COHERENT INC
Form 10-Q
February 12, 2008

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 December 29, 2007

or

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

For the transition period from to

Commission File Number: 0-5255

COHERENT, INC.

Delaware	**94-1622541**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

The number of shares outstanding of registrant s common stock, par value $.01 per share, on February 1, 2008 was 31,543,190 shares.

COHERENT, INC.

INDEX

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

PART I. FINANCIAL INFORMATION

Item I. FINANCIAL STATEMENTS

COHERENT, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited; in thousands, except per share data)

	Three Months Ended December 29, 2007		Three Months Ended December 30, 2006	
Net sales	**$**	**144,296**	$	147,509
Cost of sales		**83,802**		85,535
Gross profit		**60,494**		61,974
Operating expenses:				
Research and development		**18,319**		18,322
Selling, general and administrative		**38,818**		33,484
Restructuring and other charges				137
Amortization of intangible assets		**2,206**		1,943
Total operating expenses		**59,343**		53,886
Income from operations		**1,151**		8,088
Other income (expense):				
Interest and dividend income		**4,069**		6,073
Interest expense		**(161)**		(1,782)
Other net		**1,973**		983
Total other income, net		**5,881**		5,274
Income before income taxes		**7,032**		13,362
Provision for income taxes		**2,303**		2,604
Net income	**$**	**4,729**	$	10,758
Net income per share:				
Basic	**$**	**0.15**	$	0.34
Diluted	**$**	**0.15**	$	0.33
Shares used in computation:				
Basic		**31,417**		31,339
Diluted		**31,959**		32,125

See Accompanying Notes to Condensed Consolidated Financial Statements

COHERENT, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited; in thousands, except par value)

	December 29, 2007	September 29, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 320,795**	$ 315,927
Restricted cash	**2,514**	2,460
Short-term investments	**67,569**	45,896
Accounts receivable net of allowances of $2,827 and $2,918, respectively	**96,971**	102,314
Inventories	**112,889**	112,893
Prepaid expenses and other assets	**47,540**	50,244
Deferred tax assets	**39,554**	35,844
Total current assets	**687,832**	665,578
Property and equipment, net	**102,796**	104,305
Goodwill	**83,853**	83,376
Intangible assets, net	**33,585**	35,570
Other assets	**76,139**	58,771
Total assets	**$ 984,205**	$ 947,600
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term obligations	**$ 9**	$ 9
Accounts payable	**26,585**	27,849
Income taxes payable	**3,071**	17,829
Other current liabilities	**85,654**	83,058
Total current liabilities	**115,319**	128,745
Long-term obligations	**20**	21
Other long-term liabilities	**88,882**	47,848
Commitments and contingencies (Note 8)		
Stockholders equity:		
Common stock, par value $.01 per share:		
Authorized 500,000 shares		
Outstanding 31,546 shares and 31,552 shares, respectively	**313**	313
Additional paid-in capital	**382,873**	380,516
Accumulated other comprehensive income	**74,013**	70,672
Retained earnings	**322,785**	319,485
Total stockholders equity	**779,984**	770,986
Total liabilities and stockholders equity	**$ 984,205**	$ 947,600

See Accompanying Notes to Condensed Consolidated Financial Statements.

COHERENT, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; in thousands)

