COHERENT INC
Form 10-Q
May 06, 2014
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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 March 29, 2014

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 May 5, 2014 was 24,933,997.

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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		Six Months Ended	
	March 29, 2014	March 30, 2013	March 29, 2014	March 30, 2013
Net sales	$199,222	$200,058	$392,778	$383,260
Cost of sales	118,557	123,727	234,567	229,294
Gross profit	80,665	76,331	158,211	153,966
Operating expenses:				
Research and development	20,413	20,146	41,350	39,447
Selling, general and administrative	39,296	37,346	79,187	74,328
Amortization of intangible assets	916	1,942	1,850	2,796
Total operating expenses	60,625	59,434	122,387	116,571
Income from operations	20,040	16,897	35,824	37,395
Other income (expense):				
Interest and dividend income	58	63	117	113
Interest expense	(8)	(11)	(31)	(23)
Other—net	990	1,243	734	(232)
Total other income (expense), net	1,040	1,295	820	(142)
Income before income taxes	21,080	18,192	36,644	37,253
Provision for income taxes	5,773	3,190	9,634	8,098
Net income	$15,307	$15,002	$27,010	$29,155
Net income per share:				
Basic	$0.62	$0.62	$1.10	$1.22
Diluted	$0.61	$0.61	$1.08	$1.20
Shares used in computation:				
Basic	24,782	24,085	24,662	23,928
Diluted	25,044	24,475	24,980	24,348

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended		Six Months Ended	
	March 29, 2014	March 30, 2013	March 29, 2014	March 30, 2013
Net income	$15,307	$15,002	$27,010	$29,155
Other comprehensive income (loss): (1)				
Translation adjustment (2)	2,867	(11,228)	4,015	(7,108)
Changes in unrealized gains (losses) on available-for-sale securities, net of taxes	(6)	(8)	(17)	(7)
Other comprehensive income (loss), net of tax	2,861	(11,236)	3,998	(7,115)
Comprehensive income	$18,168	$3,766	$31,008	$22,040

(1) Reclassification adjustments were not significant during the three and six months ended March 29, 2014 and March 30, 2013.

(2) Tax expense of $153 and $1,339 was provided on translation adjustments during the three and six months ended March 29, 2014, respectively. Tax expense of $37 and $18 was provided on translation adjustments during the three and six months ended March 30, 2013, respectively. Tax expense (benefit) on changes in unrealized gains (losses) on available-for-sale securities 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)

	March 29, 2014	September 28, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$140,251	$110,444
Short-term investments	143,217	139,666
Accounts receivable—net of allowances of $1,522 and $1,386, respectively	137,470	136,759
Inventories	176,462	168,067
Prepaid expenses and other assets	52,556	52,577
Deferred tax assets	22,280	21,713
Total current assets	672,236	629,226
Property and equipment, net	114,146	114,333
Goodwill	115,354	113,408
Intangible assets, net	38,698	42,971
Other assets	68,280	66,540
Total assets	$1,008,714	$966,478
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term obligations	$—	$2
Accounts payable	33,708	36,565
Income taxes payable	11,977	24,695
Other current liabilities	99,841	84,566
Total current liabilities	145,526	145,828
Long-term obligations		—
Other long-term liabilities	64,702	62,132
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Common stock, par value $.01 per share:		
Authorized—500,000 shares		
Outstanding—24,870 shares and 24,464 shares, respectively	248	244
Additional paid-in capital	171,209	162,253
Accumulated other comprehensive income	58,448	54,450
Retained earnings	568,581	541,571
Total stockholders' equity	798,486	758,518
Total liabilities and stockholders' equity	$1,008,714	$966,478

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)

