Months Ended			
	July 3, 2010		July 4, 2009	
	Amount	**Percentage of total net sales**	**Amount**	**Percentage of total net sales**
Consolidated:				
Microelectronics	**$ 161,325**	**36.8%**	$ 96,048	29.3%
OEM components and instrumentation	**111,408**	**25.4%**	93,020	28.3%
Materials processing	**58,371**	**13.3%**	45,938	14.0%
Scientific and government programs	**107,565**	**24.5%**	93,283	28.4%
Total	**$ 438,669**	**100.0%**	$ 328,289	100.0%

Quarterly

Net sales for the third quarter of fiscal 2010 increased by $68.2 million, or 69%, including a decrease of $0.3 million due to the impact of foreign currency exchange rates, compared to the third quarter of fiscal 2009. Sales increased in all four markets, with the largest increase in the microelectronics market.

The increase in the microelectronics market of $39.2 million, or 129%, was primarily due to higher sales in advanced packaging, solar, semiconductor and flat panel display applications. Solar revenues were exceptionally high in the third quarter of fiscal 2010 due to a large order received in the first quarter of fiscal 2010. The increase in the OEM components and instrumentation market of $14.8 million, or 58%, was due primarily to higher shipments for flow cytometry applications and for machine vision applications due to the acquisition of certain product lines from StockerYale in the first quarter of fiscal 2010 as well as higher shipments for medical, military and graphic arts and display applications. Sales in the materials processing market increased $10.7 million, or 84%, primarily due to higher shipments for marking applications. Sales in the scientific and government programs market increased $3.6 million, or 12%, primarily due to higher demand for advanced research applications used by university and government research groups.

Year-to-date

Net sales for the first nine months of fiscal 2010 increased by $110.4 million, or 34%, including an increase of $6.6 million due to the impact of foreign currency exchange rates, compared to the first nine months of fiscal 2009. Sales increased in all four markets, with the largest increase in the microelectronics market.

The increase in the microelectronics market of $65.3 million, or 68%, was primarily due to higher sales in advanced packaging, flat panel display, solar and semiconductor applications. The increase in the OEM components and instrumentation market of $18.4 million, or 20%, was due primarily to higher shipments for flow cytometry applications and for machine vision applications due to the acquisition of certain product lines from StockerYale in the first quarter of fiscal 2010. Sales in the scientific and government programs market increased $14.3 million, or 15%, primarily due to higher demand for advanced research applications used by university and government research groups in part due to stimulus money. Sales in the material processing market increased $12.4 million, or 27%, primarily due to higher shipments for marking applications.

Although we continue to have a sizeable backlog of orders, current market conditions make it difficult to predict future orders.

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Segments

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

	Three Months Ended			
	July 3, 2010		July 4, 2009	
	Amount	Percentage of total net sales	Amount	Percentage of total net sales
Consolidated:				
Commercial Lasers and Components (CLC)	**$ 58,261**	**35.0%**	$ 28,061	28.5%
Specialty Lasers and Systems (SLS)	**108,411**	**65.0%**	70,393	71.5%
Corporate and other	**25**	**0.0%**	25	0.0%
Total	**$ 166,697**	**100.0%**	$ 98,479	100.0%

	Nine Months Ended			
	July 3, 2010		July 4, 2009	
	Amount	Percentage of total net sales	Amount	Percentage of total net sales
Consolidated:				
Commercial Lasers and Components (CLC)	**$ 146,856**	**33.5%**	$ 96,269	29.3%
Specialty Lasers and Systems (SLS)	**291,738**	**66.5%**	231,945	70.7%
Corporate and Other	**75**	**0.0%**	75	0.0%
Total	**$ 438,669**	**100.0%**	$ 328,289	100.0%

Quarterly

Net sales for the third quarter of fiscal 2010 increased by $68.2 million, or 69%, compared to the third quarter of fiscal 2009, with increases of $30.2 million, or 108%, in our CLC segment and increases of $38.0 million, or 54%, in our SLS segment.

The increase in our CLC segment sales was primarily due to higher advanced packaging, materials processing and flat panel display application sales. The increase in our SLS segment sales was primarily due to higher revenue for advanced packaging, solar, scientific, semiconductor and flat panel display applications.

Year-to-date

Net sales for the first nine months of fiscal 2010 increased by $110.4 million, or 34%, compared to the first nine months of fiscal 2009, with increases of $50.6 million, or 53%, in our CLC segment and increases of $59.8 million, or 26%, in our SLS segment.

The increase in our CLC segment sales was primarily due to higher materials processing, advanced packaging, flat panel display, machine vision and semiconductor application sales. The increase in our SLS segment sales was primarily due to higher revenue for flat panel display, solar, microelectronics and semiconductor applications.

GROSS PROFIT

Consolidated

Our gross profit rate increased to 44.6% in the third fiscal quarter of 2010 from 34.1% and increased to 43.5% from 37.7% in the first nine months of fiscal 2010 compared to the same periods one year ago.

The third quarter 10.5% improvement in gross profit was primarily due to higher sales volumes and a lower manufacturing cost structure. The improvement includes the benefit of a lower manufacturing cost structure as well as favorable product mix (5.6%), lower restructuring costs (2.4%), lower other costs (1.7%) related to lower inventory provisions stemming from higher sales volumes and lower warranty costs (0.7%).

The 5.8% improvement in gross profit during the first nine months of fiscal 2010 was primarily due to higher sales volumes and a lower manufacturing cost structure. The improvement includes lower other costs (2.5%) primarily due to lower inventory provisions stemming from higher sales volumes, lower restructuring costs (2.3%), lower warranty costs (0.7%) and favorable product mix and lower manufacturing cost structure (0.4%).

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Our gross profit rate has been and will continue to be affected by a variety of factors including market mix, manufacturing efficiencies, excess and obsolete inventory write-downs, warranty costs, pricing by competitors or suppliers, new product introductions, production volume, customization and reconfiguration of systems, commodity prices and foreign currency fluctuations.

Commercial Lasers and Components

The gross profit rate in our CLC segment increased to 38.4% in the third fiscal quarter of 2010 from 25.7% and to 36.5% in the first nine months of fiscal 2010 from 26.4% compared to the same periods one year ago.

The third quarter 12.7% increase in gross profit was primarily due to favorable product cost (6.6%) due to the impact of increased volumes and cost reduction efforts partially offset by unfavorable product mix in the materials processing and OEM components markets, lower warranty costs (2.8%), lower restructuring costs (2.4%) and lower other costs (0.9%) primarily due to lower inventory provisions.

The 10.1% improvement in gross profit during the first nine months of fiscal 2010 was primarily due to lower other costs (4.9%) primarily due to lower inventory provisions, lower restructuring costs (3.7%) and lower warranty costs (1.9%) partially offset by unfavorable product mix in the materials processing market (0.4%).

Specialty Lasers and Systems

The gross profit rate in our SLS segment increased to 48.1% in the third fiscal quarter of 2010 from 37.8% and to 47.3% in the first nine months of fiscal 2010 from 42.5% compared to the same periods one year ago.

The third quarter 10.3% increase in gross profit was primarily due to the impact of increased volumes and cost reduction efforts as well as favorable product mix in the microelectronics and instrumentation markets (6.1%), lower restructuring costs (2.4%) and lower other costs (2.2%) primarily due to lower inventory provisions partially offset by higher warranty costs (0.4%).

The 4.8% improvement in gross profit during the first nine months of fiscal 2010 was primarily due to lower restructuring costs (1.8%), lower other costs (1.6%) primarily due to lower inventory provisions and lower product costs (1.4%) primarily due to the impact of increased volumes and cost reduction efforts as well as favorable product mix in the microelectronics and instrumentation markets.

OPERATING EXPENSES:

	Three Months Ended			
	July 3, 2010		July 4, 2009	
	Amount	Percentage of total net sales	Amount	Percentage of total net sales
	(Dollars in thousands)			
Research and development	**$ 18,264**	**11.0%**	$ 15,529	15.8%
Selling, general and administrative	**31,584**	**18.9%**	29,223	29.7%
Impairment of goodwill				
Amortization of intangible assets	**2,041**	**1.2%**	1,907	1.9%
Total operating expenses	**$ 51,889**	**31.1%**	$ 46,659	47.4%

	Nine Months Ended			
	July 3, 2010		July 4, 2009	
	Amount	Percentage of total net sales	Amount	Percentage of total net sales
	(Dollars in thousands)			
Research and development	**$ 53,162**	**12.1%**	$ 45,917	14.0%
Selling, general and administrative	**90,727**	**20.7%**	80,813	24.6%
Impairment of goodwill			19,286	5.9%
Amortization of intangible assets	**5,958**	**1.4%**	5,744	1.7%
Total operating expenses	**$ 149,847**	**34.2%**	$ 151,760	46.2%

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Research and development

Quarterly

Research and development (R&D) expenses increased $2.7 million, or 18%, during the third fiscal quarter ended July 3, 2010 compared to the same quarter one year ago. The third quarter increase was primarily due to higher payroll spending ($2.4 million) due to higher performance-related compensation net of lower severance-related restructuring costs and the acquisition of certain product lines from StockerYale in the first quarter of fiscal 2010 ($1.0 million) partially offset by higher net reimbursements from customers for development projects ($0.5 million) and $0.2 million lower other spending. On a quarterly segment basis as compared to the prior year period, CLC spending increased $1.9 million, primarily due to higher payroll spending, the acquisition of StockerYale, and project spending related to moving wafer production from Finland to Santa Clara. SLS research and development spending increased $0.8 million primarily due to higher payroll spending and higher spending on projects. Corporate and other spending was flat.