	Three Months Ended	
	December 29, 2007	**December 30, 2006**
Cash flows from operating activities:		
Net income	**$ 4,729**	$ 10,758
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**5,981**	6,220
Amortization of intangible assets	**2,206**	1,943
Deferred income taxes	**(3,385)**	(578)
Stock-based compensation	**2,260**	3,491
Excess tax benefit from stock-based compensation arrangements		(77)
Non-cash restructuring and other charges (recoveries)		(114)
Amortization of bond issue costs		292
Other non-cash expense (income)	**(236)**	70
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	**6,205**	17,435
Inventories	**667**	1,531
Prepaid expenses and other assets	**(8,635)**	(2,642)
Other assets	**(1,239)**	(2,006)
Accounts payable	**(598)**	(1,913)
Income taxes payable/receivable	**1,230**	(2,446)
Other current liabilities	**2,536**	(5,537)
Other long-term liabilities	**1,356**	2,307
Net cash provided by operating activities	**13,077**	28,734
Cash flows from investing activities:		
Purchases of property and equipment	**(4,684)**	(5,037)
Proceeds from dispositions of property and equipment	**9,824**	143
Purchases of available-for-sale securities	**(151,939)**	(213,601)
Proceeds from sales and maturities of available-for-sale securities	**130,266**	176,506
Proceeds from sale of business	**6,519**	
Change in restricted cash	**(25)**	(14)
Premiums paid for life insurance contracts		(2,800)
Other net	**729**	196
Net cash used in investing activities	**(9,310)**	(44,607)
Cash flows from financing activities:		
Repayment of capital lease obligations	**(3)**	(1)
Cash overdrafts decrease	**(24)**	(1,874)
Issuance of common stock under employee stock option and purchase plans		3,784
Excess tax benefits from stock-based compensation arrangements		77
Net cash provided by (used in) financing activities	**(27)**	1,986
Effect of exchange rate changes on cash and cash equivalents	**1,128**	3,482
Net increase (decrease) in cash and cash equivalents	**4,868**	(10,405)
Cash and cash equivalents, beginning of period	**315,927**	445,231
Cash and cash equivalents, end of period	**$ 320,795**	$ 434,826
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		

Interest	**$**	**98**	$	393
Income taxes	**$**	**5,145**	$	6,542
Cash received during the period for:				
Income taxes	**$**	**(377)**	$	1,008
Noncash investing and financing activities:				
Unpaid property and equipment	**$**	**872**	$	1,273
Net retirement of restricted stock awards	**$**		$	225

See Accompanying Notes to Condensed Consolidated Financial Statements

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 or Coherent) consolidated financial statements and notes thereto filed on Form 10-K for the fiscal year ended September 29, 2007. In the opinion of management, all adjustments necessary for a fair presentation 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. Our fiscal year ends on the Saturday closest to September 30. Fiscal years 2008 and 2007 include 52 weeks each.

2. RECENT ACCOUNTING STANDARDS

In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes, (FIN 48) which clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards (SFAS) 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. In addition, in May 2007, the FASB issued FASB Staff Position No. FIN 48-1, Definition of Settlement in FASB Interpretation No. 48, (FSP FIN 48-1) to amend FIN No. 48 by providing that previously unrecognized tax benefits can be recognized when the tax positions are effectively settled upon examination by a taxing authority. According to FSP FIN 48-1, an enterprise s tax position will be considered effectively settled if the taxing authority has completed its examination, the enterprise does not plan to appeal, and the possibility is remote that the taxing authority would reexamine the tax position in the future. We adopted FIN 48 and FSP FIN 48-1 for our fiscal year 2008 beginning September 30, 2007. See Note 11, Income Taxes for additional information, including the effects of adoption on the Company s Condensed Consolidated Financial Statements.

In June 2006, the FASB ratified the consensus on Emerging Issues Task Force (EITF) Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (EITF 06-3) which requires a policy be adopted to present externally imposed taxes on revenue producing transactions on either a gross or net basis. Coherent s policy is to present such taxes on a gross basis. Gross or net presentation may be elected for each different type of tax, but similar taxes should be presented consistently. Taxes within the scope of this issue would include taxes that are imposed on a revenue transaction between a seller and a customer. We adopted EITF 06-3 for our fiscal year beginning September 30, 2007. The adoption of EITF 06-3 did not have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. SFAS 157 is effective for us for interim periods within our fiscal year beginning September 28, 2008. We are currently assessing the impact that the adoption of SFAS

157 will have on our consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). SFAS 159 expands the use of fair value accounting but does not affect existing standards, which require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure certain financial assets and financial liabilities, on an instrument-by-instrument basis. If the fair value option is elected, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for us for our fiscal year beginning September 28, 2008 with earlier adoption permitted. We have elected not to early adopt and are currently assessing the impact that the adoption of SFAS 159 will have on our consolidated financial position and results of operations.

