COHERENT INC
Form 10-Q
May 06, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 29, 2014

or

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

For the transition period from to

Commission File Number: 001-33962

COHERENT, INC.

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

5100 Patrick Henry Drive, Santa Clara, California 95054
(Address of principal executive offices) (Zip Code)
Registrant’s telephone number, including area code: (408) 764-4000

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

The number of shares outstanding of registrant’s common stock, par value $.01 per share, on May 5, 2014 was 24,933,997.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

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

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

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

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

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

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

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

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

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

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

1. BASIS OF PRESENTATION

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

2. RECENT ACCOUNTING STANDARDS

Adoption of New Accounting Pronouncements

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

Recently Issued Accounting Pronouncement

In July 2013, the Financial Accounting Standards Board ("FASB") issued amended guidance that resolves the diversity in practice for the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This new accounting guidance requires the netting of unrecognized tax benefits ("UTBs") against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. Under the new standard, UTBs will be netted against all available same-jurisdiction losses or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by the UTBs. The new standard requires prospective adoption but allows retrospective adoption for all periods presented. We will consider the FASB's amended guidance for our fiscal year beginning September 28, 2014. We do not expect the amended guidance to have a significant impact on our consolidated financial position, results of operations and cash flows.

3. BUSINESS COMBINATIONS

Fiscal 2013 Acquisitions

Lumera Laser GmbH

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

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

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

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

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

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

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

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

Innolight Innovative Laser and Systemtechnik GmbH

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

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

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

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

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

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

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

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

4. FAIR VALUES

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

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

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

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

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

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

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

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

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

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

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

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

(7) The principal market in which we execute our foreign currency contracts is the institutional market in an over-the-counter environment with a relatively high level of price transparency. The market participants usually are large commercial banks. Our foreign currency contracts’ valuation inputs are based on quoted prices and quoted pricing intervals from public data sources and do not involve management judgment.

(8) The fair value of mutual funds is determined based on quoted market prices. Securities traded on a national exchange are stated at the last reported sales price on the day of valuation; other securities traded in

over-the-counter markets and listed securities for which no sale was reported on that date are stated as the last quoted bid price.

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5. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

All derivatives, whether designated in hedging relationships or not, are recorded on the Condensed Consolidated Balance Sheet at fair value. We enter into foreign exchange forwards to minimize the risks of foreign currency fluctuation of specific assets and liabilities on the balance sheet; these are not designated as hedging instruments. Our derivative contracts do not contain any credit risk related contingent features and do not require collateral or other security to be furnished by us or the counterparties.

We maintain operations in various countries outside of the United States and have foreign subsidiaries that manufacture and sell our products in various global markets. The majority of our sales are transacted in U.S. dollars. However, we do generate revenues in other currencies, primarily the Japanese Yen, the Euro and the Korean Won. As a result, our earnings, cash flows and cash balances are exposed to fluctuations in foreign currency exchange rates. We attempt to limit these exposures through financial market instruments. We utilize derivative instruments, primarily forward contracts with maturities of three months or less, to manage our exposure associated with anticipated cash flows and net asset and liability positions denominated in foreign currencies. Gains and losses on the forward contracts are mitigated by gains and losses on the underlying instruments. We do not use derivative financial instruments for speculative or trading purposes. If a financial counterparty to any of our hedging arrangements experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency hedge, we may experience material financial losses.

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

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

	U.S. Notional Contract Value		U.S. Notional Fair Value	
	March 29, 2014	September 28, 2013	March 29, 2014	September 28, 2013
Euro currency hedge contracts				
Purchase	$28,902	$46,248	$28,994	$47,299
Japanese YEN currency hedge contracts				
Purchase	$—	$5,211	$—	$5,307
Sell	$(22,232)	$(11,860)	$(22,169)	$(11,753)
Korean Won currency hedge contracts				
Sell	$(15,377)	$(17,345)	$(15,397)	$(17,545)
Chinese RMB currency hedge contracts				
Sell	$(11,544)			