

COHERENT INC  
Form 10-Q  
February 10, 2016  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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(Mark One)

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

For the Quarterly Period Ended January 2, 2016

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

(State or other jurisdiction of  
incorporation or organization)

94-1622541

(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

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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  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  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

Accelerated filer

Non-accelerated filer

Smaller reporting company

(do not check if a 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

The number of shares outstanding of registrant's common stock, par value \$.01 per share, on February 9, 2016 was 24,196,201.

Table of Contents

COHERENT, INC.

INDEX

	Page	
<u>Part I.</u>	<u>Financial Information</u>	
<u>Item 1.</u>	<u>Financial Statements (unaudited)</u>	
	<u>Condensed Consolidated Statements of Operations</u> <u>Three months ended January 2, 2016 and December 27, 2014</u>	4
	<u>Condensed Consolidated Statements of Comprehensive Income</u> <u>Three months ended January 2, 2016 and December 27, 2014</u>	5
	<u>Condensed Consolidated Balance Sheets</u> <u>January 2, 2016 and October 3, 2015</u>	6
	<u>Condensed Consolidated Statements of Cash Flows</u> <u>Three months ended January 2, 2016 and December 27, 2014</u>	7
	<u>Notes to Condensed Consolidated Financial Statements</u>	8
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	36
<u>Item 4.</u>	<u>Controls and Procedures</u>	38
<u>Part II.</u>	<u>Other Information</u>	
<u>Item 1.</u>	<u>Legal Proceedings</u>	39
<u>Item 1A.</u>	<u>Risk Factors</u>	39
<u>Item 6.</u>	<u>Exhibits</u>	54
<u>Signatures</u>		55

Table of Contents

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.

Table of Contents

## 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		
	January 2, 2016	December 27, 2014	
Net sales	\$190,275	\$200,615	
Cost of sales	106,377	118,296	
Gross profit	83,898	82,319	
Operating expenses:			
Research and development	19,140	19,173	
Selling, general and administrative	36,774	38,141	
Amortization of intangible assets	701	696	
Total operating expenses	56,615	58,010	
Income from operations	27,283	24,309	
Other income (expense):			
Interest income	240	96	
Interest expense	(15	) (11	)
Other—net	(447	) (770	)
Total other expense, net	(222	) (685	)
Income before income taxes	27,061	23,624	
Provision for income taxes	6,775	6,194	
Net income	\$20,286	\$17,430	
Net income per share:			
Basic	\$0.85	\$0.70	
Diluted	\$0.84	\$0.69	
Shares used in computation:			
Basic	23,996	24,936	
Diluted	24,236	25,197	

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

	Three Months Ended	
	January 2, 2016	December 27, 2014
Net income	\$20,286	\$17,430
Other comprehensive income (loss): <sup>(1)</sup>		
Translation adjustment, net of taxes <sup>(2)</sup>	(8,506	) (14,519
Net gain (loss) on derivative instruments, net of taxes <sup>(3)</sup>	(30	) 375
Changes in unrealized gains (losses) on available-for-sale securities, net of taxes <sup>(4)</sup>	138	(73
Other comprehensive loss, net of tax	(8,398	) (14,217
Comprehensive income	\$11,888	\$3,213

<sup>(1)</sup> Reclassification adjustments were not significant during the three months ended January 2, 2016 and December 27, 2014.

<sup>(2)</sup> Tax benefit of \$346 and \$752 was provided on translation adjustments during the three months ended January 2, 2016 and December 27, 2014, respectively.

<sup>(3)</sup> Tax expense (benefit) of \$(18) and \$217 was provided on net gain (loss) on derivative instruments during the three months ended January 2, 2016 and December 27, 2014, respectively.

<sup>(4)</sup> Tax expense (benefit) of \$80 and \$(39) was provided on changes in unrealized gains (losses) on available-for-sale securities for the three months ended January 2, 2016 and December 27, 2014, respectively.

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

	January 2, 2016	October 3, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 142,343	\$ 130,607
Short-term investments	193,831	194,908
Accounts receivable—net of allowances of \$2,733 and \$3,015, respectively	144,595	142,260
Inventories	158,006	156,614
Prepaid expenses and other assets	32,733	28,294
Total current assets	671,508	652,683
Property and equipment, net	99,732	102,445
Goodwill	100,175	101,817
Intangible assets, net	20,070	22,776
Other assets	93,871	89,226
Total assets	\$985,356	\$968,947
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Short-term borrowings	\$5,000	\$—
Accounts payable	28,858	33,379
Income taxes payable	10,557	4,279
Other current liabilities	79,219	84,932
Total current liabilities	123,634	122,590
Other long-term liabilities	51,483	49,939
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Common stock, Authorized—500,000 shares, par value \$.01 per share:		
Outstanding—24,190 shares and 23,970 shares, respectively	241	238
Additional paid-in capital	130,537	128,607
Accumulated other comprehensive loss	(17,911	) (9,513 )
Retained earnings	697,372	677,086
Total stockholders' equity	810,239	796,418
Total liabilities and stockholders' equity	\$985,356	\$968,947

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

	Three Months Ended	
	January 2, 2016	December 27, 2014
Cash flows from operating activities:		
Net income	\$20,286	\$17,430
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,385	6,210
Amortization of intangible assets	2,092	2,180
Deferred income taxes	(3,492)	) 6,988
Stock-based compensation	3,745	4,390
Other non-cash expense	165	360
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(3,646)	) 2,760
Inventories	(3,713)	) 4,715
Prepaid expenses and other assets	(3,551)	) (8,650)
Other assets	(1,047)	) (658)
Accounts payable	(4,252)	) (5,358)
Income taxes payable/receivable	4,575	(7,277)
Other current liabilities	(5,128)	) 7,145
Other long-term liabilities	1,843	816
Net cash provided by operating activities	14,262	31,051
Cash flows from investing activities:		
Purchases of property and equipment	(4,765)	) (5,138)
Proceeds from dispositions of property and equipment	50	568
Purchases of available-for-sale securities	(50,151)	) (43,780)
Proceeds from sales and maturities of available-for-sale securities	51,254	77,370
Net cash provided by (used in) investing activities	(3,612)	) 29,020
Cash flows from financing activities:		
Short-term borrowings	17,160	11,542
Repayments of short-term borrowings	(12,160)	) (11,542)
Issuance of common stock under employee stock option and purchase plans	3,521	3,437
Repurchase of common stock	—	(17,298)
Net settlement of restricted common stock	(5,317)	) (5,200)
Net cash provided by (used in) financing activities	3,204	(19,061)
Effect of exchange rate changes on cash and cash equivalents	(2,118)	) (2,807)
Net increase in cash and cash equivalents	11,736	38,203
Cash and cash equivalents, beginning of period	130,607	91,217
Cash and cash equivalents, end of period	\$142,343	\$129,420
Noncash investing and financing activities:		
Unpaid property and equipment purchases	\$1,499	\$807

See Accompanying Notes to Condensed Consolidated Financial Statements.





Table of Contents

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

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. These interim condensed consolidated financial statements and notes thereto should be read in conjunction with the Coherent, Inc. (referred to herein as the “Company,” “we,” “our,” “us” or “Coherent”) condensed consolidated financial statements and notes thereto filed on Form 10-K for the fiscal year ended October 3, 2015. In the opinion of management, all adjustments necessary for a fair presentation of financial condition and results of operation as of and for the periods presented have been made and include only normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year or any other interim periods. Our fiscal year ends on the Saturday closest to September 30 and our first fiscal quarters include 13 weeks of operations in each fiscal year presented. Fiscal year 2016 includes 52 weeks and fiscal year 2015 includes 53 weeks. Certain reclassifications have been made to the prior period amounts to conform to the current period’s presentation related to the \$28.1 million reclassification of current deferred income tax assets to non-current deferred income tax assets.

2. RECENT ACCOUNTING STANDARDS

Adoption of New Accounting Pronouncement

In November 2015, the FASB issued amended guidance that clarifies that in a classified statement of financial position, an entity shall classify deferred tax liabilities and assets as noncurrent amounts. The new guidance supersedes ASC 740-10-45-5 which required the valuation allowance for a particular tax jurisdiction be allocated between current and noncurrent deferred tax assets for that tax jurisdiction on a pro rata basis. The new standard will become effective for our fiscal year beginning October 2, 2017. We elected to early adopt the standard retrospectively in the first quarter of fiscal 2016, which resulted in the reclassification of \$28.1 million from current deferred income tax assets to non-current deferred income tax assets as of October 3, 2015.

Recently Issued Accounting Pronouncements

In January 2016, the FASB issued amended guidance that revises the recognition and measurement of financial instruments. The new guidance requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income, requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset, and eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The new standard will become effective for our fiscal year beginning September 29, 2018. We are currently assessing the impact of this amended guidance and the timing of adoption.

In September 2015, the FASB issued amended guidance that simplifies the accounting for adjustments made to provisional amounts recognized in a business combination. Under previous guidance, the acquirer retrospectively adjusted the provisional amounts recognized at the acquisition date with a corresponding adjustment to goodwill, and

would have to revise comparative information for prior periods presented in financial statements as needed. The update requires an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The new standard will become effective for our fiscal year beginning October 2, 2017. We are currently assessing the impact of this amended guidance and the timing of adoption.

In May 2014, the FASB amended the Accounting Standards Codification and created a new Topic 606, "Revenue from Contracts with Customers". The new guidance establishes a single comprehensive contract-based model for entities to use in accounting for revenue arising from contracts with customers. The new model significantly changes existing GAAP, requires substantial judgment in its application, and will generally require companies to make more disclosures about

Table of Contents

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

### 3. BUSINESS COMBINATIONS

#### Fiscal 2015 Acquisitions

##### Raydiance, Inc.

On July 24, 2015, we acquired certain assets of Raydiance, Inc. ("Raydiance") for approximately \$5.0 million, excluding transaction costs. Raydiance manufactured complete tools and lasers for ultrafast processing systems and subsystems in the precision micromachining processing market. The Raydiance assets have been included in our Specialty Lasers and Systems segment.

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

Tangible assets	\$1,048
Goodwill	1,552
Intangible assets:	
Existing technology	800
Customer lists	1,600
Total	\$5,000

The purchase price allocated to goodwill was finalized in the first quarter of fiscal 2016 with an increase of \$0.4 million and has been updated from the preliminary allocation in the fourth quarter of fiscal 2015.

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.

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

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

We expensed \$0.1 million of acquisition-related costs as selling, general and administrative expenses in our consolidated statements of operations for our fiscal year 2015.

##### Tinsley Optics

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



Table of Contents

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

Tangible assets:		
Inventories	\$2,263	
Accounts receivable	2,240	
Prepaid expenses and other assets	1,132	
Property and equipment	2,451	
Liabilities assumed	(1,702	)
Deferred tax liabilities	(768	)
Gain on business combination	(1,316	)
Total	\$4,300	

The purchase price was lower than the fair value of net assets purchased, resulting in a gain of \$1.3 million recorded as a separate line item in our consolidated statements of operations for our fiscal year 2015. The Company reassessed the recognition and measurement of identifiable assets acquired and liabilities assumed and concluded that all acquired assets and assumed liabilities were recognized and that the valuation procedures and resulting measures were appropriate.

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.

The gain from the bargain purchase is not subject to income taxation.

We expensed \$0.4 million of acquisition-related costs as selling, general and administrative expenses in our consolidated statements of operations for our fiscal year 2015.

#### 4. FAIR VALUES

We have not changed our valuation techniques in measuring the fair value of any financial assets and liabilities during the period. We recognize transfers between levels within the fair value hierarchy, if any, at the end of each quarter. There were no transfers between levels during the periods presented. As of January 2, 2016 and October 3, 2015, we did not have any assets or liabilities valued based on Level 3 valuations.

