COHERENT INC
Form 10-Q
February 08, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended December 31, 2011

or

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

For the transition period from to

Commission File Number: 001-33962

COHERENT, INC.

Delaware	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 S No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 S No £

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

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

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

The number of shares outstanding of registrant's common stock, par value $.01 per share, on January 27, 2012 was 23,559,776.

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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 the negative of such terms 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 event.

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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	
	December 31, 2011	January 1, 2011
Net sales	$190,767	$183,111
Cost of sales	110,408	100,717
Gross profit	80,359	82,394
Operating expenses:		
Research and development	18,779	18,530
Selling, general and administrative	34,631	36,078
Amortization of intangible assets	1,636	2,095
Total operating expenses	55,046	56,703
Income from operations	25,313	25,691
Other income (expense):		
Interest and dividend income	202	183
Interest expense	(2)	(15)
Other—net	318	1,586
Total other income (expense), net	518	1,754
Income before income taxes	25,831	27,445
Provision for income taxes	8,780	8,332
Net income	$17,051	$19,113
Net income per share:		
Basic	$0.73	$0.77
Diluted	$0.71	$0.76
Shares used in computation:		
Basic	23,462	24,688
Diluted	23,961	25,268

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 data)

	December 31, 2011	October 1, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$167,662	$167,061
Short-term investments	35,421	53,142
Accounts receivable—net of allowances of $1,546 and $1,439, respectively	130,581	141,037
Inventories	148,047	152,385
Prepaid expenses and other assets	52,314	44,964
Deferred tax assets	23,265	22,057
Total current assets	557,290	580,646
Property and equipment, net	106,028	104,504
Goodwill	74,756	75,954
Intangible assets, net	16,405	17,980
Other assets	63,650	64,182
Total assets	$818,129	$843,266
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term obligations	$15	$15
Accounts payable	35,379	39,841
Income taxes payable	15,258	23,929
Other current liabilities	94,573	98,620
Total current liabilities	145,225	162,405
Long-term obligations	15	19
Other long-term liabilities	63,565	62,841
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Common stock, par value $.01 per share:		
Authorized—500,000 shares		
Outstanding—23,531 shares and 23,722 shares, respectively	234	236
Additional paid-in capital	114,829	130,250
Accumulated other comprehensive income	40,916	51,221
Retained earnings	453,345	436,294
Total stockholders' equity	609,324	618,001
Total liabilities and stockholders' equity	$818,129	$843,266

See Accompanying Notes to Condensed Consolidated Financial Statements.

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COHERENT, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in thousands)

	Three Months Ended	
	December 31, 2011	January 1, 2011
Cash flows from operating activities:		
Net income	$17,051	$19,113
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,828	4,767
Amortization of intangible assets	1,636	2,095
Deferred income taxes	(527)	8,096
Tax benefit from employee stock options	955	1,543
Loss on disposal of property and equipment	42	156
Stock-based compensation	4,022	2,922
Excess tax benefit from stock-based compensation arrangements	(1,681)	(1,678)
Other non-cash (income) expense	154	(58)
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	9,161	1,522
Inventories	2,671	(9,109)
Prepaid expenses and other assets	(7,321)	(2,443)
Other assets	(497)	(2,011)
Accounts payable	(4,715)	2,687
Income taxes payable/receivable	(8,210)	(1,314)
Other current liabilities	(3,110)	1,250
Other long-term liabilities	676	2,431
Net cash provided by operating activities	16,135	29,969
Cash flows from investing activities:		
Purchases of property and equipment	(8,139)	(5,129)
Proceeds from dispositions of property and equipment	26	—
Purchases of available-for-sale securities	(12,593)	(71,093)
Proceeds from sales and maturities of available-for-sale securities	30,188	19,506
Changes in restricted cash	—	(68)
Net cash provided by (used in) investing activities	9,482	(56,784)
Cash flows from financing activities:		
Short-term borrowings	4,786	285
Repayments of short-term borrowing	(4,786)	(285)
Net change in capital lease obligations	(4)	(5)
Issuance of common stock under employee stock option and purchase plans	4,568	17,331
Repurchase of common stock	(20,665)	—
Net settlement of restricted common stock	(4,413)	(2,086)
Excess tax benefits from stock-based compensation arrangements	1,681	1,678
Net cash provided by (used in) financing activities	(18,833)	16,918
Effect of exchange rate changes on cash and cash equivalents	(6,183)	(7,968)
Net increase (decrease) in cash and cash equivalents	601	(17,865)
Cash and cash equivalents, beginning of period	167,061	245,380
Cash and cash equivalents, end of period	$167,662	$227,515

Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$3	$11
Income taxes	$25,818	$3,973
Cash received during the period for:		
Income taxes	$9,662	$3,908
Non-cash investing and financing activities:		
Unpaid property and equipment	$1,933	$889

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 1, 2011. In the opinion of management, all adjustments necessary for a fair presentation of financial condition and results of operation as of and for the periods presented have been made and include only normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year or any other interim periods presented therein. Our fiscal year ends on the Saturday closest to September 30 and our first fiscal quarters include 13 weeks of operations in each fiscal year presented. Fiscal years 2012 and 2011 each include 52 weeks.

2. RECENT ACCOUNTING STANDARDS

Adoption of New Accounting Pronouncement

In September 2011, the Financial Accounting Standards Board ("FASB") amended existing guidance related to goodwill and other intangible assets by giving an entity the option to first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount. The qualitative factors are consistent with the existing guidance which requires goodwill of a reporting unit to be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. If this is the case, companies will need to perform a more detailed two-step goodwill impairment test which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. We adopted this authoritative guidance in the first quarter of fiscal 2012. The implementation of this authoritative guidance did not have a material impact on our consolidated financial position, results of operations and cash flows.
In October 2009, the FASB issued a new accounting standard for multiple deliverable revenue arrangements. The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. The FASB also issued a new accounting standard for certain revenue arrangements that include software elements. This new standard excludes software that is contained on a tangible product from the scope of software revenue guidance if the software is essential to the tangible product's functionality. We prospectively adopted both these standards in the first quarter of fiscal 2011 and it did not have a material impact on our consolidated financial position, results of operations and cash flows.

Recently Issued Accounting Pronouncements

In December 2011, the FASB issued guidance which requires an entity to disclose information about offsetting and related arrangements to enable financial statement users to evaluate the effect or potential effect of netting arrangements, including rights of setoff associated with the entity's recognized financial assets and liabilities, on the entity's financial position. The new disclosures will enable financial statement users to compare balance sheets prepared under U.S. GAAP and International Financial Reporting Standards ("IFRS"), which are subject to different offsetting models. The disclosures will be limited to financial instruments (and derivatives) subject to enforceable master netting arrangements or similar agreements. Similar agreements include derivative clearing agreements, global master repurchase agreements, and global master securities lending agreements. Financial instruments and transactions that will be subject to the disclosure requirements may include derivatives, repurchase and reverse repurchase agreements, and securities lending and borrowing arrangements. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The guidance is effective for us beginning in fiscal 2014. We are currently evaluating the potential impact, if any, of the adoption of this guidance on our consolidated financial position, results of operations and cash flows.

In June 2011, the FASB issued a final standard requiring the presentation of net income and other comprehensive income

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in either a single continuous statement or in two separate, but consecutive, statements of net income and other comprehensive income. The new standard eliminates the option currently elected by the Company to present items of other comprehensive income in the annual statement of changes in stockholders' equity. The new requirements do not change the components of comprehensive income recognized in net income or other comprehensive income, or when an item of other comprehensive income must be reclassified to net income. Earnings per share computations do not change. The new requirements are effective for interim and annual periods beginning after December 15, 2011, with early adoption permitted. Full retrospective application is required. As this standard relates only to the presentation of other comprehensive income, the adoption of this accounting standard will not have an impact on our consolidated financial position, results of operations and cash flows.

In May 2011, the FASB issued additional guidance on fair value measurements that clarifies the application of existing guidance and disclosure requirements, changes certain fair value measurement principles and requires additional disclosures about fair value measurements. The updated guidance is effective on a prospective basis for financial statements issued for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. The adoption of this guidance will not have a material impact on our consolidated financial position, results of operations and cash flows.

3. BUSINESS COMBINATIONS

On January 5, 2011, we acquired all of the assets and certain liabilities of Hypertronics Pte Ltd for approximately $14.5 million in cash. Hypertronics designs and manufactures laser-and vision-based tools for flat panel, storage, semiconductor and solar applications at facilities in Singapore and Malaysia. Hypertronics has been included in our Specialty Lasers and Systems segment.