Year-to-date

R&D expenses increased $7.2 million, or 16%, during the nine months ended July 3, 2010 compared to the same period one year ago. The increase for the first nine months was primarily due to the acquisition of certain product lines from StockerYale in the first quarter of fiscal 2010 ($2.3 million), higher payroll spending ($1.7 million) due to higher performance-related compensation net of lower severance-related restructuring costs, higher project spending ($1.2 million), higher charges for increases in deferred compensation plan liabilities ($0.9 million) with the related earnings for increases in deferred compensation plan assets recorded in other income (expense), the impact of foreign currency exchange rates ($0.6 million), $0.3 million higher stock-related compensation expense and $0.2 million higher other spending. On a segment basis for the first nine months of fiscal 2010 as compared to the prior year period, CLC spending increased $4.5 million, primarily due to higher project spending, the acquisition of certain product lines from StockerYale and higher payroll spending. SLS research and development spending increased $0.8 million, primarily due to higher payroll spending and higher project spending. Corporate and other spending increased $1.9 million primarily due to higher charges for increases in deferred compensation plan liabilities and higher stock-related compensation expense.

Selling, general and administrative

Quarterly

Selling, general and administrative (SG&A) expenses increased $2.4 million or 8%, during the third fiscal quarter ended July 3, 2010 compared to the same quarter one year ago. The third quarter increase in SG&A expenses was primarily due to $4.2 million higher payroll spending due to higher performance-related compensation spending and the elimination of mandatory time off net of savings from site consolidations and other restructuring activities, the acquisition of certain product lines from StockerYale ($0.7 million), $0.6 million higher stock-related compensation expense and $0.1 million lower other spending partially offset by $2.4 million lower charges for increases in deferred compensation plan liabilities with the related earnings for increases in deferred compensation plan assets recorded in other income (expense) and lower facilities related costs ($0.8 million). On a quarterly segment basis as compared to the prior year period, CLC spending increased $1.6 million primarily due to the acquisition of certain product lines from StockerYale and higher performance-related compensation spending. SLS segment expenses increased $1.2 million primarily due to higher performance-related compensation spending. Spending for Corporate and other decreased $0.4 million primarily due to lower charges for increases in deferred compensation plan liabilities partially offset by higher performance-related compensation spending partially and higher stock-related compensation expense.

Year-to-date

SG&A expenses increased $9.9 million, or 12%, during the nine months ended July 3, 2010 compared to the same period one year ago. The increase for the first nine months was primarily due to $5.7 million higher charges due to increases in deferred compensation plan liabilities with the related earnings for increases in deferred compensation plan assets recorded in other income (expense), $4.8 million higher payroll spending due to higher performance-related compensation spending and the elimination of mandatory time off net of savings from site consolidations and other restructuring activities, the acquisition of certain product lines from StockerYale ($1.8 million), the impact of foreign currency exchange rates ($1.3 million), higher other spending ($0.8 million) and $0.5 million higher stock-related compensation expense partially offset by $3.1 million lower costs incurred for litigation resulting from our internal stock option investigation primarily due to a receipt from the settlement of the litigation and $1.9 million lower spending on facilities due to site consolidations. On a segment basis for the first nine months of fiscal 2010 as compared to the prior year period, CLC spending increased $2.7 million primarily due to the acquisition of certain product lines from StockerYale and higher payroll spending. SLS segment expenses increased $0.7 million primarily due to higher payroll spending net of savings from site consolidations. Spending for Corporate and other increased $6.5 million primarily due to higher charges due to increases in deferred compensation plan liabilities and higher performance-related compensation spending partially offset by lower costs incurred for litigation resulting from our internal stock option investigation.

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Impairment of goodwill

Goodwill is tested for impairment on an annual basis and between annual tests in certain circumstances, and written down when impaired. 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 which indicated that the goodwill was fully impaired. We recorded a non-cash goodwill impairment charge of $19.3 million in the CLC reporting unit in the first quarter of fiscal 2009.

Amortization of intangible assets

Amortization of intangible assets increased $0.1 million in the quarter and $0.2 million in the nine months ended July 3, 2010 compared to the same periods last year. Increases due to the acquisition of certain product lines from StockerYale and the acquisition of Beam Dynamics were offset by the completion of amortization of certain intangibles related to prior acquisitions.

OTHER INCOME (EXPENSE) NET

Other income (expense), net of other expense, decreased $3.5 million and increased $4.6 million during the three and nine months ended July 3, 2010, respectively, compared to the same periods one year ago. The quarterly decrease was primarily due to lower gains, net of expenses, on our deferred compensation plan assets ($2.6 million) and lower foreign exchange gains ($0.6 million). The increase for the first nine months of fiscal 2010 was primarily due to higher gains, net of expenses, on our deferred compensation plan assets ($6.6 million) and lower foreign exchange losses ($0.4 million) partially offset by lower benefit from Japan consumption tax savings ($2.0 million) as the benefit expired in the fourth quarter of fiscal 2009 and lower interest income ($0.6 million) as a result of lower rates of return net of interest on tax refunds.

INCOME TAXES

The effective tax rate for the third quarter of fiscal 2010 of 35.3% and the effective tax rate of 37.4% for the nine months ended July 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, adjustments related to remitted foreign earnings and losses of a foreign subsidiary for which no tax benefit may be available. These amounts are partially offset by the benefit of foreign tax credits, a release of income tax reserves under ASC 740, Income Taxes, (formerly FIN 48), 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.

The difference between the statutory rate of 35% and our effective tax rate of 27.8% on income (loss) before income taxes for the third quarter of fiscal 2009 was due primarily to permanent differences related to the benefit of foreign tax credits and federal research and development tax credits, partially offset by an unrealized loss on life insurance policy investments related to our deferred compensation plan and deemed dividend inclusions under the Subpart F tax rules. The difference between the statutory rate of 35% and our effective tax rate of (0.6%) on income (loss) before income taxes for the nine months ended July 4, 2009 was due primarily to permanent differences related to the non-deductibility of the goodwill impairment charge, an increase in valuation allowance against California research and development tax credits as a result of California legislation enacted in February 2009 and certain foreign net operating loss carryforwards, an unrealized loss on life insurance policy investments related to our deferred compensation plan and deemed dividend inclusions under the Subpart F tax rules. These amounts are partially offset by permanent differences related to the benefit of foreign tax credits and the benefit of federal research and development tax credits, including additional credits reinstated from fiscal 2008 resulting from the enactment of the Emergency Economic Stabilization Act of 2008.

DEFERRED INCOME TAXES

As of July 3, 2010, our condensed consolidated balance sheet included net deferred tax assets, before valuation allowance, of approximately $75.5 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 $6.8 million reported as of July 3, 2010. We intend to maintain the valuation allowance until sufficient positive evidence exists to support reversal of the valuation allowance.

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FINANCIAL CONDITION

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

Historically, our primary source of cash has been provided by operations. Other sources of cash in the past three fiscal years include proceeds received from the sale of our stock through our employee stock option and purchase plans, as well as through debt borrowings. Our historical uses of cash have primarily been for the repurchase of our common stock, capital expenditures, acquisitions of businesses and technologies and payments of principal and interest on outstanding debt obligations. Supplemental information pertaining to our historical sources and uses of cash is presented as follows and should be read in conjunction with our condensed consolidated statements of cash flows and the notes to condensed consolidated financial statements:

	Nine Months Ended	
	July 3, 2010	July 4, 2009
	(in thousands)	
Net cash provided by operating activities	**$ 68,339**	$ 18,548
Sales of shares under employee stock plans	**19,416**	4,674
Repurchase of common stock	**(16,752)**	
Capital expenditures	**(10,117)**	(17,723)
Net debt payments	**(14)**	(6)

Net cash provided by operating activities increased by $49.8 million for the first nine months of fiscal 2010 compared to the same period one year ago. The increase in cash provided by operating activities was primarily due to higher net income, higher cash flows from other current liabilities and accounts payable and higher net cash flows due to new tax legislation which allows the carry back of net operating losses for up to five years partially offset by lower cash flows from accounts receivable and inventories due to increased sales volumes. We believe that our existing cash, cash equivalents and short term investments combined with cash to be provided by operating activities will be adequate to cover our working capital needs and planned capital expenditures for at least the next 12 months to the extent such items are known or are reasonably determinable based on current business and market conditions. However, we may elect to finance certain of our capital expenditure requirements through borrowings under our bank credit facilities or other sources of capital. We continue to follow our strategy to further strengthen our financial position by using available cash flow to fund operations.