	Six Months Ended	
	March 29, 2014	March 30, 2013
Cash flows from operating activities:		
Net income	$27,010	$29,155
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,524	12,787
Amortization of intangible assets	4,879	4,589
Deferred income taxes	(2,078)	(2,700)
Stock-based compensation	9,540	9,636
Other non-cash (income) expense	(22)	300
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(1,574)	5,913
Inventories	(7,142)	1,083
Prepaid expenses and other assets	(8,139)	(10,218)
Other assets	(2,067)	938
Accounts payable	(2,070)	9,997
Income taxes payable/receivable	(4,474)	(97)
Other current liabilities	14,330	8,993
Other long-term liabilities	2,701	48
Net cash provided by operating activities	44,418	70,424
Cash flows from investing activities:		
Purchases of property and equipment	(13,995)	(10,492)
Proceeds from dispositions of property and equipment	500	94
Purchases of available-for-sale securities	(89,900)	(116,887)
Proceeds from sales and maturities of available-for-sale securities	86,346	163,405
Acquisition of businesses, net of cash acquired	—	(67,289)
Net cash used in investing activities	(17,049)	(31,169)
Cash flows from financing activities:		
Short-term borrowings	36,768	3,199
Repayments of short-term borrowings	(36,768)	(3,199)
Capital lease repayments	(2)	(8)
Issuance of common stock under employee stock option and purchase plans	7,038	12,306
Cash dividend paid on common stock	—	(24,040)
Net settlement of restricted common stock	(7,689)	(4,046)
Net cash used in financing activities	(653)	(15,788)
Effect of exchange rate changes on cash and cash equivalents	3,091	2,376
Net increase in cash and cash equivalents	29,807	25,843
Cash and cash equivalents, beginning of period	110,444	67,761
Cash and cash equivalents, end of period	$140,251	$93,604

See Accompanying Notes to Condensed Consolidated Financial Statements.

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COHERENT, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. These interim condensed consolidated financial statements and notes thereto should be read in conjunction with the Coherent, Inc. (referred to herein as the “Company,” “we,” “our,” “us” or “Coherent”) consolidated financial statements and notes thereto filed on Form 10-K for the fiscal year ended September 28, 2013. In the opinion of management, all adjustments necessary for a fair presentation of financial condition and results of operation as of and for the periods presented have been made and include only normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year or any other interim periods presented therein. Our fiscal year ends on the Saturday closest to September 30 and our second fiscal quarters include 13 weeks of operations in each fiscal year presented. Fiscal years 2014 and 2013 each include 52 weeks.

2. RECENT ACCOUNTING STANDARDS

Adoption of New Accounting Pronouncements

In February 2013, the FASB issued guidance which requires an entity to disclose additional information for items reclassified out of accumulated other comprehensive income ("AOCI"). For items reclassified out of AOCI and into net income in their entirety, entities are required to disclose the effect of the reclassification on each affected net income line item. For AOCI reclassification items that are not reclassified in their entirety into net income, a cross reference to other disclosures is required. This information may be provided either in the notes or parenthetically on the face of the statement that reports net income as long as all the information is disclosed in a single location. We adopted this authoritative guidance in the first quarter of fiscal 2014. The adoption of this accounting standard did not have an impact on our consolidated financial position, results of operations and cash flows.

Recently Issued Accounting Pronouncement

In July 2013, the Financial Accounting Standards Board (“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 new standard requires prospective adoption but allows retrospective adoption for all periods presented. We will consider the FASB’s amended guidance for our fiscal year beginning September 28, 2014. We do not expect the amended guidance to have a significant impact on our consolidated financial position, results of operations and cash flows.

3. BUSINESS COMBINATIONS

Fiscal 2013 Acquisitions

Lumera Laser GmbH

On December 20, 2012, we acquired privately held Lumera Laser GmbH (Kaiserslautern, Germany) ("Lumera") for approximately $51.5 million, excluding transaction costs. Lumera manufactures ultrafast solid state lasers for microelectronics, OEM medical and materials processing applications. Lumera has been included in our Specialty Lasers and Systems segment.

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

Tangible assets	
Inventories	$7,364
Accounts receivable	2,770
Other tangible assets	4,380
Goodwill	24,640
Intangible assets:	
Existing technology	21,000
In-process R&D	1,800
Trade name	200
Customer lists	6,500
Backlog	900
Deferred tax liabilities	(9,300)
Liabilities assumed	(8,793)
Total	$51,461

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

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

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

In-process research and development (“IPR&D”) consists of two projects that have not yet reached technological feasibility. Acquired IPR&D assets are initially recognized at fair value and are classified as indefinite-lived assets until the successful completion or abandonment of the associated research and development efforts. The value assigned to IPR&D was determined by considering the value of the products under development to the overall development plan, estimating the resulting net cash flows from the projects when completed and discounting the net cash flows to their present value. During the development period, these assets will not be amortized as charges to earnings; instead these assets will be subject to periodic impairment testing. Upon successful completion of the development process for the acquired IPR&D projects, the assets would then be considered finite-lived intangible assets and amortization of the assets will commence. None of the projects have been completed as of March 29, 2014.

We expensed $0.6 million of acquisition-related costs as selling, general and administrative expenses in our consolidated statements of operations in fiscal 2013.