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

Tangible assets	$4,617
Goodwill	5,807
Intangible assets:	
Existing technology	3,120
In-process R&D	570
Customer lists	1,880
Trade name	410
Non-compete agreements	60
Liabilities assumed	(1,965)
Total	$14,499

The goodwill recognized from this acquisition resulted primarily from anticipated revenue growth and synergies of integrating Hypertronics scan vision technology and system capabilities with our laser technology and global sales, marketing, distribution and service network. The goodwill was included in our Specialty Lasers and Systems segment.

None of the goodwill from this purchase is deductible for tax purposes.

The identifiable intangible assets are being amortized over their respective useful lives of two to six years.

In-process research and development (“IPR&D”) consists of seven interrelated projects that will be incorporated into one product and had 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. None of the projects had been completed as of December 31, 2011.

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We expensed $0.6 million of acquisition-related costs as selling, general and administrative expenses in our consolidated statements of operations in the fiscal year ended October 1, 2011.

Results of operations for the business have been included in our consolidated financial statements subsequent to the date of acquisition and pro forma results of operations in accordance with authoritative guidance for prior periods have not been presented because the effect of the acquisition was not material to our prior period consolidated financial results.

4. FAIR VALUES

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 December 31, 2011 and October 1, 2011, we did not have any assets or liabilities valued based on Level 3 valuations.

Financial assets and liabilities measured at fair value as of December 31, 2011 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)	$16,728	$—	$16,728
Certificates of deposit (2)	—	66,916	66,916
U.S. and international government obligations (3)	—	57,642	57,642
Corporate notes and obligations (4)	—	31,259	31,259
Foreign currency contracts (5)	—	627	627
Mutual funds — Deferred comp and supplemental plan (6)	8,348	—	8,348

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

(2) Includes $64,914 recorded in cash and cash equivalents and $2,002 recorded in short-term investments on the Condensed Consolidated Balance Sheet.

(3) Includes $54,919 recorded in cash and cash equivalents and $2,723 recorded in short-term investments on the Condensed Consolidated Balance Sheet.

(4) Includes $563 recorded in cash and cash equivalents and $30,696 recorded in short-term investments on the Condensed Consolidated Balance Sheet.

(5) Includes $627 recorded in other current liabilities on the Condensed Consolidated Balance Sheet (see Note 5).

(6) Includes $2,859 recorded in prepaid expenses and other assets and $5,489 recorded in other assets on the Condensed Consolidated Balance Sheet.

Financial assets and liabilities measured at fair value as of October 1, 2011 are summarized below (in thousands):

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	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Total Fair Value
Money market fund deposits(1)	$8,135	$—	$8,135
Certificates of deposit(2)	—	65,941	65,941
U.S. and international government obligations(3)	—	62,079	62,079
Corporate notes and obligations(4)	—	48,967	48,967
Foreign currency contracts(5)	—	181	181
Mutual funds—Deferred comp and supplemental plan(6)	7,830	—	7,830

(1) Included in cash and cash equivalents on the Condensed Consolidated Balance Sheet.
(2) Includes $59,431 recorded in cash and cash equivalents and $6,510 recorded in short-term investments on the Condensed Consolidated Balance Sheet.
(3) Includes $60,978 recorded in cash and cash equivalents and $1,101 recorded in short-term investments on the Condensed Consolidated Balance Sheet.
(4) Includes $3,436 recorded in cash and cash equivalents and $45,531 recorded in short-term investments on the Condensed Consolidated Balance Sheet.
(5) Includes $578 recorded in prepaid expenses and other assets and $397 recorded in other current liabilities on the Condensed Consolidated Balance Sheet.
(6) Includes $2,844 recorded in prepaid expenses and other assets and $4,986 recorded in other assets 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, the Japanese Yen and the Korean Won. As a result, our earnings, cash flows and cash balances 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 notional contract and fair value amounts of hedge contracts, with maximum maturity of two months, are as follows (in thousands):

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	U.S. Notional Contract Value		U.S. Notional Fair Value	
	December 31, 2011	October 1, 2011	December 31, 2011	October 1, 2011
Euro currency hedge contracts				
Purchase	$47,843	$42,488	$47,344	$42,103
Sell	—	—	—	—
Net	$47,843	$42,488	$47,344	$42,103
Other foreign currency hedge contracts				
Purchase	$—	$2,351	$—	$2,355
Sell	(47,535)	(16,783)	(47,663)	(16,221)
Net	$(47,535)	$(14,432)	$(47,663)	$(13,866)

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 December 31, 2011 and October 1, 2011.

The amount of non-designated derivative instruments' gain (loss) in the Condensed Consolidated Statements of Operations for the three months ended December 31, 2011 and January 1, 2011 is as follows (in thousands):

	Amount of Gain or (Loss) Recognized in Income on Derivatives Three Months Ended December 31, 2011
Derivatives not designated as hedging instruments	
Foreign exchange contracts	$1,982

	Amount of Gain or (Loss) Recognized in Income on Derivatives Three Months Ended January 1, 2011
Derivatives not designated as hedging instruments	
Foreign exchange contracts	$1,104

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):

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	December 31, 2011			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$167,655	$7	$—	$167,662
Short-term investments:				
Available-for-sale securities:				
Certificates of deposit	$2,000	$2	$—	$2,002
International government obligations	2,667	61	(5)	2,723
Corporate notes and obligations	30,482	215	(1)	30,696
Total short-term investments	$35,149	$278	$(6)	$35,421

	October 1, 2011			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$166,931	$131	$(1)	$167,061
Short-term investments:				
Available-for-sale securities:				
Certificates of deposit	$6,500	$10	$—	$6,510
International government obligations	1,101	1	(1)	1,101
Corporate notes and obligations	45,282	275	(26)	45,531
Total short-term investments	$52,883	$286	$(27)	$53,142

The amortized cost and estimated fair value of available-for-sale investments in debt securities as of December 31, 2011 and October 1, 2011 classified as short-term investments on our condensed consolidated balance sheet were as follows (in thousands):

	December 31, 2011		October 1, 2011	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in less than 1 year	$33,149	$ 33,419	$46,383	$ 46,632
Total investments in available-for-sale debt securities	$33,149	$ 33,419	$46,383	$ 46,632

During the three months ended December 31, 2011, we received proceeds totaling $27.5 million from the sale of available-for-sale securities and realized gross gains of less than $0.1 million. During the three months ended January 1, 2011, we received proceeds totaling $18.4 million from the sale of available-for-sale securities and realized gross gains of less than $0.1 million.

At December 31, 2011, gross unrealized losses on our investments with unrealized losses that are not deemed to be other-than-temporarily impaired were $13,000 on corporate notes and obligations of $15.4 million and US treasury and agency obligations of $2.7 million.

At December 31, 2011, approximately $142.5 million of our cash, cash equivalents and short-term investments were held outside the U.S. in certain of our foreign operations, the majority of which was denominated in the Euro. In January 2012 we converted $89.8 million of these assets to U.S. dollars and invested those funds in U.S. Treasury securities within a European subsidiary whose functional currency is the U.S. dollar. Accordingly, there will be no future translation expense arising from these U.S. dollar denominated investments.

7. GOODWILL AND INTANGIBLE ASSETS

Goodwill is tested for impairment on an annual basis and between annual tests if events or circumstances indicate that an

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impairment loss may have occurred, and we write down these assets when impaired. 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.

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.

During the three months ended December 31, 2011, 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 1, 2011 to December 31, 2011 are as follows (in thousands):

	Commercial Lasers and Components	Specialty Lasers and Systems	Total
Balance as of October 1, 2011	$6,365	$69,589	$75,954
Translation adjustments and other	(2)	(1,196)	(1,198)
Balance as of December 31, 2011	$6,363	$68,393	$74,756

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

	December 31, 2011			October 1, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Existing technology	$52,011	$(42,646)	$9,365	$52,283	$(41,615)	$10,668
Patents	6,982	(6,956)	26	7,246	(7,220)	26
Customer lists	9,748	(5,248)	4,500	9,807	(5,142)	4,665
Trade name	3,483	(2,539)	944	3,566	(2,504)	1,062
Non-compete agreement	831	(764)	67	837	(784)	53
Production know-how	910	(627)	283	910	(621)	289
In-process research & development	1,220	—	1,220	1,217	—	1,217
Total	$75,185	$(58,780)	$16,405	$75,866	$(57,886)	$17,980

Amortization expense for intangible assets for the three months ended December 31, 2011 and January 1, 2011 was $1.6 million and $2.1 million, respectively, which includes $1.2 million and $1.4 million, respectively, for amortization of existing technology and production know-how.