Financial assets and liabilities measured at fair value as of January 2, 2016 and October 3, 2015 are summarized below (in thousands):

Table of Contents

	Aggregate Fair Value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Aggregate Fair Value	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs
	January 2, 2016	(Level 1)	(Level 2)	October 3, 2015	(Level 1)	(Level 2)
<b>Assets:</b>						
<b>Cash equivalents:</b>						
Money market fund deposits	\$21,763	\$ 21,763	\$—	\$8,297	\$ 8,297	\$—
Commercial paper <sup>(2)</sup>	9,694	—	9,694	—	—	—
<b>Short-term investments:</b>						
U.S. Treasury and agency obligations <sup>(2)</sup>	\$ 147,487	\$ —	\$ 147,487	\$ 150,748	\$ —	\$ 150,748
Corporate notes and obligations <sup>(2)</sup>	19,803	—	19,803	17,942	—	17,942
Commercial paper <sup>(2)</sup>	9,497	—	9,497	9,740	—	9,740
Equity securities <sup>(1)</sup>	17,044	17,044	—	16,478	16,478	—
<b>Prepaid and other assets:</b>						
Foreign currency contracts <sup>(3)</sup>	1,780	—	1,780	258	—	258
Mutual funds — Deferred comp and supplemental plan <sup>(4)</sup>	14,815	14,815	—	13,891	13,891	—
<b>Total</b>	<b>\$241,883</b>	<b>\$ 53,622</b>	<b>\$ 188,261</b>	<b>\$217,354</b>	<b>\$ 38,666</b>	<b>\$ 178,688</b>
<b>Liabilities:</b>						
<b>Other current liabilities:</b>						
Foreign currency contracts <sup>(3)</sup>	\$(384 )	\$ —	\$(384 )	\$(239 )	\$ —	\$(239 )
Short term borrowings	(5,000 )	(5,000 )	—	—	—	—
<b>Total</b>	<b>\$236,499</b>	<b>\$ 48,622</b>	<b>\$ 187,877</b>	<b>\$217,115</b>	<b>\$ 38,666</b>	<b>\$ 178,449</b>

(1) Valuations are based upon quoted market prices.

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

(3) The principal market in which we execute our foreign currency contracts is the institutional market in an over-the-counter environment with a relatively high level of price transparency. The market participants usually are large commercial banks. Our foreign currency contracts’ valuation inputs are based on quoted prices and quoted pricing intervals from public data sources and do not involve management judgment. At January 2, 2016, prepaid expenses and other assets include \$1,780 non-designated forward contracts and \$0 foreign currency contracts designated for cash flow hedges, respectively; other current liabilities include \$380 non-designated forward contracts and \$4 foreign currency contracts designated for cash flow hedges, respectively. At October 3, 2015, prepaid expenses and other assets include \$217 non-designated forward contracts and \$41 foreign currency contracts designated for cash flow hedges, respectively; other current liabilities include \$239 non-designated forward contracts and \$0 foreign currency contracts designated for cash flow hedges, respectively. See Note 6,

"Derivative Instruments and Hedging Activities".



Table of Contents

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

## 5. 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):

	January 2, 2016			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	\$ 142,343	\$—	\$—	\$ 142,343
Short-term investments:				
Available-for-sale securities:				
Commercial paper	\$9,497	\$—	\$—	\$9,497
U.S. Treasury and agency obligations	146,996	706	(215	) 147,487
Corporate notes and obligations	19,744	104	(45	) 19,803
Equity securities	15,269	1,775	—	17,044
Total short-term investments	\$ 191,506	\$ 2,585	\$(260	) \$ 193,831
	October 3, 2015			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	\$ 130,607	\$—	\$—	\$ 130,607
Short-term investments:				
Available-for-sale securities:				
Commercial paper	\$9,740	\$—	\$—	\$9,740
U.S. Treasury and agency obligations	149,708	1,040	—	150,748
Corporate notes and obligations	17,892	52	(2	) 17,942
Equity Securities	15,269	1,209	—	16,478
Total short-term investments	\$ 192,609	\$ 2,301	\$(2	) \$ 194,908

None of the unrealized losses as of January 2, 2016 or October 3, 2015 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 January 2, 2016 and October 3, 2015 classified as short-term investments on our condensed consolidated balance sheet were as follows (in thousands):



Table of Contents

	January 2, 2016 Amortized Cost	Estimated Fair Value	October 3, 2015 Amortized Cost	Estimated Fair Value
Investments in available-for-sale debt securities due in less than one year	\$ 140,303	\$ 140,835	\$ 148,088	\$ 149,100
Investments in available-for-sale debt securities due in one to five years <sup>(1)</sup>	\$ 35,934	\$ 35,952	\$ 29,252	\$ 29,330

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

During the three months ended January 2, 2016, we received proceeds totaling \$15.1 million from the sale of available-for-sale securities and realized gross gains of less than \$0.1 million. During the three months ended December 27, 2014, we received proceeds totaling \$29.6 million from the sale of available-for-sale securities and realized gross gains of less than \$0.1 million.

## 6. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We maintain operations in various countries outside of the United States and have foreign subsidiaries that manufacture and sell our products in various global markets. The majority of our sales are transacted in U.S. dollars. However, we do generate revenues in other currencies, primarily the Euro, Japanese Yen, South Korean Won and Chinese Renminbi (RMB). As a result, our earnings, cash flows and cash balances are exposed to fluctuations in foreign currency exchange rates. We attempt to limit these exposures through financial market instruments. We utilize derivative instruments, primarily forward contracts with maturities of two months or less, to manage our exposure associated with anticipated cash flows and net asset and liability positions denominated in foreign currencies. Gains and losses on the forward contracts are mitigated by gains and losses on the underlying instruments. We do not use derivative financial instruments for speculative or trading purposes. The credit risk amounts represent the Company's gross exposure to potential accounting loss on derivative instruments that are outstanding or unsettled if all counterparties failed to perform according to the terms of the contract, based on then-current currency or interest rates at each respective date.

### Non-Designated Derivatives

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

Table of Contents

	U.S. Notional Contract Value		U.S. Fair Value	
	January 2, 2016	October 3, 2015	January 2, 2016	October 3, 2015
Euro currency hedge contracts				
Purchase	\$56,001	\$52,699	\$1,500	\$33
Sell	(2,710	) —	19	—
Japanese Yen currency hedge contracts				
Purchase	\$—	\$558	\$—	\$8
Sell	\$(21,743	) \$(15,804	) \$(340	) \$(84
South Korean Won currency hedge contracts				
Purchase	\$—	\$253	\$—	\$—
Sell	\$(14,034	) \$(17,747	) \$131	\$30
Chinese RMB currency hedge contracts				
Sell	\$(9,957	) \$(10,900	) \$37	\$(106
Other foreign currency hedge contracts				
Purchase	\$5,220	\$3,283	\$(30	) \$(49
Sell	\$(5,597	) \$(5,835	) \$83	\$146

## Designated Derivatives

Cash flow hedges related to anticipated transactions are designated and documented at the inception of the hedge when we enter into contracts for specific future transactions. Cash flow hedges are evaluated for effectiveness quarterly. The effective portion of the gain or loss on these hedges is reported as a component of OCI in stockholder's equity and is reclassified into earnings when the underlying transaction affects earnings. The majority of the after-tax net income or loss related to derivative instruments included in OCI at January 2, 2016 is expected to be reclassified into earnings within 12 months. Changes in the fair value of currency forward contracts due to changes in time value are excluded from the assessment of effectiveness and recognized in other income (expense) as incurred. We classify the cash flows from the foreign exchange forward contracts that are accounted for as cash flow hedges in the same section as the underlying item, primarily within cash flows from operating activities since we do not designate our cash flow hedges as investing or financing activities.

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 asset (liability) amounts of designated cash flow hedge contracts, with maximum maturity of thirteen months, are as follows (in thousands):

	U.S. Notional Contract Value		U.S. Fair Value	
	January 2, 2016	October 3, 2015	January 2, 2016	October 3, 2015
Japanese Yen currency hedge contracts				
Sell	\$(901	) \$(2,093	) \$(4	) \$41

We have entered into certain derivative forward contracts to sell Japanese Yen and buy Euro to hedge revenue exposures related to our photonics-based solutions in Asia. In order to facilitate the hedge, we transact with counterparties in the U.S. directly and then allocate the hedge contracts to our affiliates through a back-to-back relationship with our German subsidiary. The German subsidiary designates these hedge contracts as cash flow hedges

under ASC 815.

The fair value of our derivative instruments is included in prepaid expenses and other assets and in other current liabilities in our Condensed Consolidated Balance Sheets (See Note 4).

14

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Table of Contents

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

	Location in financial statements	Three Months Ended	
		January 2, 2016	December 27, 2014
Derivatives designated as hedging instruments			
Gains(losses) in OCI on derivatives (effective portion), after tax	OCI	\$ (30 )	\$ 375
Gains(losses) reclassified from OCI into income (effective portion)	Cost of sales	\$ —	\$ (614 )
Gains(losses) reclassified from OCI into income (effective portion)	Revenue	\$ —	\$ 300
Gains(losses) recognized in income on derivatives (ineffective portion and amount excluded from effectiveness testing)	Other income(expense)	\$ (29 )	\$ 35
Derivatives not designated as hedging instruments			
Losses recognized in income	Other income(expense)	\$ (2,331 )	\$ (712 )

During the first quarter of fiscal 2016 we recognized a loss of \$31 in other income (expense) as ineffectiveness related to a portion of an anticipated hedged transaction that failed to occur within the original hedge period plus two months. The remainder of the hedged transaction is still expected to occur and the effective portion is recorded in OCI as shown in the above table.

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

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

Offsetting of Financial Assets/Liabilities under Master Netting Agreements with Derivative Counterparties as of January 2, 2016 and October 3, 2015 (in thousands):

Table of Contents

	Gross Amounts of Recognized Derivative Assets	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Derivative Assets Presented in the Condensed Consolidated Balance Sheets	Financial Instruments (1)	Cash Collateral Received	Net Amounts	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets
As of January 2, 2016:							
Foreign exchange contracts	\$1,780	\$—	\$1,780	\$(384	) \$—	\$1,396	
As of October 3, 2015:							
Foreign exchange contracts	\$258	\$—	\$258	\$(116	) \$—	\$142	

(1) The balances at January 2, 2016 and October 3, 2015 were related to derivative liabilities which are allowed to be net settled against derivative assets in accordance with the master netting agreements.

	Gross Amounts of Recognized Derivative Liabilities	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Derivative Liabilities Presented in the Condensed Consolidated Balance Sheets	Financial Instruments (1)	Cash Collateral Paid	Net Amounts	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets
As of January 2, 2016:							
Foreign exchange contracts	\$(384	) \$—	\$(384	) \$384	\$—	\$—	
As of October 3, 2015:							
Foreign exchange contracts	\$(239	) \$—	\$(239	) \$116	\$—	\$(123	)

(1) The balances at January 2, 2016 and October 3, 2015 were related to derivative assets which are allowed to be net settled against derivative liabilities in accordance with the master netting agreements.

## 7. GOODWILL AND INTANGIBLE ASSETS

During the three months ended January 2, 2016, we noted no indications of impairment or triggering events to cause us to review goodwill for potential impairment. We will conduct our annual goodwill testing during the fourth fiscal quarter.

The changes in the carrying amount of goodwill by segment for the period from October 3, 2015 to January 2, 2016 are as follows (in thousands):

Specialty	Commercial	Total
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	Lasers and Systems	Lasers and Components	
Balance as of October 3, 2015	\$95,454	\$6,363	\$101,817
Translation adjustments and other	(1,642	) —	(1,642 )
Balance as of January 2, 2016	\$93,812	\$6,363	\$100,175

16

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Table of Contents

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

	January 2, 2016			October 3, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Existing technology	\$70,402	\$(56,517)	\$13,885	\$71,365	\$(55,452)	\$15,913
Customer lists	15,803	(10,027)	5,776	16,099	(9,661)	6,438
Trade name	390	(344)	46	399	(349)	50
In-process research & development	363	—	363	375	—	375
Total	\$86,958	\$(66,888)	\$20,070	\$88,238	\$(65,462)	\$22,776

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

Amortization expense for intangible assets for the three months ended January 2, 2016 and December 27, 2014 was \$2.1 million and \$2.2 million, respectively, which includes \$1.6 million and \$1.7 million, respectively, for amortization of existing technology. The change in the accumulated amortization also includes \$0.7 million and \$0.9 million of foreign exchange impact for the three months ended January 2, 2016 and December 27, 2014, respectively.