3. 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 one-year 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 relative fair values, which is determined based on the price charged for each deliverable on a standalone basis.

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 other 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 is recognized as revenue after these services have been provided.

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. Marketable short-term investments in debt securities are classified and accounted for as available-for-sale securities and are valued based on quoted market prices. 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):

	December 29, 2007			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$ 323,201	$ 111	$ (3)	$ 323,309
Less: restricted cash				(2,514)
				$ 320,795
Short-term investments:				
Available-for-sale securities:				
U.S. Treasury and agency obligations	$ 39,305	$ 254	$ (4)	$ 39,555
State and municipal obligations	3,000	23		3,023
Corporate notes and obligations	24,978	74	(61)	24,991
Total short-term investments	$ 67,283	$ 351	$ (65)	$ 67,569

	September 29, 2007			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$ 318,352	$ 35	$	$ 318,387
Less: restricted cash				(2,460)
				$ 315,927
Short-term investments:				
Available-for-sale securities:				
U.S. Treasury and agency obligations	$ 6,036	$ 7	$	$ 6,043
Corporate notes and obligations	39,740	132	(19)	39,853
Total short-term investments	$ 45,776	$ 139	$ (19)	$ 45,896

At December 29, 2007 and September 29, 2007, $2.5 million of cash and cash equivalents were restricted for remaining close out costs associated with our purchase of the remaining outstanding shares of Lambda Physik.

5. INTANGIBLE ASSETS

The changes in the carrying amount of goodwill by segment for the period from September 29, 2007 to December 29, 2007 are as follows (in thousands):

	Commercial Lasers and Components	Specialty Laser Systems	Total
Balance as of September 29, 2007	$ 24,091	$ 59,285	$ 83,376
Translation adjustments and other	47	430	477
Balance as of December 29, 2007	$ 24,138	$ 59,715	$ 83,853

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

	December 29, 2007			September 29, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Existing technology	$ 54,303	$ (28,578)	$ 25,725	$ 54,091	$ (26,955)	$ 27,136
Patents	10,310	(7,259)	3,051	10,184	(6,943)	3,241
Drawings	1,408	(1,408)		1,390	(1,390)	
Order backlog	4,966	(4,933)	33	4,907	(4,864)	43
Customer lists	5,396	(2,775)	2,621	5,366	(2,562)	2,804
Trade name	3,797	(1,877)	1,920	3,754	(1,751)	2,003
Non-compete agreement	2,424	(2,189)	235	2,408	(2,065)	343
Total	$ 82,604	$ (49,019)	$ 33,585	$ 82,100	$ (46,530)	$ 35,570

Amortization expense for intangible assets for the three months ended December 29, 2007 was $2.2 million. At December 29, 2007, estimated amortization expense for the remainder of fiscal 2008, the next five succeeding fiscal years and all fiscal years thereafter are as follows (in thousands):

		Estimated Amortization Expense
2008 (remainder)	$	6,335
2009		7,902
2010		6,511
2011		5,092
2012		3,341
2013		2,394
Thereafter		2,010
Total	$	33,585

6. BALANCE SHEET DETAILS

Inventories consist of the following (in thousands):

		December 29, 2007		September 29, 2007
Purchased parts and assemblies	$	32,592	$	29,786
Work-in-process		42,514		44,368
Finished goods		37,783		38,739
Inventories	$	112,889	$	112,893

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

		December 29, 2007		September 29, 2007
Prepaid and refundable income taxes	$	13,397	$	8,616
Prepaid expenses and other		34,143		41,628
Total prepaid expenses and other assets	$	47,540	$	50,244