We intend to continue pursuing acquisition opportunities at valuations we believe are reasonable based upon market conditions as demonstrated by our acquisition of businesses from StockerYale in the first quarter of fiscal 2010 and Beam Dynamics in the third quarter of fiscal 2010. However, we cannot accurately predict the timing, size and success of our acquisition efforts or our associated potential capital commitments. Furthermore, we cannot assure you that we will be able to acquire businesses on terms acceptable to us. We expect to fund future acquisitions through existing cash balances and cash flows from operations. If required, we will look for additional borrowings or consider the issuance of securities. The extent to which we will be willing or able to use our common stock to make acquisitions will depend on its market value at the time and the willingness of potential sellers to accept it as full or partial payment.

On April 29, 2010, the Company announced that the Board of Directors had authorized the Company to repurchase up to $50 million of its common stock under its stock repurchase program. The program is authorized for 12 months. In the third quarter of fiscal 2010, we repurchased and retired 476,910 shares of outstanding common stock for a total of $16.7 million, net of expenses.

During fiscal year 2008, we initiated restructuring plans to decrease costs by consolidating facilities and by reducing our workforce. As of July 3, 2010, we had made payments in connection with the restructuring plans in the amount of $20.1 million. We expect to complete payments for substantially all anticipated costs related to the restructuring plans by the first or second quarter of fiscal 2011.

Additional sources of cash available to us were multi-currency and domestic lines of credit and bank credit facilities totaling $56.1 million as of July 3, 2010, of which $53.2 million was unused and available. These credit facilities were used in Europe during the first nine months of fiscal 2010 as guarantees. Our domestic line of credit includes a $40 million unsecured revolving credit account with Union Bank of California, which expires on March 31, 2012 and is subject to covenants related to financial ratios and tangible net worth. No amounts have been drawn upon our domestic line of credit and $1.9 million has been used of the multi-currency lines as of July 3, 2010.

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Our ratio of current assets to current liabilities was 4.0:1 at July 3, 2010 compared to 5.6:1 at October 3, 2009. The decrease in our ratio from October 3, 2009 to July 3, 2010 is primarily due to increases in other current liabilities and accounts payable as well as decreases in cash due to our stock repurchase program and our fiscal 2010 acquisitions. Our cash position, short-term investments, working capital and total debt obligations are as follows:

	July 3, 2010	October 3, 2009
	(in thousands)	
Cash and cash equivalents	**$ 210,351**	$ 199,950
Short-term investments	**43,656**	43,685
Restricted cash, current	**625**	
Working capital	**390,268**	396,428
Total debt obligations	**56**	15

Contractual Obligations and Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements as defined under Regulation S-K of the Securities Act of 1933. Information regarding our long-term debt payments, operating lease payments, asset retirement obligations, purchase commitments with suppliers and purchase obligations is provided in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the fiscal year ended October 3, 2009. There have been no material changes in contractual obligations since October 3, 2009, with the exception of increased inventory purchases to support new customer orders. Information regarding our other financial commitments at July 3, 2010 is provided in the notes to the condensed consolidated financial statements in this filing.

Changes in Financial Condition

Cash provided by operating activities during the first nine months of fiscal 2010 was $68.3 million, which included net income of $27.1 million, depreciation and amortization of $22.7 million, increases in net deferred tax assets of $13.9 million, stock-based compensation expense of $6.1 million and $1.1 million other partially offset by cash used by operating assets and liabilities of $2.6 million.

Cash used in investing activities during the first nine months of fiscal 2010 was $35.2 million, which included $20.8 million used to acquire certain assets of StockerYale and our acquisition of Beam Dynamics, $10.1 million used to acquire property and equipment and improve buildings, $2.5 million net purchases of available-for-sale securities, a $2.0 million investment in SiOnyx, and $0.6 million increase in restricted cash, partially offset by $0.8 million in proceeds from dispositions of property and equipment.

Cash provided by financing activities during the first nine months of fiscal 2010 was $2.1 million, which included $19.4 million generated from our employee stock option and stock purchase plans partially offset by $16.8 million used to repurchase our common stock and $0.5 million other.

Changes in exchange rates during the first nine months of fiscal 2010 used $24.8 million, primarily due to the weakening of the Euro against the U.S. dollar.

RECENT ACCOUNTING STANDARDS

See Note 2. Recent Accounting Standards in the Notes to Condensed Consolidated Financial Statements for a full description of recent accounting pronouncements, including the respective dates of adoption or expected adoption and effects on our consolidated financial position, results of operations and cash flows.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk disclosures

We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes.

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Interest rate sensitivity

A portion of our investment portfolio is composed of fixed income securities. These securities are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10% from levels at July 3, 2010, the fair value of the portfolio, based on quoted market prices in active markets involving similar assets, would decline by an immaterial amount. We have the ability to generally hold our fixed income investments until maturity and therefore we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on our securities portfolio. If necessary, we may sell short-term investments prior to maturity to meet our liquidity needs.

At July 3, 2010, the fair value of our available-for-sale debt securities was $34.4 million, all of which were classified as short-term investments. Gross unrealized gains and losses on available-for-sale debt securities were $19,000 and ($3,000), respectively, at July 3, 2010.

Foreign currency exchange risk

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, cash flows and cash balances are exposed to fluctuations in foreign currency exchange rates. A substantial portion of our cash balance is Euro denominated. 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.

We do not anticipate any material adverse effect on our consolidated financial position, results of operations or cash flows resulting from the use of these instruments. There can be no assurance that these strategies will be effective or that transaction losses can be minimized or forecasted accurately. 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. In the current economic environment, the risk of failure of a financial party remains high.

A hypothetical 10% change in foreign currency rates would not have a material impact on our results of operations.

The following table provides information about our foreign exchange forward contracts at July 3, 2010. The table presents the weighted average contractual foreign currency exchange rates, the value of the contracts in U.S. dollars at the contract exchange rate as of the contract maturity date and fair value. The U.S. notional fair value represents the contracted amount valued at July 3, 2010 rates.

Forward contracts to sell (buy) foreign currencies for U.S. dollars (in thousands, except contract rates):

	Average Contract Rate		U.S. Notional Contract Value		U.S. Notional Fair Value
Euro	1.2299	$	(21,192)	$	(21,688)
Japanese Yen	91.1400	$	(6,278)	$	(6,522)
British Pound	1.4786	$	4,629	$	4,754
Korean Won	1,233.600	$	2,309	$	2,317
Chinese Renminbi	6.8955	$	1,021	$	1,039

ITEM 4. CONTROLS AND PROCEDURES

Management s Evaluation of Disclosure Controls and Procedures

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures; as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as of July 3, 2010 (Evaluation Date). The controls evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective in providing reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

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Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended July 3, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations over Internal Control

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Our internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

Management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of internal controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Also, any evaluation of the effectiveness of controls in future periods are subject to the risk that those internal controls may become inadequate because of changes in business conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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.

Income Tax Audits

The Internal Revenue Service (IRS) has concluded reviewed and accepted the examination report for the audits of our 2003 and 2004 U.S. federal tax returns and this matter is now closed. 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 the IRS concluding the audits and accepting the examination report. 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. 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.

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In the current quarter, the German tax authorities have concluded the audit of our subsidiary in Gottingen for the tax years 1999 through 2001. As a result of the audit settlement, there is a release of income tax reserves under ASC 740 net of the tax audit assessment and the amount was not material. The German tax authorities are still conducting an audit of this subsidiary for the tax years 2002 through 2005.

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.

ITEM 1A. RISK FACTORS

BUSINESS ENVIRONMENT AND INDUSTRY TRENDS

Risks Associated with Our Industry, Our Business and Market Conditions

Our operating results, including net sales, net income (loss) and adjusted EBITDA percentage, as well as our stock price have varied in the past, and our future operating results will continue to be subject to quarterly and annual fluctuations based upon numerous factors, including those listed in this section and throughout this report. Our stock price will continue to be subject to daily variations as well. In addition, our future operating results and stock price may not follow any past trends or meet our guidance and expectations.