At January 2, 2016, estimated amortization expense for the remainder of fiscal 2016, the next five succeeding fiscal years and all fiscal years thereafter are as follows (in thousands):

	Estimated Amortization Expense
2016 (remainder)	\$5,892
2017	6,902
2018	4,247
2019	2,190
2020	684
2021	52
Thereafter	103
Total	\$20,070

## 8. BALANCE SHEET DETAILS

Inventories consist of the following (in thousands):

	January 2, 2016	October 3, 2015
Purchased parts and assemblies	\$49,308	\$50,182
Work-in-process	60,225	56,225
Finished goods	48,473	50,207
Total inventories	\$158,006	\$156,614

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

	January 2, 2016	October 3, 2015
Prepaid and refundable income taxes	\$9,570	\$8,846
Other taxes receivable	6,844	6,574

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Prepaid expenses and other assets	16,319	12,874
Total prepaid expenses and other assets	\$32,733	\$28,294

Other assets consist of the following (in thousands):

17

---

Table of Contents

	January 2, 2016	October 3, 2015
Assets related to deferred compensation arrangements	\$26,202	\$25,131
Deferred tax assets	64,118	60,254
Other assets	3,551	3,841
Total other assets	\$93,871	\$89,226

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

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

	January 2, 2016	October 3, 2015
Accrued payroll and benefits	\$27,689	\$35,504
Deferred revenue	16,805	16,474
Warranty reserve	14,645	15,308
Accrued expenses and other	11,792	10,965
Other taxes payable	5,687	4,888
Customer deposits	2,601	1,793
Total other current liabilities	\$79,219	\$84,932

Components of the reserve for warranty costs during the first three months of fiscal 2016 and 2015 were as follows (in thousands):

	Three Months Ended	
	January 2, 2016	December 27, 2014
Beginning balance	\$15,308	\$16,961
Additions related to current period sales	4,954	5,608
Warranty costs incurred in the current period	(5,390)	(5,135)
Adjustments to accruals related to foreign exchange and other	(227)	(830)
Ending balance	\$14,645	\$16,604

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

	January 2, 2016	October 3, 2015
Long-term taxes payable	\$7,691	\$7,651
Deferred compensation	27,753	26,691
Deferred tax liabilities	2,754	2,717
Deferred revenue	3,495	3,149
Asset retirement obligations liability	2,625	2,654
Other long-term liabilities	7,165	7,077
Total other long-term liabilities	\$51,483	\$49,939

## 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 \$12.9 million of unsecured foreign lines of credit as of January 2, 2016. At January 2, 2016, we had used \$2.9 million of

these available foreign lines of credit as guarantees. These credit facilities were used in Europe and Japan during the first three months of fiscal 2016. In addition, our domestic line of credit consists of a \$50.0 million unsecured revolving credit account. The

Table of Contents

agreement will expire on May 31, 2017. The line of credit is subject to covenants related to financial ratios and tangible net worth with which we are currently in compliance. We have an outstanding balance of \$5.0 million and have used \$1.1 million for letters of credit against our domestic line of credit as of January 2, 2016.

## 10. STOCK-BASED COMPENSATION

## Fair Value of Stock Compensation

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

## Determining Fair Value

The fair values of shares purchased under the Employee Stock Purchase Plan (“ESPP”) for the three months ended January 2, 2016 and December 27, 2014, respectively, were estimated using the following weighted-average assumptions:

	Employee Stock Purchase Plan Three Months Ended		
	January 2, 2016	December 27, 2014	
Expected life in years	0.5	0.5	
Expected volatility	28.7	% 24.8	%
Risk-free interest rate	0.19	% 0.10	%
Expected dividend yield	—	% —	%
Weighted average fair value per share	\$13.27	\$13.97	

There were no stock options granted during the three months ended January 2, 2016 and December 27, 2014.

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

	Three Months Ended		
	January 2, 2016	December 27, 2014	
Risk-free interest rate	1.20	% 0.96	%
Volatility	27.0	% 28.7	%
Weighted average fair value	\$74.48	\$70.57	

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

## Stock Compensation Expense

The following table shows total stock-based compensation expense and related tax benefits included in the condensed consolidated statements of operations for the three months ended January 2, 2016 and December 27, 2014 (in thousands):



Table of Contents

	Three Months Ended	
	January 2, 2016	December 27, 2014
Cost of sales	\$605	\$597
Research and development	426	330
Selling, general and administrative	2,714	3,463
Income tax benefit	(351	) (430
	\$3,394	\$3,960

During the three months ended January 2, 2016, \$0.6 million was capitalized into inventory for all stock plans, \$0.6 million was amortized to cost of sales and \$0.7 million remained in inventory at January 2, 2016. During the three months ended December 27, 2014, \$0.7 million was capitalized into inventory for all stock plans, \$0.6 million was amortized to cost of sales and \$0.8 million remained in inventory at December 27, 2014.

At January 2, 2016, 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 \$30.5 million, net of estimated forfeitures of \$2.9 million. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 1.7 years and will be adjusted for subsequent changes in estimated forfeitures.

At January 2, 2016, total compensation cost related to options to purchase common shares under the ESPP but not yet vested was approximately \$0.6 million, which will be recognized over the six month offering period.

#### Stock Awards Activity

The following table summarizes the activity of our time-based and performance restricted stock units for the first three months of fiscal 2016 (in thousands, except per share amounts):

	Time Based Restricted Stock Units		Performance Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested stock at October 3, 2015	394	\$65.17	199	\$67.09
Granted	231	61.06	57	74.48
Vested <sup>(1)</sup>	(168	) 60.59	(57	) 48.48
Forfeited	(1	) 65.04	(38	) 48.48
Nonvested stock at January 2, 2016	456	\$64.78	161	\$74.09

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

#### 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, now expired in all jurisdictions, 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. Following the filing of the infringement suit, our subsidiaries filed a separate nullity action with the Federal Patent Court in Munich, Germany requesting that the court hold that the Patent was invalid based on prior art. On October 1, 2015, the Federal Patent Court ruled that the German portion of the Patent was invalid. Imra has filed a notice



## Table of Contents

to appeal this decision to the German Supreme Court. The infringement action is currently stayed pending the outcome of such appeal. 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.

The United States and many foreign governments impose tariffs and duties on the import and export of certain products we sell. From time to time our duty calculations and payments are audited by government agencies. We are currently under audit in South Korea for customs duties and value added tax for the period March 2009 to March 2014. Although we do not expect that the audit will ultimately have a material adverse effect on our condensed consolidated financial position, results of operations or cash flows, an adverse result in this matter could negatively affect our results in the period in which it occurs. As of January 2, 2016, management has accrued an estimated liability of \$1.6 million related to this matter, of which \$1.5 million had been paid to date in the second quarter of fiscal 2016.

## 12. STOCK REPURCHASE

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

On January 21, 2015, our Board of Directors authorized an additional stock repurchase program to repurchase up to \$25.0 million of our outstanding common stock from time to time through January 31, 2016. During the fourth quarter of fiscal 2015, we repurchased and retired 430,675 shares of outstanding common stock under this plan at an average price of \$58.05 per share for a total of \$25.0 million.

On August 25, 2015, our Board of Directors authorized an additional stock repurchase program to repurchase up to \$25.0 million of our outstanding common stock from time to time through August 31, 2016. During the fourth quarter of fiscal 2015, we repurchased and retired 437,534 shares of outstanding common stock under this plan at an average price of \$57.14 per share for a total of \$25.0 million.

## 13. EARNINGS PER SHARE

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

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

Table of Contents

	Three Months Ended	
	January 2, 2016	December 27, 2014
Weighted average shares outstanding —basic	23,996	24,936
Dilutive effect of employee stock awards	240	261
Weighted average shares outstanding—diluted	24,236	25,197
Net income	\$20,286	\$17,430
Net income per basic share	\$0.85	\$0.70
Net income per diluted share	\$0.84	\$0.69

A total of 32,213 and 159,618 potentially dilutive securities have been excluded from the diluted share calculation for the three months ended January 2, 2016 and December 27, 2014, respectively as their effect was anti-dilutive.

## 14. OTHER INCOME (EXPENSE)

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

	Three Months Ended	
	January 2, 2016	December 27, 2014
Foreign exchange loss	\$(1,322	) \$(1,161
Gain on deferred compensation investments, net	875	384
Other	—	7
Other - net	\$(447	) \$(770

## 15. INCOME TAXES

Income tax expense includes a provision for federal, state and foreign taxes based on the annual estimated effective tax rate applicable to us and our subsidiaries, adjusted for items which are considered discrete to the period. Our effective tax rate for the three months ended January 2, 2016 was 25.0%. Our effective tax rate for the three months ended January 2, 2016 was lower than the statutory rate of 35% primarily due to differences related to the benefit of income subject to foreign tax rates that are lower than U.S. tax rates including the Singapore tax exemption, the benefit of foreign tax credits and the benefit of federal research and development tax credits including renewal of the federal research and development tax credits for fiscal 2015. These amounts are partially offset by deemed dividend inclusions under the Subpart F tax rules, stock-based compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m).

The effective tax rate on income before income taxes for the first quarter of fiscal 2015 of 26.2% was lower than the statutory rate of 35.0% primarily due to differences related to the benefit of income subject to foreign tax rates that are lower than U.S. tax rates including South Korea and Singapore tax exemptions, the benefit of foreign tax credits and the benefit of federal research and development tax credits including renewal of the federal research and development tax credits for fiscal 2014. These amounts are partially offset by deemed dividend inclusions under the Subpart F tax rules, stock-based compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m).

Determining the consolidated provision for income taxes, income tax liabilities and deferred tax assets and liabilities involves judgment. We calculate and provide for income taxes in each of the tax jurisdictions in which we operate, which involves estimating current tax exposures as well as making judgments regarding the recoverability of deferred

tax assets in each jurisdiction. The estimates used could differ from actual results, which may have a significant impact on operating results in future periods.

Table of Contents

We are subject to taxation and file income tax returns in the U.S. federal jurisdiction and in many state and foreign jurisdictions. For U.S. federal income tax purposes, all years prior to 2011 are closed. In our major foreign jurisdictions and our major state jurisdictions, the years prior to 2006 and 2011, 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. In September 2015, the German tax authorities issued preliminary tax findings for Coherent GmbH for the years 2006 to 2010 and Coherent management met with the German tax authorities in December 2015 to discuss the preliminary assessments. In July 2015, Coherent Kaiserslautern GmbH (formerly Lumera Laser GmbH) received a tax audit notice for the years 2010 to 2013. The audit began in August 2015. We acquired the shares of Lumera Laser GmbH in December 2012 and we should not have responsibility for any assessments related to the pre-acquisition period.

Management believes that it has adequately provided reserves 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.

The Consolidated Appropriations Act of 2016 (“the Act”), was enacted on December 18, 2015. Under the Act, the federal research and development tax credit was retroactively extended for amounts paid or incurred after December 31, 2014 through December 31, 2015 and the credit was made permanent. The effects of the change in the tax law are recognized in our first quarter of fiscal 2016, which is the quarter that the law was enacted. Accordingly, prior year research and development tax credits of approximately \$1.2 million, after netting with appropriate reserves, were recognized in the first quarter of fiscal 2016.

## 16. SEGMENT INFORMATION

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

	Three Months Ended	
	January 2, 2016	December 27, 2014
Net sales:		
Specialty Laser Systems	\$ 135,951	\$ 145,091
Commercial Lasers and Components	54,324	55,524
Total net sales	\$ 190,275	\$ 200,615
Income from operations:		
Specialty Laser Systems	\$ 35,795	\$ 34,554
Commercial Lasers and Components	1,815	1,825 703
Corporate and other	(10,327	) (10,948
Total income from operations	27,283	24,309
Total other expense, net	(222	) (685
Income before income taxes	27,061	23,624
Provision for income taxes	6,775	6,194
Net Income	\$ 20,286	\$ 17,430

### Major Customers

We had one major customer during the three months ended January 2, 2016 who accounted for 17.6% of consolidated revenue. We had another major customer who accounted for 10.6% and 18.6% of consolidated revenue for the three months ended January 2, 2016 and December 27, 2014, respectively. The customers purchased primarily from our SLS segment.

## Table of Contents

We had one major customer who accounted for 22.8% of accounts receivable at January 2, 2016. We had another major customer who accounted for 16.3% and 21.4% of accounts receivable at January 2, 2016 and October 3, 2015, respectively. The customers purchased primarily from our SLS segment.

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

### COMPANY OVERVIEW

#### BUSINESS BACKGROUND

We are one of the world's leading providers of lasers and laser-based technology in a broad range of scientific, commercial and industrial 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 original equipment manufacturer ("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, OEM components and instrumentation and microelectronics.

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

#### MARKET APPLICATIONS

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

#### OUR STRATEGY

We strive to develop innovative and proprietary products and solutions that meet the needs of our customers and that are based on our core expertise in lasers and optical technologies. In pursuit of our strategy, we intend to: Leverage our technology portfolio and application engineering to lead the proliferation of photonics into broader markets—We will continue to identify opportunities in which our technology portfolio and application engineering can be used to offer innovative solutions and gain access to new markets. We plan to utilize our expertise to increase our market share in the mid to high power material processing applications.