Other assets consist of the following (in thousands):

		December 29, 2007		September 29, 2007
Assets related to deferred compensation arrangements	$	31,957	$	30,706
Deferred tax assets		41,513		25,165
Other assets		2,669		2,900
Total other assets	$	76,139	$	58,771

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

	December 29, 2007	September 29, 2007
Accrued payroll and benefits	$ 23,618	$ 28,247
Accrued expenses and other	16,176	18,471
Reserve for warranty	13,804	13,660
Other taxes payable	18,090	9,840
Deferred income	10,760	10,496
Customer deposits	2,777	1,868
Accrued restructuring charges	429	476
Total other current liabilities	$ 85,654	$ 83,058

We provide warranties on certain of our product sales (generally one year) 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. 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 quarter of fiscal 2008 and 2007 were as follows (in thousands):

	First Quarter Fiscal 2008	First Quarter Fiscal 2007
Beginning balance	$ 13,660	$ 11,462
Additions related to current period sales	5,654	5,261
Warranty costs incurred in the current period	(5,584)	(4,699)
Adjustments to accruals related to prior period sales	74	145
Ending balance	$ 13,804	$ 12,169

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

	December 29, 2007	September 29, 2007
Deferred compensation	$ 32,625	$ 31,336
Long-term taxes payable	38,918	
Deferred tax liabilities	10,887	10,433
Deferred income	1,674	1,585
Asset retirement liability	1,285	1,256
Other long-term liabilities	3,493	3,238
Total other long-term liabilities	$ 88,882	$ 47,848

The following table reconciles changes in our asset retirement liability, which is reported in other long-term liabilities on our condensed consolidated balance sheets (in thousands):

	First Quarter Fiscal 2008	First Quarter Fiscal 2007
Beginning balance	$ 1,256	$ 1,765
Adjustment to asset retirement obligations recognized	(8)	(7)
Accretion recognized	24	37
Changes due to foreign currency exchange	13	111
Ending balance	$ 1,285	$ 1,906

7. STOCK-BASED COMPENSATION

Stock-Based Benefit Plans

We have two Stock Option Plans for which all service providers are eligible participants and a Directors Stock Option Plan for which only non-employee directors are eligible participants. The Director s Stock Option Plan is designed to work automatically without administration, however to the extent administration is necessary, it will be performed by the Board of Directors or a committee thereof. Under these three plans, we may grant options to purchase up to an aggregate of 5,500,000, 6,300,000 and 681,000 shares of common stock, respectively of which no, 3,143,548 and 224,000 shares, respectively, remain available for grant at December 29, 2007. Employee options are generally exercisable between two to four years from the grant date at a price equal to the fair market value of the common stock on the date of the grant and generally vest 25% to 50% annually. We settle stock option exercises with newly issued shares of common stock. Grants under employee plans expire six years from the original grant date, unless otherwise determined by the Board or a committee thereof, up to a maximum of ten years. Director options are automatically granted to our non-employee directors. Such directors initially receive a stock option for 24,000 shares exercisable over a three-year period and an award of restricted stock units of 2,000 shares. Additionally, the non-employee directors receive an annual grant of 6,000 shares exercisable as to 50% of the shares on the day prior to each of the next two annual stockholder meetings. Grants under director plans expire ten years from the original grant date. In addition, each non-employee director receives an annual grant of 2,000 shares of restricted stock units that vest on the day prior to the annual stockholder meeting held in the third calendar year following the date of grant.