Innolight Innovative Laser and Systemtechnik GmbH

On October 30, 2012, we acquired all of the outstanding shares of Innolight Innovative Laser and Systemtechnik GmbH ("Innolight") for approximately $18.3 million, excluding transaction costs. Innolight provides a core technology building block for an emerging class of commercial, sub-nanosecond lasers for microelectronics manufacturing. Its semiconductor-based architecture delivers pulsed output that can be amplified by conventional or fiber amplifiers to ultimately deliver infrared, green or ultraviolet light capable of processing a range of materials. Innolight has been included in our Specialty Lasers and Systems segment.

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

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Tangible assets	$2,510
Goodwill	8,312
Intangible assets:	
Existing technology	8,500
In-process R&D	430
Trade name	100
Customer lists	2,800
Deferred tax liabilities	(3,836)
Liabilities assumed	(480)
Total	$18,336

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

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

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

IPR&D consists of two projects that have not yet reached technological feasibility. The projects have not been completed as of March 29, 2014.

We expensed $0.2 million of acquisition-related costs as selling, general and administrative expenses in our consolidated statements of operations in fiscal 2013.

4. FAIR VALUES

We measure our cash equivalents and marketable securities at fair value. The fair values of our financial assets and liabilities are determined using quoted market prices of identical assets or quoted market prices of similar assets from active markets. Level 1 valuations are obtained from real-time quotes for transactions in active exchange markets involving identical assets. Level 2 valuations are obtained from quoted market prices in active markets involving similar assets; these instruments, which mature within two years and are issued by counterparties with high credit ratings, include U.S. Treasury and international government obligations, investment-grade corporate bonds, certificates of deposit and commercial paper. Level 3 valuations would be based on unobservable inputs to a valuation model and include our own data about assumptions market participants would use in pricing the asset or liability based on the best information available under the circumstances. As of March 29, 2014 and September 28, 2013, we did not have any assets or liabilities valued based on Level 3 valuations.

Financial assets and liabilities measured at fair value as of March 29, 2014 and September 28, 2013 are summarized below (in thousands):

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	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs
	March 29, 2014		September 28, 2013	
	(Level 1)	(Level 2)	(Level 1)	(Level 2)
Money market fund deposits[1]	$ 11,473	$ —	$ 12,468	$ —
Commercial paper[2][6]	—	10,993	—	9,995
Certificates of deposit[1]	—	70,193	—	28,447
U.S. and international government obligations[3][6]	—	110,929	—	109,263
Corporate notes and obligations[3][6]	—	23,294	—	20,408
Foreign currency contracts[4][7]	—	324	—	746
Mutual funds — Deferred comp and supplemental plan[5][8]	13,952	—	13,419	—

(1) Included in cash and cash equivalents on the Condensed Consolidated Balance Sheet. The carrying amounts approximate fair value due to the short-term maturities of the cash equivalents.

(2) March 29, 2014: Includes $1,999 recorded in cash and cash equivalents and $8,994 recorded in short-term investments on the Condensed Consolidated Balance Sheet.

September 28, 2013: Included in short-term investments on the Condensed Consolidated Balance Sheet.

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

(4) March 29, 2014: Includes $346 recorded in prepaid expenses and other assets and $22 recorded in other current liabilities on the Condensed Consolidated Balance Sheet (see Note 5).

September 28, 2013: Includes $1,270 recorded in prepaid expenses and other assets and $524 recorded in other current liabilities on the Condensed Consolidated Balance Sheet (see Note 5).

(5) March 29, 2014: Includes $1,410 recorded in prepaid expenses and other assets and $12,542 recorded in other assets on the Condensed Consolidated Balance Sheet.

September 28, 2013: Includes $1,361 recorded in prepaid expenses and other assets and $12,058 recorded in other assets on the Condensed Consolidated Balance Sheet.

(6) 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.

(7) 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.

(8) 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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5. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

All derivatives, whether designated in hedging relationships or not, are recorded on the Condensed Consolidated Balance Sheet at fair value. We enter into foreign exchange forwards to minimize the risks of foreign currency fluctuation of specific assets and liabilities on the balance sheet; these are not designated as hedging instruments. 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.

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 Japanese Yen, the Euro and the Korean Won. As a result, our earnings, cash flows and cash balances are exposed to fluctuations in foreign currency exchange rates. We attempt to limit these exposures through financial market instruments. We utilize derivative instruments, primarily forward contracts with maturities of three months or less, to manage our exposure associated with anticipated cash flows and net asset and liability positions denominated in foreign currencies. Gains and losses on the forward contracts are mitigated by gains and losses on the underlying instruments. We do not use derivative financial instruments for speculative or trading purposes. If a financial counterparty to any of our hedging arrangements experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency hedge, we may experience material financial losses.