Our net sales and operating results, such as adjusted EBITDA percentage, net income/loss and costs, and our stock price has varied in the past and may vary significantly from quarter to quarter and from year to year in the future. We believe a number of factors, many of which are outside of our control, could cause these variations and make them difficult to predict, including:

- general economic uncertainties in the macroeconomic and local economies facing us, our customers and the markets we serve;
- access to applicable credit markets by us, our customers and their end customers;
- fluctuations in demand for our products or prolonged downturns in the industries that we serve;
- the ability of our suppliers, both internal and external, to produce and deliver components and parts, including sole or limited source components, in a timely manner, in the quantity, quality and prices desired;
- timing or cancellation of customer orders and shipment scheduling;
- fluctuations in our product mix;
- foreign currency fluctuations, especially with regards to the Euro, Yen and British Pound;

- commodity pricing;
- introductions of new products and product enhancements by our competitors, entry of new competitors into our markets, pricing pressures and other competitive factors;
- our ability to develop, introduce, manufacture and ship new and enhanced products in a timely manner without defects;
- our ability to manage our and our suppliers capacity;
- our increased reliance on domestic and foreign contract manufacturing;
- delay of achievement of our footprint consolidation effort;
- the rate of market acceptance of our new products;
- the ability of our customers to pay for our products;
- seasonal sales trends;
- delays or reductions in customer purchases of our products in anticipation of the introduction of new and enhanced products by us or our competitors;

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- our ability to control expenses;
- the level of capital spending of our customers;
- potential excess and/or obsolescence of our inventory;
- costs and timing of adhering to current and developing governmental regulations and reviews relating to our products and business;
- costs related to acquisitions of technology or businesses;
- impairment of goodwill, intangible assets and other long term assets;
- our ability to meet our expectations and forecasts and those of public market analysts and investors;
- costs and expenses from litigation;
- the availability of funding by the United States and foreign governments for research funding with regards to our customers in the scientific business, such as universities;
- continued spending by the United States government on defense-related projects where we are a subcontractor;
- government support of the alternative energy industries, such as solar;
- maintenance of supply relating to products sold to the government on terms which we would prefer not to accept; and
- distraction of management related to acquisition or divestment activities.

In addition, we often recognize a substantial portion of our sales in the last month of the quarter. Our expenses for any given quarter are typically based on expected sales and if sales are below expectations in any given quarter, the adverse impact of the shortfall on our operating results may be magnified by our inability to adjust spending quickly enough to compensate for the shortfall. We also base our manufacturing on our forecasted product mix for the quarter. If the actual product mix varies significantly from our forecast, we may not be able to fill some orders during that quarter, which would result in delays in the shipment of our products. Accordingly, variations in timing of sales, particularly for our higher priced, higher margin products, can cause significant fluctuations in quarterly operating results.

Due to these and other factors, we believe that quarter-to-quarter and year-to-year comparisons of our historical operating results may not be meaningful. You should not rely on our results for any quarter or year as an indication of our future performance. Our operating results in future quarters and years may be below public market analysts or investors expectations, which would likely cause the price of our stock to fall. In addition, over the past several years, the stock market has experienced extreme price and volume fluctuations that have affected the stock prices of many technology companies. There has not always been a direct correlation between this volatility and the performance of particular companies subject to these stock price fluctuations. Further, over the last twelve months, equity markets around the world have significantly fluctuated across most sectors. These factors, as well as general economic and political conditions or investors concerns regarding the credibility of corporate financial statements, may have a material adverse effect on the market price of our stock in the future.

We are exposed to risks associated with worldwide economic conditions and related uncertainties.

Volatility and disruption in the capital and credit markets, depressed consumer confidence, negative economic conditions, volatile corporate profits and reduced capital spending could negatively impact demand for our products. In particular, it is difficult to develop and implement strategy, sustainable business models and efficient operations, as well as effectively manage supply chain relationships in the face of such conditions including uncertainty regarding the ability of some of our suppliers to continue operations and provide us with uninterrupted supply flow. Our ability to maintain our research and development investments in our broad product offerings may be adversely impacted in the event that our sales decline and do not increase in the future. Spending and the timing thereof by consumers and businesses has a significant impact on our results and, where such spending is delayed or canceled, it could cause a material negative impact on our operating results. The current global economic conditions remain uncertain and challenging. Weakness in our end markets could negatively impact our revenue, gross margin and operating expenses, and consequently have a material adverse effect on our business, financial condition and results of operations.

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The recent financial turmoil affecting the banking system and financial markets and the possibility that additional financial institutions may consolidate or go out of business have resulted in a tightening in the credit markets, and a low level of liquidity in many financial markets. There could be a number of follow-on effects from the credit crisis on our business, including the insolvency of key suppliers or their inability to obtain credit to finance development and/or manufacture products resulting in product delays; inability of customers to obtain credit to finance purchases of our products and/or customer insolvencies; and failure of financial institutions negatively impacting our treasury operations. In the event our customers are unable to obtain credit or otherwise pay for our shipped products it could significantly impact our ability to collect on our outstanding accounts receivable. Other income and expense also could vary materially from expectations depending on gains or losses realized on the sale or exchange of financial instruments; impairment charges resulting from revaluations of debt and equity securities and other investments; interest rates; cash balances; and changes in fair value of derivative instruments. The current volatility in the financial markets and overall economic uncertainty increase the risk that the actual amounts realized in the future on our financial instruments could differ significantly from the fair values currently assigned to them. Uncertainty about current global economic conditions could also continue to increase the volatility of our stock price.

In addition, political and social turmoil related to international conflicts and terrorist acts may put further pressure on economic conditions in the United States and abroad. Unstable economic, political and social conditions make it difficult for our customers, our suppliers and us to accurately forecast and plan future business activities. For example, while the recent political unrest in Thailand did not materially impact us, our suppliers in Thailand could be affected in the future. If such conditions persist, our business, financial condition and results of operations could suffer. Additionally, unstable economic conditions can provide significant pressures and burdens on individuals, thus fostering an atmosphere of greater potential exposure for inappropriate business conduct. See Part I, Item 4. CONTROLS AND PROCEDURES Inherent Limitations over Internal Control.

Our cash and cash equivalents and short-term investments are managed through various banks around the world and volatility in the capital and credit market conditions could cause financial institutions to fail or materially harm service levels provided by such banks, both of which could have an adverse affect on our ability to timely access funds.

World capital and credit markets have been and continue to experience extreme volatility and disruption. In some cases, the markets have exerted downward pressure on stock prices and credit capacity for certain issuers, as well as pressured the solvency of some financial institutions. These financial institutions, including banks, have had difficulty timely performing regular services and in some cases have failed or otherwise been largely taken over by governments. We maintain our cash, cash equivalents and short-term investments with a number of financial institutions around the world. Should some or all of these financial institutions fail or otherwise be unable to timely perform requested services, we would likely have a limited ability to timely access our cash deposited with such institutions, or, in extreme circumstances the failure of such institutions could cause us to be unable to access cash for the foreseeable future. If we are unable to quickly access our funds, we may need to increase our use of our existing credit lines or access more expensive credit, if available. If we are unable to access our cash or if we access existing or additional credit or are unable to access additional credit, it could have a negative impact on our operations, including our reported net income.

We are exposed to credit risk and fluctuations in the market values of our investment portfolio.

Although we have not recognized any material losses on our cash, cash equivalents and short-term investments, future declines in their market values could have a material adverse effect on our financial condition and operating results. Given the global nature of our business, we have investments both domestically and internationally. There has recently been growing pressure on the creditworthiness of sovereign nations, particularly in Europe, which results in corresponding pressure on the valuation of the securities issued by such nations. Additionally, our overall investment portfolio is often concentrated in the financial sector, which has been negatively impacted by the recent market liquidity conditions. We also maintain a certain mix of government-issued securities. Credit ratings and pricing of these investments can be negatively impacted by liquidity, credit deterioration or losses, financial results, or other factors. Additionally, liquidity issues or political actions by sovereign nations could result in decreased values for our investments in certain government securities. As a result, the value or liquidity of our cash, cash equivalents and short-term investments could decline and result in a material impairment, which could have a material adverse effect on our financial condition and operating results. See Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

If our goodwill or intangible assets become impaired, we may be required to record a significant charge to earnings.