Optimize our leadership position in existing markets—There are a number of markets where we have historically been at the forefront of technological development and product deployment and from which we have derived a substantial portion of our revenues. We plan to optimize our financial returns from these markets.

Maintain and develop additional strong collaborative customer and industry relationships—We believe that the Coherent brand name and reputation for product quality, technical performance and customer satisfaction will help us to further develop our loyal customer base. We plan to maintain our current customer relationships and develop new ones with customers who are industry leaders and work together with these customers to design and develop innovative product systems and solutions as they develop new technologies.

Develop and acquire new technologies and market share—We will continue to enhance our market position through our existing technologies and develop new technologies through our internal research and development

## Table of Contents

efforts, as well as through the acquisition of additional complementary technologies, intellectual property, manufacturing processes and product offerings.

Streamline our manufacturing structure and improve our cost structure—We will focus on optimizing the mix of products that we manufacture internally and externally. We will utilize vertical integration where our internal manufacturing process is considered proprietary and seek to leverage external sources when the capabilities and cost structure are well developed and on a path towards commoditization.

Focus on long-term improvement of adjusted EBITDA, in dollars and as a percentage of net sales—We define adjusted EBITDA as operating income adjusted for depreciation, amortization, stock compensation expenses, major restructuring costs and certain other non-operating income and expense items. Key initiatives to reach our goals for EBITDA improvements include utilization of our Asian manufacturing locations, rationalizing our supply chain and continued leveraging of our infrastructure.

## APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America and pursuant to the rules and regulations of the SEC. The preparation of these condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We have identified the following as the items that require the most significant judgment and often involve complex estimation: revenue recognition, accounting for long-lived assets (including goodwill and intangible assets), inventory valuation, warranty reserves, stock-based compensation and accounting for income taxes. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for our fiscal year ended October 3, 2015.

## 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.



Table of Contents

	Three Months Ended		Change	% Change	
	January 2, 2016	December 27, 2014			
	(Dollars in thousands)				
Bookings	\$273,004	\$162,524	\$110,480	68.0	%
Book-to-bill ratio	1.43	0.81	0.62	76.5	%
Net sales—Specialty Lasers and Systems	\$135,951	\$145,091	\$(9,140)	(6.3)	)%
Net sales—Commercial Lasers and Components	\$54,324	\$55,524	\$(1,200)	(2.2)	)%
Gross profit as a percentage of net sales—Specialty Lasers and Systems	47.6	% 44.0	% 3.6	% 8.2	%
Gross profit as a percentage of net sales—Commercial Lasers and Components	36.4	% 34.7	% 1.7	% 4.9	%
Research and development as a percentage of net sales	10.1	% 9.6	% 0.5	% 5.2	%
Income before income taxes	\$27,061	\$23,624	\$3,437	14.5	%
Net cash provided by operating activities	\$14,262	\$31,051	\$(16,789)	(54.1)	)%
Days sales outstanding in receivables	68.4	58.5	9.9	16.9	%
Annualized first quarter inventory turns	2.7	2.9	(0.2)	(6.9)	)%
Capital spending as a percentage of net sales	2.5	% 2.6	% (0.1)	)% (3.8)	)%
Net income as a percentage of net sales	10.7	% 8.7	% 2.0	% 23.0	%
Adjusted EBITDA as a percentage of net sales	21.3	% 18.7	% 2.6	% 13.9	%

Definitions and analysis of these performance indicators are as follows:

#### Bookings and Book-to-Bill Ratio

Bookings represent orders received during the current period for products and services to be provided pursuant to service contracts. While we generally have not experienced a significant rate of cancellation, bookings are generally cancelable by our customers without substantial penalty and, therefore, we cannot assure all bookings will be converted to net sales.

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

Bookings were a new quarterly record and increased 68.0% in the first quarter of fiscal 2016 compared to the same quarter one year ago, led by a significant increase in the microelectronics market. Compared to the fourth quarter of fiscal 2015, bookings increased 32.9% with a significant increase in the microelectronics market partially offset by decreases in the materials processing and OEM components and instrumentation markets. The book-to-bill ratio was 1.43 in the first quarter of fiscal 2016.

Backlog represents orders which we expect to be shipped within 12 months and the current portion of service contracts. For a discussion of backlog, see “BACKLOG”.

#### Microelectronics

Microelectronics bookings were a new quarterly record and increased 162% compared to the same quarter one year ago and 94% from bookings in the fourth quarter of fiscal 2015. The microelectronics book-to-bill ratio for the first quarter of fiscal 2016 was 1.96.

Record flat panel display orders in the first quarter of fiscal 2016 increased 497% from orders in the first quarter of fiscal 2015 and 152% from orders in the fourth quarter of fiscal 2015, primarily due to the timing of order placement by customers, with orders received from multiple customers for large format Linebeam systems to be used in organic light-emitting diode (OLED) production. In the second quarter of fiscal 2016, we have received additional Linebeam system orders and we believe that there

## Table of Contents

are additional orders pending for the balance of the second quarter and for the remainder of fiscal 2016. In order to meet our delivery commitments, we are expanding our footprint in Göttingen, Germany, adding optics fabrication capacity at our site in Richmond, California and increasing purchases of certain long-lead time supplies. We expect that deliveries for these large orders already received will begin in the third quarter of fiscal 2016 and run through calendar 2017. Despite the recent increase in orders for flat panel display systems, we expect continued fluctuations in order volumes on a quarterly basis going forward.

Orders in the advanced packaging (API) market decreased 38% from orders in the first quarter of fiscal 2015 and decreased 25% from orders in the fourth quarter of fiscal 2015. API equipment manufacturers have adopted a more cautionary posture for legacy products based on recent trends in the semiconductor market. We believe that flex packaging and system in package ("SiP") are two applications that are promising in the API market. Flex packaging, which relies upon UV lasers, is used in mobile and wearable devices and several systems manufacturers have seen strength in this area. SiP has been building momentum in mobile devices and future smartphones are likely to incorporate more SiP design elements, which we believe will lead to an increase in ultrafast lasers for packaging.

Orders from semiconductor capital equipment OEMs decreased 6% from the first quarter of fiscal 2015 but increased 10% from the fourth quarter of fiscal 2015. The correlation between semiconductor inventories and fab utilization rates was evident in the first quarter of fiscal 2016, with inventories rising and utilization dipping. We experienced a predictable response in our service business skewed towards legacy nodes, but new system orders improved for a second consecutive quarter and we believe these orders are linked to specific capacity expansions rather than signaling the start of a broader cycle.

### Materials Processing

Materials processing orders decreased 15% compared to the same quarter one year ago and decreased 39% from the fourth quarter of fiscal 2015. The materials processing book-to-bill ratio for the first quarter of fiscal 2016 was 0.88. Bookings were adversely affected by the timing of certain orders, a slowdown in China and seasonality. We have been working on a number of projects for marking new materials and expected orders in the first or second quarter of fiscal 2016, but these orders have been delayed as final details of the process window and tool configuration are being finalized. China was stable in fiscal 2015, but the market softened in the first quarter of fiscal 2016 and inventories have been trimmed accordingly. Customers are citing volatility of the Chinese stock market and the ensuing impact on consumer confidence as the main reason for the softening market, with some additional contribution from the devaluation of the Chinese currency that have made imports more expensive. This has more of an effect upon the low end of the laser market where local alternatives are available and is less of an issue at higher performance levels. Overall, our outlook for China in fiscal 2016 is neutral with specific projects offsetting market uncertainty. We are scheduled to begin deliveries of our second-generation fiber laser platform in the second quarter of fiscal 2016, an important step towards validating our platform and building a position in the market.

### OEM Components and Instrumentation

OEM Components and Instrumentation orders decreased 5% compared to the same quarter one year ago and 27% from the fourth quarter of fiscal 2015. The book-to-bill ratio for the first quarter of fiscal 2016 was 0.76.

Instrumentation orders decreased 20% compared to the same quarter one year ago and 47% compared to the fourth quarter of fiscal 2015 due to timing of orders coming off the high orders in the fourth quarter of fiscal 2015. The large decrease from the fourth quarter of fiscal 2015 is primarily a result of order timing in the instrumentation business with a smaller macro effect in the medical OEM market. Bioinstrumentation customers remain positive on their opportunities in personalized medicine, especially for age-related, chronic diseases and the fight against global epidemics, which is driving growth in dedicated, tabletop instruments. We are seeing our customers increasing their

investment in two areas: expanding their bioassay or reagent portfolio and introducing dedicated tools to support testing. For dedicated tools to support testing, we are developing multi-wavelength, plug-and-play light engines based upon our OBIS™ and BioRay™ platforms.

Orders for medical OEM products decreased 10% compared to the same quarter one year ago and 9% compared to the fourth quarter of fiscal 2015. The medical OEM market experienced some slowdowns from inventory management tied to concerns about China. Much of the market focus is on cataract treatment and dental procedures. Testing of our Monaco™ laser for cataracts is proceeding well and our position for next generation tools is strengthening. Within the dental market, reviews for the CO<sub>2</sub>-based procedure have been positive and we believe our products are positioned to be successfully adopted by customers in this market.

Scientific and Government Programs

## Table of Contents

Scientific and government programs orders decreased 3% compared to the same quarter one year ago and increased 1% from the fourth quarter of fiscal 2015. The book-to-bill for the first quarter of fiscal 2016 was 1.07.

Demand for amplified ultrafast systems including the Astrella™, Libra™ and Legend™ series remained strong across all regions, with key contributions from the biological imaging market. We saw market share growth in Japan due to the Chameleon™ Discovery being qualified with a major microscope vendor. In addition we see a shift from the traditional microscope companies to smaller players that specialize in neuroscience solutions. On a geographic basis, China was particularly strong as institutions spent the remaining funds in the last quarter of the country's prior five-year plan.

### Net Sales

Net sales include sales of lasers, laser tools, related accessories and service. Net sales for the first fiscal quarter decreased 6.3% in our SLS segment and decreased 2.2% in our CLC segment from the same quarter one year ago. For a description of the reasons for changes in net sales refer to the "Results of Operations" section of this quarterly report.

### Gross Profit as a Percentage of Net Sales

Gross profit as a percentage of net sales ("gross profit percentage") is calculated as gross profit for the period divided by net sales for the period. Gross profit percentage in the first quarter increased from 44.0% to 47.6% in our SLS segment and increased from 34.7% to 36.4% in our CLC segment from the same quarter one year ago. For a description of the reasons for changes in gross profit refer to the "Results of Operations" section of this quarterly report.

### Research and Development as a Percentage of Net Sales

Research and development as a percentage of net sales ("R&D percentage") is calculated as research and development expense for the period divided by net sales for the period. Management considers R&D percentage to be an important indicator in managing our business as investing in new technologies is a key to future growth. R&D percentage increased to 10.1% from 9.6% in our first fiscal quarter compared to the same period one year ago. For a description of the reasons for changes in R&D spending refer to the "Results of Operations" section of this quarterly report.

### Net Cash Provided by Operating Activities

Net cash provided by operating activities as reflected on our Condensed Consolidated Statements of Cash Flows primarily represents the excess of cash collected from billings to our customers and other receipts over cash paid to our vendors for expenses and inventory purchases to run our business. We believe that cash flows from operations is an important performance indicator because cash generation over the long term is essential to maintaining a healthy business and providing funds to help fuel growth. For a description of the reasons for changes in Net Cash Provided by Operating Activities refer to the "Liquidity and Capital Resources" section of this quarterly report.

### Days Sales Outstanding in Receivables

We calculate days sales outstanding ("DSO") in receivables as net receivables at the end of the period divided by net sales during the period and then multiplied by the number of days in the period, using 90 days for quarters. DSO in receivables indicates how well we are managing our collection of receivables, with lower DSO in receivables resulting in higher working capital availability. The more money we have tied up in receivables, the less money we have available for research and development, acquisitions, expansion, marketing and other activities to grow our business. Our DSO in receivables for the first quarter of fiscal 2016 increased from 58.5 days to 68.4 days compared to the same quarter one year ago primarily due to the timing of flat panel display system sales towards the end of the quarter in Japan, slower collections in the U.S. and Asia, and the unfavorable impact of foreign exchange rates.

