COHERENT INC
Form 10-Q
August 12, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended July 4, 2015

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 x 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 x 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 x	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 x

The number of shares outstanding of registrant’s common stock, par value $.01 per share, on August 10, 2015 was 24,837,033.

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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,” "outlook," “forecast” or the negative of or other comparable terminology, including without limitation statements made under “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 “Our Strategy,” “Risk Factors,” “Key Performance Indicators,” as well as any other cautionary language in this quarterly report. All forward-looking statements included in the document are based on information available to us on the date hereof. We undertake no obligation to update these forward-looking statements as a result of events or circumstances or to reflect the occurrence of unanticipated events or non-occurrence of anticipated events.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

COHERENT, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Net sales	$188,502	$196,517	$592,838	$589,295
Cost of sales	109,720	122,256	348,433	356,823
Gross profit	78,782	74,261	244,405	232,472
Operating expenses:				
Research and development	21,270	19,046	61,467	60,396
Selling, general and administrative	36,154	37,226	113,777	116,413
Impairment of investment	2,017	—	2,017	—
Amortization of intangible assets	647	841	2,009	2,691
Total operating expenses	60,088	57,113	179,270	179,500
Income from operations	18,694	17,148	65,135	52,972
Other income (expense):				
Interest and dividend income	183	201	440	318
Interest expense	(4)	(9)	(29)	(40)
Other—net	(787)	(415)	286	319
Total other income (expense), net	(608)	(223)	697	597
Income before income taxes	18,086	16,925	65,832	53,569
Provision for income taxes	4,822	3,926	16,725	13,560
Net income	$13,264	$12,999	$49,107	$40,009
Net income per share:				
Basic	$0.54	$0.52	$1.98	$1.62
Diluted	$0.53	$0.52	$1.96	$1.60
Shares used in computation:				
Basic	24,737	24,837	24,794	24,720
Diluted	24,972	25,115	25,018	25,025

See Accompanying Notes to Condensed Consolidated Financial Statements.

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COHERENT, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited; in thousands)

	Three Months Ended		Nine Months Ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Net income	$13,264	$12,999	$49,107	$40,009
Other comprehensive income (loss): [1]				
Translation adjustment, net of taxes [2]	1,108	(800)	(46,691)	3,215
Net gain (loss) on derivative instruments, net of taxes [3]	77	(157)	627	(157)
Changes in unrealized gains (losses) on available-for-sale securities, net of taxes [4]	1,059	25	1,260	8
Other comprehensive income (loss), net of tax	2,244	(932)	(44,804)	3,066
Comprehensive income (loss)	$15,508	$12,067	$4,303	$43,075

(1) Reclassification adjustments were not significant during the three and nine months ended July 4, 2015 and June 28, 2014.

(2) Tax expense (benefit) of $(98) and $(1,960) was provided on translation adjustments during the three and nine months ended July 4, 2015, respectively. Tax expense (benefit) of $118 and $1,457 was provided on translation adjustments during the three and nine months ended June 28, 2014, respectively.

(3) Tax expense (benefit) of $45 and $364 was provided on net gain (loss) on derivative instruments during the three and nine months ended July 4, 2015. Tax expense (benefit) of $(91) was provided on net gain (loss) on derivative instruments during the three and nine months ended June 28, 2014.

(4) Tax expense (benefit) of $619 and $738 was provided on unrealized gains (losses) on available for sale securities during the three and nine months ended July 4, 2015. Tax expense (benefit) on changes in unrealized gains (losses) on available-for-sale securities for the three and nine months ended June 28, 2014 was insignificant.

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	July 4, 2015	September 27, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$103,138	$91,217
Short-term investments	233,628	227,058
Accounts receivable—net of allowances of $1,030 and $1,155, respectively	144,688	137,324
Inventories	157,778	170,483
Prepaid expenses and other assets	47,316	27,839
Deferred tax assets	24,391	27,134
Total current assets	710,939	681,055
Property and equipment, net	98,996	107,424
Goodwill	100,096	109,513
Intangible assets, net	22,163	31,666
Other assets	64,898	69,717
Total assets	$997,092	$999,375
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$32,196	$32,784
Income taxes payable	923	2,029
Other current liabilities	96,664	82,506
Total current liabilities	129,783	117,319
Long-term obligations	—	—
Other long-term liabilities	53,345	62,407
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Common stock, Authorized—500,000 shares, par value $.01 per share:		
Outstanding—24,836 shares and 24,950 shares, respectively	247	248
Additional paid-in capital	174,055	184,042
Accumulated other comprehensive income (loss)	(10,122)	34,682
Retained earnings	649,784	600,677
Total stockholders' equity	813,964	819,649
Total liabilities and stockholders' equity	$997,092	$999,375

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Nine Months Ended	
	July 4, 2015	June 28, 2014
Cash flows from operating activities:		
Net income	$49,107	$40,009
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,453	20,006
Amortization of intangible assets	6,176	7,281
Impairment of investment	2,017	—
Deferred income taxes	5,312	(3,115)
Stock-based compensation	13,737	14,207
Other non-cash (income) expense	8	(376)
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(15,637)	5,749
Inventories	2,011	(10,262)
Prepaid expenses and other assets	(21,193)	(11,898)
Other assets	(670)	(2,714)
Accounts payable	641	(3,855)
Income taxes payable/receivable	(11,800)	(13,808)
Other current liabilities	19,177	19,944
Other long-term liabilities	1,496	3,729
Net cash provided by operating activities	68,835	64,897
Cash flows from investing activities:		
Purchases of property and equipment	(16,187)	(17,862)
Proceeds from dispositions of property and equipment	1,848	417
Purchases of available-for-sale securities	(274,832)	(161,180)
Proceeds from sales and maturities of available-for-sale securities	270,044	147,285
Net cash used in investing activities	(19,127)	(31,340)
Cash flows from financing activities:		
Short-term borrowings	24,354	45,927
Repayments of short-term borrowings	(24,354)	(45,091)
Net change in capital lease obligations	—	(2)
Issuance of common stock under employee stock option and purchase plans	7,256	10,513
Repurchase of common stock	(25,009)	—
Net settlement of restricted common stock	(5,295)	(7,793)
Net cash provided by(used in) financing activities	(23,048)	3,554
Effect of exchange rate changes on cash and cash equivalents	(14,739)	2,013
Net increase in cash and cash equivalents	11,921	39,124
Cash and cash equivalents, beginning of period	91,217	110,444
Cash and cash equivalents, end of period	$103,138	$149,568
Noncash investing and financing activities:		
Unpaid property and equipment purchases	$941	$1,425

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") condensed consolidated financial statements and notes thereto filed on Form 10-K for the fiscal year ended September 27, 2014. 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. Our fiscal year ends on the Saturday closest to September 30 and our third fiscal quarters include 13 weeks of operations in each fiscal year presented. Fiscal year 2015 includes 53 weeks and fiscal year 2014 includes 52 weeks.