At December 31, 2011, estimated amortization expense for the remainder of fiscal 2012, the next five succeeding fiscal years and all fiscal years thereafter are as follows (in thousands):

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	Estimated Amortization Expense
2012 (remainder)	$4,710
2013	4,857
2014	3,373
2015	2,044
2016	1,257
2017	154
Thereafter	10
Total	$16,405

8. BALANCE SHEET DETAILS

Inventories consist of the following (in thousands):

	December 31, 2011	October 1, 2011
Purchased parts and assemblies	$41,844	$44,824
Work-in-process	54,582	52,457
Finished goods	51,621	55,104
Total inventories	$148,047	$152,385

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

	December 31, 2011	October 1, 2011
Prepaid and refundable income taxes	$9,517	$9,193
Prepaid expenses and other	42,797	35,771
Total prepaid expenses and other assets	$52,314	$44,964

Other assets consist of the following (in thousands):

	December 31, 2011	October 1, 2011
Assets related to deferred compensation arrangements	$23,133	$22,737
Deferred tax assets	36,136	37,156
Other assets	4,381	4,289
Total other assets	$63,650	$64,182

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

	December 31, 2011	October 1, 2011
Accrued payroll and benefits	$26,703	$39,639
Deferred income	15,318	14,893
Reserve for warranty	16,035	16,704
Accrued expenses and other	13,590	12,473
Other taxes payable	18,343	11,067
Accrued restructuring charges	615	634
Customer deposits	3,969	3,210
Total other current liabilities	$94,573	$98,620

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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 completed in the third quarter of fiscal 2011. These closures resulted in charges primarily for employee termination and other exit related costs associated with a plan approved by management.

There were no additions to restructuring in the first three months of fiscal 2012. Restructuring charges for the first three months of fiscal 2011 are recorded in cost of sales, research and development and selling, general and administrative expenses in our condensed consolidated statements of operations.

The following table presents our current liability as accrued on our balance sheet for restructuring charges. The table sets forth an analysis of the components of the restructuring charges and payments and other deductions made against the accrual for the first three months of fiscal 2012 and 2011 (in thousands):

	Severance Related	Facilities-related Charges	Other Restructuring Costs	Total
Balance at October 2, 2010	$912	$17	$1,303	$2,232
Provisions	218	—	87	305
Payments and other	(228)	(17)	(491)	(736)
Balance at January 1, 2011	$902	$—	$899	$1,801
Balance at October 1, 2011	$—	$—	$634	$634
Payments and other	—	—	(19)	(19)
Balance at December 31, 2011	$—	$—	$615	$615

We provide warranties on certain 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 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.

Components of the reserve for warranty costs during the first three months of fiscal 2012 and 2011 were as follows (in thousands):

	Three Months Ended	
	December 31, 2011	January 1, 2011
Beginning balance	$16,704	$13,499
Additions related to current period sales	6,374	5,876
Warranty costs incurred in the current period	(7,249)	(5,297)
Adjustments to accruals, including foreign exchange	206	(178)
Ending balance	$16,035	$13,900

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

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	December 31, 2011	October 1, 2011
Long-term taxes payable	$28,195	$27,775
Deferred compensation	23,274	22,685
Deferred tax liabilities	1,953	2,194
Deferred income	2,483	2,636
Asset retirement obligations	1,888	1,878
Other long-term liabilities	5,772	5,673
Total other long-term liabilities	$63,565	$62,841

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 $20.2 million of foreign lines of credit as of December 31, 2011. At December 31, 2011, we had used $2.8 million of these available foreign lines of credit. These credit facilities were used in Europe and Japan during the first fiscal quarter of 2012. In addition, our domestic line of credit consists of a $40.0 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 December 31, 2011.

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 shares purchased under the Employee Stock Purchase Plan (“ESPP”) for the three months ended December 31, 2011 and January 1, 2011, respectively, were estimated using the following weighted-average assumptions:

	Employee Stock Purchase Plan Three Months Ended			
	December 31, 2011		January 1, 2011	
Expected life in years	0.5		0.5	
Expected volatility	49.3	%	30.6	%
Risk-free interest rate	0.1	%	0.2	%
Expected dividends	—		—	
Weighted average fair value per share	$14.93		$9.78	

(1) There were no options granted during the three months ended December 31, 2011 and January 1, 2011.

Restricted stock awards and restricted stock units are independent of option grants and are typically subject to vesting restrictions—either time-based or performance-based conditions for vesting. Until restricted stock vests, shares (including those issuable upon vesting of the applicable restricted stock unit) are subject to forfeiture if employment terminates prior to the release of restrictions and cannot be transferred.

- The service based restricted stock awards generally vest three years from the date of grant.
- The service based restricted stock unit awards are generally subject to annual vesting over three years from the date of grant.

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- The market-based performance restricted stock unit award grants are generally either subject to annual vesting over three years from the date of grant or subject to a single vest measurement three years from the date of grant, depending upon achievement of performance measurements ("Performance RSUs") based on the performance of the Company's Total Shareholder Returns (as defined) compared with the performance of the Russell 2000 Index.

We granted market-based performance restricted stock units to officers and certain employees. The performance stock unit agreements provide for the award of performance stock units with each unit representing the right to receive one share of Coherent, Inc. common stock to be issued after the applicable award period. The final number of units awarded for this grant will be determined as of the vesting dates, based upon our total shareholder return over the performance period compared to the Russell 2000 Index and could range from a minimum of no units to a maximum of twice the initial award. The weighted average fair value for these performance units was $71.59 and was determined using a Monte Carlo simulation model incorporating the following weighted average assumptions:

Risk-free interest rate	0.39	%
Volatility	41.8	%

We recognize the estimated cost of these awards, as determined under the simulation model, over the related service period, with no adjustment in future periods based upon the actual shareholder return over the performance period.

Stock-Based Compensation Expense

The following table shows total stock-based compensation expense and related tax benefits included in the Condensed Consolidated Statements of Operations for the three months ended December 31, 2011 and January 1, 2011 (in thousands):

	Three Months Ended	
	December 31, 2011	January 1, 2011
Cost of sales	$369	$244
Research and development	393	337
Selling, general and administrative	3,260	2,342
Income tax benefit	(1,328)	(675)
	$2,694	$2,248

During the three months ended December 31, 2011, $0.5 million was capitalized into inventory for all stock plans, $0.4 million was amortized to cost of sales and $0.5 million remained in inventory at December 31, 2011. During the three months ended January 1, 2011, $0.4 million was capitalized into inventory for all stock plans, $0.2 million was amortized to cost of sales and $0.4 million remained in inventory at January 1, 2011. Management has made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

At December 31, 2011, the total compensation cost related to unvested stock-based awards granted to employees under the Company’s stock plans but not yet recognized was approximately $24.6 million, net of estimated forfeitures of $2.7 million. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 1.6 years and will be adjusted for subsequent changes in estimated forfeitures.

At December 31, 2011, total compensation cost related to options to purchase common shares under the ESPP but not yet vested was approximately $0.7 million, which will be recognized over the offering period.

The cash flows resulting from excess tax benefits (tax benefits related to the excess of tax deduction resulting from an employee’s exercises of stock options over the stock-based compensation cost recognized for those options) are classified as financing cash flows. During the first three months of fiscal 2012 and fiscal 2011, we recorded $1.7 million and $1.7 million, respectively, of excess tax benefits as cash flows from financing activities.

Stock Options & Awards Activity

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

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	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at October 1, 2011	917	$27.80		
Granted	—	—		
Exercised	(66)	26.27		
Forfeitures	—	—		
Expirations	—	—		
Outstanding at December 31, 2011	851	$27.91	4.0	$20,742
Vested and expected to vest at December 31, 2011	845	$27.87	4.0	$20,626
Exercisable at December 31, 2011	662	$27.67	3.5	$16,291

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 0.9 million outstanding options that were in-the-money as of December 31, 2011. The aggregate intrinsic value of options exercised under the Company's stock plans for the three months ended December 31, 2011 and January 1, 2011 were $1.6 million and $6.6 million, respectively, determined as of the date of option exercise.

The following table summarizes the activity of our time based and market- performance based restricted stock units for the first three months of fiscal 2012 (in thousands, except per share amounts):

	Time Based Restricted Stock Units		Market-Based Performance Restricted Stock Units	
	Number of Shares(1)	Weighted Average Grant Date Fair Value	Number of Shares(2)	Weighted Average Grant Date Fair Value
Nonvested stock at October 1, 2011	404	$34.71	101	$49.77
Granted	224	53.46	95	63.85
Vested	(172)	30.93	(44)	53.18
Forfeited	—	—	—	—
Nonvested stock at December 31, 2011	456	$45.37	152	$57.55

(1)Service-based restricted stock vested during each fiscal year.
(2)Performance-based awards and units included at 100% of target goal; under the terms of the awards, the recipient may earn between 0% and 200% of the award.

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. 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.

12. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

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	Three Months Ended	
	December 31, 2011	January 1, 2011
Net income	$17,051	$19,113
Other comprehensive income (loss):		
Translation adjustment	(10,321)	(11,426)
Changes in unrealized gains on available-for-sale securities, net of taxes	16	(1)
Other comprehensive income (loss), net of tax	(10,305)	(11,427)
Comprehensive income (loss)	$6,746	$7,686

Accumulated other comprehensive income (net of tax) at December 31, 2011 is comprised of accumulated translation adjustments of $40.9 million. Accumulated other comprehensive income (net of tax) at October 1, 2011 is comprised of accumulated translation adjustments of $51.2 million.