### Annualized Third Quarter Inventory Turns

We calculate annualized first quarter inventory turns as the cost of sales during the first quarter annualized and divided by net inventories at the end of the first quarter. This indicates how well we are managing our inventory levels, with higher inventory turns resulting in more working capital availability and a higher return on our investments in inventory. The more money we have tied up in inventory, the less money we have available for research and development, acquisitions, expansion, marketing and other activities to grow our business. Our annualized inventory turns for the first quarter of fiscal 2016 decreased from 2.9 to 2.7 turns compared to the same quarter one year ago primarily due to the planned build-up of inventory levels in certain business units to support increased demand.

Table of Contents

## Capital Spending as a Percentage of Net Sales

Capital spending as a percentage of net sales (“capital spending percentage”) is calculated as capital expenditures for the period divided by net sales for the period. Capital spending percentage indicates the extent to which we are expanding or improving our operations, including investments in technology and equipment. Management monitors capital spending levels as this assists management in measuring our cash flows, net of capital expenditures. Our capital spending percentage decreased to 2.5% from 2.6% for the first quarter compared to the same period one year ago primarily due to lower purchases of production-related assets partially offset by lower revenues in the first quarter of fiscal 2016. We expect higher capital spending in the remainder of fiscal 2016 to expand our footprint in Göttingen, Germany and add optics fabrication capacity at our site in Richmond, California.

## Adjusted EBITDA as a Percentage of Net Sales

We define adjusted EBITDA as operating income adjusted for depreciation, amortization, stock compensation expenses, major restructuring costs and certain other non-operating income and expense items. Key initiatives to reach our goals for EBITDA improvements include utilization of our Asian manufacturing locations, rationalizing our supply chain and continued leveraging of our infrastructure.

We utilize a number of different financial measures, both GAAP and non-GAAP, such as adjusted EBITDA as a percentage of net sales, in analyzing and assessing our overall business performance, for making operating decisions and for forecasting and planning future periods. We consider the use of non-GAAP financial measures helpful in assessing our current financial performance and ongoing operations. While we use non-GAAP financial measures as a tool to enhance our understanding of certain aspects of our financial performance, we do not consider these measures to be a substitute for, or superior to, the information provided by GAAP financial measures. We provide adjusted EBITDA in order to enhance investors' understanding of our ongoing operations. This measure is used by some investors when assessing our performance.

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

	Three Months Ended		
	January 2, 2016	December 27, 2014	
Net income as a percentage of net sales	10.7	% 8.7	%
Income tax expense	3.5	% 3.1	%
Interest and other income (expense), net	0.6	% 0.6	%
Depreciation and amortization	4.5	% 4.1	%
Stock-based compensation	2.0	% 2.2	%
Adjusted EBITDA as a percentage of net sales	21.3	% 18.7	%

## RESULTS OF OPERATIONS

## CONSOLIDATED SUMMARY

The following table sets forth, for the periods indicated, the percentage of total net sales represented by the line items reflected in our condensed consolidated statements of operations:





Table of Contents

	Three Months Ended			
	January 2, 2016	December 27, 2014		
Net sales	100.0	% 100.0		%
Cost of sales	55.9	% 59.0		%
Gross profit	44.1	% 41.0		%
Operating expenses:				
Research and development	10.1	% 9.6		%
Selling, general and administrative	19.3	% 19.0		%
Amortization of intangible assets	0.4	% 0.3		%
Total operating expenses	29.8	% 28.9		%
Income from operations	14.3	% 12.1		%
Other expense	(0.1)	)% (0.3)		)%
Income before income taxes	14.2	% 11.8		%
Provision for income taxes	3.5	% 3.1		%
Net income	10.7	% 8.7		%

Net income for the first quarter of fiscal 2016 was \$20.3 million (\$0.84 per diluted share) including \$3.4 million of after-tax stock-related compensation expense, \$1.4 million amortization of intangible assets and a benefit of \$1.2 million related to the renewal of the federal research and development tax credits for fiscal 2015. Net income for the first quarter of fiscal 2015 was \$17.4 million (\$0.69 per diluted share) including \$4.0 million of after-tax stock-related compensation expense, \$1.6 million amortization of intangible assets and a benefit of \$1.1 million related to the renewal of the federal research and development tax credits for fiscal 2014.

**BACKLOG**

Backlog represents orders which we expect to be shipped within 12 months and the current portion of service contracts. Orders used to compute backlog are generally cancelable and subject to rescheduling by our customers without substantial penalties. Historically, we have not experienced a significant rate of cancellation or rescheduling, though we cannot guarantee that the rate of cancellations or rescheduling will not increase in the future. We have a backlog of orders shippable within 12 months of \$370.0 million at January 2, 2016, including a significant concentration in the flat panel display market (46%) for customers which are primarily in Asia.

**NET SALES****Market Application**

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

	Three Months Ended			December 27, 2014	
	January 2, 2016	Percentage of total net sales		Amount	Percentage of total net sales
Consolidated:					
Microelectronics	\$96,506	50.7	% \$99,311	49.5	%
OEM components and instrumentation	39,333	20.7	% 41,289	20.6	%
Materials processing	23,034	12.1	% 28,758	14.3	%

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Scientific and government programs	31,402	16.5	%	31,257	15.6	%
Total	\$190,275	100.0	%	\$200,615	100.0	%

30

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Table of Contents

Net sales for the first quarter of fiscal 2016 decreased by \$10.3 million, or 5%, compared to the first quarter of fiscal 2015, including decreases due to the unfavorable impact of foreign exchange rates. Sales decreased in the materials processing, microelectronics and OEM components and instrumentation markets.

Sales in the materials processing market decreased \$5.7 million, or 20%, primarily due to lower shipments for cutting and other materials processing applications. The decrease in the microelectronics market of \$2.8 million, or 3%, was primarily due to lower shipments for advanced packaging and micro materials processing applications partially offset by higher shipments for semiconductor applications. The decrease in the OEM components and instrumentation market of \$2.0 million, or 5%, was due primarily to lower shipments for medical and machine vision applications partially offset by higher shipments for military and bio-instrumentation applications. Sales in the scientific and government programs market increased less than 1%.

The timing for shipments of our higher average selling price excimer products in the flat panel display market have historically fluctuated and are in the future expected to fluctuate from quarter-to-quarter due to customer scheduling, our ability to manufacture these products and/or availability of supplies. As a result, the timing to convert orders for these products to net sales will likely fluctuate from quarter-to-quarter.

## Segments

We are organized into two reportable operating segments: SLS and CLC. SLS develops and manufactures configurable, advanced-performance products largely serving the microelectronics, scientific research and government programs and OEM components and instrumentation markets. CLC focuses on higher volume products that are offered in set configurations. CLC's primary markets include materials processing, OEM components and instrumentation and microelectronics.

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

	Three Months Ended		December 27, 2014		
	January 2, 2016	Percentage of total net sales	Amount	Percentage of total net sales	
Consolidated:					
Specialty Lasers and Systems (SLS)	\$135,951	71.4	% \$145,091	72.3	%
Commercial Lasers and Components (CLC)	54,324	28.6	% 55,524	27.7	%
Total	\$190,275	100.0	% \$200,615	100.0	%

Net sales for the first quarter of fiscal 2016 decreased by \$10.3 million, or 5%, compared to the first quarter of fiscal 2015, with decreases of \$9.1 million, or 6%, in our SLS segment and decreases of \$1.2 million, or 2%, in our CLC segment. The decreases in both SLS and CLC segment sales included decreases due to the unfavorable impact of foreign exchange rates.

The decrease in our SLS segment sales was primarily due to lower advanced packaging, medical and materials processing application sales. The decrease in our CLC segment sales was primarily due to lower materials processing and machine vision application sales partially offset by higher sales to the bio-instrumentation market.

## GROSS PROFIT

Consolidated

Our gross profit rate increased to 44.1% in the first quarter of fiscal 2016 from 41.0% in the first quarter of fiscal 2015.

The increase in the gross profit rate was primarily due to favorable product margins (2.8%) as a result of favorable mix for both service and systems in the microelectronics market, particularly in flat panel display applications, and the favorable impact from foreign currency fluctuations partially offset by the unfavorable impact of the acquisitions of Tinsley and Raydiance in the fourth quarter of fiscal 2015. Also contributing to the increase in gross profit rate were lower warranty costs (0.2%) due to fewer warranty events.

Our gross profit rate has been and will continue to be affected by a variety of factors including market and product mix, pricing on volume orders, shipment volumes, our ability to manufacture advanced and more complex products, manufacturing

Table of Contents

efficiencies, excess and obsolete inventory write-downs, warranty costs, amortization of intangibles, pricing by competitors or suppliers, new product introductions, production volume, customization and reconfiguration of systems, commodity prices and foreign currency fluctuations, particularly the recent weakening of the Euro and a lesser extent, the Japanese Yen and South Korean Won.

## Specialty Lasers and Systems

The gross profit rate in our SLS segment increased to 47.6% in the first quarter of fiscal 2016 from 44.0% in the first quarter of fiscal 2015.

The 3.6% first quarter increase in the gross profit rate was primarily due to favorable product margins (3.2%) resulting from favorable product mix and pricing in the microelectronics market related to improved mix and pricing with a favorable service revenue mix and improved mix and pricing in system shipments to the flat panel display market. In addition, the favorable impact from foreign currency fluctuations as well as favorable mix in the scientific and government programs market partially offset by the unfavorable impact of the acquisitions of Tinsley and Raydiance in the fourth quarter of fiscal 2015 impacted the gross profit rate. Also contributing to the increase in gross profit rate were lower warranty costs (0.4%) due to fewer warranty events.

## Commercial Lasers and Components

The gross profit rate in our CLC segment increased to 36.4% in the first quarter of fiscal 2016 from 34.7% in the first quarter of fiscal 2015.

The 1.7% first quarter increase in the gross profit rate was primarily due to favorable product margins (2.1%) and lower other costs (0.1%) as a percentage of sales due to lower freight costs and lower inventory provisions in certain business units partially offset by higher warranty costs (0.5%) due to more warranty events. The 2.1% product margin improvement results from favorable product mix in the OEM components and instrumentation and materials processing markets.

## OPERATING EXPENSES:

	Three Months Ended		December 27, 2014		
	January 2, 2016	Percentage of total net sales	Amount	Percentage of total net sales	
	Amount				
	(Dollars in thousands)				
Research and development	\$19,140	10.1	% \$19,173	9.6	%
Selling, general and administrative	36,774	19.3	% 38,141	19.0	%
Amortization of intangible assets	701	0.4	% 696	0.3	%
Total operating expenses	\$56,615	29.8	% \$58,010	28.9	%

## Research and development

Research and development (“R&D”) expenses were flat during the first fiscal quarter ended January 2, 2016 compared to the same quarter one year ago. Lower project spending of \$0.7 million was primarily due to the favorable impact of foreign exchange rates and lower spending on various projects partially offset by lower customer reimbursements for development projects. Offsetting the lower project spending were increases of \$0.7 million due to incremental spending from the acquisitions of Tinsley and Raydiance in the fourth quarter of fiscal 2015. On a segment basis as

compared to the prior year period, SLS research and development spending decreased \$0.1 million primarily due to lower net spending on projects partially offset by the impact of the acquisitions of Tinsley and Raydiance. CLC spending was flat with lower project spending offset by lower customer reimbursements. Corporate and other spending increased \$0.1 million due to higher stock-based compensation expense.

#### Selling, general and administrative

Selling, general and administrative (“SG&A”) expenses decreased \$1.4 million or 4%, during the first fiscal quarter ended January 2, 2016 compared to the same quarter one year ago. The decrease was primarily due to lower payroll spending (\$0.9

## Table of Contents

million) resulting from the favorable impact of foreign exchange rates and lower variable compensation and \$0.9 million lower stock-based compensation expense due to higher estimated forfeitures. The decreases were partially offset by \$0.3 million higher charges for increases in deferred compensation plan liabilities and \$0.1 million higher other net variable spending resulting from incremental spending from the acquisitions of Tinsley and Raydiance in the fourth quarter of fiscal 2015 and higher other consulting costs net of the favorable impact of foreign exchange rates. On a segment basis as compared to the prior year period, SLS segment expenses decreased \$0.2 million primarily due to lower payroll spending partially offset by higher other net variable spending. CLC spending decreased \$0.5 million primarily due to lower payroll spending and lower other net variable spending. Corporate and other spending decreased \$0.7 million primarily due to lower stock-based compensation expense net of higher charges for increases in deferred compensation plan liabilities.

### Amortization of intangible assets

Amortization of intangible assets was flat in the three months ended January 2, 2016 compared to the same period last year. Increases due to the acquisition of Raydiance in the fourth quarter of fiscal 2015 were offset by the completion of amortization of certain intangibles from prior acquisitions.