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2. RECENT ACCOUNTING STANDARDS

Adoption of New Accounting Pronouncements

In July 2013, the FASB issued amended guidance that resolves the diversity in practice for the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This new accounting guidance requires the netting of unrecognized tax benefits ("UTBs") against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. Under the new standard, UTBs will be netted against all available same-jurisdiction losses or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by the UTBs. The standard requires prospective adoption but allows retrospective adoption for all periods presented. In the first quarter of fiscal year 2015, we adopted the FASB’s amended guidance prospectively in accordance with the standard. As a result of this adoption, both long-term income taxes payable and noncurrent deferred tax assets decreased by $7.9 million on our condensed consolidated balance sheet.

Recently Issued Accounting Pronouncement

In May 2014, the FASB amended the Accounting Standards Codification and created a new Topic 606, Revenue from Contracts with Customers. The new guidance establishes a single comprehensive contract-based model for entities to use in accounting for revenue arising from contracts with customers. The new model significantly changes existing GAAP, requires substantial judgment in its application, and will generally require companies to make more disclosures about revenue. The core principle of the amendment is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the new guidance, an entity will (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the contract’s performance obligations; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The new standard provides for two alternative implementation methods. The first is to apply the new standard retrospectively to each prior reporting period presented. This method does allow the use of certain practical expedients. The second method is to apply the new standard retrospectively in the year of initial adoption and record a cumulative effect adjustment for the impact of adjusting contracts open at the date of adoption. Under this transition method, we would apply this guidance retrospectively only to contracts that are not completed contracts at the date of initial application. We would then recognize the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings. This method also requires us to disclose comparative information for the year of adoption. In July 2015, the FASB approved a one-year deferral of the effective date. The new standard will become effective for our fiscal year beginning September 30, 2018. We are currently evaluating the new guidance and have not determined the impact this standard may have on our financial statements nor have we decided upon the method of adoption.

3. FAIR VALUES

We have not changed our valuation techniques in measuring the fair value of any financial assets and liabilities during the period. We recognize transfers between levels within the fair value hierarchy, if any, at the end of each quarter. There were no transfers between levels during the periods presented. As of July 4, 2015 and September 27, 2014, we did not have any assets or liabilities valued based on Level 3 valuations.

Financial assets and liabilities measured at fair value as of July 4, 2015 and September 27, 2014 are summarized below (in thousands):

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	Aggregate Fair Value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Aggregate Fair Value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs
	July 4, 2015			September 27, 2014		
		(Level 1)	(Level 2)		(Level 1)	(Level 2)
Assets:						
Cash equivalents:						
Money market fund deposits	$13,187	$ 13,187	$—	$5,975	$ 5,975	$—
Certificates of deposit	—	—	—	12,084	—	12,084
Commercial paper [2]	—	—	—	1,400	—	1,400
Short-term investments:						
U.S. Treasury and agency obligations [2]	158,991	—	158,991	150,088	—	150,088
Corporate notes and obligations [2]	48,317	—	48,317	52,987	—	52,987
Commercial paper [2]	8,995	—	8,995	23,983	—	23,983
Equity securities [1]	17,325	17,325	—	—	—	—
Prepaid and other assets:						
Foreign currency contracts [3]	431	—	431	366	—	366
Mutual funds — Deferred comp and supplemental plan [4]	14,626	14,626	—	15,000	15,000	—
Total	$261,872	$ 45,138	$216,734	$261,883	$ 20,975	$240,908
Liabilities:						
Other current liabilities:						
Foreign currency contracts [3]	(249)	—	(249)	(2,196)	—	(2,196)
Total	$261,623	$ 45,138	$216,485	$259,687	$ 20,975	$238,712

(1) Valuations are based upon quoted market prices.

(2) Valuations are based upon quoted market prices in active markets involving similar assets. The market inputs used to value these instruments generally consist of market yields, reported trades, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. Pricing sources include industry standard data providers, security master files from large financial institutions, and other third party sources which are input into a distribution-curve-based algorithm to determine a daily market value. This creates a “consensus price” or a weighted average price for each security.

(3) The principal market in which we execute our foreign currency contracts is the institutional market in an over-the-counter environment with a relatively high level of price transparency. The market participants usually are large commercial banks. Our foreign currency contracts’ valuation inputs are based on quoted prices and quoted pricing intervals from public data sources and do not involve management judgment. At September 27, 2014, prepaid expenses and other assets include $303 non-designated forward contracts and $63 foreign currency contracts designated for cash flow hedges, respectively; other current liabilities include $1,246 non-designated forward contracts and $950 cash flow contracts, respectively. At July 4, 2015, prepaid expenses and other assets include $348 non-designated forward contracts and $83 cash flow contracts, respectively; other current liabilities include $249 non-designated forward contracts and $0 cash flow contracts, respectively. See Note 5, "Derivative Instruments and Hedging Activities".

(4) The fair value of mutual funds is determined based on quoted market prices. Securities traded on a national exchange are stated at the last reported sales price on the day of valuation; other securities traded in over-the-counter markets and listed securities for which no sale was reported on that date are stated as the last quoted bid price.

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4. SHORT-TERM INVESTMENTS

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

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

	July 4, 2015			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$103,138	$—	$—	$103,138
Short-term investments:				
Available-for-sale securities:				
Commercial paper	$8,995	$—	$—	$8,995
U.S. Treasury and agency obligations	158,412	618	(39)	158,991
Corporate notes and obligations	48,187	194	(64)	48,317
Equity securities	15,269	2,056	—	17,325
Total short-term investments	$230,863	$2,868	$(103)	$233,628

	September 27, 2014			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$91,217	$—	$—	$91,217
Short-term investments:				
Available-for-sale securities:				
Commercial paper	$23,983	$—	$—	$23,983
U.S. Treasury and agency obligations	149,260	831	(3)	150,088
Corporate notes and obligations	52,834	195	(42)	52,987
Total short-term investments	$226,077	$1,026	$(45)	$227,058

None of the unrealized losses as of July 4, 2015 or September 27, 2014 were considered to be other-than-temporary impairments.

The amortized cost and estimated fair value of available-for-sale investments in debt securities as of July 4, 2015 and September 27, 2014 classified as short-term investments on our condensed consolidated balance sheet were as follows (in thousands):

July 4, 2015		September 27, 2014	
Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
$160,201	$ 160,728	$178,329	$ 179,223

Investments in available-for-sale debt securities due in less than one year				
Investments in available-for-sale debt securities due in one to five years [(1)]	$55,393	$ 55,575	$47,748	$ 47,835

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(1) Classified as short-term investments because these securities are highly liquid and can be sold at any time.

During the three and nine months ended July 4, 2015, we received proceeds totaling $44.6 million and $122.5 million, respectively, from the sale of available-for-sale securities and realized gross gains of less than $0.1 million and $0.1 million, respectively. During the three and nine months ended June 28, 2014, we received proceeds totaling $7.0 million and $21.1 million, respectively, from the sale of available-for-sale securities and realized gross gains of less than $0.1 million and $0.1 million, respectively.

5. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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, Japanese Yen, Korean Won and Chinese Renminbi (RMB). 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. The credit risk amounts represent the Company's gross exposure to potential accounting loss on derivative instruments that are outstanding or unsettled if all counterparties failed to perform according to the terms of the contract, based on then-current currency or interest rates at each respective date.

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

Non-Designated Derivatives

The outstanding notional contract and fair value asset (liability) amounts of non-designated hedge contracts, with maximum maturity of four months, are as follows (in thousands):

	U.S. Notional Contract Value		U.S. Fair Value	
	July 4, 2015	September 27, 2014	July 4, 2015	September 27, 2014
Euro currency hedge contracts				
Purchase	$20,672	$31,926	$(73)	$(1,153)
Japanese Yen currency hedge contracts				
Purchase	$2,449	$471	$(32)	$(3)
Sell	$(5,395)	$(15,084)	$11	$169
Korean Won currency hedge contracts				
Purchase	$—	$—	$—	$—
Sell	$(11,073)	$(2,991)	$(86)	$72
Chinese RMB currency hedge contracts				
Purchase	$—	$—	$—	$—
Sell	$(10,051)	$(15,678)	$36	$(56)

Other foreign currency hedge contracts				
Purchase	$3,581	$1,899	$(15)	$(35)
Sell	$(6,297)	$(3,515)	$60	$63

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Designated Derivatives

Cash flow hedges related to anticipated transactions are designated and documented at the inception of the hedge when we enter into contracts for specific future transactions. Cash flow hedges are evaluated for effectiveness quarterly. The effective portion of the gain or loss on these hedges is reported as a component of Other Comprehensive Income ("OCI") in stockholder's equity and is reclassified into earnings when the underlying transaction affects earnings. The majority of the after-tax net income or loss related to derivative instruments included in OCI at July 4, 2015 is expected to be reclassified into earnings within 12 months. Changes in the fair value of currency forward contracts due to changes in time value are excluded from the assessment of effectiveness and recognized in other income (expense) as incurred. We classify the cash flows from the foreign exchange forward contracts that are accounted for as cash flow hedges in the same section as the underlying item, primarily within cash flows from operating activities since we do not designate our cash flow hedges as investing or financing activities.
The outstanding notional contract and fair value asset (liability) amounts of designated cash flow hedge contracts, with maximum maturity of thirteen months, are as follows (in thousands):

	U.S. Notional Contract Value		U.S. Fair Value	
	July 4, 2015	September 27, 2014	July 4, 2015	September 27, 2014
Euro currency hedge contracts				
Purchase	$—	$11,149	$—	$(950)
Japanese Yen currency hedge contracts				
Sell	$(2,821)	$(12,091)	$(83)	$63

We have entered into certain derivative forward contracts to sell Japanese Yen and buy Euro to hedge revenue exposures related to our photonics-based solutions in Asia. In order to facilitate the hedge, we transact with counterparties in the U.S. directly and then allocate the hedge contracts to our affiliates through a back-to-back relationship with our German subsidiary. The German subsidiary designates these hedge contracts as cash flow hedges under ASC 815.
The fair value of our derivative instruments is included in prepaid expenses and other assets and in other current liabilities in our Condensed Consolidated Balance Sheets (See Note 3); such amounts were not material as of July 4, 2015 and September 27, 2014.

The locations and amounts of designated and non-designated derivative instruments' gains and losses in the condensed consolidated financial statements for the indicated periods were as follows (in thousands):

	Location in financial statements	Three Months Ended		Nine Months Ended	
		July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Derivatives designated as hedging instruments					
Gains(losses) in OCI on derivatives (effective portion), after tax	OCI	$77	$(248)	$627	$(248)
Gains(losses) reclassified from OCI into income (effective portion)	Cost of sales	$—	$—	$(1,720)	$—
Gains(losses) reclassified from OCI into income (effective portion)	Revenue	$—	$—	$208	$—
Gains(losses) recognized in income on derivatives (ineffective portion and amount excluded from effectiveness testing)	Other income(expense)	$—	$17	$(112)	$17

Derivatives not designated as hedging instruments					
Gains(losses) recognized in income	Other income(expense)	$(29)	$(1,367)	$(6,154)	$(1,208)

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During the nine months ended July 4, 2015 we recognized a loss of $0.1 million in other income (expense) as ineffectiveness related to a portion of an anticipated hedged transaction that failed to occur within the original hedge period plus two months. The remainder of the hedged transaction occurred as expected and effective amounts were recognized in revenue as disclosed in the above table.

The amounts that will be reclassified from accumulated OCI ("AOCI") to earnings will generally be offset by the recognition of the hedged transactions (e.g., anticipated cost of sales) in earnings, thereby achieving the realization of prices contemplated by the underlying risk management strategies and will vary from the expected amounts presented above as a result of changes in foreign exchange rates.

To mitigate credit risk in derivative transactions, we enter into master netting arrangements that allow each counterparty in the arrangements to net settle amounts of multiple and separate derivative transactions under certain conditions. We present the fair value of derivative assets and liabilities within our condensed consolidated balance sheet on a gross basis even when derivative transactions are subject to master netting arrangements and may otherwise qualify for net presentation. Our derivative contracts do not contain any credit risk related contingent features and do not require collateral or other security to be furnished by us or the counterparties.

Offsetting of Financial Assets/Liabilities under Master Netting Agreements with Derivative Counterparties as of July 4, 2015 and September 27, 2014 (in thousands):

				Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
	Gross Amounts of Recognized Derivative Assets	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Derivative Assets Presented in the Condensed Consolidated Balance Sheets	Financial Instruments (1)	Cash Collateral Received	Net Amounts
As of July 4, 2015:						
Foreign exchange contracts	$431	$—	$431	$(131)	$—	$300
As of September 27, 2014:						
Foreign exchange contracts	$367	$—	$367	$(367)	$—	$—

(1) The balances at July 4, 2015 and September 27, 2014 were related to derivative liabilities which are allowed to be net settled against derivative assets in accordance with the master netting agreements.

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	Gross Amounts of Recognized Derivative Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Derivative Liabilities Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instruments (1)	Cash Collateral Paid	Net Amounts
As of July 4, 2015:						
Foreign exchange contracts	$(249)	$—	$(249)	$131	$—	$(118)
As of September 27, 2014:						
Foreign exchange contracts	$(2,197)	$—	$(2,197)	$367	$—	$(1,830)

(1) The balances at July 4, 2015 and September 27, 2014 were related to derivative assets which are allowed to be net settled against derivative liabilities in accordance with the master netting agreements.