13. EARNINGS PER SHARE

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

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

	Three Months Ended	
	December 31, 2011	January 1, 2011
Weighted average shares outstanding —basic	23,462	24,688
Dilutive effect of employee stock awards	499	580
Weighted average shares outstanding—diluted	23,961	25,268
Net income	$17,051	$19,113
Net income per basic share	$0.73	$0.77
Net income per diluted share	$0.71	$0.76

A total of 207,517 and 52,192 potentially dilutive securities have been excluded from the dilutive share calculation for the three months ended December 31, 2011 and January 1, 2011, respectively, as their effect was anti-dilutive.

14. OTHER INCOME (EXPENSE)

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

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	Three Months Ended	
	December 31, 2011	January 1, 2011
Foreign exchange gain	$313	$6
Gain (loss) on deferred compensation investments, net	(41)	1,554
Interest and dividend income	202	183
Interest expense	(2)	(15)
Other—net	46	26
Other income (expense), net	$518	$1,754

15. STOCK REPURCHASES

On August 25, 2011, we announced that the Board of Directors had authorized the repurchase of up to $50.0 million of our common stock. The program is authorized for 12 months from the date of authorization. At October 1, 2011, $25.0 million of shares remained authorized for repurchase under this stock repurchase program.

During the quarter ended December 31, 2011, we repurchased and retired 450,500 shares of outstanding common stock at an average price of $45.84 per share for a total of $20.7 million, excluding expenses. Such repurchases were accounted for as a reduction in additional paid in capital.

At December 31, 2011, $4.3 million remains authorized for repurchase under our current stock repurchase program. The timing and size of any purchases will be subject to, among other things, market conditions.

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 ended December 31, 2011 was 34.0%. Our effective tax rate for the three months ended December 31, 2011 was lower than the statutory rate of 35% primarily due to permanent differences related to the benefit of income subject to foreign tax rates that are lower than U.S. tax rates, the benefit of foreign tax credits, the benefit of federal and California research and development tax credits and the benefit of a domestic production activities deduction. These amounts are partially offset by deemed dividend inclusions under the Subpart F tax rules, state income taxes, limitations on the utilization of certain foreign losses, stock compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m).

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 December 31, 2011, the total amount of gross unrecognized tax benefits was $28.8 million of which $19.8 million, if recognized, would affect our effective tax rate. Our total gross unrecognized tax benefits, net of certain deferred tax assets, 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 December 31, 2011, the total amount of gross interest and penalties accrued was $3.5 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 2005 are closed. In our major state jurisdiction and our major foreign jurisdiction, the years subsequent to 2000 and 2005, respectively, currently remain open and could be subject to examination by the taxing authorities. In December 2011 and January 2012, our three German subsidiaries received notices of tax audits for the fiscal years 2006 through 2010. These audits have either commenced or are expected to begin by March 2012.

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Management believes that it has adequately provided for any adjustments that may result from tax examinations. The Company regularly engages in discussions and negotiations with tax authorities regarding tax matters in various jurisdictions. It is reasonably possible that certain federal, foreign and state tax matters may be concluded in the next 12 months and we anticipate a lapse in certain statute of limitations which could result in a release of interest expense under ASC 740 "Income Taxes." Specific positions that may be resolved include issues involving research and development credits, transfer pricing and various other matters. The Company estimates that the net unrecognized tax benefits and related interest at December 31, 2011 could be reduced by approximately $1.0 million to $3.0 million in the next 12 months.

Deferred Income Taxes

As of December 31, 2011, our condensed consolidated balance sheet included net deferred tax assets, before valuation allowance, of approximately $63.3 million, which consists of tax credits carryovers, accruals and reserves, competent authority offset to transfer pricing tax reserves, employee stock-based compensation expenses, 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 $8.5 million as of December 31, 2011. We intend to maintain the valuation allowance until sufficient positive evidence exists to support reversal of the valuation allowance.

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 dedicated engineering, manufacturing, product business management and product line management functions. 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. As assets are not a measure used to assess the performance of the company by the CODM, asset information is not tracked or compiled by segment and is not available to be reported 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):

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	Three Months Ended December 31, 2011	January 1, 2011
Net sales:		
Commercial Lasers and Components	$55,150	$61,358
Specialty Laser Systems	135,617	121,753
Corporate and other	—	—
Total net sales	$190,767	$183,111
Income (loss) from operations:		
Commercial Lasers and Components	$4,020	$8,325
Specialty Laser Systems	31,030	28,861
Corporate and other	(9,737)	(11,495)
Total income from operations	$25,313	$25,691

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

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broader markets—We will continue to identify opportunities in which our technology portfolio and application engineering can be used to offer innovative solutions and gain access to new markets. We plan to utilize our expertise to expand into new markets, such as laser-based processing development tools for solar manufacturing and high power materials processing solutions.

- Optimize our leadership position in existing markets—There are a number of markets where we have historically been at the forefront of technological development and product deployment and from which we have derived a substantial portion of our revenues. We plan to optimize our financial returns from these markets.
- Maintain and develop additional strong collaborative customer and industry relationships—We believe that the Coherent brand name and reputation for product quality, technical performance and customer satisfaction will help us to further develop our loyal customer base. We plan to maintain our current customer relationships and develop new ones with customers who are industry leaders and work together with these customers to design and develop innovative product systems and solutions as they develop new technologies.
- Develop and acquire new technologies and market share—We will continue to enhance our market position through our existing technologies and develop new technologies through our internal research and development efforts, as well as through the acquisition of additional complementary technologies, intellectual property, manufacturing processes and product offerings.
- Streamline our manufacturing structure and improve our cost structure—We will focus on optimizing the mix of products that we manufacture internally and externally. We will utilize vertical integration where our internal manufacturing process is considered proprietary and seek to leverage external sources when the capabilities and cost structure are well developed and on a path towards commoditization.
- Focus on long-term improvement of adjusted EBITDA, in dollars and as a percentage of net sales—We define adjusted EBITDA as operating income adjusted for depreciation, amortization, stock compensation expenses, major restructuring costs and certain other non-operating income and expense items. Key initiatives to reach our goals for EBITDA improvements include utilization of our Asian manufacturing locations, rationalizing our supply chain and continued leveraging of our infrastructure.

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 consolidated 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 consolidated 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 original equipment manufacturers (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 fair values or a selling price hierarchy, for arrangements entered into subsequent to October 2, 2010, as discussed below.

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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.

In October 2009, the FASB issued a new accounting standard for multiple deliverable revenue arrangements. The new standard changes the requirements for establishing separate units of accounting in a multiple element arrangement and requires the allocation of arrangement consideration to each deliverable to be based on the relative selling price. The FASB also issued a new accounting standard for certain revenue arrangements that include software elements. This new standard excludes software that is contained on a tangible product from the scope of software revenue guidance if the software is essential to the tangible product's functionality. We prospectively adopted both these standards in the first quarter of fiscal 2011. The impact of adopting these standards was not material to net sales or our condensed consolidated financial statements for the three months ended January 1, 2011.

Under these new standards, when a sales arrangement contains multiple elements, such as products and/or services, we allocate revenue to each element based on a selling price hierarchy. Using the selling price hierarchy, we determine the selling price of each deliverable using vendor specific objective evidence ("VSOE"), if it exists, and otherwise third-party evidence ("TPE"). If neither VSOE nor TPE of selling price exists, we use estimated selling price ("ESP"). We generally expect that we will not be able to establish TPE due to the nature of the markets in which we compete, and, as such, we typically will determine selling price using VSOE or if not available, ESP.

Our basis for establishing VSOE of a deliverable's selling price consists of standalone sales transactions when the same or similar product or service is sold separately. However, when services are never sold separately, such as product installation services, VSOE is based on the product's estimated installation hours based on historical experience multiplied by the standard service billing rate. In determining VSOE, we require that a substantial majority of the selling price for a product or service fall within a reasonably narrow price range, as defined by us. We also consider the geographies in which the products or services are sold, major product and service groups, and other environmental variables in determining VSOE. Absent the existence of VSOE and TPE, our determination of a deliverable's ESP involves evaluating several factors based on the specific facts and circumstances of these arrangements, which include pricing strategy and policies driven by geographies, market conditions, competitive landscape, correlation between proportionate selling price and list price established by management having the relevant authority, and other environmental variables in which the deliverable is sold.

For multiple element arrangements which include extended maintenance contracts, we allocate and defer the amount of consideration equal to the separately stated price and recognize revenue on a straight-line basis over the contract period.