Under accounting principles generally accepted in the United States, we review our intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or other intangible assets may not be recoverable include declines in our stock price and market capitalization or future cash flows projections. We recorded a material charge during the first quarter of fiscal 2009 related to the impairment of goodwill in our

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CLC operating segment. A decline in our stock price, or any other adverse change in market conditions, particularly if such change has the effect of changing one of the critical assumptions or estimates we used to calculate the estimated fair value of our reporting units, could result in a change to the estimation of fair value that could result in an impairment charge. Any such material charges, whether related to goodwill or purchased intangible assets, may have a material negative impact on our financial and operating results.

We depend on sole source or limited source suppliers, both internal and external, for some of our key components and materials, including exotic materials and crystals, in our products, which make us susceptible to supply shortages or price fluctuations that could adversely affect our business.

We currently purchase several key components and materials used in the manufacture of our products from sole source or limited source suppliers, both internal and external. Some of these suppliers are relatively small private companies that may discontinue their operations at any time and which may be particularly susceptible to the current economic conditions. We typically purchase our components and materials through purchase orders or agreed upon terms and conditions and we do not have guaranteed supply arrangements with many of these suppliers. We may fail to obtain these supplies in a timely manner in the future. We may experience difficulty identifying alternative sources of supply for certain components used in our products. We would experience further delays while identifying, evaluating and testing the products of these potential alternative suppliers. Furthermore, financial or other difficulties faced by these suppliers or significant changes in demand for these components or materials could limit their availability. Additionally, we are in the process of managing multiple projects moving certain internal suppliers to different locations. When we transition locations we may increase our inventory of such products as a safety stock during the transition, which may cause the amount of inventory reflected on our balance sheet to increase. Any interruption or delay in the supply of any of these components or materials, or the inability to obtain these components and materials from alternate sources at acceptable prices and within a reasonable amount of time, or our failure to properly manage these moves, would impair our ability to meet scheduled product deliveries to our customers and could cause customers to cancel orders.

We have historically relied exclusively on our own production capability to manufacture certain strategic components, optics and optical systems (which has recently been outsourced to a third party), crystals, semiconductor lasers, lasers and laser-based systems. Because we manufacture, package and test these components, products and systems at our own facilities, and such components, products and systems are not readily available from other sources, any interruption in manufacturing would adversely affect our business. In addition, our failure to achieve adequate manufacturing yields of these items at our manufacturing facilities may materially and adversely affect our operating results and financial condition.

Our future success depends on our ability to increase our sales volumes and decrease our costs to offset anticipated declines in the average selling prices (ASPs) of our products and, if we are unable to realize greater sales volumes and lower costs, our operating results may suffer.

Our ability to increase our sales volume, and therefore, our future success depends on the continued growth of the markets for lasers, laser systems and related accessories, as well as our ability to identify, in advance, emerging markets for laser-based systems. We cannot assure you that we will be able to successfully identify, on a timely basis, new high-growth markets in the future. Moreover, we cannot assure you that new markets will develop for our products or our customers products, or that our technology or pricing will enable such markets to develop. Future demand for our products is uncertain and will depend to a great degree on continued technological development and the introduction of new or enhanced products. If this does not continue, sales of our products may decline and our business will be harmed.

We have historically been the photonics industry s high quality supplier of laser systems. We have in the past experienced decreases in the ASPs of some of our products. We anticipate that as competing products become more widely available, the ASPs of our products may decrease. If we are unable to offset the anticipated decrease in our ASPs by increasing our sales volumes, our net sales will decline. In addition, to maintain our gross margins, we must continue to reduce the cost of manufacturing our products while maintaining their high quality. From time to time, our products, like many complex technological products, may fail in greater frequency than anticipated. This can lead to further charges, which can result in higher costs, lower gross margins and lower operating results. Furthermore, as ASPs of our current products decline, we must develop and introduce new products and product enhancements with higher margins. If we cannot maintain our gross margins, our operating results could be seriously harmed, particularly if the ASPs of our products decrease significantly.

Our future success depends on our ability to develop and successfully introduce new and enhanced products that meet the needs of our customers.

Our current products address a broad range of commercial and scientific research applications in the photonics markets. We cannot assure you that the market for these applications will continue to generate significant or consistent demand for our products. Demand for our products could be significantly diminished by disrupting technologies or products that replace them or render them obsolete. Furthermore, the new and enhanced products generally continue to be smaller in size and have lower ASPs, and therefore, we have to sell more units to maintain revenue levels. Accordingly, we must continue to invest in research and development in order to develop competitive products.

During fiscal years 2009, 2008 and 2007, our research and development expenses have been in the range of 12% to 14% of net sales. Our future success depends on our ability to anticipate our customers needs and develop products that address those needs. Introduction of new products and product enhancements will require that we effectively transfer production processes from research and development to manufacturing and coordinate our efforts with those of our suppliers to achieve volume production rapidly. If we fail to transfer production processes effectively, develop product enhancements or introduce new products in sufficient quantities to meet the needs of our customers as scheduled, our net sales may be reduced and our business may be harmed.

We face risks associated with our foreign operations and sales that could harm our financial condition and results of operations.

For the three and nine months ended July 3, 2010, 68% and 69%, respectively, of our net sales were derived from customers outside of the United States. For fiscal 2009, 66% of our net sales were derived from customers outside of the United States. For fiscal years 2008 and 2007, 68% of our net sales were derived from customers outside of the United States. We anticipate that foreign sales will continue to account for a significant portion of our revenues in the foreseeable future. A global economic slowdown could have a negative effect on various foreign markets in which we operate. Such a slowdown may cause us to reduce our presence in certain countries, which may negatively affect the overall level of business in such countries. The majority of our foreign sales occur through our foreign sales subsidiaries and the remainder of our foreign sales result from exports to foreign distributors, resellers and customers. Our foreign operations and sales are subject to a number of risks, including:

- longer accounts receivable collection periods;
- the impact of recessions and other economic conditions in economies outside the United States;
- unexpected changes in regulatory requirements;
- certification requirements;
- environmental regulations;
- reduced protection for intellectual property rights in some countries;

- potentially adverse tax consequences;
- political and economic instability;
- import/export regulations, tariffs and trade barriers;
- cultural and management differences;
- preference for locally produced products; and
- impairment of our shipping and other logistics.

Our business could also be impacted by international conflicts, terrorist and military activity, civil unrest and pandemic illness which could cause a slowdown in customer orders or cause customer order cancellations.

We are also subject to the risks of fluctuating foreign currency exchange rates, which could materially adversely affect the sales price of our products in foreign markets, as well as the costs and expenses of our foreign subsidiaries. While we use forward exchange contracts and other risk management techniques to hedge our foreign currency exposure, we remain exposed to the economic risks of foreign currency fluctuations.

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We may not be able to protect our proprietary technology which could adversely affect our competitive advantage.

Maintenance of intellectual property rights and the protection thereof is important to our business. We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We cannot assure you that our patent applications will be approved, that any patents that may be issued will protect our intellectual property or that any issued patents will not be challenged by third parties. Other parties may independently develop similar or competing technology or design around any patents that may be issued to us. We cannot be certain that the steps we have taken will prevent the misappropriation of our intellectual property, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. Further, we may be required to enforce our intellectual property or other proprietary rights through litigation, which, regardless of success, could result in substantial costs and diversion of management s attention. Additionally, there may be existing patents of which we are unaware that could be pertinent to our business and it is not possible for us to know whether there are patent applications pending that our products might infringe upon since these applications are often not publicly available until a patent is issued or published.

We may, in the future, be subject to claims or litigation from third parties, for claims of infringement of their proprietary rights or to determine the scope and validity of our proprietary rights or the proprietary rights of competitors. These claims could result in costly litigation and the diversion of our technical and management personnel. Adverse resolution of litigation may harm our operating results or financial condition.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. This has also been seen in our industry as well, for example in the litigation brought by IMRA America, Inc. against IPG Photonics Corporation. From time to time, like many other technology companies, we have received communications from other parties asserting the existence of patent rights, copyrights, trademark rights or other intellectual property rights which such third parties believe may cover certain of our products, processes, technologies or information. In the future, we may be a party to litigation to protect our intellectual property or as a result of an alleged infringement of others intellectual property whether through direct claims or by way of indemnification claims of our customers, as, in some cases, we contractually agree to indemnify our customers against third-party infringement claims relating to our products. These claims and any resulting lawsuit, if successful, could subject us to significant liability for damages or invalidation of our proprietary rights. These lawsuits, regardless of their success, would likely be time-consuming and expensive to resolve and would divert management time and attention. Any potential intellectual property litigation could also force us to do one or more of the following:

- stop manufacturing, selling or using our products that use the infringed intellectual property;

- obtain from the owner of the infringed intellectual property right a license to sell or use the relevant technology, although such license may not be available on reasonable terms, or at all; or

- redesign the products that use the technology.

If we are forced to take any of these actions or are otherwise a party to lawsuits of this nature, we may incur significant losses for which we do not have insurance and our business may be seriously harmed. We do not have insurance to cover potential claims of this type.