### OTHER INCOME (EXPENSE) — NET

Other expense, net of other income, decreased \$0.5 million during the three months ended January 2, 2016 compared to the same period one year ago. The decrease in net other expense was primarily due to \$0.5 million higher gains, net of expenses, on our deferred compensation plan assets and \$0.1 million higher interest income partially offset by higher net foreign exchange losses (\$0.2 million).

### INCOME TAXES

The effective tax rate on income before income taxes for the first quarter of fiscal 2016 of 25.0% was lower than the statutory rate of 35.0% primarily due to differences related to the benefit of income subject to foreign tax rates that are lower than U.S. tax rates including the Singapore tax exemption, the benefit of foreign tax credits and the benefit of federal research and development tax credits including renewal of the federal research and development credits for fiscal 2015. These amounts are partially offset by deemed dividend inclusions under the Subpart F tax rules, stock-based compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m).

The effective tax rate on income before income taxes for the first quarter of fiscal 2015 of 26.2% was lower than the statutory rate of 35.0% primarily due to differences related to the benefit of income subject to foreign tax rates that are lower than U.S. tax rates including South Korea and Singapore tax exemptions, the benefit of foreign tax credits and the benefit of federal research and development tax credits including renewal of the federal research and development credits for fiscal 2014. These amounts are partially offset by deemed dividend inclusions under the Subpart F tax rules, stock-based compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m).

### LIQUIDITY AND CAPITAL RESOURCES

At January 2, 2016, we had assets classified as cash and cash equivalents and short-term investments, in an aggregate amount of \$336.2 million, compared to \$325.5 million at October 3, 2015. At January 2, 2016, approximately \$294.1 million of this cash and securities was held in certain of our foreign subsidiaries, \$78.9 million of which was denominated in currencies other than the U.S. dollar. We currently have approximately \$287.6 million of cash held by foreign subsidiaries where we intend to permanently reinvest our accumulated earnings in these entities and our

current plans do not demonstrate a need for these funds to support our domestic operations. If, however, a portion of these funds were needed for and distributed to our operations in the United States, we would be subject to additional U.S. income taxes and foreign withholding taxes. The amount of the taxes due would depend on the amount and manner of repatriation, as well as the location from where the funds are repatriated. We actively monitor the third-party depository institutions that hold these assets, primarily focusing on the safety of principal and secondarily maximizing yield on these assets. We diversify our cash and cash equivalents and investments among various financial institutions, money market funds, sovereign debt and other securities in order to reduce our exposure should any one of these financial institutions or financial instruments fail or encounter difficulties. To date, we have not experienced any material loss or lack of access to our invested cash, cash equivalents or short-term investments. However, we can provide no assurances that access to our invested cash, cash equivalents or short-term investments will not be impacted by adverse conditions in the financial markets.

In the first quarter of fiscal 2016, the second quarter of fiscal 2015 and the fourth quarter of fiscal 2014, we converted \$33.0 million, \$42.3 million and \$62.7 million, respectively, of cash and securities held in certain of our foreign subsidiaries to U.S.



Table of Contents

dollars and invested those funds within a European subsidiary whose functional currency is the U.S. dollar. At January 2, 2016, this subsidiary had \$203.1 million of U.S. dollar denominated investments primarily in U.S. Treasury Securities, corporate notes and commercial paper. Accordingly, there is no translation expense arising from this entity holding U.S. dollar denominated investments. The converted funds are not intended to be repatriated to the U.S. and no U.S. tax was triggered on the transfer of these funds to the European subsidiary. See ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK below for more information about risks and trends related to foreign currencies.

## Sources and Uses of Cash

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

	Three Months Ended	
	January 2, 2016	December 27, 2014
	(in thousands)	
Net cash provided by operating activities	\$14,262	\$31,051
Sales of shares under employee stock plans	3,521	3,437
Repurchase of common stock	—	(17,298)
Capital expenditures	(4,765)	(5,138)
Short-term borrowings, net of repayments	5,000	—

Net cash provided by operating activities decreased by \$16.8 million for the first three months of fiscal 2016 compared to the same period one year ago. The decrease in cash provided by operating activities was primarily due to lower cash flows from the timing of shipments of large systems from inventory and lower cash flows from accounts receivable. We believe that our existing cash, cash equivalents and short term investments combined with cash to be provided by operating activities and amounts available under our lines of credit will be adequate to cover our working capital needs and planned capital expenditures for at least the next 12 months to the extent such items are known or are reasonably determinable based on current business and market conditions. However, we may elect to finance certain of our capital expenditure requirements through additional borrowings under our bank credit facilities or other sources of capital. We continue to follow our strategy to further strengthen our financial position by using available cash flow to fund operations.

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

In fiscal 2015, under plans authorized by the Board of Directors, we repurchased and retired 1,302,323 shares of outstanding common stock at an average price of \$57.59 per share for a total of \$75.0 million.

Additional sources of cash available to us were domestic and international currency lines of credit and bank credit facilities totaling \$62.9 million as of January 2, 2016, of which \$53.9 million was unused and available. These unsecured international credit facilities were used in Europe and Japan during the first three months of fiscal 2016. Our domestic line of credit consists of a \$50 million unsecured revolving credit account, which expires on May 31, 2017 and is subject to covenants related to financial ratios and tangible net worth. We were in compliance with these covenants as of January 2, 2016. As of January 2, 2016, we have drawn \$5.0 million and have used \$1.1 million for letters of credit against our domestic line of credit.

Our ratio of current assets to current liabilities was 5.4:1 at January 2, 2016 compared to 5.3:1 at October 3, 2015. The increase in our ratio is primarily due to decreases in other current liabilities and accounts payable as well as increases in cash and cash

Table of Contents

equivalents partially offset by increases in income taxes payable and short-term borrowings. Our cash and cash equivalents, short-term investments and working capital are as follows:

	January 2, 2016 (in thousands)	October 3, 2015
Cash and cash equivalents	\$142,343	\$130,607
Short-term investments	193,831	194,908
Working capital	547,874	530,093

## Contractual Obligations and Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements as defined under Regulation S-K of the Securities Act of 1933. Information regarding our long-term debt payments, operating lease payments, asset retirement obligations, purchase commitments with suppliers and purchase obligations is provided in Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the fiscal year ended October 3, 2015. There have been no material changes in contractual obligations outside of the ordinary course of business since October 3, 2015. Information regarding our other financial commitments at January 2, 2016 is provided in the notes to the condensed consolidated financial statements in this report.

## Changes in Financial Condition

Cash provided by operating activities during the first three months of fiscal 2016 was \$14.3 million, which included net income of \$20.3 million, depreciation and amortization of \$8.5 million, stock-based compensation expense of \$3.7 million and \$0.2 million other partially offset by cash used by operating assets and liabilities of \$14.9 million and net increases in deferred tax assets of \$3.5 million. Cash provided by operating activities during the first three months of fiscal 2015 was \$31.1 million, which included net income of \$17.4 million, depreciation and amortization of \$8.4 million, decreases in net deferred tax assets of \$7.0 million, stock-based compensation expense of \$4.4 million and \$0.4 million other partially offset by cash used by operating assets and liabilities of \$6.5 million.

Cash used in investing activities during the first three months of fiscal 2016 was \$3.6 million, which included \$4.7 million used to acquire property and equipment and improve buildings net of proceeds from dispositions partially offset by \$1.1 million net sales of available-for-sale securities. Cash provided by investing activities during the first three months of fiscal 2015 was \$29.0 million, which included \$33.6 million net sales of available-for-sale securities partially offset by \$4.6 million used to acquire property and equipment and improve buildings net of proceeds from dispositions.

Cash provided by financing activities during the first three months of fiscal 2016 was \$3.2 million, which included \$5.0 million net short-term borrowings and \$3.5 million generated from our employee stock option and purchase plans partially offset by \$5.3 million net settlement of restricted stock. Cash used by financing activities during the first three months of fiscal 2015 was \$19.1 million, which included \$17.3 million repurchases of common stock and \$5.2 million net settlement of restricted stock partially offset by \$3.4 million generated from our employee stock option and purchase plans.

Changes in exchange rates during the first three months of fiscal 2016 decreased our cash balances by \$2.1 million. Changes in exchange rates during the first three months of fiscal 2015 decreased our cash balances by \$2.8 million.

## RECENT ACCOUNTING STANDARDS

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

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk disclosures

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

Interest rate sensitivity

A portion of our investment portfolio is composed of fixed income securities. These securities are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately (whether due to changes in overall market rates or credit worthiness of the issuers of our individual securities) and uniformly by 10% from levels at January 2, 2016, the fair value of the portfolio, based on quoted market prices in active markets involving similar assets, would decline by an immaterial amount due to their short-term maturities. We have the ability to generally hold our fixed income investments until maturity and therefore we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on our securities portfolio. If necessary, we may sell short-term investments prior to maturity to meet our liquidity needs.

At January 2, 2016, the fair value of our available-for-sale debt securities was \$186.5 million, \$9.7 million of which was classified as cash and cash equivalents and \$176.8 million of which was classified as short-term investments. Gross unrealized gains and losses on available-for-sale debt securities were both less than \$0.1 million at January 2, 2016.

Foreign currency exchange risk

We maintain operations in various countries outside of the United States and have foreign subsidiaries that manufacture and sell our products in various global markets. The majority of our sales are transacted in U.S. dollars. However, we do generate revenues in other currencies, primarily the Euro, the Japanese Yen, the South Korean Won and the Chinese Renminbi. Additionally we have operations in different countries around the world with costs incurred in other local currencies, such as British Pound Sterling, Singapore Dollars and Malaysian Ringgit. As a result, our earnings, cash flows and cash balances are exposed to fluctuations in foreign currency exchange rates. For example, we have significant manufacturing operations in Europe so that a weakening Euro is advantageous to the Company's financial results. We attempt to limit these exposures through financial market instruments. We utilize derivative instruments, primarily forward contracts with maturities of two months or less, to manage our exposure associated with anticipated cash flows and net asset and liability positions denominated in foreign currencies. Gains and losses on the forward contracts are mitigated by gains and losses on the underlying instruments. We do not use derivative financial instruments for trading purposes.

On occasion, we enter into currency forward exchange contracts to hedge specific anticipated foreign currency denominated transactions generally expected to occur within the next 12 months. These cash flow hedges are designated for hedge accounting treatment and gains and losses on these contracts are recorded in accumulated other comprehensive income in stockholder's equity and reclassified into earnings at the time that the related transactions being hedged are recognized in earnings. See Note 6 "Derivative Instruments and Hedging Activities".

We do not anticipate any material adverse effect on our condensed consolidated financial position, results of operations or cash flows resulting from the use of these instruments. There can be no assurance that these strategies will be effective or that transaction losses can be minimized or forecasted accurately. While we model currency valuations and fluctuations, these may not ultimately be accurate. If a financial counterparty to any of our hedging

arrangements experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency hedge, we may experience material financial losses. In the current economic environment, the risk of failure of a financial party remains high.

At January 2, 2016, approximately \$294.1 million of our cash, cash equivalents and short-term investments were held outside the U.S. in certain of our foreign operations, \$78.9 million of which was denominated in currencies other than the U.S. dollar.

A hypothetical 10% change in foreign currency rates on our forward contracts would not have a material impact on our results of operations, cash flows or financial position.

The following table provides information about our foreign exchange forward contracts at January 2, 2016. The table presents the weighted average contractual foreign currency exchange rates, the value of the contracts in U.S. dollars at the contract exchange rate as of the contract maturity date and fair value. The U.S. fair value represents the fair value of the contracts valued at January 2, 2016 rates.

Table of Contents

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

	Average Contract Rate	U.S. Notional Contract Value	U.S. Fair Value
Non-Designated - For US Dollars			
Euro	1.0609	\$(53,291	) \$(1,519 )
Japanese Yen	121.4383	\$21,743	\$340
British Pound	1.4971	\$1,117	\$(6 )
South Korean Won	1,162.3138	\$14,034	\$(131 )
Chinese Renminbi	6.4638	\$9,957	\$(37 )
Singaporean Dollar	1.4106	\$(3,030	) \$(5 )
Malaysian Ringgit	4.2300	\$2,290	\$(42 )
Designated - For Euros			
Japanese Yen	121.4383	\$901	\$4

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

Management's Evaluation of Disclosure Controls and Procedures

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as of January 2, 2016 ("Evaluation Date"). The controls evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective in providing reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the quarter ended January 2, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations over Internal Control

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

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on the financial statements.