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

The outstanding notional contract and fair value amounts of hedge contracts, with maximum maturity of three months, are as follows (in thousands):

	U.S. Notional Contract Value		U.S. Notional Fair Value	
	March 29, 2014	September 28, 2013	March 29, 2014	September 28, 2013
Euro currency hedge contracts				
Purchase	$28,902	$46,248	$28,994	$47,299
Japanese YEN currency hedge contracts				
Purchase	$—	$5,211	$—	$5,307
Sell	$(22,232)	$(11,860)	$(22,169)	$(11,753)
Korean Won currency hedge contracts				
Sell	$(15,377)	$(17,345)	$(15,397)	$(17,545)
Chinese RMB currency hedge contracts				
Sell	$(11,544)	$(11,524)	$(11,374)	$(11,793)
Other foreign currency hedge contracts				
Purchase	$3,220	$1,466	$3,233	$1,481
Sell	$(3,046)	$(2,512)	$(3,042)	$(2,568)

The fair value of our derivative instruments are included in prepaid expenses and other assets and in other current liabilities in our Condensed Consolidated Balance Sheets; such amounts were not material as of March 29, 2014 and September 28, 2013.

The amount of non-designated derivative instruments’ gain (loss) in the Condensed Consolidated Statements of Operations included in other income (expense) for the three and six months ended March 29, 2014 and March 30, 2013 is as follows (in thousands):

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	Amount of Gain or (Loss) Recognized in Income on Derivatives	
	Three Months Ended March 29, 2014	Six Months Ended March 29, 2014
Derivatives not designated as hedging instruments		
Foreign exchange contracts	$197	$159

	Amount of Gain or (Loss) Recognized in Income on Derivatives	
	Three Months Ended March 30, 2013	Six Months Ended March 30, 2013
Derivatives not designated as hedging instruments		
Foreign exchange contracts	$853	$1,138

6. SHORT-TERM INVESTMENTS

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

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

	March 29, 2014			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$140,251	$—	$—	$140,251
Short-term investments:				
Available-for-sale securities:				
Commercial paper	$8,994	$—	$—	$8,994
U.S. Treasury and agency obligations	105,375	522	(2)	105,895
International government obligations	5,008	28	(2)	5,034
Corporate notes and obligations	23,276	42	(24)	23,294
Total short-term investments	$142,653	$592	$(28)	$143,217

	September 28, 2013			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$110,444	$—	$—	$110,444
Short-term investments:				
Available-for-sale securities:				
Commercial paper	$9,995	$—	$—	$9,995
U.S. Treasury and agency obligations	103,694	507	(1)	104,200
International government obligations	5,040	28	(5)	5,063

Corporate notes and obligations	20,352	66	(10)	20,408
Total short-term investments	$139,081	$601	$(16)	$139,666

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None of the unrealized losses as of March 29, 2014 or September 28, 2013 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 March 29, 2014 and September 28, 2013 classified as short-term investments on our condensed consolidated balance sheet were as follows (in thousands):

	March 29, 2014		September 28, 2013	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Investments in available-for-sale debt securities due in less than one year	$127,481	$ 128,047	$139,081	$ 139,666
Investments in available-for-sale debt securities due in one to five years	$15,172	$ 15,170	$—	$ —

During the three and six months ended March 29, 2014, we received proceeds totaling $7.0 million and $14.1 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. During the three and six months ended March 30, 2013, we received proceeds totaling $9.1 million and $65.7 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.

7. GOODWILL AND INTANGIBLE ASSETS

Goodwill is tested for impairment on an annual basis and between annual tests if events or circumstances indicate that an impairment loss may have occurred, and we write down these assets when impaired. We perform our annual impairment tests during the fourth quarter of each fiscal year using the opening balance sheet as of the first day of the fourth quarter, with any resulting impairment recorded in the fourth quarter of the fiscal year.