We are exposed to lawsuits in the normal course of business which could have a material adverse effect on our business, operating results, or financial condition.

We are exposed to lawsuits in the normal course of our business, including product liability claims, if personal injury, death or commercial losses occur from the use of our products. While we typically maintain customary levels of business insurance, including directors and officers policies, litigation can be expensive, lengthy, and disruptive to normal business operations, including the potential impact of indemnification obligations for individuals named in any such lawsuits. We may not, however, be able to secure insurance coverage on terms acceptable to us in the future. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit, including a recall or redesign of products if ultimately determined to be defective, could have a material adverse effect on our business, operating results, or financial condition.

We depend on skilled personnel to operate our business effectively in a rapidly changing market, and if we are unable to retain existing or hire additional personnel when needed, our ability to develop and sell our products could be harmed.

Our ability to continue to attract and retain highly skilled personnel will be a critical factor in determining whether we will be successful in the future. Recruiting and retaining highly skilled personnel in certain functions continues to be difficult. At certain locations where we operate, the cost of living is extremely high and it may be difficult to retain key employees and management at a reasonable cost. We may not be successful in attracting, assimilating or retaining qualified personnel to fulfill our current or future needs. Our failure to attract additional employees and retain our existing employees could adversely affect our growth and our business.

Our future success depends upon the continued services of our executive officers and other key engineering, sales, marketing, manufacturing and support personnel, any of whom may leave, which could harm our business and our results of operations.

The long sales cycles for our products may cause us to incur significant expenses without offsetting revenues.

Customers often view the purchase of our products as a significant and strategic decision. As a result, customers typically expend significant effort in evaluating, testing and qualifying our products before making a decision to purchase them, resulting in a lengthy initial sales cycle. While our customers are evaluating our products and before they place an order with us, we may incur substantial sales and marketing and research and development expenses to customize our products to the customer s needs. We may also expend significant management efforts, increase manufacturing capacity and order long lead-time components or materials prior to receiving an order. Even after this evaluation process, a potential customer may not purchase our products. As a result, these long sales cycles may cause us to incur significant expenses without ever receiving revenue to offset such expenses.

The markets in which we sell our products are intensely competitive and increased competition could cause reduced sales levels, reduced gross margins or the loss of market share.

Competition in the various photonics markets in which we provide products is very intense. We compete against a number of large public and private companies, including CVI Melles Griot, Cymer, Inc., GSI Group, Inc., IPG Photonics Corporation, JDS Uniphase Corporation, Newport Corporation, Rofin-Sinar Technologies, Inc., and Trumpf GmbH, as well as other smaller companies. Some of our competitors are large companies that have significant financial, technical, marketing and other resources. These competitors may be able to devote greater resources than we can to the development, promotion, sale and support of their products. Some of our competitors are much better positioned than we are to acquire other companies in order to gain new technologies or products that may displace our product lines. Any of these acquisitions could give our competitors a strategic advantage. Any business combinations or mergers among our competitors, forming larger competitors with greater resources, could result in increased competition, price reductions, reduced margins or loss of market share, any of which could materially and adversely affect our business, results of operations and financial condition.

Additional competitors may enter the market and we are likely to compete with new companies in the future. We may encounter potential customers that, due to existing relationships with our competitors, are committed to the products offered by these competitors. Further, our current or potential customers may determine to develop and produce products for their own use which are competitive to our products. As a result of the foregoing factors, we expect that competitive pressures may result in price reductions, reduced margins, loss of sales and loss of market share. In addition, in markets where there are a limited number of customers, such as the microelectronics market, competition is particularly intense.

Some of our laser systems are complex in design and may contain defects that are not detected until deployed by our customers, which could increase our costs and reduce our revenues.

Laser systems are inherently complex in design and require ongoing regular maintenance. The manufacture of our lasers, laser products and systems involves a highly complex and precise process. As a result of the technological complexity of our products, changes in our or our suppliers manufacturing processes or the inadvertent use of defective materials by us or our suppliers could result in a material adverse effect on our ability to achieve acceptable manufacturing yields and product reliability. To the extent that we do not achieve and maintain our projected yields or product reliability, our business, operating results, financial condition and customer relationships would be adversely affected. We provide warranties on a majority of our product sales, and reserves for estimated warranty costs are recorded during the period of sale. The determination of such reserves requires us to make estimates of failure rates and expected costs to repair or replace the products under warranty. We typically establish warranty reserves based on historical warranty costs for each product line. 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 which could have an adverse effect on our results of operations.

Our customers may discover defects in our products after the products have been fully deployed and operated under the end user s peak stress conditions. In addition, some of our products are combined with products from other vendors, which may contain defects. As a result, should problems occur, it may be difficult to identify the source of the problem. If we are unable to identify and fix defects or other problems, we could experience, among other things:

- loss of customers;

- increased costs of product returns and warranty expenses;

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- damage to our brand reputation;
- failure to attract new customers or achieve market acceptance;
- diversion of development and engineering resources; and
- legal actions by our customers and/or their end users.

The occurrence of any one or more of the foregoing factors could seriously harm our business, financial condition and results of operations.

If we fail to accurately forecast component and material requirements for our products, we could incur additional costs and incur significant delays in shipments, which could result in a loss of customers.

We use rolling forecasts based on anticipated product orders and material requirements planning systems to determine our product requirements. It is very important that we accurately predict both the demand for our products and the lead times required to obtain the necessary components and materials. We depend on our suppliers for most of our product components and materials. Lead times for components and materials that we order vary significantly and depend on factors including the specific supplier requirements, the size of the order, contract terms and current market demand for components. For substantial increases in our sales levels, some of our suppliers may need at least nine months lead-time. If we overestimate our component and material requirements, we may have excess inventory, which would increase our costs. If we underestimate our component and material requirements, we may have inadequate inventory, which could interrupt and delay delivery of our products to our customers. Any of these occurrences would negatively impact our net sales, business or operating results.

Our increased reliance on contract manufacturing and other outsourcing may adversely impact our financial results and operations due to our decreased control over the performance and timing of certain aspects of our manufacturing.

Our manufacturing strategy includes partnering with contract manufacturers to outsource non-core subassemblies and less complex turnkey products, including some performed at international sites located in Asia and Eastern Europe. Additionally, we have outsourced the manufacture of certain of our optics components to a third party. Our ability to resume internal manufacturing operations for certain products and components in a timely manner may be eliminated. The cost, quality, performance and availability of contract manufacturing operations are and will be essential to the successful production and sale of many of our products. Our financial condition or results of operation could be adversely impacted if any contract manufacturer or other supplier is unable for any reason, including as a result of the impact of current worldwide economic conditions, to meet our cost, quality, performance, and availability standards. We may not be able to provide contract manufacturers with product volumes that are high enough to achieve sufficient cost savings. If shipments fall below forecasted levels, we may incur increased costs or be required to take ownership of the inventory. Also, our ability to control the quality of products produced by contract manufacturers may be limited and quality issues may not be resolved in a timely manner, which could adversely impact our financial condition or results of operations.

If we fail to effectively manage our footprint consolidation effort, our business could be disrupted, which could harm our operating results.

We have previously announced our intent to reduce our global operating footprint. To that end, we closed our Auburn, California, Munich, Germany, St. Louis, Missouri, San Jose, California and Yokohama, Japan facilities during fiscal 2009. We announced our intention to close our Tampere, Finland and Montreal, Canada operations. If we are not able to effectively and timely transition the activities from one site to another or effectively close these facilities (including the manufacture of any applicable increased safety stock) there could be an adverse impact on our results of operations.

If we fail to manage our growth or, alternatively, our spending during downturns, effectively, our business could be disrupted, which could harm our operating results.

Our ability to successfully offer our products and implement our business plan in evolving markets requires an effective planning and management process. In economic downturns, we must effectively manage our spending and operations to ensure our competitive position during the downturn, as well as our future opportunities when the economy improves, remain intact. The failure to effectively manage our spending and operations could disrupt our business and harm our operating results. The growth in sales, combined with the challenges of managing geographically dispersed operations, can place a significant strain on our management systems and resources, and our anticipated growth in future operations could continue to place such a strain. The failure to effectively manage our growth could disrupt our business and harm our operating results.

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Historically, acquisitions have been an important element of our strategy. However, we may not find suitable acquisition candidates in the future and we may not be able to successfully integrate and manage acquired businesses. Any acquisitions we make could disrupt our business and harm our financial condition.