Restricted stock awards granted under our Stock Option Plans are independent of option grants and are subject to restrictions. At December 29, 2007, we had 205,315 shares of restricted stock outstanding, including 48,800 performance-based restricted stock awards, all of which are subject to forfeiture if employment terminates prior to the release of restrictions. During this period, ownership of the shares cannot be transferred. The service-based restricted awards generally vest three years from the date of grant. The performance-based restricted stock grants are subject to annual vesting over three years depending upon the achievement of performance measurements tied to the Company s internal metrics for revenue growth and earnings before income, taxes, depreciation and amortization (EBITDA) percentage and is variable. For fiscal 2007 awards, none of the target shares were issued. The number of shares earned can range from 0% to 200% of the grant target for 2008. Restricted stock (not including performance-based restricted stock) has the same cash dividend and voting rights as other common stock and is considered to be currently issued and outstanding. The cost of the awards, determined to be the fair market value of the shares at the date of grant, is expensed ratably over the period the restrictions lapse.

We have an Employee Stock Purchase Plan (ESPP) whereby eligible employees may authorize payroll deductions of up to 10% of their regular base salary to purchase shares at the lower of 85% of the fair market value of the common stock on the date of commencement of the offering or on the last day of the six-month offering period. At December 29, 2007, 224,536 shares of our common stock were reserved for future issuance under the plan.

In the second quarter of fiscal 2007, the stock purchase plan was suspended and employee contributions made to the ESPP were returned while a voluntary review of our historical stock option practices was conducted. There was no activity under the ESPP in the first quarter of fiscal 2008.

SFAS 123(R)

In accordance with the fair value recognition provisions of SFAS No. 123 (Revised 2004), Share-Based Payment, (SFAS 123(R)), we recognize compensation expense for all share-based payment awards on a straight-line basis over the respective requisite service period of the awards.

Determining Fair Value

Valuation and amortization method We estimate the fair value of stock options granted using the Black-Scholes-Merton option-pricing formula and a single option award approach. This fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period.

Expected Term The expected term represents the period that our stock-based awards are expected to be outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior as influenced by changes to the terms of its stock-based awards.

Expected Volatility Our computation of expected volatility is based on a combination of historical volatility and market-based implied volatility.

Risk-Free Interest Rate The risk-free interest rate used in the Black-Scholes-Merton valuation method is based on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term.

Expected Dividend The expected dividend assumption is based on our current expectations about our anticipated dividend policy.

The fair values of our stock options granted to employees and shares purchased under the stock purchase plan for the first quarter of fiscal 2008 and fiscal 2007 were estimated using the following weighted-average assumptions:

	Employee Stock Option Plans First Quarter		Employee Stock Purchase Plans First Quarter	
	Fiscal 2008	Fiscal 2007	Fiscal 2008 (1)	Fiscal 2007
Expected life in years	3.5	4.4		0.5
Expected volatility	29.5%	34.2%	%	29.0%
Risk-free interest rate	4.1%	4.7%	%	5.1%
Expected dividends	none	none		none
Weighted average fair value	$ 9.01	$ 12.04	$	$ 8.43

(1) During the second quarter of fiscal 2007, the stock purchase plan was suspended and employee contributions were returned while a voluntary review of our historical stock option practices was conducted. There was no activity under the ESPP during the first quarter of fiscal 2008.

Stock Compensation Expense

The following table shows total stock-based compensation expense included in the Condensed Consolidated Statements of Operations for the first quarter of fiscal 2008 and 2007 (in thousands):

	First Quarter Fiscal 2008	First Quarter Fiscal 2007
Cost of sales	$ 385	$ 437
Research and development	320	560
Selling, general and administrative	2,000	2,495
Income tax benefit	(772)	(1,301)
	$ 1,933	$ 2,191

During the first quarter of fiscal 2008, $0.3 million for all stock plans was capitalized into inventory, $0.2 million was amortized to cost of sales and $0.3 million remained in inventory at December 29, 2007. As required by SFAS 123(R), management made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

At December 29, 2007, the total compensation cost related to unvested stock-based awards granted to employees under the Company s stock option plans but not yet recognized was approximately $8.5 million, net of estimated forfeitures of $0.3 million. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 1.1 years and will be adjusted for subsequent changes in estimated forfeitures.