During the six months ended March 29, 2014, 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 28, 2013 to March 29, 2014 are as follows (in thousands):

	Specialty Lasers and Systems	Commercial Lasers and Components	Total
Balance as of September 28, 2013	$107,045	$6,363	$113,408
Translation adjustments and other	1,946	—	1,946
Balance as of March 29, 2014	$108,991	$6,363	$115,354

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

March 29, 2014	September 28, 2013

	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Existing technology	$82,914	$(55,654)	$27,260	$82,220	$(51,570)	$30,650
Customer lists	17,525	(8,541)	8,984	17,341	(7,465)	9,876
Trade name	455	(342)	113	710	(576)	134
Non-compete agreement	60	(54)	6	570	(558)	12
In-process research & development	2,335	—	2,335	2,299	—	2,299
Total	$103,289	$(64,591)	$38,698	$103,140	$(60,169)	$42,971

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

Amortization expense for intangible assets for the six months ended March 29, 2014 and March 30, 2013 was $4.9 million and $4.6 million, respectively, which includes $3.8 million and $2.8 million, respectively, for amortization of existing technology and production know-how.

At March 29, 2014, estimated amortization expense for the remainder of fiscal 2014, the next five succeeding fiscal years and all fiscal years thereafter are as follows (in thousands):

	Estimated Amortization Expense
2014 (remainder)	$4,616
2015	9,443
2016	9,059
2017	7,971
2018	4,680
2019	2,571
Thereafter	358
Total	$38,698

8. BALANCE SHEET DETAILS

Inventories consist of the following (in thousands):

	March 29, 2014	September 28, 2013
Purchased parts and assemblies	$52,458	$50,275
Work-in-process	65,533	60,089
Finished goods	58,471	57,703
Total inventories	$176,462	$168,067

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

	March 29, 2014	September 28, 2013
Prepaid and refundable income taxes	$15,786	$23,939
Other taxes receivable	23,290	16,225
Prepaid expenses and other	13,480	12,413
Total prepaid expenses and other assets	$52,556	$52,577

Other assets consist of the following (in thousands):

	March 29, 2014	September 28, 2013
Assets related to deferred compensation arrangements	$25,177	$23,446
Deferred tax assets	37,385	37,637
Other assets	5,718	5,457
Total other assets	$68,280	$66,540

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

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	March 29, 2014	September 28, 2013
Accrued payroll and benefits	$31,627	$29,723
Deferred income	16,452	16,994
Reserve for warranty	17,981	18,508
Accrued expenses and other	10,160	11,552
Other taxes payable	20,688	6,147
Customer deposits	2,933	1,642
Total other current liabilities	$99,841	$84,566

We provide warranties on the majority of our product sales and reserves for estimated warranty costs are recorded during the period of sale. The determination of such reserves requires us to make estimates of product return rates and expected costs to repair or replace the products under warranty. We currently establish warranty reserves based on historical warranty costs for each product line. The weighted average warranty period covered is approximately 15 months. If actual return rates and/or repair and replacement costs differ significantly from our estimates, adjustments to cost of sales may be required in future periods.

Components of the reserve for warranty costs during the first six months of fiscal 2014 and 2013 were as follows (in thousands):

	Six Months Ended	
	March 29, 2014	March 30, 2013
Beginning balance	$18,508	$17,442
Additions related to current period sales	12,434	11,198
Warranty costs incurred in the current period	(12,713)	(12,991)
Accruals resulting from acquisitions	—	1,735
Adjustments to accruals related to foreign exchange and other	(248)	(107)
Ending balance	$17,981	$17,277

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

	March 29, 2014	September 28, 2013
Long-term taxes payable	$15,659	$15,715
Deferred compensation	26,369	24,723
Deferred tax liabilities	10,658	10,487
Deferred income	3,236	2,734
Asset retirement obligations liability	2,266	2,247
Other long-term liabilities	6,514	6,226
Total other long-term liabilities	$64,702	$62,132

9. SHORT-TERM BORROWINGS

We have several lines of credit which allow us to borrow in the applicable local currency. We have a total of $14.6 million of unsecured foreign lines of credit as of March 29, 2014. At March 29, 2014, we had used $3.5 million of these available foreign lines of credit as guarantees. These credit facilities were used in Europe and Japan during the second fiscal quarter of 2014. In addition, our domestic line of credit consists of a $50.0 million unsecured revolving credit account with Union Bank of California. The agreement will expire on May 31, 2014. 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 March 29, 2014.

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10. STOCK-BASED COMPENSATION

Fair Value of Stock Compensation

We recognize compensation expense for all share based payment awards based on the fair value of such awards. The expense is recognized on a straight-line basis over the respective requisite service period of the awards.