We have in the past made strategic acquisitions of other corporations and entities, as well as asset purchases, and we continue to evaluate potential strategic acquisitions of complementary companies, products and technologies. In the event of any future acquisitions, we could:

- issue stock that would dilute our current stockholders percentage ownership;
- pay cash that would decrease our working capital;
- incur debt;
- assume liabilities; or
- incur expenses related to impairment of goodwill and amortization.

Acquisitions also involve numerous risks, including:

- problems combining the acquired operations, systems, technologies or products;
- an inability to realize expected operating efficiencies or product integration benefits;
- difficulties in coordinating and integrating geographically separated personnel, organizations, systems and facilities;
- writing off goodwill, intangible assets or other long term assets;

- difficulties integrating business cultures;
- unanticipated costs or liabilities, including the costs associated with improving the internal controls of the acquired company;
- diversion of management s attention from our core businesses;
- adverse effects on existing business relationships with suppliers and customers;
- potential loss of key employees, particularly those of the purchased organizations;
- incurring unforeseen obligations or liabilities in connection with acquisitions; and
- the failure to complete acquisitions even after signing definitive agreements which, among other things, would result in the expensing of potentially significant professional fees and other charges in the period in which the acquisition or negotiations are terminated.

We cannot assure you that we will be able to successfully integrate any businesses, products, technologies or personnel that we might acquire in the future or achieve the anticipated benefits of such transactions, which may harm our business.

We use standard laboratory and manufacturing materials that could be considered hazardous and we could be liable for any damage or liability resulting from accidental environmental contamination or injury.

Although most of our products do not incorporate hazardous or toxic materials and chemicals, some of the gases used in our excimer lasers and some of the liquid dyes used in some of our scientific laser products are highly toxic. In addition, our operations involve the use of standard laboratory and manufacturing materials that could be considered hazardous. Also, if a facility fire were to occur at our Tampere, Finland or our Sunnyvale, California sites and were to spread to a reactor used to grow semiconductor wafers, it could release highly toxic emissions. We believe that our safety procedures for handling and disposing of such materials comply with all federal, state and offshore regulations and standards. However, the risk of accidental environmental contamination or injury from such materials cannot be entirely eliminated. In the event of such an accident involving such materials, we could be liable for damages and such liability could exceed the amount of our liability insurance coverage and the resources of our business which could have an adverse effect on our financial results or our business as a whole.

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Compliance or the failure to comply with current and future environmental regulations could cause us significant expense.

We are subject to a variety of federal, state, local and foreign environmental regulations relating to the use, storage, discharge and disposal of hazardous chemicals used during our manufacturing process or requiring design changes or recycling of products we manufacture. If we fail to comply with any present and future regulations, we could be subject to future liabilities, the suspension of production or a prohibition on the sale of products we manufacture. In addition, such regulations could restrict our ability to expand our facilities or could require us to acquire costly equipment, or to incur other significant expenses to comply with environmental regulations, including expenses associated with the recall of any non-compliant product and the management of historical waste.

From time to time new regulations are enacted, and it is difficult to anticipate how such regulations will be implemented and enforced. We continue to evaluate the necessary steps for compliance with regulations as they are enacted. These regulations include, for example, the Registration, Evaluation, Authorization and Restriction of Chemical substances (REACH), the Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Directive (RoHS) and the Waste Electrical and Electronic Equipment Directive (WEEE) enacted in the European Union which regulate the use of certain hazardous substances in, and require the collection, reuse and recycling of waste from, certain products we manufacture. This and similar legislation that has been or is in the process of being enacted in Japan, China, Korea and various states of the United States may require us to re-design our products to ensure compliance with the applicable standards, for example by requiring the use of different types of materials. These redesigns or alternative materials may detrimentally impact the performance of our products, add greater testing lead-times for product introductions or have other similar effects. We believe we comply with all such legislation where our products are sold and we will continue to monitor these laws and the regulations being adopted under them to determine our responsibilities. In addition, we are monitoring legislation relating to the reduction of carbon emissions from industrial operations to determine whether we may be required to incur any additional material costs or expenses associated with our operations. We are not currently aware of any such material costs or expenses. Our failure to comply with any of the foregoing regulatory requirements or contractual obligations could result in our being directly or indirectly liable for costs, fines or penalties and third-party claims, and could jeopardize our ability to conduct business in the United States and foreign countries.

If our operations, logistics or facilities or those of our suppliers and contract manufacturers were to experience catastrophic loss, our operations would be seriously harmed.

Our operations, logistics and facilities and those of our suppliers and contract manufacturers could be subject to a catastrophic loss from fire, flood, earthquake, volcanic eruption, work stoppages, acts of war, pandemic illnesses, energy shortages, theft of assets, other natural disasters or terrorist activity. A substantial portion of our research and development activities, manufacturing, our corporate headquarters and other critical business operations are located near major earthquake faults in Santa Clara, California, an area with a history of seismic events. Any such loss or detrimental impact to any of our operations, logistics or facilities could disrupt our operations, delay production, shipments and revenue and result in large expenses to repair or replace the facility. While we have obtained insurance to cover most potential losses, after reviewing the costs and limitations associated with earthquake insurance, we have decided not to procure such insurance. We believe that this decision is consistent with decisions reached by numerous other companies located nearby. We cannot assure you that our existing insurance coverage will be adequate against all other possible losses.

Provisions of our charter documents and Delaware law, and our Change-of-Control Severance Plan may have anti-takeover effects that could prevent or delay a change in control.

Provisions of our certificate of incorporation and bylaws may discourage, delay or prevent a merger or acquisition or make removal of incumbent directors or officers more difficult. These provisions may discourage takeover attempts and bids for our common stock at a premium over the market price. These provisions include:

- the ability of our Board of Directors to alter our bylaws without stockholder approval;
- limiting the ability of stockholders to call special meetings; and
- establishing advance notice requirements for nominations for election to our Board of Directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

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We are subject to Section 203 of the Delaware General Corporation Law, which prohibits a publicly-held Delaware corporation from engaging in a merger, asset or stock sale or other transaction with an interested stockholder for a period of three years following the date such person became an interested stockholder, unless prior approval of our board of directors is obtained or as otherwise provided. These provisions of Delaware law also may discourage, delay or prevent someone from acquiring or merging with us without obtaining the prior approval of our board of directors, which may cause the market price of our common stock to decline. In addition, we have adopted a change of control severance plan, which provides for the payment of a cash severance benefit to each eligible employee based on the employee s position. If a change of control occurs, our successor or acquirer will be required to assume and agree to perform all of our obligations under the change of control severance plan which may discourage potential acquirors or result in a lower stock price.

Changes in tax rates, tax liabilities or tax accounting rules could affect future results.

As a global company, we are subject to taxation in the United States and various other countries and jurisdictions. Significant judgment is required to determine worldwide tax liabilities. Our future tax rates could be affected by changes in the composition of earnings in countries or states with differing tax rates, changes in the valuation of our deferred tax assets and liabilities, or changes in the tax laws. In addition, we are subject to regular examination of our income tax returns by the Internal Revenue Service (IRS) and other tax authorities. From time to time the United States, foreign and state governments make substantive changes to tax rules and the application of rules to companies, including the recent announcement from the United States government potentially impacting our ability to defer taxes on international earnings. We regularly assess the likelihood of favorable or unfavorable outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. Although we believe our tax estimates are reasonable, there can be no assurance that any final determination will not be materially different than the treatment reflected in our historical income tax provisions and accruals, which could materially and adversely affect our operating results and financial condition.

We could incur tax liabilities under Section 409A of the Internal Revenue Code and other tax penalties.

As a result of our investigation into our historical stock option granting practices, we have determined that a number of our outstanding stock option awards were granted at exercise prices below the fair market value of our stock on the appropriate accounting measurement date. The primary adverse tax consequence is that the re-measured options vesting after December 31, 2004, or options that are materially modified after October 3, 2004, are potentially subject to option holder excise tax under Section 409A of the Internal Revenue Code (and, as applicable, similar excise taxes under state law or foreign law). Option holders who hold options which are determined to have been granted with exercise prices below the fair market value of the underlying shares of common stock on the appropriate measurement date would be subject to taxes, penalties and interest under Section 409A if no action is taken to cure the options from exposure under Section 409A before December 31, 2008. We took action in fiscal year 2008 to cure certain options from exposure under Section 409A. However, there can be no assurance that such action cured all potential circumstances in which Section 409A would apply. Should it be found that excise taxes under Section 409A apply to option holders subsequent to our ability to cure the options from exposure to Section 409A, and we decide to reimburse option holders for such taxes, our results of operations may be materially adversely affected.

Also as a result of our investigation into our historical stock option granting practices, we have determined that certain payroll taxes, interest and penalties apply under various sections of the Internal Revenue Code, various state tax statutes, and tax statutes in various foreign jurisdictions. We have reviewed these liabilities and paid them. There can be no assurance that our payments covered all potential circumstances in which additional payroll taxes, interest and penalties would apply. Should it be found that additional payroll taxes, interest and penalties would apply, our results of operations may be materially adversely affected.