In accordance with SFAS 123(R), the cash flows resulting from excess tax benefits (tax benefits related to the excess of proceeds 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 quarter of fiscal 2008 and fiscal 2007, we recorded no and $0.1 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 Option Plans (in thousands, except per share amounts and remaining contractual term in years):

	Number of Shares		Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term in Years		Aggregate Intrinsic Value
Outstanding at September 30, 2007	3,196	$	28.54			
Granted	775		32.95			
Exercised						
Forfeitures	(6)		31.81			
Expirations	(87)		27.04			
Outstanding at December 29, 2007	3,878	$	29.45	3.0	$	3,354
Vested and expected to vest at December 29, 2007	3,674	$	29.43	3.0	$	3,354
Exercisable at December 29, 2007	2,586	$	28.05	2.0	$	3,354

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the 0.6 million options that were in-the-money at December 29, 2007. During the first quarter of fiscal 2008, no options were exercised under the Company s stock option plans; therefore there was no intrinsic value. During the first quarter of fiscal 2007, the aggregate intrinsic value of options exercised under the Company s stock option plans was $0.5 million, determined as of the date of option exercise.

The following table summarizes our restricted stock award activity for the first quarter of fiscal 2008 (in thousands, except per share amounts):

	Number of Shares		Weighted Average Grant Date Fair Value
Nonvested stock at September 30, 2007	261	$	33.02
Granted			
Vested			
Forfeited	(56)		32.36
Nonvested stock at December 29, 2007	205	$	33.04

8. COMMITMENTS AND CONTINGENCIES

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

Derivative Lawsuits Between February 15, 2007 and March 2, 2007, three purported shareholder derivative lawsuits were filed in the United States District Court for the Northern District of California against certain of Coherent s current and former officers and directors. Coherent is named as a nominal defendant. The complaints generally allege that the defendants breached their fiduciary duties and violated the securities laws in connection with the granting of stock options, the accounting treatment for such grants, and the issuance of allegedly misleading public statements and stock sales by certain of the individual defendants. On May 29, 2007, these lawsuits were consolidated under the caption *In* *re Coherent, Inc. Shareholder Derivative Litigation*, Lead Case No. C-07-0955-JF (N.D. Cal.). On June 25, 2007, plaintiffs filed an amended consolidated complaint. The consolidated complaint asserts causes of action for alleged violations of federal securities laws, violations of California securities laws, breaches of fiduciary duty and/or aiding and abetting breaches of fiduciary duty, abuse of control, gross mismanagement, constructive fraud, corporate waste, unjust enrichment, insider selling and misappropriation of information. The consolidated complaint seeks, among other relief, disgorgement and damages in an unspecified amount, an accounting, rescission of allegedly improper stock option grants, punitive damages and attorneys fees and costs.

The Company s Board of Directors has appointed a Special Litigation Committee (SLC) comprised of independent director Sandeep Vij to investigate and evaluate the claims asserted in the derivative litigation and to determine what action(s) should be taken with respect to the derivative litigation. The SLC s investigation is ongoing.

Securities and Exchange Commission Inquiry In 2006, the Company was advised that the San Francisco District Office of the Securities and Exchange Commission was conducting an informal inquiry relating to the Company s past granting of stock options. The Company is cooperating fully with the inquiry.

Income Tax Audits The Internal Revenue Service (IRS) is conducting an audit of our 2003 and 2004 tax returns. The IRS has issued a number of Notices of Proposed Adjustments to these returns. Among other items, the IRS has challenged our research and development credits and our extraterritorial income (ETI) exclusion. We have agreed to the various adjustments proposed by the IRS and we believe that we have adequately provided for these exposures and any other items identified by the IRS as a result of the audit of these tax years. As part of its audit of our 2003 and 2004 years, the IRS has requested information related to our stock option investigation and we will comply with this request and address any issues that are raised in a timely manner. The IRS has also indicated that it may consider an audit of our 2005 and 2006 tax returns.