6. GOODWILL AND INTANGIBLE ASSETS

During the nine months ended July 4, 2015, 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 September 27, 2014 to July 4, 2015 are as follows (in thousands):

	Specialty Lasers and Systems	Commercial Lasers and Components	Total
Balance as of September 27, 2014	$103,150	$6,363	$109,513
Translation adjustments and other	(9,417)	—	(9,417)
Balance as of July 4, 2015	$93,733	$6,363	$100,096

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

	July 4, 2015			September 27, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Existing technology	$76,483	$(60,033)	$16,450	$81,551	$(57,827)	$23,724
Customer lists	15,237	(9,942)	5,295	16,632	(9,199)	7,433
Trade name	394	(345)	49	431	(346)	85
In-process research & development	369	—	369	424	—	424
Total	$92,483	$(70,320)	$22,163	$99,038	$(67,372)	$31,666

For accounting purposes, when an intangible asset is fully amortized, it is removed from the disclosure schedule.

Amortization expense for intangible assets for the nine months ended July 4, 2015 and June 28, 2014 was $6.2 million and $7.3 million, respectively, which includes $4.8 million and $5.7 million, respectively, for amortization of existing technology. The change in the accumulated amortization also includes $3.3 million of foreign exchange impact for the nine months ended July 4, 2015.

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At July 4, 2015, estimated amortization expense for the remainder of fiscal 2015, the next five succeeding fiscal years and all fiscal years thereafter are as follows (in thousands):

	Estimated Amortization Expense
2015 (remainder)	$2,082
2016	7,427
2017	6,409
2018	3,758
2019	1,987
2020	422
Thereafter	78
Total	$22,163

7. BALANCE SHEET DETAILS

Inventories consist of the following (in thousands):

	July 4, 2015	September 27, 2014
Purchased parts and assemblies	$49,580	$51,091
Work-in-process	61,018	70,486
Finished goods	47,180	48,906
Total inventories	$157,778	$170,483

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

	July 4, 2015	September 27, 2014
Prepaid and refundable income taxes	$10,432	$11,001
Other taxes receivable	23,070	5,184
Prepaid expenses and other	13,814	11,654
Total prepaid expenses and other assets	$47,316	$27,839

Other assets consist of the following (in thousands):

	July 4, 2015	September 27, 2014
Assets related to deferred compensation arrangements	$26,495	$26,484
Deferred tax assets	34,513	37,616
Other assets	3,890	5,617
Total other assets	$64,898	$69,717

On June 8, 2010, we invested $2.0 million in SiOnyx, a privately-held company. The investment was included in other assets and was being carried on a cost basis. During the third quarter of fiscal 2015 we determined that our investment became other-than temporarily impaired. As a result, during the third quarter of fiscal 2015, we recorded a non-cash charge of $2.0 million in our results of operations to impair this investment. In determining the fair value of the cost method investment, we considered many factors including but not limited to operating performance of the investee, the amount of cash that the investee has on-hand, the ability to obtain additional financing and the overall market conditions in which the investee operates. The fair value of the cost method investment represents a Level 3 valuation as the assumptions used in valuing the investment were not directly or indirectly observable.

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

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	July 4, 2015	September 27, 2014
Accrued payroll and benefits	$29,210	$29,228
Deferred income	16,586	15,536
Warranty reserve	15,679	16,961
Accrued expenses and other	11,018	13,410
Other taxes payable	22,128	5,036
Customer deposits	2,043	2,335
Total other current liabilities	$96,664	$82,506

Components of the reserve for warranty costs during the first nine months of fiscal 2015 and 2014 were as follows (in thousands):

	Nine Months Ended	
	July 4, 2015	June 28, 2014
Beginning balance	$16,961	$18,508
Additions related to current period sales	16,605	17,990
Warranty costs incurred in the current period	(15,065)	(18,320)
Adjustments to accruals related to foreign exchange and other	(2,822)	(303)
Ending balance	$15,679	$17,875

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

	July 4, 2015	September 27, 2014
Long-term taxes payable	$7,752	$15,776
Deferred compensation	28,119	27,858
Deferred tax liabilities	5,137	6,511
Deferred income	3,397	3,448
Asset retirement obligations liability	2,125	2,222
Other long-term liabilities	6,815	6,592
Total other long-term liabilities	$53,345	$62,407

8. SHORT-TERM BORROWINGS

We have several lines of credit which allow us to borrow in the applicable local currency. We have a total of $12.9 million of unsecured foreign lines of credit as of July 4, 2015. At July 4, 2015, we had used $2.5 million of these available foreign lines of credit as guarantees. These credit facilities were used in Europe, Japan and China during the first nine months of 2015. In addition, our domestic line of credit consists of a $50.0 million unsecured revolving credit account. The agreement will expire on May 31, 2017. The line of credit is subject to covenants related to financial ratios and tangible net worth with which we are currently in compliance. No amounts have been drawn upon our domestic line of credit as of July 4, 2015.

9. 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.

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Determining Fair Value

The fair values of shares purchased under the Employee Stock Purchase Plan ("ESPP") for the three and nine months ended July 4, 2015 and June 28, 2014, respectively, were estimated using the following weighted-average assumptions:

	Employee Stock Purchase Plan			
	Three Months Ended		Nine Months Ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Expected life in years	0.5	0.5	0.5	0.5
Expected volatility	30.8 %	24.2 %	26.8 %	23.9 %
Risk-free interest rate	0.06 %	0.06 %	0.06 %	0.07 %
Expected dividend yield	— %	— %	— %	— %
Weighted average fair value per share	$14.58	$13.55	$14.27	$13.64

There were no stock options granted during the three and nine months ended July 4, 2015 and June 28, 2014.

We grant market-based performance restricted stock unit award grants 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 our common stock to be issued after the applicable award vesting period. The final number of units awarded, if any, for these performance grants 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 no units to a maximum of twice the initial award units. The weighted average fair value for these performance units was determined using a Monte Carlo simulation model incorporating the following weighted average assumptions:

	Nine Months Ended	
	July 4, 2015	June 28, 2014
Risk-free interest rate	0.96 %	0.62 %
Volatility	28.7 %	36.9 %
Weighted average fair value	$70.57	$77.10

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 and nine months ended July 4, 2015 and June 28, 2014 (in thousands):

	Three Months Ended		Nine Months Ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Cost of sales	$664	$611	$1,937	$1,797
Research and development	529	504	1,415	1,526
Selling, general and administrative	3,372	3,552	10,385	10,884
Income tax benefit	(1,272)	(1,270)	(3,005)	(3,935)
	$3,293	$3,397	$10,732	$10,272

During the three and nine months ended July 4, 2015, $0.6 million and $1.9 million was capitalized into inventory for all stock plans, $0.7 million and $1.9 million was amortized to cost of sales and $0.7 million remained in inventory at July 4, 2015. During the three and nine months ended June 28, 2014, $0.6 million and $1.9 million was capitalized

into inventory for all stock plans, $0.6 million and $1.8 million was amortized to cost of sales and $0.7 million remained in inventory at June 28, 2014.

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At July 4, 2015, 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 $23.0 million, net of estimated forfeitures of $0.7 million. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 1.4 years and will be adjusted for subsequent changes in estimated forfeitures.