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

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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 three months ended December 31, 2011, we noted no indications of impairment or triggering events to cause us to review goodwill for potential impairment.

At December 31, 2011, we had $74.8 million of goodwill, $16.4 million of purchased intangible assets and $106.0 million of property and equipment 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, 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 fair value. We estimate the fair value of stock options granted using the Black-Scholes Merton model and estimate the fair value of market-based performance restricted stock units granted using a Monte Carlo simulation 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 service-based restricted stock units using the intrinsic value method and amortize the value on a straight-line basis over the restriction period. We value market-based performance restricted stock units using a Monte Carlo simulation model and amortize the value over the performance period, with no adjustment in future periods, based upon the actual shareholder return over the performance period. See Note 10 “Stock-Based Compensation” for a description of our stock-based employee compensation plans and the assumptions we use to calculate the fair value of stock-based employee compensation.

Income Taxes

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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 condensed 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.

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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 December 31, 2011	January 1, 2011	Change	% Change
	(Dollars in thousands)			
Bookings	$201,848	$234,424	$(32,576)	(13.9)%
Book-to-bill ratio	1.06	1.28	(0.22)	(17.2)%
Net sales—Commercial Lasers and Components	$55,150	$61,358	$(6,208)	(10.1)%
Net sales—Specialty Lasers and Systems	$135,617	$121,753	$13,864	11.4 %
Gross profit as a percentage of net sales—Commercial Lasers and Components	39.0 %	43.7 %	(4.7)%	(10.8)%
Gross profit as a percentage of net sales—Specialty Lasers and Systems	43.8 %	46.0 %	(2.2)%	(4.8)%
Research and development as a percentage of net sales	9.8 %	10.1 %	(0.3)%	(3.0)%
Income before income taxes	$25,831	$27,445	$(1,614)	(5.9)%
Net cash provided by operating activities	$16,135	$29,969	$(13,834)	(46.2)%
Days sales outstanding in receivables	61.6	53.1	8.5	16.0 %
First quarter inventory turns	3.0	3.3	(0.3)	(9.1)%
Capital spending as a percentage of net sales	4.3 %	2.8 %	1.5 %	53.6 %

Definitions and analysis of these performance indicators are as follows:

Bookings and Book-to-Bill Ratio

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.

The book-to-bill ratio is calculated as quarterly bookings divided by quarterly net sales. This is an indication of the strength of our business but can sometimes be impacted by a single large order. A ratio of greater than 1.0 indicates that demand for our products is greater than what we supply in the quarter.

Although bookings decreased 13.9% in the first quarter of fiscal 2012 compared to the same quarter one year ago, the book-to-bill ratio was 1.06. Decreases in all four markets included a significant decrease in the microelectronics market. Compared to the fourth quarter of fiscal 2011, bookings increased 3.3% with a significant increase in the microelectronics market offset by decreases in the OEM components and instrumentation, materials processing and scientific and government programs markets.

Microelectronics

Microelectronics bookings decreased 23% compared to the same quarter one year ago but increased 34% from bookings in the fourth quarter of fiscal 2011. The book-to-bill for the first quarter of fiscal 2012 was 1.08.

Flat panel display orders in the first quarter of fiscal 2012 increased significantly from the fourth quarter of fiscal 2011, including system orders from new customers as well as increases in service orders. We expect this market to be strong in the remainder of fiscal 2012 as the primary market driver, the proliferation of smartphones and tablets, remains intact. Our facility expansion in Göttingen and new service center in Korea will start shipping product in the third quarter of fiscal 2012.

In the first quarter of fiscal 2012, the semiconductor capital equipment market was strong, with increased orders for new systems and service suggesting improvement in utilization rates. We expect this market to improve further during the remainder of fiscal 2012. We continue to develop next generation technologies to support higher throughput and higher accuracy.

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In spite of strong demand for smartphones and tablets, the advanced packaging (API) market is being impacted by tight credit in China where it is difficult for customers to establish letters of credit for new equipment purchases. We expect that China's credit policies will improve in the second quarter of fiscal 2012. We anticipate that market growth will come from increased adoption of smartphones and tablets as well as from the 3D packaging market.

Materials Processing

Materials processing orders decreased 10% compared to the same quarter one year ago and decreased 18% from the fourth quarter of fiscal 2011. The book-to-bill for the first quarter of fiscal 2012 was 0.98. During the first quarter of fiscal 2012, materials processing orders were negatively impacted by the tight credit policies in China and sovereign debt issues in Europe.

Marking and engraving for commodity and consumer product applications remains our largest submarket, with modest growth anticipated in fiscal 2012. We introduced several new products at the Fabtech tradeshow in November 2011 to diversify our laser systems and manufacturing tools to address more applications. In addition, our upcoming kilowatt class fiber laser will address metal cutting and we expect first revenue shipments in fiscal 2012.

OEM Components and Instrumentation

OEM Components and Instrumentation orders decreased 2% compared to the same quarter one year ago but decreased 26% from the fourth quarter of fiscal 2011. The book-to-bill for the first quarter of fiscal 2012 was 0.99.

The decrease compared to the fourth quarter of fiscal 2011 is primarily due to timing in the medical OEM market as the fourth quarter of fiscal 2011included several large orders to address market growth in Asia. While these orders were not repeated in the first quarter of fiscal 2012, we expect market growth to remain high, especially due to government investment in China. Markets for eye disease management and home-based aesthetic products remain strong.

We have increased our product offerings for the instrumentation market with new versions of the Sapphire™ optically pumped semiconductor ("OPS") laser and wavelength extensions of our OBIS™ platform, which can be used in a wide array of applications including super resolution microscopy and cytometry.

Scientific and Government Programs

Scientific and government programs orders decreased slightly compared to the same quarter one year ago and decreased 3% from the fourth quarter of fiscal 2011. The book-to-bill for the first quarter of fiscal 2012 was 1.12.

Scientific orders remain strong, with orders for multiphoton spectroscopy applications the largest contributor to first quarter fiscal 2012 bookings. Our Chameleon™ product family continues to lead this market due to a combination of power, stability and tunability. First quarter bookings were favorably impacted by significant investment in biological research in China, which is consistent with the country's five-year research plan. In addition, multi photon excitation bookings were also strong in Europe.

Net Sales

Net sales include sales of lasers, laser tools, related accessories and service contracts. Net sales for the first fiscal quarter decreased 10.1% in our CLC segment and increased 11.4% in our SLS segment from the same quarter one year ago. For a 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 first quarter decreased from 43.7% to 39.0% in our CLC segment and decreased from 46.0% to 43.8% in our SLS segment from the same quarter one year ago. For a 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

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managing our business as investing in new technologies is a key to future growth. R&D percentage decreased to 9.8% from 10.1% in our first fiscal quarter compared to the same period one year ago. For a 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 as reflected 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 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 first quarter of fiscal 2012 increased 8.5 days from the same quarter one year ago primarily due to a higher mix of receivables and revenue in regions with longer payment terms.

Annualized Inventory Turns

We calculate annualized inventory turns as the cost of sales during the quarter annualized and 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 first quarter of fiscal 2012 decreased by 0.3 turns from the same quarter one year ago primarily due to increased inventory levels to support increasing volumes.

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 increased to 4.3% from 2.8% for the first quarter of fiscal 2012 compared to the same period one year ago primarily due to building improvements and purchases of production-related assets to support our expansion in Asia and higher sales volumes.

SIGNIFICANT EVENTS

On August 25, 2011, the Board of Directors authorized the repurchase of up to $50.0 million of our common stock. The program is authorized for 12 months from the date of authorization. At October 1, 2011, $25.0 million remained authorized for repurchase under this stock repurchase program. During the quarter ended December 31, 2011, we repurchased and retired 450,500 shares of outstanding common stock at an average price of $45.84 per share for a total of $20.7 million, excluding expenses.

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:

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	Three Months Ended			
	December 31, 2011		January 1, 2011	
Net sales	100.0	%	100.0	%
Cost of sales	57.9	%	55.0	%
Gross profit	42.1	%	45.0	%
Operating expenses:				
Research and development	9.8	%	10.1	%
Selling, general and administrative	18.2	%	19.7	%
Amortization of intangible assets	0.9	%	1.2	%
Total operating expenses	28.9	%	31.0	%
Income from operations	13.2	%	14.0	%
Other income (net)	0.3	%	1.0	%
Income before income taxes	13.5	%	15.0	%
Provision for income taxes	4.6	%	4.6	%
Net income	8.9	%	10.4	%

Net income for the first quarter of fiscal 2012 was $17.1 million ($0.71 per diluted share) including $2.7 million of after-tax stock-related compensation expense. Net income for the first quarter of fiscal 2011 was $19.1 million ($0.76 per diluted share) including $2.2 million of after-tax stock-related compensation expense.