The IRS is also auditing the research and development credits generated in the years 1999 through 2001 and carried forward to future tax years. We believe that we have adequately provided for any adjustments that may be proposed by the IRS related to these credits.

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

9. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

	First Quarter	
	Fiscal 2008	Fiscal 2007
Net income	$ 4,729	$ 10,758
Other comprehensive income (loss):		
Translation adjustment	3,186	6,827
Net gain on derivative instruments, net of taxes	1	30

Changes in unrealized gains (losses) on available-for-sale securities, net of taxes		154		145
Other comprehensive income (loss), net of tax		3,341		7,002
Comprehensive income	$	8,070	$	17,760

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

Balance, October 1, 2006	$	(135)
Changes in fair value of derivatives		
Net losses reclassified from OCI		30
Balance, December 30, 2006	$	(105)
Balance, September 30, 2007	$	(98)
Changes in fair value of derivatives		
Net losses reclassified from OCI		1
Balance, December 29, 2007	$	(97)

Accumulated other comprehensive income (net of tax) at December 29, 2007 is comprised of accumulated translation adjustments of $74.1 million and net loss on derivative instruments of $0.1 million. Accumulated other comprehensive income (net of tax) at September 29, 2007 is comprised of accumulated translation adjustments of $71.0 million, net loss on derivative instruments of $0.1 million and unrealized loss on available-for-sale securities of $0.2 million, respectively.

10. 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 and stock purchase 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):

	First Quarter	
	Fiscal 2008	Fiscal 2007
Weighted average shares outstanding(1) basic	31,417	31,339
Dilutive effect of employee stock awards	542	786
Weighted average shares outstanding diluted	31,959	32,125
Net income	$ 4,729	$ 10,758
Net income per basic share	$ 0.15	$ 0.34
Net income per diluted share	$ 0.15	$ 0.33

(1) Net of restricted stock

A total of 2,519,135 and 1,007,657 potentially dilutive securities have been excluded from the dilutive share calculation for the first quarter of fiscal 2008 and fiscal 2007, respectively, as their effect was anti-dilutive.

In September 2004, the Emerging Issues Task Force (EITF) reached final consensus on EITF No. 04-8, The Effect of Contingently Convertible Instruments on Diluted Earnings per Share , that contingently convertible debt should be treated as convertible debt and included in the calculation of diluted earnings per share (EPS). The assumed proceeds under the treasury stock method were calculated by subtracting the aggregate weighted-average conversion price from the average market price of the shares related to the contingently convertible debt. As the market price for our shares did not reach the conversion price at any point during the quarter ended December 30, 2006, there was no dilutive effect from our $200.0 million 2.75% convertible subordinated notes in our diluted EPS calculation under the treasury stock method for the first quarter of fiscal 2007. Therefore we did not include any shares related to the convertible subordinated notes, in accordance with the provisions of EITF No. 90-19, Convertible Bonds With Issuer Option to Settle in Cash Upon Conversion and SFAS No. 128, Earnings Per Share . The contingently convertible debt was paid on August 21, 2007; therefore there was no impact in the first quarter of fiscal 2008.

11. INCOME TAXES

The Company accounts for income taxes under the provisions of SFAS No. 109, Accounting for Income Taxes (SFAS 109). Under the provisions of SFAS 109, deferred tax assets and liabilities are recognized based on the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, utilizing the tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Income tax expense includes a provision for federal, state and foreign taxes based on the annual estimated effective tax rate applicable to the Company and its subsidiaries. The Company s estimated effective tax rate for the three months ended December 29, 2007 was 32.8%. The difference between the statutory rate of 35% and the Company s effective tax rate for the three months ended December 29, 2007 was due primarily to the benefit of foreign tax credits and research and development tax credits, partially offset by permanent differences related to deemed dividend inclusions under the Subpart F tax rules.