Determining Fair Value

The fair values of shares purchased under the Employee Stock Purchase Plan ("ESPP") for the three and six months ended March 29, 2014 and March 30, 2013, respectively, were estimated using the following weighted-average assumptions:

	Employee Stock Purchase Plan			
	Three Months Ended		Six Months Ended	
	March 29, 2014	March 30, 2013	March 29, 2014	March 30, 2013
Expected life in years	0.5	0.5	0.5	0.5
Expected volatility	22.8 %	34.2 %	23.7 %	34.5 %
Risk-free interest rate	0.1 %	0.2 %	0.1 %	0.2 %
Expected dividend yield	— %	1.0 %	— %	1.0 %
Weighted average fair value per share	$13.89	$10.30	$13.69	$10.44

There were no stock options granted during the three and six months ended March 29, 2014 and March 30, 2013.

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

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

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 period. The final number of units awarded, for this grant will be determined as of the vesting dates, based upon our total shareholder return over the performance period compared to the Russell 2000 Index and could range from a minimum of no units to a maximum of twice the initial award. The weighted average fair value for these performance units was determined using a Monte Carlo simulation model incorporating the following weighted average assumptions:

	Six Months Ended	
	March 29, 2014	March 30, 2013
Risk-free interest rate	0.62 %	0.33 %
Volatility	36.9 %	37.9 %
Weighted average fair value	$77.10	$48.48

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.

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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 six months ended March 29, 2014 and March 30, 2013 (in thousands):

	Three Months Ended		Six Months Ended	
	March 29, 2014	March 30, 2013	March 29, 2014	March 30, 2013
Cost of sales	$648	$594	$1,186	$1,029
Research and development	500	467	1,022	943
Selling, general and administrative	3,524	3,581	7,332	7,664
Income tax benefit	(1,326)	(1,145)	(2,665)	(2,628)
	$3,346	$3,497	$6,875	$7,008

During the three and six months ended March 29, 2014, $0.6 million and $1.3 million was capitalized into inventory for all stock plans, $0.6 million and $1.2 million was amortized to cost of sales and $0.7 million remained in inventory at March 29, 2014. During the three and six months ended March 30, 2013, $0.6 million and $1.2 million was capitalized into inventory for all stock plans, $0.6 million and $1.0 million was amortized to cost of sales and $0.7 million remained in inventory at March 30, 2013. Management has made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

At March 29, 2014, 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 $25.4 million, net of estimated forfeitures of $1.0 million. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 1.6 years and will be adjusted for subsequent changes in estimated forfeitures.

At March 29, 2014, total compensation cost related to options to purchase common shares under the ESPP but not yet vested was approximately $0.1 million, which will be recognized over the six month offering period.

The stock option exercise tax benefits reported in the statement of cash flows results from the excess tax benefits arising from tax deductions in excess of the stock-based compensation cost recognized, determined on a grant-by-grant basis. During the first six months of fiscal 2014 and fiscal 2013, we have not generated any 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 weighted average remaining contractual term in years):

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at September 28, 2013	270	$26.90		
Granted	—	—		
Exercised	(153)	25.47		
Forfeitures	—	—		
Expirations	—	—		
Outstanding at March 29, 2014	117	$28.75	4.1 years	$4,155

Vested and expected to vest at March 29, 2014	117	$28.75	4.1 years	$4,155
Exercisable at March 29, 2014	109	$27.58	3.9 years	$3,999

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying options and the quoted price of our common stock at the end of the reporting period. The aggregate intrinsic value of options exercised under the Company's stock plans for the three and six months ended March 29, 2014 were $0.4 million and

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$6.2 million, respectively, determined as of the date of option exercise. The aggregate intrinsic value of options exercised under the Company's stock plans for the three and six months ended March 30, 2013 were $6.9 million and $8.1 million, respectively, determined as of the date of option exercise.

The following table summarizes the activity of our time based and market- performance based restricted stock units for the first six months of fiscal 2014 (in thousands, except per share amounts):

	Time Based Restricted Stock Units		Market-Based Performance Restricted Stock Units	
	Number of Shares(1)	Weighted Average Grant Date Fair Value	Number of Shares(2)	Weighted Average Grant Date Fair Value
Nonvested stock units at September 28, 2013	453	$48.22	213	$54.63
Granted	226	65.80	52	77.10
Vested	(268)	47.71	(32)	43.25
Forfeited	—	—	(1)	44.98
Nonvested stock at March 29, 2014	411	$58.21	232	$61.29

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

11. COMMITMENTS AND CONTINGENCIES

We are subject to legal claims and litigation arising in the ordinary course of business, such as product liability, employment or intellectual property claims, 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. Management has made an accrual 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 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.

12. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income (net of tax) at March 29, 2014 and September 28, 2013 are substantially comprised of accumulated translation adjustments of $58.5 million and $54.4 million, respectively.

13. EARNINGS PER SHARE

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

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

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	Three Months Ended		Six Months Ended	
	March 29, 2014	March 30, 2013	March 29, 2014	March 30, 2013
Weighted average shares outstanding —basic	24,782	24,085	24,662	23,928
Dilutive effect of employee stock awards	262	390	318	420
Weighted average shares outstanding—diluted	25,044	24,475	24,980	24,348
Net income	$15,307	$15,002	$27,010	$29,155
Net income per basic share	$0.62	$0.62	$1.10	$1.22
Net income per diluted share	$0.61	$0.61	$1.08	$1.20

A total of zero and 40,738 potentially dilutive securities have been excluded from the diluted share calculation for the three and six months ended March 29, 2014 as their effect was anti-dilutive. A total of zero and 76,877 potentially dilutive securities have been excluded from the diluted share calculation for the three and six months ended March 30, 2013 as their effect was anti-dilutive.

14. OTHER INCOME (EXPENSE)

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

	Three Months Ended		Six Months Ended	
	March 29, 2014	March 30, 2013	March 29, 2014	March 30, 2013
Foreign exchange gain (loss)	$(388)	$41	$(2,512)	$(1,728)
Gain on deferred compensation investments, net	1,291	983	3,167	1,277
Other—net	87	219	79	219
Other income (expense), net	$990	$1,243	$734	$(232)

15. STOCK REPURCHASES AND DIVIDENDS

On October 4, 2012, the Board of Directors authorized a buyback program whereby we are authorized to repurchase up to $25.0 million of our common stock. The program was authorized for 12 months from the date of authorization. No shares had been purchased under this program at its expiration in October 2013.

On December 10, 2012, we announced that the Board of Directors approved a $1.00 per share special cash dividend on our outstanding common stock payable on December 27, 2012 to stockholders of record on December 19, 2012, resulting in a payment of $24.0 million in the first quarter of fiscal 2013.

16. INCOME TAXES

Income tax expense includes a provision for federal, state and foreign taxes based on the annual estimated effective tax rate applicable to us and our subsidiaries, adjusted for items which are considered discrete to the period. Our estimated effective tax rates for the three and six months ended March 29, 2014 were 27.4% and 26.3%. Our effective tax rates for the three and six months ended March 29, 2014 were lower than the statutory rate of 35% primarily due to permanent differences related to the benefit of income subject to foreign tax rates that are lower than U.S. tax rates including 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 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

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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 2010 are closed. In our major foreign jurisdictions and our major state jurisdictions, the years prior to 2006 and 2009, 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 addition, our German subsidiary of Coherent Kaiserslautern GmbH (formerly Lumera Laser GmbH) that was acquired in December 2012 is currently under audit for the fiscal years 2007 through 2009. As the years under the audit for Coherent Kaiserslautern GmbH are related to the pre-acquisition periods, any tax assessment should be recoverable from the escrow account for the acquisition.

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 federal, foreign and state tax matters may be concluded in the next 12 months.

17. SEGMENT INFORMATION

We are organized into two reportable 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 work to deliver cost-effective solutions, SLS develops and manufacturers 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 our 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 product service and repairs are based upon advanced replacement and depot (i.e., factory) repair. CLC's primary markets include materials processing, OEM components and instrumentation and microelectronics.

We have identified SLS and CLC as operating segments for which discrete financial information is available. Both units have dedicated engineering, manufacturing, product business management and product line management functions. Occasionally, a small portion of our outside revenue is attributable to projects and recently developed products for which a segment has not yet been determined. The associated direct and indirect costs are presented in the category of Corporate and other, along with other corporate costs as described below.

Our Chief Executive Officer has been identified as the chief operating decision maker (CODM) as he assesses the performance of the segments and decides how to allocate resources to the segments. Income (loss) from operations is the measure of profit and loss that our CODM uses to assess performance and make decisions. As assets are not a measure used to assess the performance of the company by the CODM, asset information is not tracked or compiled by segment and is not available to be reported in our disclosures. Income (loss) from operations represents the net sales less the cost of sales and direct operating expenses incurred within the operating segments as well as allocated expenses such as shared sales and manufacturing costs. We do not allocate to our operating segments certain operating expenses which we manage separately at the corporate level. These unallocated costs include stock-based compensation and corporate functions (certain research and development, management, finance, legal and human resources) and are included in the results below under Corporate and other in the reconciliation of operating results. Management does not consider unallocated Corporate and other costs in its measurement of segment performance.