At July 4, 2015, total compensation cost related to options to purchase common shares under the ESPP but not yet vested was approximately $0.6 million, which will be recognized over the six month offering period.

Stock Awards Activity

The following table summarizes the activity of our time-based and market-based performance restricted stock units for the first nine months of fiscal 2015 (in thousands, except per share amounts):

	Time Based Restricted Stock Units		Market-Based Performance Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested stock at September 27, 2014	390	$58.66	230	$61.46
Granted	236	64.87	51	70.57
Vested[(1)]	(218)	53.61	(39)	53.46
Forfeited	(11)	58.78	(43)	53.46
Nonvested stock at July 4, 2015	397		199	

(1)Service-based restricted stock vested during each fiscal year. 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.

10. COMMITMENTS AND CONTINGENCIES

We are subject to legal claims and litigation arising in the ordinary course of business, such as product liability, employment or intellectual property claims, including, but not limited to, the matters described below. On May 14, 2013, IMRA America ("Imra") filed a complaint for patent infringement against two of our subsidiaries in the Regional Court of Düsseldorf, Germany, captioned In re IMRA America Inc. versus Coherent Kaiserslautern GmbH et. al. 4b O 38/13. The complaint alleges that the use of certain of the Company's lasers infringes upon EP Patent No. 754,103, entitled "Method For Controlling Configuration of Laser Induced Breakdown and Ablation," issued November 5, 1997. The patent is owned by the University of Michigan and licensed to Imra. The complaint seeks unspecified compensatory damages, the cost of court proceedings and seeks to permanently enjoin the Company from infringing the patent in the future. The referenced patent has since expired. Management has made an accrual of the amount which is reasonably estimable and probable with respect to this matter and has determined, based on its current knowledge, that the amount or range of reasonably possible losses in excess of the amounts already accrued is not reasonably estimable. Although we do not expect that such legal claims and litigation will ultimately have a material adverse effect on our condensed consolidated financial position, results of operations or cash flows, an adverse result in one or more matters could negatively affect our results in the period in which they occur.

The United States and many foreign governments impose tariffs and duties on the import and export of certain products we sell. From time to time our duty calculations and payments are audited by government agencies. We are currently under audit in South Korea for customs duties and value added tax for the period March 2009 to March 2014. Although we do not expect that the audit will ultimately have a material adverse effect on our condensed consolidated financial position, results of operations or cash flows, an adverse result in this matter could negatively affect our results in the period in which it occurs. As of July 4, 2015, management has accrued an estimated liability of $1.3 million related to this matter.

11. STOCK REPURCHASE

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On July 25, 2014, the Board of Directors authorized a buyback program whereby we were authorized to repurchase up to $25.0 million of our common stock from time to time through July 31, 2015. During the first quarter of fiscal 2015, we repurchased and retired 300,441shares of outstanding common stock at an average price of $57.55 per share for a total of $17.3 million, excluding expenses. During the second quarter of fiscal 2015, we repurchased and retired 133,673 shares of outstanding common stock under this plan at an average price of $57.66 per share for a total of $7.7 million, completing the repurchase program.

On January 21, 2015, our Board of Directors authorized an additional stock repurchase program to repurchase up to $25.0 million of our outstanding common stock from time to time through January 31, 2016. No repurchases have been made under this program as of July 4, 2015.

12. 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		Nine Months Ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Weighted average shares outstanding —basic	24,737	24,837	24,794	24,720
Dilutive effect of employee stock awards	235	278	224	305
Weighted average shares outstanding—diluted	24,972	25,115	25,018	25,025
Net income	$13,264	$12,999	$49,107	$40,009
Net income per basic share	$0.54	$0.52	$1.98	$1.62
Net income per diluted share	$0.53	$0.52	$1.96	$1.60

A total of 333 and 44,688 potentially dilutive securities have been excluded from the diluted share calculation for the three and nine months ended July 4, 2015 as their effect was anti-dilutive. A total of 758 and 44,563 potentially dilutive securities have been excluded from the diluted share calculation for the three and nine months ended June 28, 2014 as their effect was anti-dilutive.

13. OTHER INCOME (EXPENSE)

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

	Three Months Ended		Nine Months Ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Foreign exchange loss	$(869)	$(736)	$(950)	$(3,248)
Gain on deferred compensation investments, net	121	331	1,176	3,498
Other	(39)	(10)	60	69
Other - net	$(787)	$(415)	$286	$319

14. 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 effective tax rates

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for the three and nine months ended July 4, 2015 were 26.7% and 25.4%, respectively. Our effective tax rates for the three and nine months ended July 4, 2015 were lower than the statutory rate of 35% primarily due to differences related to the benefit of income subject to foreign tax rates that are lower than U.S. statutory tax rates including South Korea and Singapore tax exemptions, the benefit of foreign tax credits and the benefit of federal research and development tax credits including renewal of the federal research and development tax credits for fiscal 2014. These amounts are partially offset by deemed dividend inclusions under the Subpart F tax rules, stock-based compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m).

The effective tax rate on income before income taxes for the third quarter of fiscal 2014 of 23.2% and the effective tax rate on income before income taxes of 25.3% for the nine months ended June 28, 2014 were lower than the statutory rate of 35.0% primarily due to differences related to the benefit of income subject to foreign tax rates that are lower than U.S. tax rates including South Korea and Singapore tax exemptions and the benefit of foreign tax credits. These amounts are partially offset by deemed dividend inclusions under the Subpart F tax rules, stock-based 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.

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 2011 are closed. In our major foreign jurisdictions and our major state jurisdictions, the years prior to 2006 and 2010, respectively, are closed to examination. Earlier years in our various jurisdictions may remain open for adjustment to the extent that we have tax attribute carryforwards from those years. In December 2011 and January 2012, three of our German subsidiaries received notices of tax audits for the fiscal years 2006 through 2010. In fiscal year 2013, we received a preliminary assessment for two of the German subsidiaries and the amount is immaterial; the audit for the other German subsidiary is currently in process. In July 2015, Coherent Kaiserslautern GmbH (formerly Lumera Laser GmbH) received a tax audit notice for the years 2010 to 2013. The audit will begin in August 2015. We acquired the shares of Lumera Laser GmbH in December 2012 and we should not have responsibility for any assessments related to the pre-acquisition period.

Management believes that it has adequately provided for any adjustments that may result from tax examinations. We regularly engage in discussions and negotiations with tax authorities regarding tax matters in various jurisdictions. It is reasonably possible that certain foreign tax matters may be concluded in the next 12 months.

The Tax Increase Prevention Act of 2014 (“the Act”), was enacted on December 19, 2014. Under the Act, the federal research and development tax credit was retroactively extended for amounts paid or incurred after December 31, 2013 through December 31, 2014. The effects of the change in the tax law are recognized in our first quarter of fiscal 2015, which is the quarter that the law was enacted. Accordingly, prior year research and development tax credits of approximately $1.3 million less appropriate reserves were recognized in the first quarter of fiscal 2015.