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					
	December 31, 2011			January 1, 2011		
	Amount	Percentage of total net sales		Amount	Percentage of total net sales	
Consolidated:						
Microelectronics	$92,892	48.7	%	$84,431	46.1	%
OEM components and instrumentation	35,940	18.8	%	38,350	20.9	%
Materials processing	23,379	12.3	%	22,275	12.2	%
Scientific and government programs	38,556	20.2	%	38,055	20.8	%
Total	$190,767	100.0	%	$183,111	100.0	%

Net sales for the first quarter of fiscal 2012 increased by $7.7 million, or 4%, including an increase of $3.2 million due to the impact of foreign currency exchange rates, compared to the first quarter of fiscal 2011. Sales increases in the microelectronics, materials processing and scientific and government programs markets were partially offset by a decrease in the OEM components and instrumentation market.

The increase in the microelectronics market of $8.5 million, or 10%, was due to higher sales in flat panel display applications partially offset by lower shipments for advanced packaging, semiconductor, solar and micro materials processing applications. The decrease in the OEM components and instrumentation market of $2.4 million, or 6%, was due primarily to lower shipments for military, machine vision and bio-instrumentation applications partially offset by higher shipments for medical applications. Sales in the materials processing market increased $1.1 million, or 5%, primarily due to higher shipments for marking and engraving applications. Sales in the scientific and government programs market increased $0.5 million, or 1%, primarily due to higher demand for advanced research applications used by university and government research groups.

Segments

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We are organized into two reportable operating segments: Commercial Lasers and Components ("CLC") and Specialty Lasers and Systems ("SLS"). CLC focuses on higher volume products that are offered in set configurations. CLC's primary markets include OEM components and instrumentation and materials processing. SLS develops and manufacturers configurable, advanced-performance products largely serving the microelectronics and scientific research markets.

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					
	December 31, 2011			January 1, 2011		
	Amount	Percentage of total net sales		Amount	Percentage of total net sales	
Consolidated:						
Commercial Lasers and Components (CLC)	$55,150	28.9	%	$61,358	33.5	%
Specialty Lasers and Systems (SLS)	135,617	71.1	%	121,753	66.5	%
Total	$190,767	100.0	%	$183,111	100.0	%

Net sales for the first quarter of fiscal 2012 increased by $7.7 million, or 4%, compared to the first quarter of fiscal 2011, with increases of $13.9 million, or 11%, in our SLS segment and decreases of $6.2 million, or 10%, in our CLC segment.

The increase in our SLS segment sales was primarily due to higher revenue for flat panel display applications partially offset by lower shipments for materials processing, semiconductor, solar and micro materials processing applications. The decrease in our CLC segment sales was primarily due to lower advanced packaging, flat panel display and military application sales partially offset by higher materials processing application sales.

GROSS PROFIT

Consolidated

Our gross profit rate decreased to 42.1% in the first quarter of fiscal 2012 from 45.0% in the first quarter of fiscal 2011. The decrease in the gross profit rate was primarily due to unfavorable product margins (1.9%) due to lower volumes in several business units, higher manufacturing expense to expand Excimer tube production in Korea and increased expense related to the flooding in Thailand, higher warranty and installation costs (0.7%) for installations to support the service and flat panel display markets, higher other costs (0.2%) due to higher inventory provisions and higher stock-based compensation expense (0.1%).

Our gross profit rate has been and will continue to be affected by a variety of factors including market mix, pricing on volume orders, 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 decreased to 39.0% in the first quarter of fiscal 2012 from 43.7% in the first quarter of fiscal 2011. The 4.7% decrease in the gross profit rate was primarily due to unfavorable product costs (2.2%) primarily due to the impact of lower volumes in a few business units serving primarily the advanced packaging and components markets, higher warranty costs (1.4%) due to a higher installed base from high sales volumes in fiscal 2011 and lower current quarter volumes and higher other costs (1.1%) primarily due to higher inventory provisions.

Specialty Lasers and Systems

The gross profit rate in our SLS segment decreased to 43.8% in the first quarter of fiscal 2012 from 46.0% in the first quarter of fiscal 2011. The 2.2% decrease in the gross profit rate was primarily due to unfavorable product costs (1.9%) due to lower volumes in several business units serving primarily non-flat panel display markets, increased investments in Excimer manufacturing capabilities to support the growing flat panel display revenue net of favorable product mix within the microelectronics market and higher installation costs net of lower warranty costs (0.3%) due to higher service costs to support installations of a growing number of laser annealing systems in the flat panel display market.

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OPERATING EXPENSES:

	Three Months Ended			
	December 31, 2011		January 1, 2011	
	Amount	Percentage of total net sales	Amount	Percentage of total net sales
	(Dollars in thousands)			
Research and development	$18,779	9.8 %	$18,530	10.1 %
Selling, general and administrative	34,631	18.2 %	36,078	19.7 %
Amortization of intangible assets	1,636	0.9 %	2,095	1.2 %
Total operating expenses	$55,046	28.9 %	$56,703	31.0 %

Research and development

Research and development (“R&D”) expenses increased $0.2 million, or 1%, during the first fiscal quarter ended December 31, 2011 compared to the same quarter one year ago. The increase was primarily due to higher project spending ($0.6 million), the acquisition of Hypertronics in the second quarter of fiscal 2011 ($0.3 million) and higher stock-related compensation expense ($0.1 million) partially offset by lower payroll spending ($0.5 million) due to lower performance-related compensation net of increased headcount, lower charges for increases in deferred compensation plan liabilities ($0.2 million) and higher net reimbursements from customers for development projects ($0.1 million). On a segment basis as compared to the prior year period, CLC spending decreased $0.4 million primarily due to lower project spending and lower payroll spending. SLS research and development spending increased $0.8 million primarily due to higher project spending and the acquisition of Hypertronics in the second quarter of fiscal 2011 partially offset by lower payroll spending and higher net reimbursements from customers for development projects. Corporate and other spending decreased $0.2 million due to lower charges for increases in deferred compensation plan liabilities partially offset by higher stock-related compensation expense.

Selling, general and administrative

Selling, general and administrative (“SG&A”) expenses decreased $1.4 million or 4%, during the first fiscal quarter ended December 31, 2011 compared to the same quarter one year ago. The decrease was primarily due to $2.2 million lower payroll spending due to lower performance-related compensation spending partially offset by higher headcount and increased salaries, $1.4 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 decreased spending on legal and consulting related to acquisitions ($0.7 million) partially offset by $0.9 million higher stock-related compensation expense, the acquisition of Hypertronics in the second quarter of fiscal 2011 ($0.7 million), higher spending on demo amortization and tradeshows ($0.6 million), the impact of foreign currency exchange rates ($0.3 million) and higher other variable net spending ($0.4 million). On a segment basis as compared to the prior year period, CLC spending decreased $0.4 million primarily due to lower payroll spending. SLS segment expenses increased $0.7 million primarily due to the acquisition of Hypertronics, higher spending on demo amortization and tradeshows and the impact of foreign exchange rates partially offset by lower payroll spending. Spending for Corporate and other decreased $1.7 million primarily due to lower charges for increases in deferred compensation plan liabilities, lower payroll spending and decreased spending on legal and consulting related to acquisitions partially offset by higher stock-related compensation expense.

Amortization of intangible assets

Amortization of intangible assets decreased $0.5 million in the three months ended December 31, 2011 compared to the same period last year primarily due to the completion of amortization of intangibles from older acquisitions partially offset by amortization of intangibles from the acquisition of Hypertronics in the second quarter of fiscal 2011.

OTHER INCOME (EXPENSE) — NET

Other income, net of other expense, decreased $1.2 million during the three months ended December 31, 2011 compared to the same period one year ago. The decrease was primarily due to lower gains, net of expenses, on our deferred compensation plan assets ($1.6 million) partially offset by higher net foreign exchange gains ($0.3 million).

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INCOME TAXES

The effective tax rate for the first quarter of fiscal 2012 of 34.0% was lower than the statutory rate of 35% primarily due to permanent differences related to the benefit of income subject to foreign tax rates that are lower than U.S. tax rates, the benefit of foreign tax credits, the benefit of federal and California research and development tax credits and the benefit of a domestic production activities deduction. These amounts are partially offset by deemed dividend inclusions under the Subpart F tax rules, state income taxes, limitations on the utilization of certain foreign losses, stock compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m).

The effective tax rate for the first quarter of fiscal 2011 of 30.4%was lower than the statutory rate of 35% primarily due to permanent differences related to the benefit of income subject to foreign tax rates that are lower than U.S. tax rates, the benefit of federal research and development tax credits, including additional credits reinstated from fiscal 2010 resulting from the enactment of the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," and the benefit of unrealized gain on life insurance policy investments related to our deferred compensation plans. These amounts are partially offset by deemed dividend inclusions under the Subpart F tax rules, state income taxes, limitations on the deductibility of compensation under IRC Section 162(m) and stock compensation not deductible for tax purposes.