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



procedures may deteriorate.

38

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Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information with respect to this item may be found in Note 11 to our condensed consolidated financial statements in Part I, Item 1 of this report and is incorporated herein by reference.

ITEM 1A. RISK FACTORS

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

BUSINESS ENVIRONMENT AND INDUSTRY TRENDS

Our operating results, including net sales, net income (loss) and adjusted EBITDA in dollars and as a percentage of net sales, as well as our stock price have varied in the past, and our future operating results will continue to be subject to quarterly and annual fluctuations based upon numerous factors, including those discussed in this Item 1A and throughout this report. Our stock price will continue to be subject to daily variations as well. Our future operating results and stock price may not follow any past trends or meet our guidance and expectations.

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

• general economic uncertainties in the macroeconomic and local economies facing us, our customers and the markets we serve;

• fluctuations in demand for our products or downturns in the industries that we serve;

• the ability of our suppliers, both internal and external, to produce and deliver components and parts, including sole or limited source components, in a timely manner, in the quantity, quality and prices desired;

• the timing of receipt and conversion of bookings to net sales;

• the concentration of a significant amount of our backlog, and resultant net sales, with a few customers;

• rescheduling of shipments or cancellation of orders by our customers;

• fluctuations in our product mix;

• the ability of our customers' other suppliers to provide sufficient material to support our customers' products;

currency fluctuations and stability, in particular the Euro, the Japanese Yen, the South Korean Won, the Chinese Renminbi and the US dollar as compared to other currencies;

commodity pricing;

introductions of new products and product enhancements by our competitors, entry of new competitors into our markets, pricing pressures and other competitive factors;

Table of Contents

our ability to develop, introduce, manufacture and ship new and enhanced products in a timely manner without defects;

our ability to successfully expand our manufacturing footprint in Göttingen, Germany and add optics fabrication capacity at our site in Richmond, California;

our ability to manage our manufacturing capacity and that of our suppliers;

our reliance on contract manufacturing;

the rate of market acceptance of our new products;

- the ability of our customers to pay for our products;

expenses associated with acquisition-related activities;

seasonal sales trends;

access to applicable credit markets by us, our customers and their end customers;

delays or reductions in customer purchases of our products in anticipation of the introduction of new and enhanced products by us or our competitors;

our ability to control expenses;

the level of capital spending of our customers;

potential excess and/or obsolescence of our inventory;

costs and timing of adhering to current and developing governmental regulations and reviews relating to our products and business;

costs related to acquisitions of technology or businesses;

impairment of goodwill, intangible assets and other long-lived assets;

our ability to meet our expectations and forecasts and those of public market analysts and investors;

the availability of research funding by governments with regard to our customers in the scientific business, such as universities;

continued government spending on defense-related projects where we are a subcontractor;

maintenance of supply relating to products sold to the government on terms which we would prefer not to accept;

changes in policy, interpretations, or challenges to the allowability of costs incurred under government cost accounting standards;

• damage to our reputation as a result of coverage in social media, Internet blogs or other media outlets;

• managing our and other parties' compliance with contracts in multiple languages and jurisdictions;

• managing our internal and third party sales representatives and distributors, including compliance with all applicable laws;

• impact of government economic policies on macroeconomic conditions;

• costs and expenses from litigation;

Table of Contents

costs associated with designing around or payment of licensing fees associated with issued patents in our fields of business;

government support of alternative energy industries, such as solar;

the future impact of legislation, rulemaking, and changes in accounting, tax, defense procurement, or export policies; and

distraction of management related to acquisition or divestment activities.

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

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

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

We currently purchase several key components and materials used in the manufacture of our products from sole source or limited source suppliers, both internal and external. Our failure to timely receive these key components and materials could cause delays in the shipment of our products. Some of these suppliers are relatively small private companies that may discontinue their operations at any time and which may be particularly susceptible to prevailing economic conditions. Some of our suppliers are located in regions which may be susceptible to natural disasters, such as the flooding in Thailand and the earthquake, tsunami and resulting nuclear disaster in Japan and severe flooding and power loss in the Eastern part of the United States in recent years. Some may be vulnerable to man-made disasters, such as the recent worldwide shortage of neon gas as a result of the conflict in Ukraine. We typically purchase our components and materials through purchase orders or agreed upon terms and conditions and we do not have guaranteed supply arrangements with many of these suppliers. For certain long-lead time supplies or in order to lock-in pricing, we may be obligated to place purchase orders which are not cancelable or otherwise assume liability for a large amount of the ordered supplies, which limit our ability to adjust down our inventory liability in the event of market downturns or other customer cancellations or rescheduling of their purchase orders for our products. Some of our products, particularly in the flat panel display industry, require designs and specifications which are at the cutting-edge of available technologies. Our and our customers' designs and specifications frequently change to meet

rapidly evolving market demands. Accordingly certain of our products require components and supplies which may be technologically difficult and unpredictable to manufacture. By their very nature, these types of components may only be available by a single supplier. These characteristics further pressure the timely delivery of such components. We may fail to obtain these supplies in a timely manner in the future. We may experience difficulty identifying alternative sources of supply for certain components used in our products and may have to incur expenses and management distraction in assisting our current and future suppliers to meet our and our customers' technical requirements. We would experience further delays while identifying, evaluating and testing the products of these potential alternative suppliers. Furthermore, financial or other difficulties faced by these suppliers or significant changes in demand for these components or materials could limit their availability. We continue to consolidate our supply base and move supplier locations. When we transition locations we may increase our inventory of such products as a "safety stock" during the transition, which may cause the amount of inventory reflected on our balance sheet to increase. Additionally, many of our customers rely on sole source suppliers. In the event of a disruption of our customers' supply chain, orders from our customers could decrease or be delayed.

Table of Contents

Any interruption or delay in the supply of any of these components or materials, or the inability to obtain these components and materials from alternate sources at acceptable prices and within a reasonable amount of time, or our failure to properly manage these moves, would impair our ability to meet scheduled product deliveries to our customers and could cause customers to cancel orders. We have historically relied exclusively on our own production capability to manufacture certain strategic components, crystals, semiconductor lasers, lasers and laser-based systems. Because we manufacture, package and test these components, products and systems at our own facilities, and such components, products and systems are not readily available from other sources, any interruption in manufacturing would adversely affect our business. Since many of our products have lengthy qualification periods, our ability to introduce multiple suppliers for parts may be limited. In addition, our failure to achieve adequate manufacturing yields of these items at our manufacturing facilities may materially and adversely affect our operating results and financial condition.

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

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

We participate in the flat panel display market, which has a relatively limited number of end customer manufacturers. Our backlog, timing of net sales and results of operations could be negatively impacted in the event our customers reschedule or cancel orders.

In the flat panel display market, there are a relatively limited number of manufacturers who are the end customers for our annealing products. In each of our last three fiscal years and the first fiscal quarter of 2016, Advanced Process Systems Corporation, an integrator in the flat panel display market based in South Korea, has contributed more than 10% of our revenue. Another customer, Japanese Steel Works, Ltd., an integrator in the flat panel display market based in Japan, has contributed more than 10% of our revenue in the first fiscal quarter of 2016. Given macroeconomic conditions, varying consumer demand and technical process limitations at manufacturers, our customers may seek to reschedule or cancel orders. This was recently seen with a requested expedited shipment of a Linebeam 1500 product for our third fiscal quarter of 2015, which delivery date was then changed at the customer's request back to its originally scheduled date in the fourth fiscal quarter of 2015. These larger flat panel-related systems have large average selling prices. Any rescheduling or canceling of such orders by our customers will likely have a significant impact on our quarterly or annual net sales and results of operations and could negatively impact inventory values and backlog. Additionally, challenges in meeting evolving technological requirements for these complex products by us and our suppliers could also result in delays in shipments, rescheduled or canceled orders by our customers. This could negatively impact our backlog, timing of net sales and results of operations.

As of January 2, 2016, flat panel display systems represented 46% of our backlog. Since our backlog includes higher average selling price flat panel display systems, any delays or cancellation of shipments could have a material adverse effect on our financial results.

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



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

Table of Contents

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

• loss of customers or orders;

• increased costs of product returns and warranty expenses;

• damage to our brand reputation;

• failure to attract new customers or achieve market acceptance;

• diversion of development, engineering and manufacturing resources; and

- legal actions by our customers and/or their end users.

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

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

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

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

We are exposed to risks associated with worldwide economic conditions and related uncertainties which could negatively impact demand for our products and results of operations.

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

Uncertainty in global fiscal policy has likely had an adverse impact on global financial markets and overall economic activity. Should this uncertain financial policy recur, it would likely negatively impact global economic activity. Any weakness in global economies would also likely have negative repercussions on U.S. and global credit and financial markets, and further

Table of Contents

exacerbate sovereign debt concerns in the European Union. All of these factors would likely adversely impact the global demand for our products and the performance of our investments, and would likely have a material adverse effect on our business, results of operations and financial condition.

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

In addition, political and social turmoil related to international conflicts, terrorist acts, civil unrest and mass migration may put further pressure on economic conditions in the United States and the rest of the world. Unstable economic, political and social conditions make it difficult for our customers, our suppliers and us to accurately forecast and plan future business activities. If such conditions persist, our business, financial condition and results of operations could suffer. Additionally, unstable economic conditions can provide significant pressures and burdens on individuals, which could cause them to engage in inappropriate business conduct. See “Part I, Item 4. CONTROLS AND PROCEDURES.”

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

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

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

Although we have not recognized any material losses on our cash, cash equivalents and short-term investments, future declines in their market values could have a material adverse effect on our financial condition and operating results.

Given the global nature of our business, we have investments both domestically and internationally. There has recently been growing pressure on the creditworthiness of sovereign nations, particularly in Europe where a significant portion of our cash, cash equivalents and short-term investments are invested, which results in corresponding pressure on the valuation of the securities issued by such nations. Additionally, our overall investment portfolio is often concentrated in government-issued securities such as U.S. Treasury securities and government agencies, corporate notes, commercial paper and money market funds. Credit ratings and pricing of these investments can be negatively impacted by liquidity, credit deterioration or losses, financial results, or other factors. Additionally, liquidity issues or political actions by sovereign nations could result in decreased values for our investments in certain government securities. As a result, the value or liquidity of our cash, cash equivalents and short-term investments could decline or become materially impaired, which could have a material adverse effect on our financial condition and operating results. See “Item 3. Quantitative and Qualitative Disclosures about Market Risk.”

Table of Contents

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

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

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

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

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

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

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

For the three months ended January 2, 2016, 73% of our net sales were derived from customers outside of the United States. For fiscal 2015, fiscal 2014 and fiscal 2013, 73%, 74%, and 77%, respectively, of our net sales were derived from customers outside of the United States. We anticipate that foreign sales, particularly in Asia, will continue to account for a significant portion of our net sales in the foreseeable future.

A global economic slowdown or a natural disaster could have a negative effect on various foreign markets in which we operate, such as the earthquake, tsunami and resulting nuclear disaster in Japan and the flooding in Thailand in recent years. Such a slowdown may cause us to reduce our presence in certain countries, which may negatively affect the overall level of business in such countries. Our foreign sales are primarily through our direct sales force. Additionally, some foreign sales are made through foreign distributors and representatives. Our foreign operations and sales are subject to a number of risks, including:

- longer accounts receivable collection periods;

- the impact of recessions and other economic conditions in economies outside the United States;

- unexpected changes in regulatory requirements;

- certification requirements;

45

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Table of Contents

- environmental regulations;
- reduced protection for intellectual property rights in some countries;
- potentially adverse tax consequences;
- political and economic instability;
- import/export regulations, tariffs and trade barriers;
- compliance with applicable United States and foreign anti-corruption laws;
- cultural and management differences;
- reliance in some jurisdictions on third party sales channel partners;
- preference for locally produced products; and
- shipping and other logistics complications.

Our business could also be impacted by international conflicts, terrorist and military activity, civil unrest and pandemic illness which could cause a slowdown in customer orders, cause customer order cancellations or negatively impact availability of supplies or limit our ability to timely service our installed base of products.