15. SEGMENT INFORMATION

The following table provides net sales and income from operations for our operating segments and a reconciliation of our total income from operations to net income (in thousands):

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	Three Months Ended			Nine Months Ended		
	July 4, 2015		June 28, 2014	July 4, 2015	June 28, 2014	
Net sales:						
Specialty Laser Systems	$123,341		$137,590	$408,448	$418,208	
Commercial Lasers and Components	65,161		58,927	184,390	171,087	
Total net sales	$188,502		$196,517	$592,838	$589,295	
Income (expense) from operations:						
Specialty Laser Systems	$24,760		$27,144	$91,392	$86,893	
Commercial Lasers and Components	4,227	1,825	(162)	7,209	15	7,209
Corporate and other	(10,293)		(9,834)	(33,466)	(33,936)	
Total income from operations	18,694		17,148	65,135	52,972	
Total other income, net	(608)		(223)	697	597	
Income before income taxes	18,086		16,925	65,832	53,569	
Provision for income taxes	4,822		3,926	16,725	13,560	
Net Income	$13,264		$12,999	$49,107	$40,009	

Major Customers

We had one major customer during the three months ended July 4, 2015 who accounted for 12.3% of consolidated revenue. We had another major customer during the nine months ended July 4, 2015 who accounted for 15.4% of consolidated revenue. This major customer also accounted for 13.9% and 13.0% of consolidated revenue for the three and nine months ended June 28, 2014. Both customers purchased primarily from our SLS segment.

We had two major customers who accounted for 16.4% and 16.1%, respectively, of accounts receivable at July 4, 2015. The same two major customers accounted for 15.2% and 11.6% of accounts receivable, respectively, at September 27, 2014. Both customers purchased primarily from our SLS segment.

16. SUBSEQUENT EVENTS

On July 24, 2015, we acquired certain assets of Raydiance, Inc. ("Raydiance") for approximately $5.0 million, excluding transaction fees. Raydiance manufactured complete tools and lasers for ultrafast processing systems and subsystems in the precision micromachining processing market. The Raydiance assets will be included in our SLS segment.

On July 27, 2015, we acquired the assets and certain liabilities of the Tinsley Optics ("Tinsley") business from L-3 Communications Corporation for approximately $4.3 million, excluding transaction fees. Tinsley is a specialized manufacturer of high precision optical components and subsystems sold primarily in the aerospace and defense industry. Tinsley manufactures the large form factor optics for our excimer laser annealing systems. Tinsley will be included in our SLS segment.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

COMPANY OVERVIEW

BUSINESS BACKGROUND

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

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We are organized into two operating segments: Specialty Lasers and Systems (“SLS”) and Commercial Lasers and Components (“CLC”). This segmentation reflects the go-to-market strategies for various products and markets. While both segments deliver cost-effective photonics solutions, SLS develops and manufactures configurable, advanced performance products largely serving the microelectronics, scientific research and government programs and OEM components and instrumentation 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. 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, original equipment manufacturer (“OEM”) components and instrumentation and microelectronics.

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

MARKET APPLICATIONS

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

OUR STRATEGY

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

- Leverage our technology portfolio and application engineering to lead the proliferation of photonics into broader markets—We will continue to identify opportunities in which our technology portfolio and application engineering can be used to offer innovative solutions and gain access to new markets. We plan to utilize our expertise to increase our market share in the mid to high power material processing applications.
- 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.
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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.

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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 condensed 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 condensed 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. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for our fiscal year ended September 27, 2014.

KEY PERFORMANCE INDICATORS

Below is a summary of some of the quantitative performance indicators (as defined below) that are evaluated by management to assess our financial performance. Some of the indicators are non-GAAP measures and should not be considered as an alternative to any other measure for determining operating performance or liquidity that is calculated in accordance with generally accepted accounting principles.

	Three Months Ended			
	July 4, 2015	June 28, 2014	Change	% Change
	(Dollars in thousands)			
Bookings	$176,665	$244,527	$(67,862)	(27.8)%
Book-to-bill ratio	0.94	1.24	(0.30)	(24.2)%
Net sales—Specialty Lasers and Systems	$123,341	$137,590	$(14,249)	(10.4)%
Net sales—Commercial Lasers and Components	$65,161	$58,927	$6,234	10.6%
Gross profit as a percentage of net sales—Specialty Lasers and Systems	45.4%	40.9%	4.5%	11.0%
Gross profit as a percentage of net sales—Commercial Lasers and Components	35.8%	31.6%	4.2%	13.3%
Research and development as a percentage of net sales	11.3%	9.7%	1.6%	16.5%
Income before income taxes	$18,086	$16,925	$1,161	6.9%
Net cash provided by (used in) operating activities	$(11,579)	$20,478	$(32,057)	(156.5)%
Days sales outstanding in receivables	69.1	59.9	9.2	15.4%
Annualized third quarter inventory turns	2.8	2.7	0.1	3.7%
Capital spending as a percentage of net sales	2.1%	2.0%	0.1%	5.0%
Net income as a percentage of net sales	7.0%	6.6%	0.4%	6.1%
Adjusted EBITDA as a percentage of net sales	18.4%	15.8%	2.6%	16.5%

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	Nine Months Ended			
	July 4, 2015	June 28, 2014	Change	% Change
	(Dollars in thousands)			
Bookings	$559,741	$707,826	$(148,085)	(20.9)%
Book-to-bill ratio	0.94	1.20	(0.26)	(21.7)%
Net sales—Specialty Lasers and Systems	$408,448	$418,208	$(9,760)	(2.3)%
Net sales—Commercial Lasers and Components	$184,390	$171,087	$13,303	7.8%
Gross profit as a percentage of net sales—Specialty Lasers and Systems	44.5%	42.5%	2.0%	4.7%
Gross profit as a percentage of net sales—Commercial Lasers and Components	35.1%	33.2%	1.9%	5.7%
Research and development as a percentage of net sales	10.4%	10.2%	0.2%	2.0%
Income before income taxes	$65,832	$53,569	$12,263	22.9%
Net cash provided by operating activities	$68,835	$64,897	$3,938	6.1%
Capital spending as a percentage of net sales	2.7%	3.0%	(0.3)%	(10.0)%
Net income as a percentage of net sales	8.3%	6.8%	1.5%	22.1%
Adjusted EBITDA as a percentage of net sales	18.3%	16.6%	1.7%	10.2%

Definitions and analysis of these performance indicators are as follows:

Bookings and Book-to-Bill Ratio

Bookings represent orders received during the current period for products 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 or a single large shipment. A ratio of greater than 1.0 indicates that demand for our products is greater than what we supply in the quarter whereas a ratio of less than 1.0 indicates that demand for our products is less than what we supply in the quarter.

Bookings decreased 27.8% in the third quarter of fiscal 2015 compared to the same quarter one year ago, with decreases in the microelectronics, OEM components and instrumentation and materials processing markets. Compared to the second quarter of fiscal 2015, bookings decreased 19.9% with decreases in the OEM components and instrumentation, microelectronics and materials processing markets partially offset by increases in the scientific and government programs market. The book-to-bill ratio was 0.94 in the third quarter of fiscal 2015.