DEFERRED INCOME TAXES

As of December 31, 2011, our condensed consolidated balance sheet included net deferred tax assets, before valuation allowance, of approximately $63.3 million, which consists of tax credit carryovers, accruals and reserves, competent authority offset to transfer pricing tax reserves, employee stock-based compensation expenses, 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 $8.5 million as of December 31, 2011. We intend to maintain the valuation allowance until sufficient positive evidence exists to support reversal of the valuation allowance.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2011, we had assets classified as cash and cash equivalents, as well as time deposits and fixed income securities classified as short-term investments, in an aggregate amount of $203.1 million, compared to $220.2 million at October 1, 2011. At December 31, 2011, approximately $142.5 million of this cash and securities was held outside the U.S. in certain of our foreign operations, the majority of which was denominated in the Euro. In January 2012, we converted $89.8 million of these assets to U.S. dollars and invested those funds in U.S. Treasury securities within a European subsidiary whose functional currency is the U.S. dollar. Accordingly, there will be no future translation expense arising from these U.S. dollar denominated investments. The converted funds were not repatriated to the U.S. and no U.S. tax was triggered on the transfer of these funds to the European subsidiary. We expect to incur additional foreign income taxes of approximately $650,000 related to this distribution. We currently intend to permanently reinvest approximately $135 million of the cash held by our foreign subsidiaries, including the investment in U.S. Treasury securities. If, however, a portion of these funds were needed for and distributed to our operations in the United States, we would be subject to additional U.S. income taxes and foreign withholding taxes. The amount of the taxes due would depend on the amount and manner of repatriation, as well as the location from where the funds are repatriated. We actively monitor the third-party depository institutions that hold these assets, primarily focusing on the safety of principal and secondarily maximizing yield on these assets. We diversify our cash and cash equivalents and investments among various financial institutions, money market funds and sovereign debt in order to reduce our exposure should any one of these financial institutions or financial instruments fail or encounter difficulties. To date, we have not experienced any material loss or lack of access to our invested cash, cash equivalents or short-term investments. However, we can provide no assurances that access to our invested cash, cash equivalents or short-term investments will not be impacted by adverse conditions in the financial markets.

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. Our historical uses of cash have primarily been for the repurchase of our common stock, capital expenditures and acquisitions of businesses and technologies. Supplemental information pertaining to our historical sources and uses of cash is presented as follows and should

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be read in conjunction with our condensed consolidated statements of cash flows and the notes to condensed consolidated financial statements:

	Three Months Ended December 31, 2011	January 1, 2011
	(in thousands)	
Net cash provided by operating activities	$16,135	$29,969
Sales of shares under employee stock plans	4,568	17,331
Repurchase of common stock	(20,665)	—
Capital expenditures	(8,139)	(5,129)

Net cash provided by operating activities decreased by $13.8 million for the first three months of fiscal 2012 compared to the same period one year ago. The decrease in cash provided by operating activities was primarily due to higher tax payments and lower cash flows from accounts payable and other current liabilities, including accrued variable compensation. 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 Hypertronics in the second quarter of fiscal 2011. 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 August 25, 2011, the Board of Directors authorized the repurchase of up to $50.0 million of our common stock. The program is authorized for 12 months from the date of authorization. At October 1, 2011, $25.0 million of shares remained authorized for repurchase under this stock repurchase program. During the quarter ended December 31, 2011, we repurchased and retired 450,500 shares of outstanding common stock at an average price of $45.84 per share for a total of $20.7 million, excluding expenses.

During fiscal year 2008, we initiated restructuring plans to decrease costs by consolidating facilities and by reducing our workforce. As of December 31, 2011, we had made payments in connection with the restructuring plans in the amount of $27.7 million. We completed payments for substantially all anticipated costs related to the restructuring plans in the third quarter of fiscal 2011.

Additional sources of cash available to us were domestic and international currency lines of credit and bank credit facilities totaling $60.2 million as of December 31, 2011, of which $57.4 million was unused and available. These unsecured credit facilities were used in Europe and Japan during the first three months of fiscal 2012. Our domestic line of credit consists of 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 $2.8 million of the international currency lines has been used as of December 31, 2011.

Our ratio of current assets to current liabilities was 3.8:1 at December 31, 2011 compared to 3.6:1 at October 1, 2011. The increase in our ratio from October 1, 2011 to December 31, 2011 is primarily due to a higher proportion of decreases in current liabilities (taxes payable, accounts payable and other current liabilities) than current assets (short-term investments and accounts receivable). Our cash and cash equivalents, short-term investments, working capital and debt obligations are as follows:

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	December 31, 2011	October 1, 2011
	(in thousands)	
Cash and cash equivalents	$167,662	$167,061
Short-term investments	35,421	53,142
Working capital	412,065	418,241
Total debt obligations	30	34

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 1, 2011. There have been no material changes in contractual obligations outside of the ordinary course of business since October 1, 2011. Information regarding our other financial commitments at December 31, 2011 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 three months of fiscal 2012 was $16.1 million, which included net income of $17.1 million, depreciation and amortization of $7.5 million and stock-based compensation expense of $4.0 million partially offset by cash used by operating assets and liabilities of $11.3 million, decreases in net deferred tax assets of $0.5 million due to utilization of tax credits and $0.7 million other.

Cash provided by investing activities during the first three months of fiscal 2012 was $9.5 million, which included $17.6 million net sales of available-for-sale securities partially offset by $8.1 million used to acquire property and equipment and improve buildings.

Cash used by financing activities during the first three months of fiscal 2012 was $18.8 million, which included $20.7 million used to repurchase our common stock and $2.7 million other partially offset by $4.6 million generated from our employee stock option and stock purchase plans.

Changes in exchange rates during the first three months of fiscal 2012 used $6.2 million.

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 condensed consolidated financial position, results of operations and cash flows.

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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.

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 December 31, 2011, 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 December 31, 2011, the fair value of our available-for-sale debt securities was $33.4 million, all of which were classified as short-term investments. Gross unrealized gains and losses on available-for-sale debt securities were $276,000 and $(6,000), respectively, at December 31, 2011.

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, the Japanese Yen and the Korean Won. 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.

At December 31, 2011, approximately $142.5 million of our cash, cash equivalents and short-term investments were held outside the U.S. in certain of our foreign operations, the majority of which was denominated in the Euro. In January 2012, we converted $89.8 million of these assets to U.S. dollars and invested those funds in U.S. Treasury securities within a European subsidiary whose functional currency is the U.S. dollar. Accordingly, there will be no future translation expense arising from these U.S. dollar denominated investments.

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

The following table provides information about our foreign exchange forward contracts at December 31, 2011. 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 December 31, 2011 rates.

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

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	Average Contract Rate	U.S. Notional Contract Value	U.S. Notional Fair Value
Euro	1.3188	$(47,843)	$(47,344)
Japanese Yen	77.722	$10,688	$10,711
Canadian Dollar	0.9714	$562	$571
British Pound	1.5571	$6,043	$6,056
Korean Won	1,157.325	$22,798	$22,820
Chinese Renminbi	6.3770	$7,443	$7,505

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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 December 31, 2011 (“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.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2011 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 generally accepted accounting principles ("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.

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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

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 2005 are closed. In our major state jurisdiction and our major foreign jurisdiction, the years subsequent to 2000 and 2005, respectively, currently remain open and could be subject to examination by the taxing authorities. In December 2011 and January 2012, our three German subsidiaries received notices of tax audits for the fiscal years 2006 through 2010. These audits have either commenced or are expected to begin by March 2012.

Management believes that it has adequately provided for any adjustments that may result from tax examinations. The Company regularly engages in discussions and negotiations with tax authorities regarding tax matters in various jurisdictions. It is reasonably possible that certain federal, foreign and state tax matters may be concluded in the next 12 months and we anticipate a lapse in certain statute of limitations which could result in a release of interest expense under ASC 740 "Income Taxes." Specific positions that may be resolved include issues involving research and development credits, transfer pricing and various other matters. The Company estimates that the net unrecognized tax benefits and related interest at December 31, 2011 could be reduced by approximately $1.0 million to $3.0 million in the next 12 months.

ITEM 1A. RISK FACTORS

You should carefully consider the followings risks when considering an investment in our Common Stock. These risks could materially affect our business, results of operations or financial condition, cause the trading price of our Common Stock to decline materially or cause our actual results to differ materially from those expected or those expressed in any forward-looking statements made by or on behalf of Coherent. These risks are not exclusive, and additional risks to which we are subject include, but are not limited to, the factors mentioned under “Forward-Looking Statements.” Additionally, these risks and uncertainties described herein are not the only ones facing us. Other events that we do not currently anticipate or that we currently deem immaterial also may affect our business, results of operations or financial conditions.