Determining the consolidated provision for income tax expense, income tax liabilities and deferred tax assets and liabilities involves judgment. The Company calculates and provides for income taxes in each of the tax jurisdictions in which it operates, 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.

Effective September 30, 2007, the Company adopted the provisions of FIN 48 and FSP FIN 48-1. Upon adoption, the Company recorded a cumulative effect of a change in accounting principle that resulted in a decrease to retained earnings of $1.4 million in accordance with the transition rules under FIN 48. The Company had historically classified interest and penalties and unrecognized tax benefits as current liabilities. With the adoption of FIN 48, the Company classifies gross interest and penalties and unrecognized tax benefits that are not expected to result in payment or receipt of cash within one year as non-current liabilities in the condensed consolidated balance sheets. The total amount of gross unrecognized tax benefits as of the date of adoption of FIN 48 was $44.9 million, of which $21.7 million, if recognized, would affect the Company s effective tax rate. As of December 29, 2007, the total amount of gross unrecognized tax benefits was $45.3 million, of which $22.0 million, if recognized, would affect the Company s effective tax rate. The Company s total gross unrecognized tax benefit was classified as non-current liabilities in the condensed consolidated balance sheets.

The Company s policy to include interest and penalties related to unrecognized tax benefits within the provision for income taxes did not change as a result of adopting FIN 48. As of the date of adoption, the Company had accrued $4.7 million for the gross interest and penalties relating to the gross unrecognized tax benefits. As of December 29, 2007, the total amount of gross interest and penalties accrued was $5.2 million, which is classified as non-current liabilities in the condensed consolidated balance sheets.

The Company is subject to taxation and files income tax returns in the U.S. federal jurisdiction and in many state and foreign jurisdictions. For U.S. federal income tax purposes, all years prior to 1999 are closed. The years 2003 and 2004 are currently under examination by the IRS. The IRS has also indicated that it may consider an audit of our 2005 and 2006 tax returns. In major state jurisdictions and major foreign jurisdictions, the years subsequent to 1998 generally remain open and could be subject to examination by the taxing authorities.

Management believes that it has adequately provided for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. Should any issues addressed in the Company s tax audits be resolved in a manner not consistent with management s expectations, the Company could be required to adjust its provision for income tax in the period such resolution occurs. Although timing of the resolution and/or closure of audits is highly uncertain, the Company does not believe it is reasonably possible that its unrecognized tax benefits would materially change in the next 12 months.

12. SEGMENT INFORMATION

During the second quarter of fiscal 2007, we established a new organizational and reporting structure whereby our previously single reportable operating segment was separated into two 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. The product architectures are designed for easy exchange at the point of use such that product service and repairs are 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 manufacturers configurable, advanced-performance products largely serving the microelectronics and scientific research 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.

We have identified CLC and SLS as operating segments for which discrete financial information was available. Both operating segments have engineering, marketing, product business management and product line management. Prior period financial information has been restated to conform to the current segment presentation. 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.

Pursuant to SFAS 131, Disclosures about Segments of an Enterprise and Related Information , our Chief Executive Officer has been identified as the chief operating decision maker (CODM) as he assesses the performance of the segments and decides how to allocate resources to the segments. Income (loss) from operations is the measure of profit and loss that our CODM uses to assess performance and make decisions. Assets are not a measure used to assess the performance of the company by the CODM; therefore we do not report assets by segment internally or in our disclosures. Income (loss) from operations represents the net sales less the cost of sales and direct operating expenses incurred within the operating segments as well as allocated expenses such as shared sales and manufacturing costs. We do not allocate to our operating segments certain operating expenses, which we manage separately at the corporate level. These unallocated costs include stock-based compensation, 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 from operations for our operating segments (in thousands):

	Three Months Ended	
	December 29, 2007	**December 30, 2006**
Net sales:		
Commercial Lasers and Components	**$ 68,604**	$ 67,227
Specialty Laser Systems	**75,667**	78,770
Corporate and other	**25**	1,512
Total net sales		