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

	Three Months Ended		Six Months Ended	
	March 29, 2014	March 30, 2013	March 29, 2014	March 30, 2013
Net sales:				
Specialty Laser Systems	$143,795	$142,682	$280,618	$274,142
Commercial Lasers and Components	55,427	57,376	112,160	109,118
Total net sales	$199,222	$200,058	$392,778	$383,260
Income (loss) from operations:				
Specialty Laser Systems	$31,117	$26,585	$59,749	$56,919
Commercial Lasers and Components	(129)	1,448	177	3,272
Corporate and other	(10,948)	(11,136)	(24,102)	(22,796)
Total income from operations	$20,040	$16,897	$35,824	$37,395

The following table provides a reconciliation of our total income (loss) from operations to net income (in thousands):

	Three Months Ended		Six Months Ended	
Reconciliation of Income From Operations to Net Income	March 29, 2014	March 30, 2013	March 29, 2014	March 30, 2013
Total income from operations	$20,040	$16,897	$35,824	$37,395
Total other income, net	1,040	1,295	820	(142)
Income before income taxes	21,080	18,192	36,644	37,253
Provision for income taxes	5,773	3,190	9,634	8,098
Net Income	$15,307	$15,002	$27,010	$29,155

Major Customers

We had one customer during the three and six months ended March 29, 2014 who accounted for 11.5% and 12.6% respectively, of consolidated revenue; the customer purchased primarily from our SLS segment. We had one customer during the three and six months ended March 30, 2013 who accounted for 13.1% and 11.7% respectively, of consolidated revenue; the customer purchased primarily from our SLS segment.

We had one customer who accounted for 17.2% of accounts receivable at March 29, 2014. There were two customers who accounted for 15.2% and 11.7%, respectively, of accounts receivable at September 28, 2013.

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

COMPANY OVERVIEW

BUSINESS BACKGROUND

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

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

MARKET APPLICATIONS

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

OUR STRATEGY

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

- Leverage our technology portfolio and application engineering to lead the proliferation of photonics into broader markets—We will continue to identify opportunities in which our technology portfolio and application engineering can be used to offer innovative solutions and gain access to new markets. We plan to utilize our expertise to 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.
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Maintain and develop additional strong collaborative customer and industry relationships—We believe that the Coherent brand name and reputation for product quality, technical performance and customer satisfaction will help us to further develop our loyal customer base. We plan to maintain our current customer relationships and develop new ones with customers who are industry leaders and work together with these customers to design and develop innovative product systems and solutions as they develop new technologies.

- Develop and acquire new technologies and market share—We will continue to enhance our market position through our existing technologies and develop new technologies through our internal research and development efforts, as well as through the acquisition of additional complementary technologies, intellectual property, manufacturing processes and product offerings.

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- Streamline our manufacturing structure and improve our cost structure—We will focus on optimizing the mix of products that we manufacture internally and externally. We will utilize vertical integration where our internal manufacturing process is considered proprietary and seek to leverage external sources when the capabilities and cost structure are well developed and on a path towards commoditization.
- Focus on long-term improvement of adjusted EBITDA, in dollars and as a percentage of net sales—We define adjusted EBITDA as operating income adjusted for depreciation, amortization, stock compensation expenses, major restructuring costs and certain other non-operating income and expense items. Key initiatives to reach our goals for EBITDA improvements include utilization of our Asian manufacturing locations, rationalizing our supply chain and continued leveraging of our infrastructure.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the SEC. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We have identified the following as the items that require the most significant judgment and often involve complex estimation: revenue recognition, accounting for long-lived assets (including goodwill and intangible assets), inventory valuation, warranty reserves, stock-based compensation and accounting for income taxes. 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 28, 2013.

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			
	March 29, 2014	March 30, 2013	Change	% Change
	(Dollars in thousands)			
Bookings	$261,837	$201,825	$60,012	29.7 %
Book-to-bill ratio	1.31	1.01	0.3	29.7 %
Net sales—Specialty Lasers and Systems	$143,795	$142,682	$1,113	0.8 %
Net sales—Commercial Lasers and Components	$55,427	$57,376	$(1,949)	(3.4)%
Gross profit as a percentage of net sales—Specialty Lasers and Systems	43.5 %	39.9 %	3.6 %	9.0 %
Gross profit as a percentage of net sales—Commercial Lasers and Components	33.9 %	34.8 %	(0.9)%	(2.6)%
Research and development as a percentage of net sales	10.2			