Microelectronics

Microelectronics bookings decreased 27% compared to the same quarter one year ago and decreased 14% from bookings in the second quarter of fiscal 2015. The microelectronics book-to-bill ratio for the third quarter of fiscal 2015 was 0.98.

Flat panel display orders in the third quarter of fiscal 2015 decreased 29% from orders in the third quarter of fiscal 2014, primarily due to the timing of order placement by customers. Flat panel display orders decreased 16% from orders in the second quarter of fiscal 2015 primarily due to lower service bookings. We expect continued fluctuations in order volumes on a quarterly basis. We shipped the first and second Triple Vyper™ Linebeam 1500 systems in the first and second quarters of fiscal 2015, respectively. Based on current discussions with the customer, we anticipate shipping the third Triple Vyper™ Linebeam 1500 system in the fourth quarter of fiscal 2015. Longer term, published reports by industry experts indicate the potential for growth in high-definition displays, in mobile applications, especially as compared to the growth rate of mobile devices. Given these reports and factoring in the growth in demand for higher pixels per inch, we expect that in the long-run there should be additional significant capital investment in Korea, China and Japan. In addition, we project increases in automotive applications using flexible organic light-emitting diodes (OLED). In response to these opportunities, several capital

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projects have already been publicly announced by panel manufacturers. We expect that these capital projects should lead to additional orders for our Linebeam products.

Our Linebeam product family ranges from our 750 through to the new 1500 product. While we have multiple vendors who provide optics for the 750 product, we had developed L-3 Communications' Tinsley division ("Tinsley") as our sole source supplier for the 1300nm and 1500nm optics needed for our Linebeam 1300 and 1500 products. L-3 made a strategic decision to exit this business and we decided to acquire the business rather than face supply chain risk or possible price increases from a new owner. As a strategic optics supplier, they have helped us scale line-beam sizes beyond 1.5m, enabling our mobile display customers to process up to the latest Generation 6 glass sizes in a single pass, enabling increased yield and lowest costs per panel. We plan to continue to serve Tinsley's core aerospace & defense specialty optics markets, in addition to enabling increased vertical integration in our ELA business.

Orders in the advanced packaging (API) market decreased 3% from orders in the third quarter of fiscal 2014 and decreased 18% from orders in the second quarter of fiscal 2015. We continue to see positive signs for recovery in the CO_2 via drilling market, with OEM customers engaged in a number of projects with packaging houses. We expect several of these opportunities to utilize our new J-Series lasers due to advances in integration, reliability and service. Laser direct imaging has evolved into a two-tier market where lasers are used for high throughput/high resolution applications and ultraviolet diodes are used for low resolution work. Similar to the semiconductor capital market, utilization of lasers remains high, yielding solid service revenue.
During the third fiscal quarter we introduced a new J-Series laser based upon carbon monoxide or CO gas that emits light at five microns rather than ten microns. The time to revenue for our new CO laser will be longer due to process and tool development, but the market is sizable.

Orders from semiconductor capital equipment OEMs decreased 40% from the third quarter of fiscal 2014 and decreased 9% from the second quarter of fiscal 2015. Industry reports indicate the semiconductor market continues to worsen with 2015 growth projections reduced to low single digits. While utilization rates remain high as do the associated service revenues, new laser demand has all but ceased. As a result, we expect customers will consume existing inventory and maximize cash which has eliminated several million dollars of previously scheduled new system shipments from our revenues for the fourth quarter of fiscal 2015.

Short pulse processing has been an active environment that promised large orders for successful solutions. After receiving a few orders, the follow-on orders have been slow or failed to materialize as the consumer electronics products that utilize the short-pulse processing techniques have failed to meet their market acceptance and volume goals. We have seen a couple more examples of this recently, resulting in the deferral of approximately $10 million of sales originally planned for the fourth quarter of fiscal 2015. We need to position ourselves to better address potential in this market. To that end, we have purchased the assets of Raydiance, Inc. ("Raydiance") and retained a core team of its former employees. Raydiance has built a strong share and application know-how position in the ultrafast laser and optical sub-system markets for precision micro-materials processing, specifically automotive fuel injectors and medical device manufacturing.

Materials Processing

Materials processing orders decreased 31% compared to the same quarter one year ago and decreased 18% from the second quarter of fiscal 2015. The materials processing book-to-bill ratio for the third quarter of fiscal 2015 was 0.95. Volatile bookings are not new in our materials processing business. There were a number of positive order events in the third quarter of fiscal 2015 that were offset by other decreases. We received record CO_2 orders for marking in China which is very encouraging given the high level of domestic and international competition, suggesting that customers recognize the performance and reliability advantages of our products. Included in the CO_2 orders were first articles for a competitive displacement of a major customer. If successful, we will see volume orders in fiscal 2016.

We also received initial bookings for a major converting project using E-1000 lasers and J-3 lasers for denim marking; both opportunities could lead to increased fiscal 2016 revenue. On the downside, we have seen an investment slowdown for cladding in the oil and gas industry, highlighting the sensitivity that consumer demand plays in this market.

A significant event for us was the formal launch of our second generation Highlight™ FL fiber laser system. The new architecture is easily scalable by aggregating building blocks. The initial range is 2-4kW with higher powers becoming available in the future. We can offer various levels of integration from a fully integrated, turnkey box all the way down to components and subsystems, allowing customers of different scales and capabilities to select the best option for their specific needs. If successful, we would expect revenue opportunities to emerge in the second half of fiscal 2016.

OEM Components and Instrumentation

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OEM Components and Instrumentation orders decreased 44% compared to the same quarter one year ago and 46% from the record orders in the second quarter of fiscal 2015. The book-to-bill ratio for the third quarter of fiscal 2015 was 0.77.

Instrumentation orders decreased 6% compared to the same quarter one year ago and 41% compared to the second quarter of fiscal 2015 due to timing of orders coming off the high orders in the second quarter. We are seeing investments in the bioinstrumentation business driven by a goal of precise, personalized medicine. Many sequencing applications are moving closer to deployment and we have secured key design wins with U.S. and Asian OEMs. We expect the first of these next generation sequencers to become commercially available in the second half of fiscal 2016 with more to follow in fiscal 2017.

Orders for medical OEM products were 66% lower in the third quarter of fiscal 2015 compared to the same quarter one year ago due to a large multi-year order placed in the second quarter of fiscal 2014 and 55% lower than very strong orders in the second quarter of fiscal 2015. In spite of the decrease in orders, the medical OEM market remains strong, especially for vision treatment and eye disease management. Modern cataract treatment is amazing. However, it tends to be a one-size-fits-all approach. Ophthalmologists would prefer to have greater performance flexibility and control over the laser parameters so as to optimize individual patient treatment. As a result, we developed the Monaco™, an all-fiber ultrafast laser with variable pulsewidth and power capability. Monaco was recently introduced and we expect initial shipments in fiscal 2015, with first volume orders expected to occur in fiscal 2016.