Compliance with changing regulation of corporate governance and public disclosure may create uncertainty regarding compliance matters.

Federal securities laws, rules and regulations, as well as the rules and regulations of self-regulatory organizations such as Nasdaq and the NYSE, require companies to maintain extensive corporate governance measures, impose comprehensive reporting and disclosure requirements, set strict independence and financial expertise standards for audit and other committee members and impose civil and criminal penalties for companies and their chief executive officers, chief financial officers and directors for securities law violations. These laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices, which could harm our results of operations and divert management s attention from business operations. Changing laws, regulations and standards relating to corporate governance and public disclosure may create uncertainty regarding compliance matters. New or changed laws, regulations and standards are subject to varying interpretations in many cases. As a result, their application in practice may evolve over time. We are committed to maintaining high standards of ethics, corporate governance and public disclosure. Complying with evolving interpretations of new or changed legal requirements may cause us to incur higher costs as we revise current practices, policies and procedures, and may divert management

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time and attention from revenue generating to compliance activities. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may also be harmed.

Governmental regulations affecting the import or export of products could negatively affect our revenues.

The United States and various foreign governments have imposed tariffs, controls, export license requirements and restrictions on the import or export of some technologies, especially encryption technology. In addition, from time to time, governmental agencies have proposed additional regulation of encryption technology, such as requiring the escrow and governmental recovery of private encryption keys. Governmental regulation of encryption technology and regulation of imports or exports, or our failure to obtain required import or export approval for our products, could harm our international and domestic sales and adversely affect our revenues.

We may experience difficulties with our enterprise resource planning (ERP) system and other IT systems. System failure or malfunctioning may result in disruption of operations and the inability to process transactions, and this could adversely affect our ability to timely or accurately provide our financial results.

System failure or malfunctioning could disrupt our ability to timely and accurately process and report key components of our results of operations, financial position and cash flows. Any disruptions or difficulties that may occur in connection with our ERP system or other systems could also adversely affect our ability to complete important business processes such as the evaluation of our internal controls and attestation activities pursuant to Section 404 of the Sarbanes-Oxley Act of 2002. If we encounter unforeseen problems with regard to our ERP system or other systems, our business and resulting financial reporting could be adversely affected.

If our security measures are breached and unauthorized access is obtained to a customer s data or our data, our service may be perceived as not being secure, customers may curtail or stop using our service and we may incur significant legal and financial exposure and liabilities.

Our operations include the storage of customers proprietary information, and security breaches could expose us to a risk of loss of this information, litigation and possible liability. If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, and, as a result, someone obtains unauthorized access to our data or our customers data, our reputation could be damaged, our business may suffer and we could incur significant liability. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our data or our customers data, which could result in significant legal and financial exposure and a loss of confidence in the security of our service that would harm our future business prospects. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose sales and customers.

We employ technology licensed from third parties for use in or with our solutions, and the loss or inability to maintain these licenses or errors in the software we license could result in increased costs, or reduced service levels, which would adversely affect our business.

Our hosted solutions incorporate certain technology obtained under licenses from other companies, such as Salesforce.com and Oracle. We anticipate that we will continue to license technology and development tools from third parties in the future. Although we believe that there are commercially reasonable software alternatives to the third-party software we currently license, this may not always be the case, or we may license third-party software that is more difficult or costly to replace than the third party software we currently license. In addition, integration of our products with new third-party software may require significant work and require substantial allocation of our time and resources. Also, to the extent that our products depend upon the successful operation of third-party products in conjunction with our products, any undetected errors in these third-party products could prevent the implementation or impair the functionality of our products, delay new product introductions and injure our reputation. Our use of additional or alternative third-party software would require us to enter into license agreements with third parties, which could result in higher costs.

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Our market is unpredictable and characterized by rapid technological changes and evolving standards demanding a significant investment in research and development, and, if we fail to address changing market conditions, our business and operating results will be harmed.

The photonics industry is characterized by extensive research and development, rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. Because this industry is subject to rapid change, it is difficult to predict its potential size or future growth rate. Our success in generating revenues in this industry will depend on, among other things:

- maintaining and enhancing our relationships with our customers;

- the education of potential end-user customers about the benefits of lasers and laser systems; and

- our ability to accurately predict and develop our products to meet industry standards.

For the three and nine months ended July 3, 2010, our research and development expenses were $18.3 million (11.0% of net sales) and $53.2 million (12.1% of net sales), respectively. For our fiscal years 2009, 2008 and 2007, our research and development costs were $61.4 million (14.1% of net sales), $74.3 million (12.4% of net sales) and $74.6 million (12.4% of net sales), respectively. We cannot assure you that our expenditures for research and development will result in the introduction of new products or, if such products are introduced, that those products will achieve sufficient market acceptance or to generate sales to offset the costs of development. Our failure to address rapid technological changes in our markets could adversely affect our business and results of operations.

Continued volatility in the semiconductor manufacturing industry could adversely affect our business, financial condition and results of operations.

Our net sales depend in part on the demand for our products by semiconductor equipment companies. The semiconductor market has historically been characterized by sudden and severe cyclical variations in product supply and demand, which have often severely affected the demand for semiconductor manufacturing equipment, including laser-based tools and systems. The timing, severity and duration of these market cycles are difficult to predict, and we may not be able to respond effectively to these cycles. The continuing uncertainty in this market severely limits our ability to predict our business prospects or financial results in this market.

During industry downturns, our revenues from this market may decline suddenly and significantly. Our ability to rapidly and effectively reduce our cost structure in response to such downturns is limited by the fixed nature of many of our expenses in the near term and by our need to continue our investment in next-generation product technology and to support and service our products. In addition, due to the relatively long manufacturing lead times for some of the systems and subsystems we sell to this market, we may incur expenditures or purchase raw materials or components for products we cannot sell. Accordingly, downturns in the semiconductor capital equipment market may materially harm our operating results. Conversely, when upturns in this market occur, we must be able to rapidly and effectively increase our manufacturing capacity to meet increases in customer demand that may be extremely rapid, and if we fail to do so we may lose business to our competitors and our relationships with our customers may be harmed.

We participate in the microelectronics market, which requires significant research and development expenses to develop and maintain products and a failure to achieve market acceptance for our products could have a significant negative impact on our business and results of operations.

The microelectronics market is characterized by rapid technological change, frequent product introductions, changing customer requirements and evolving industry standards. The nature of this market requires significant research and development expenses to participate, with substantial resources invested in advance of material sales of our products to our customers in this market. In the event either our customers or our products fail to gain market acceptance, or the microelectronics market fails to grow, it would likely have a significant negative effect on our business and results of operations.

Failure to maintain effective internal controls may cause a loss of investor confidence in the reliability of our financial statements or to cause us to delay filing our periodic reports with the SEC and adversely affect our stock price.

The SEC, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring public companies to include a report of management on internal control over financial reporting in their annual reports on Form 10-K that contain an assessment by management of the effectiveness of the Company s internal control over financial reporting. In addition, our independent registered public accounting firm must attest to and report on the effectiveness of our internal control over financial reporting. Although we review our internal control over financial reporting in order to ensure compliance with the Section 404 requirements, our failure to maintain adequate internal controls over financial reporting could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements or a delay in our ability to timely file our periodic reports with the SEC, which ultimately could negatively impact our stock price.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Stock repurchases during the three months ended July 3, 2010 were as follows:

Period	Total Number of Shares Purchased		Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs		Maximum Dollar Value that May Yet Be Purchased Under the Plans or Programs
April 4, 2010 May 1, 2010					$	50,000,000
May 2, 2010 May 29, 2010	476,910	$	35.10	476,910		33,261,444
May 30, 2010 July 3, 2010						33,261,444
Total	476,910	$	35.10	476,910	$	33,261,444

On April 29, 2010, we announced that the Board of Directors had authorized the repurchase of up to $50 million of our common stock. The timing and size of any purchases will be subject to market conditions. The program is authorized for 12 months.

ITEM 6. EXHIBITS

Exhibit No.	Description
10.1	Second Lease Amendment by and between Coherent, Inc. and 5200 Patrick Henry Associates LLC dated as of July 23, 2010.
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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COHERENT, INC.

SIGNATURES

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

	Coherent, Inc. (Registrant)	
Date: August 11, 2010	/s/:	JOHN R. AMBROSEO John R. Ambroseo President and Chief Executive Officer (Principal Executive Officer)
Date: August 11, 2010	/s/:	HELENE SIMONET Helene Simonet Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

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