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

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

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

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



In recent years, there has been significant litigation in the United States and around the world involving patents and other intellectual property rights. This has been seen in our industry, for example in the recently concluded patent-related litigation between IMRA America, Inc. ("Imra") and IPG Photonics Corporation and in Imra's recently brought litigation against two of our German subsidiaries. From time to time, like many other technology companies, we have received communications from other parties asserting the existence of patent rights, copyrights, trademark rights or other intellectual property rights which such third parties believe may cover certain of our products, processes, technologies or information. In the future, we may be a party to litigation to protect our intellectual property or as a result of an alleged infringement of others' intellectual property whether through direct claims or by way of indemnification claims of our customers, as, in some cases, we contractually agree to indemnify our customers against third-party infringement claims relating to our products. These claims and any resulting lawsuit, if successful, could subject us to significant liability for damages or invalidation of our proprietary rights. These

Table of Contents

lawsuits, regardless of their success, would likely be time-consuming and expensive to resolve and would divert management time and attention. Any potential intellectual property litigation could also force us to do one or more of the following:

- stop manufacturing, selling or using our products that use the infringed intellectual property;
- obtain from the owner of the infringed intellectual property right a license to sell or use the relevant technology, although such license may not be available on reasonable terms, or at all; or
- redesign the products that use the technology.

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

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

Under accounting principles generally accepted in the United States, we review our intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered in determining whether a change in circumstances indicating that the carrying value of our goodwill or other intangible assets may not be recoverable include declines in our stock price and market capitalization or future cash flows projections. A decline in our stock price, or any other adverse change in market conditions, particularly if such change has the effect of changing one of the critical assumptions or estimates we used to calculate the estimated fair value of our reporting units, could result in a change to the estimation of fair value that could result in an impairment charge. Any such material charges, whether related to goodwill or purchased intangible assets, may have a material negative impact on our financial and operating results.

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

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

Our future success depends upon the continued services of our executive officers and other key engineering, sales, marketing, manufacturing and support personnel, any of whom may leave and our ability to effectively transition to their successors. Our inability to retain or to effectively transition to their successors could harm our business and our results of operations.

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

Customers often view the purchase of our products as a significant and strategic decision. As a result, customers typically expend significant effort in evaluating, testing and qualifying our products before making a decision to purchase them, resulting in a lengthy initial sales cycle. While our customers are evaluating our products and before

they place an order with us, we may incur substantial sales and marketing and research and development expenses to customize our products to the customers' needs. We may also expend significant management efforts, increase manufacturing capacity and order long lead-time components or materials prior to receiving an order. Even after this evaluation process, a potential customer may not purchase our products. As a result, these long sales cycles may cause us to incur significant expenses without ever receiving net sales to offset such expenses.

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

Competition in the various photonics markets in which we provide products is very intense. We compete against a number of large public and private companies, including CVI Melles Griot, GSI Group, Inc., IPG Photonics Corporation, Lumentum Holdings Inc., Newport Corporation, Rofin-Sinar Technologies, Inc., and Trumpf GmbH, as well as other smaller companies. Some of our competitors are large companies that have significant financial, technical, marketing and other resources. These competitors may be able to devote greater resources than we can to the development, promotion, sale and support of their products. Some of our competitors are much better positioned than we are to acquire other companies in order to gain new

Table of Contents

technologies or products that may displace our product lines. Any of these acquisitions could give our competitors a strategic advantage. Any business combinations or mergers among our competitors, forming larger companies with greater resources, could result in increased competition, price reductions, reduced margins or loss of market share, any of which could materially and adversely affect our business, results of operations and financial condition.

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

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

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

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

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

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

Growth in sales, combined with the challenges of managing geographically dispersed operations, can place a significant strain on our management systems and resources, and our anticipated growth in future operations could continue to place such a strain. The failure to effectively manage our growth could disrupt our business and harm our

operating results. Our ability to successfully offer our products and implement our business plan in evolving markets requires an effective planning and management process. In economic downturns, we must effectively manage our spending and operations to ensure our competitive position during the downturn, as well as our future opportunities when the economy improves, remain intact. The failure to effectively manage our spending and operations could disrupt our business and harm our operating results.

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

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

Table of Contents

• issue stock that would dilute our current stockholders' percentage ownership;

• pay cash that would decrease our working capital;

• incur debt;

• assume liabilities; or

• incur expenses related to impairment of goodwill and amortization.

Acquisitions also involve numerous risks, including:

• problems combining the acquired operations, systems, technologies or products;

• an inability to realize expected operating efficiencies or product integration benefits;

• difficulties in coordinating and integrating geographically separated personnel, organizations, systems and facilities;

• difficulties integrating business cultures;

• unanticipated costs or liabilities, including the costs associated with improving the internal controls of the acquired company;

• diversion of management's attention from our core businesses;

• adverse effects on existing business relationships with suppliers and customers;

• potential loss of key employees, particularly those of the purchased organizations;

• incurring unforeseen obligations or liabilities in connection with acquisitions; and

the failure to complete acquisitions even after signing definitive agreements which, among other things, would result in the expensing of potentially significant professional fees and other charges in the period in which the acquisition or negotiations are terminated.

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

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

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

- maintaining and enhancing our relationships with our customers;
- the education of potential end-user customers about the benefits of lasers and laser systems; and
- our ability to accurately predict and develop our products to meet industry standards.

For the three months ended January 2, 2016, our research and development costs were \$19.1 million (10.1% of net sales). For our fiscal years 2015, 2014 and 2013, our research and development costs were \$81.5 million (10.2% of net sales), \$79.1 million (10.0% of net sales) and \$82.8 million (10.2% of net sales), respectively. We cannot assure you that our expenditures for research and development will result in the introduction of new products or, if such products are introduced, that those products

## Table of Contents

will achieve sufficient market acceptance or to generate sales to offset the costs of development. Our failure to address rapid technological changes in our markets could adversely affect our business and results of operations.

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

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

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

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

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

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

From time to time new regulations are enacted, and it is difficult to anticipate how such regulations will be implemented and enforced. We continue to evaluate the necessary steps for compliance with regulations as they are enacted. These regulations include, for example, the Registration, Evaluation, Authorization and Restriction of Chemical substances ("REACH"), the Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Directive ("RoHS") and the Waste Electrical and Electronic Equipment Directive ("WEEE") enacted in the European Union which regulate the use of certain hazardous substances in, and require the collection, reuse and recycling of waste from, certain products we manufacture. This and similar legislation that has been or is in the process of being enacted in Japan, China, South Korea and various states of the United States may require us to re-design our products to ensure compliance with the applicable standards, for example by requiring the use of



different types of materials. These redesigns or alternative materials may detrimentally impact the performance of our products, add greater testing lead-times for product introductions or have other similar effects. We believe we comply with all such legislation where our products are sold and we will continue to monitor these laws and the regulations being adopted under them to determine our responsibilities. In addition, we are monitoring legislation relating to the reduction of carbon emissions from industrial operations to determine whether we may be required to incur any additional material costs or expenses associated with our operations. We are not currently aware of any such material costs or expenses. The SEC has promulgated rules requiring disclosure regarding the use of certain “conflict minerals” mined from the Democratic Republic of Congo and adjoining countries and procedures regarding a manufacturer's efforts to prevent the sourcing of such minerals. The implementation of such rules has required us to incur additional expense and internal resources and may continue to do so in the future, particularly in the event that only a limited pool of suppliers are available to certify that products are free from “conflict minerals.” Our failure to comply with any of the foregoing regulatory requirements or contractual obligations could result in our being directly or indirectly liable for costs, fines or penalties and third-party claims, and could jeopardize our ability to conduct business in the United States and foreign countries.

Table of Contents

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

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

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

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

Our information systems are subject to attacks, interruptions and failures.

As part of our day-to-day business, we store our data and certain data about our customers in our global information technology system. While our system is designed with access security, if a third party gains unauthorized access to our data, including any regarding our customers, such a security breach could expose us to a risk of loss of this information, loss of business, litigation and possible liability. Our security measures may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our customers' data or our data, including our intellectual property and other confidential business information, or our information technology systems. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any unauthorized access could result in a loss of confidence by our customers, damage our reputation, disrupt our business, lead to legal liability and negatively impact our future sales. Additionally, such actions could result in significant costs associated with loss of our intellectual property, impairment of our ability to conduct our operations, rebuilding our network and systems, prosecuting and defending litigation, responding to regulatory inquiries or actions, paying damages or taking other remedial steps.

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

As a global company, we are subject to taxation in the United States and various other countries and jurisdictions. Significant judgment is required to determine our worldwide tax liabilities. A number of factors may affect our future

effective tax rates including, but not limited to:

- changes in the composition of earnings in countries or states with differing tax rates;

- changes in the valuations of our deferred tax assets and liabilities;

- the resolution of issues arising from tax audits with various tax authorities, and in particular, the outcome of the pending German tax audits of our tax returns for fiscal years 2006 - 2013;

Table of Contents

• changes in our global structure that involve an increased investment in technology outside of the United States to better align asset ownership and business functions with revenues and profits;

• adjustments to estimated taxes upon finalization of various tax returns;

• increases in expenses not deductible for tax purposes, including impairments of goodwill in connection with acquisitions;

• our ability to meet the eligibility requirements for tax holidays of limited time tax-advantage status in various jurisdictions;

• changes in available tax credits;

• changes in share-based compensation;

• changes in the tax laws or the interpretation of such tax laws, including the Base Erosion Profit Shifting (“BEPS”) project being conducted by the Organization for Economic Co-operation and Development (“OECD”);

• changes in generally accepted accounting principles; and

• the repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes.

We are also engaged in discussions with various tax authorities regarding the appropriate level of profitability for Coherent entities and this may result in changes to our worldwide tax liabilities. In addition, we are subject to regular examination of our income tax returns by the Internal Revenue Service (“IRS”) and other tax authorities. From time to time the United States, foreign and state governments make substantive changes to tax rules and the application of rules to companies, including various announcements from the United States government potentially impacting our ability to defer taxes on international earnings. We regularly assess the likelihood of favorable or unfavorable outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. Although we believe our tax estimates are reasonable, there can be no assurance that any final determination will not be materially different than the treatment reflected in our historical income tax provisions and accruals, which could materially and adversely affect our operating results and financial condition.

Changing laws, regulations and standards relating to corporate governance and public disclosure may create uncertainty regarding compliance matters.

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

harmed.

Governmental regulations, including duties, affecting the import or export of products could negatively affect our net sales.

The United States and many foreign governments impose tariffs and duties on the import and export of products, including some of those which we sell. In particular, given our worldwide operations, we pay duties on certain products when they are imported into the United States for repair work as well as on certain of our products which are manufactured by our foreign subsidiaries. These products can be subject to a duty on the product value. Additionally, the United States and various foreign governments have imposed tariffs, controls, export license requirements and restrictions on the import or export of some technologies, especially encryption technology. From time to time, government agencies have proposed additional regulation of encryption technology, such as requiring the escrow and governmental recovery of private encryption keys. Governmental

52

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Table of Contents

regulation of encryption technology and regulation of imports or exports, or our failure to obtain required import or export approval for our products, could harm our international and domestic sales and adversely affect our net sales. From time to time our duty calculations and payments are audited by government agencies. For example, we are currently under audit in South Korea for customs duties and value-added-tax for the period March 2009 to March 2014. In the event of an adverse audit result, we could be liable for additional payments, duties, taxes and penalties, any of which could have a material adverse effect on our business or financial position, results of operations, or cash flows. As of January 2, 2016, we have accrued an estimated liability of \$1.6 million related to this matter.

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

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

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

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

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

- the ability of our Board of Directors to alter our bylaws without stockholder approval;

- limiting the ability of stockholders to call special meetings; and

- establishing advance notice requirements for nominations for election to our Board of Directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

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

result in a lower stock price.

53

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Table of Contents

## ITEM 6. EXHIBITS

Exhibit No.	Description
10.1‡ **	Fiscal 2016 Variable compensation plan payout scale
10.2‡	Fiscal 2015 Variable compensation plan payout scale
10.3‡	Offer letter with Kevin Palatnik
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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*	In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Exchange Act of 1934, and otherwise is not subject to liability under these sections.
‡	Identifies management contract or compensatory plans or arrangements required to be filed as an exhibit.
**	Portions of this exhibit are redacted and confidential treatment has been requested with the Securities and Exchange Commission.





Table of Contents

COHERENT, INC.

SIGNATURES

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

Coherent, Inc.  
(Registrant)

Date: February 10, 2016

/s/ JOHN R. AMBROSEO  
John R. Ambroseo  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: February 10, 2016

/s/ HELENE SIMONET  
Helene Simonet  
Executive Vice President and Chief  
Financial Officer  
(Principal Financial and Accounting  
Officer)

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
10.1‡ **	Fiscal 2016 Variable compensation plan payout scale
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10.3‡	Offer letter with Kevin Palatnik
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