Scientific and Government Programs

Scientific and government programs orders increased 1.1% compared to the same quarter one year ago and increased 10% from the second quarter of fiscal 2015. The book-to-bill for the third quarter of fiscal 2015 was 1.04.

The sequential order growth was led by our Chameleon™ product family in biological imaging and neuroscience, with most of the increase coming from North America while Europe and Japan posted modest improvements. The Chameleon mix is evolving from traditional Ti:sapphire-based lasers to the fiber-based Chameleon Discovery™ as it is qualified by more of our imaging partners. Discovery accounted for roughly 20% of new Chameleon orders in the third quarter of fiscal 2015 and we expect its market share and mix contribution to continue to rise. In addition, Ultrafast amplifier orders increased. The current trend is for individual researchers to rely upon integrated, single-box solutions such as the Astrella™ or Libra™ platforms while large multi-user facilities favor the configurable Legend™ system.

Net Sales

Net sales include sales of lasers, laser tools, related accessories and service. Net sales for the third fiscal quarter decreased 10.4% in our SLS segment and increased 10.6% in our CLC segment from the same quarter one year ago. Net sales for the first nine months decreased 2.3% in our SLS segment from the same period one year ago and increased 7.8% in our CLC segment from the same period 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 third quarter increased from 40.9% to 45.4% in our SLS segment and increased from 31.6% to 35.8% in our CLC segment from the same quarter one year ago. Gross profit percentage in the first nine months increased from 42.5% to 44.5% in our SLS segment and increased from 33.2% to 35.1% in our CLC segment from the same period 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 managing our business as investing in new technologies is a key to future growth. R&D percentage increased to 11.3% from 9.7% in our third fiscal quarter and increased to 10.4% from 10.2% for the first nine months of fiscal 2015 compared to the same periods 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

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Net cash provided by operating activities as reflected on our Condensed Consolidated Statements of Cash Flows primarily represents the excess 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 higher working capital availability. The more money we have tied up in receivables, the less money we have available for research and development, acquisitions, expansion, marketing and other activities to grow our business. Our DSO in receivables for the third quarter of fiscal 2015 increased from 59.9 days to 69.1 days compared to the same quarter one year ago primarily due to unfavorable sales linearity particularly in Japan, the timing of payments at quarter end, a higher concentration of sales in Japan where DSO is typically higher and slower collections in Asia, particularly in Korea and China.

Annualized Third Quarter Inventory Turns

We calculate annualized third quarter inventory turns as the cost of sales during the third quarter annualized and divided by net inventories at the end of the third quarter. This indicates how well we are managing our inventory levels, with higher inventory turns resulting in more working capital availability and a higher return on our investments in inventory. The more money we have tied up in inventory, the less money we have available for research and development, acquisitions, expansion, marketing and other activities to grow our business. Our annualized inventory turns for the third quarter of fiscal 2015 increased from 2.7 to 2.8 turns compared to the same quarter one year ago primarily due to the favorable impact of foreign exchange rates.

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 and equipment. Management monitors capital spending levels as this assists management in measuring our cash flows, net of capital expenditures. Our capital spending percentage increased to 2.1% from 2.0% for the third quarter and decreased to 2.7% from 3.0% for the first nine months of fiscal 2015 compared to the same periods one year ago primarily due to lower revenues in the third quarter of fiscal 2015 and lower purchases of production-related assets in the first nine months of fiscal 2015.

Adjusted EBITDA 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.

We utilize a number of different financial measures, both GAAP and non-GAAP, such as adjusted EBITDA as a percentage of net sales, in analyzing and assessing our overall business performance, for making operating decisions and for forecasting and planning future periods. We consider the use of non-GAAP financial measures helpful in

assessing our current financial performance and ongoing operations. While we use non-GAAP financial measures as a tool to enhance our understanding of certain aspects of our financial performance, we do not consider these measures to be a substitute for, or superior to, the information provided by GAAP financial measures. We provide adjusted EBITDA in order to enhance investors' understanding of our ongoing operations. This measure is used by some investors when assessing our performance.

Below is the reconciliation of our net income as a percentage of net sales to our adjusted EBITDA as a percentage of net sales:

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	Three Months Ended		Nine Months Ended	
	July 4, 2015	June 28, 2014	July 4, 2015	June 28, 2014
Net income as a percentage of net sales	7.0 %	6.6 %	8.3 %	6.8 %
Income tax expense	2.6 %	2.0 %	2.8 %	2.3 %
Interest and other income (expense), net	0.4 %	0.3 %	0.1 %	0.5 %
Depreciation and amortization	4.2 %	4.5 %	4.2 %	4.6 %
Customs audit	0.7 %	— %	0.2 %	— %
Impairment of investment	1.1 %	— %	0.4 %	— %
Stock-based compensation	2.4 %	2.4 %	2.3 %	2.4 %
Adjusted EBITDA as a percentage of net sales	18.4 %	15.8 %	18.3 %	16.6 %

RESULTS OF OPERATIONS

SIGNIFICANT EVENTS

On July 25, 2014, the Board of Directors authorized a buyback program whereby we were authorized to repurchase up to $25.0 million of our common stock from time to time through July 31, 2015. During the first quarter of fiscal 2015, we repurchased and retired 300,441 shares of outstanding common stock under this plan at an average price of $57.55 per share for a total of $17.3 million. During the second quarter of fiscal 2015, we repurchased and retired 133,673 shares of outstanding common stock under this plan at an average price of $57.66 per share for a total of $7.7 million, which concluded this program.

On January 21, 2015, our board of directors authorized an additional stock repurchase program to repurchase up to $25.0 million of the Company's outstanding common stock from time to time through January 31, 2016. No repurchases have been made under this program as of July 4, 2015.

On June 8, 2010, we invested $2.0 million in SiOnyx, Inc., a privately-held company. The investment was included in other assets and was being carried on a cost basis. During the third quarter of fiscal 2015 we determined that our investment became other-than temporarily impaired. As a result, we recorded a non-cash charge of $2.0 million to operating expense in our results of operations in the third quarter of fiscal 2015.

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				Nine Months Ended			
	July 4, 2015		June 28, 2014		July 4, 2015		June 28, 2014	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales	58.2	%	62.2	%	58.8	%	60.6	%
Gross profit	41.8	%	37.8	%	41.2	%	39.4	%
Operating expenses:								
Research and development	11.3	%	9.7	%	10.4	%	10.2	%
Selling, general and administrative	19.2	%	19.0	%	19.2	%	19.7	%
Impairment of investment	1.1	%	—	%	0.3	%	—	%
Amortization of intangible assets	0.3	%	0.4	%	0.3	%	0.5	%
Total operating expenses	31.9	%	29.1	%	30.2	%	30.4	%
Income from operations	9.9	%	8.7	%	11.0	%	9.0	%