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 in dollars and as a percentage of net sales, 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 discussed in this Item 1A and throughout this report. Our stock price will continue to be subject to daily variations as well. 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 operating expenses, and our stock price have 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 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

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limited source components, in a timely manner, in the quantity, quality and prices desired;

- the timing of conversion of booking to revenue;
- timing or cancellation of customer orders and shipment scheduling;
- fluctuations in our product mix;
- the ability of our customers' suppliers to provide sufficient material to support our customers' products;
- currency fluctuations and stability, in particular the Euro;
- 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 capacity and that of our suppliers;
- our increased reliance on domestic and foreign contract manufacturing;
- the rate of market acceptance of our new products;
- the ability of our customers to pay for our products;
- expenses associated with acquisition-related activities;
- 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;
- 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 research funding by governments with regard to our customers in the scientific business, such as universities;
- continued government spending on defense-related projects where we are a subcontractor;
- government support of the alternative energy industries, such as solar;

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- maintenance of supply relating to products sold to the government on terms which we would prefer not to accept;
- changes in policy, interpretations, or challenges to the allowability of costs incurred under government cost accounting standards;
- damage to our reputation as a result of coverage in social media, Internet blogs or other media outlets;
- managing our and other parties' compliance with contracts in multiple languages and jurisdictions;
- managing our internal and third party sales representatives and distributors, including compliance with all applicable laws;
- costs associated with designing around or payment of licensing fees associated with issued patents in our fields of business;
- the future impact of legislation, rulemaking, and changes in accounting, tax, defense procurement, or export policies; 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 our fiscal quarters. 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.

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 continued tightening in the credit markets, and lower levels of liquidity in some financial markets. There could be a number of follow-on effects from the tightened credit environment 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 functions. 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. Volatility in the financial markets and any 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, terrorist acts and civil unrest 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. 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, which could cause them to engage in 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 may continue to experience 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 when we need them, we may need to increase the 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 where a majority of our cash, cash equivalents and short-term investments are invested, which results in corresponding pressure on the valuation of the securities issued by such nations. Additionally, our overall investment portfolio is often concentrated in certificates of deposit and money market funds. We maintain a 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 or become materially impaired, which could have a material adverse effect on our financial condition and operating results. See “Item 3. Quantitative and Qualitative Disclosures about Market Risk.”

We depend on sole source or limited source suppliers, both internal and external, for some of our key components and materials, including exotic materials, certain cutting-edge optics 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. Our failure to timely receive these key components and materials, such as the large optics used in our flat panel display manufacturing applications, could cause delays in the shipment of our products. Some of these suppliers are relatively small private companies that may discontinue their operations at any time and which may be particularly susceptible to prevailing economic conditions. Some of our suppliers are located in regions which may be susceptible to natural disasters, such as the recent flooding in Thailand and the earthquake, tsunami and resulting nuclear disaster in Japan. 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. We continue to consolidate our supply base and move supplier 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. Additionally, many of our customers rely on sole source suppliers. In the event of a disruption of supply, orders from our customers could decrease or be delayed. 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, 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 potential 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 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 in the past experienced decreases in the ASPs of some of our products. As competing products become more widely available, the ASPs of our products may decrease. If we are unable to offset any 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.

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 months ended December 31, 2011, 76% of our net sales were derived from customers outside of the United States.

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For fiscal 2011, fiscal 2010 and fiscal 2009, 74%, 67% and 66%, respectively, of our net sales were derived from customers outside of the United States. We anticipate that foreign sales, particularly in Asia, will continue to account for a significant portion of our revenues in the foreseeable future.

A global economic slowdown or a natural disaster could have a negative effect on various foreign markets in which we operate, such as the earthquake, tsunami and resulting nuclear disaster during fiscal 2011 in Japan and the recent flooding in Thailand. 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. Our foreign sales are primarily through our direct sales force. Additionally, some foreign sales are made through foreign distributors and resellers. 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;
- compliance with applicable United States and foreign anti-corruption laws;
- cultural and management differences;
- preference for locally produced products; and
- shipping and other logistics complications.

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.

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 or other rights holders. 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 been seen in our industry, for example in the recently concluded patent-related litigation between IMRA America, Inc. and 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.

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 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 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 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

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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 companies 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 markets in which we serve, both foreign and domestic, 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, 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;

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- increased costs of product returns and warranty expenses;
- 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 of certain products, 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 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 growth or, alternatively, our spending during downturns, our business could be disrupted, which could 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. 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.

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.

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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;
- 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 identify appropriate acquisition candidates, to 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 Sunnyvale, California site 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.

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.

Our operations would be seriously harmed if our logistics or facilities or those of our suppliers, our customers' suppliers or our contract manufacturers were to experience catastrophic loss.

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, power outages, acts of war, pandemic illnesses, energy shortages, theft of assets, other natural disasters or terrorist activity, such as the recent flooding in Thailand. 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.

Difficulties with our enterprise resource planning (“ERP”) system and other parts of our global information technology system could harm our business and results of operation. If our network security measures are breached and unauthorized access is obtained to a customer's data or our data or our information technology systems, we may incur significant legal and financial exposure and liabilities.

Like many modern multinational corporations, we maintain a global information technology system, including software products licensed from third parties. Any system, network or Internet failures, misuse by system users, the hacking into or disruption caused by the unauthorized access by third parties or loss of license rights could disrupt our ability to timely and accurately manufacture and ship products or to report our financial information in compliance with the timelines mandated by the Securities and Exchange Commission. Any such failure, misuse, hacking, disruptions or loss would likely cause a diversion of management's attention from the underlying business and could harm our operations. In addition, a significant failure of our global information technology system could adversely affect our ability to complete an evaluation of our internal controls and attestation activities pursuant to Section 404 of the Sarbanes-Oxley Act of 2002.

As part of our day-to-day business, we store our data and certain data about our customers in our global information technology system. While our system is designed with access security, if a third party gain unauthorized access to our data, including any regarding our customers, such security breach could expose us to a risk of loss of this information, loss of business, litigation and possible liability. These security measures may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise. 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 customers' data or our data, including our intellectual property and other confidential

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business information, or our information technology systems. 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. Any security breach could result in a loss of confidence by our customers, damage our reputation, disrupt our business, lead to legal liability and negatively impact our future sales.

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 various announcements 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.
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 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, including duties, affecting the import or export of products could negatively affect our revenues.

The United States and many foreign governments impose tariffs and duties on the import and export of products, including some of those which we sell. In particular, given our worldwide operations, we pay duties on certain products when they are imported into the United States for repair work as well as on certain of our products which are manufactured by our foreign subsidiaries. These products can be subject to a duty on the product value. Additionally, 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. From time to time, government 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. From time to time our duty calculations and payments are audited by government agencies.

In addition, compliance with the directives of the Directorate of Defense Trade Controls (“DDTC”) may result in substantial expenses and diversion of management. Any failure to adequately address the directives of DDTC could result in civil fines or suspension or loss of our export privileges, any of which could have a material adverse effect on our business or financial position, results of operations, or cash flows.

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.

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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 months ended December 31, 2011, our research and development costs were $18.8 million (9.8% of net sales). For our fiscal years 2011, 2010 and 2009, our research and development costs were $81.2 million (10.1% of net sales), $72.4 million (12.0% of net sales) and $61.4 million (14.1% 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.

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, the volatility of product supply and demand (particularly in the semiconductor industry), 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.

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

A portion of our net sales in the microelectronics market depend 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.

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 test 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

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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.

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.

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.

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

There were no sales of unregistered securities during the first quarter of fiscal 2012.

Stock repurchases during the three months ended December 31, 2011 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 (1)
October 2, 2011 - October 29, 2011	334,200	$45.28	334,200	$9,852,000
October 30, 2011 - November 26, 2011	26,100	$47.96	26,100	$8,600,000
November 27, 2011 - December 31, 2011	90,200	$47.30	90,200	$4,333,000
Total	450,500	$45.84	450,500	$4,333,000

(1) On August 25, 2011, we announced that the Board of Directors had authorized the repurchase of up to $50.0 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 from the date of authorization.

ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS

Exhibit No.	Description
10.1‡	Coherent, Inc. 2005 Deferred Compensation Plan, as amended.
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.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase
101.DEF*	XBRL Taxonomy Extension Definition Linkbase
101.LAB*	XBRL Taxonomy Extension Label Linkbase
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase

‡ Identifies management contract or compensatory plans or arrangements required to be filed as an exhibit.

* In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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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: February 8, 2012	/s/: JOHN R. AMBROSEO John R. Ambroseo President and Chief Executive Officer (Principal Executive Officer)
Date: February 8, 2012	/s/: HELENE SIMONET Helene Simonet Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

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EXHIBIT INDEX

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

‡ Identifies management contract or compensatory plans or arrangements required to be filed as an exhibit.

* In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections.