COHERENT INC
Form 10-Q
August 07, 2018
Table of Contents

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 June 30, 2018
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 Website, 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, a smaller reporting company, or an emerging growth company. See definitions of “large accelerated filer,” “accelerated filer”, “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

| | |
|---|---|
| Large accelerated filer x | Accelerated filer ¨ |
| Non-accelerated filer ¨<br>(do not check if a smaller reporting company) | Smaller reporting company ¨ |
| Emerging growth company ¨ | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

1

Table of Contents

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

The number of shares outstanding of registrant's common stock, par value $.01 per share, on August 6, 2018 was 24,299,303.

Table of Contents

COHERENT, INC.

INDEX

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” 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” and “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 | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Net sales | $482,342 | $464,107 | $1,441,025 | $1,233,013 |
| Cost of sales | 274,006 | 256,921 | 800,236 | 704,798 |
| Gross profit | 208,336 | 207,186 | 640,789 | 528,215 |
| Operating expenses: | | | | |
| Research and development | 34,303 | 30,483 | 100,478 | 88,103 |
| Selling, general and administrative | 70,291 | 72,383 | 220,874 | 218,602 |
| Gain from business combination | — | — | — | (5,416) |
| Impairment and other charges | 611 | — | 766 | — |
| Amortization of intangible assets | 2,607 | 3,743 | 8,163 | 13,060 |
| Total operating expenses | 107,812 | 106,609 | 330,281 | 314,349 |
| Income from operations | 100,524 | 100,577 | 310,508 | 213,866 |
| Other income (expense): | | | | |
| Interest income | 444 | 282 | 1,355 | 560 |
| Interest expense | (4,737) | (7,494) | (21,209) | (24,456) |
| Other—net | (3,332) | (730) | (5,781) | 10,871 |
| Total other income (expense), net | (7,625) | (7,942) | (25,635) | (13,025) |
| Income from continuing operations before income taxes | 92,899 | 92,635 | 284,873 | 200,841 |
| Provision for income taxes | 25,929 | 29,764 | 110,698 | 65,084 |
| Net income from continuing operations | 66,970 | 62,871 | 174,175 | 135,757 |
| Loss from discontinued operations, net of income taxes | — | (1,754) | (2) | (2,387) |
| Net income | $66,970 | $61,117 | $174,173 | $133,370 |
| | | | | |
| Basic net income per share: | | | | |
| Income per share from continuing operations | $2.72 | $2.56 | $7.06 | $5.55 |
| Loss per share from discontinued operations, net of income taxes | $— | $(0.07) | $— | $(0.10) |
| Net income per share | $2.72 | $2.49 | $7.06 | $5.45 |
| | | | | |
| Diluted net income per share: | | | | |
| Income per share from continuing operations | $2.69 | $2.53 | $6.98 | $5.49 |
| Loss per share from discontinued operations, net of income taxes | $— | $(0.07) | $— | $(0.10) |
| Net income per share | $2.69 | $2.46 | $6.98 | $5.39 |
| | | | | |
| Shares used in computation: | | | | |
| Basic | 24,658 | 24,537 | 24,684 | 24,460 |
| Diluted | 24,877 | 24,823 | 24,971 | 24,741 |

See Accompanying Notes to Condensed Consolidated Financial Statements.

4

Table of Contents

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Net income | $66,970 | $61,117 | $174,173 | $133,370 |
| Other comprehensive income (loss): [1] | | | | |
| Translation adjustment, net of taxes [2] | (39,283) | 19,893 | (17,847) | 15,815 |
| Changes in unrealized losses on available-for-sale securities, net of taxes [3] | 4 | — | (4) | (3,334) |
| Defined benefit pension plans, net of taxes [4] | (504) | (401) | (701) | 133 |
| Other comprehensive income (loss), net of tax | (39,783) | 19,492 | (18,552) | 12,614 |
| Comprehensive income | $27,187 | $80,609 | $155,621 | $145,984 |

(1) Reclassification adjustments were not significant during the three and nine months ended June 30, 2018 and July 1, 2017.

(2) Tax expenses (benefits) were not provided on translation adjustments during the three and nine months ended June 30, 2018. Tax benefits of $0 and $326 were provided on translation adjustments during the three and nine months ended July 1, 2017, respectively.

(3) Tax expenses (benefits) of $1 and $(2) were provided on changes in unrealized gains (losses) on available-for-sale securities for the three and nine months ended June 30, 2018, respectively. Tax benefits of $0 and $1,878 were provided on changes in unrealized gains (losses) on available-for-sale securities for the three and nine months ended July 1, 2017, respectively.

(4) Tax benefits of $224 and $279 were provided on changes in defined benefit pension plans for the three and nine months ended June 30, 2018, respectively. Tax benefits of $56 and $35 were provided on changes in defined benefit pension plans for the three and nine months ended July 1, 2017, 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)

| | June 30, 2018 | September 30, 2017 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $232,458 | $ 443,066 |
| Restricted cash | 1,082 | 1,097 |
| Short-term investments | — | 32,510 |
| Accounts receivable—net of allowances of $6,074 and $6,890, respectively | 337,560 | 305,668 |
| Inventories | 494,967 | 414,807 |
| Prepaid expenses and other assets | 88,490 | 70,268 |
| Assets held for sale | — | 44,248 |
| Total current assets | 1,154,557 | 1,311,664 |
| Property and equipment, net | 303,214 | 278,850 |
| Goodwill | 444,066 | 417,694 |
| Intangible assets, net | 157,364 | 190,027 |
| Non-current restricted cash | 12,738 | 12,924 |
| Other assets | 115,629 | 126,641 |
| Total assets | $2,187,568 | $ 2,337,800 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Short-term borrowings and current-portion of long-term obligations | $7,076 | $ 5,078 |
| Accounts payable | 82,602 | 75,860 |
| Income taxes payable | 104,193 | 103,206 |
| Other current liabilities | 158,285 | 235,001 |
| Total current liabilities | 352,156 | 419,145 |
| Long-term obligations | 422,285 | 589,001 |
| Other long-term liabilities | 181,976 | 166,390 |
| Commitments and contingencies (Note 11) | | |
| Stockholders' equity: | | |
| Common stock, Authorized—500,000 shares, par value $.01 per share: | | |
| Outstanding—24,299 shares and 24,631 shares, respectively | 242 | 245 |
| Additional paid-in capital | 70,051 | 171,403 |
| Accumulated other comprehensive income | 1,354 | 19,906 |
| Retained earnings | 1,159,504 | 971,710 |
| Total stockholders' equity | 1,231,151 | 1,163,264 |
| Total liabilities and stockholders' equity | $2,187,568 | $ 2,337,800 |

See Accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

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

| | Nine Months Ended | |
|---|---|---|
| | June 30, 2018 | July 1, 2017 |
| Cash flows from operating activities: | | |
| Net income | $174,173 | $133,370 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 38,735 | 31,576 |
| Amortization of intangible assets | 45,638 | 44,303 |
| Gain on business combination | — | (5,416) |
| Deferred income taxes | 18,380 | 1,964 |
| Amortization of debt issuance cost | 8,251 | 2,970 |
| Stock-based compensation | 24,069 | 19,078 |
| Non-cash restructuring charges | 964 | 4,395 |
| Other non-cash expense | 194 | 201 |
| Changes in assets and liabilities, net of effect of acquisitions: | | |
| Accounts receivable | (27,520) | (23,519) |
| Inventories | (84,867) | 4,067 |
| Prepaid expenses and other assets | (7,712) | (3,902) |
| Other long-term assets | (5,369) | (3,319) |
| Accounts payable | 3,484 | 6,535 |
| Income taxes payable/receivable | 9,720 | 28,319 |
| Other current liabilities | (69,634) | 39,849 |
| Other long-term liabilities | 4,487 | 5,729 |
| Cash flows from discontinued operations | — | (918) |
| Net cash provided by operating activities | 132,993 | 285,282 |
| | | |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (65,990) | (45,352) |
| Proceeds from dispositions of property and equipment | 2,738 | 1,002 |
| Purchases of available-for-sale securities | (54,323) | — |
| Proceeds from sales and maturities of available-for-sale securities | 86,787 | 25,113 |
| Acquisition of businesses, net of cash acquired | (45,448) | (740,481) |
| Proceeds from sale of discontinued operation | 25,000 | — |
| Proceeds from sale of other entities | 6,250 | — |
| Cash flows from discontinued operations | — | (649) |
| Other | 470 | — |
| Net cash used in investing activities | (44,516) | (760,367) |
| | | |
| Cash flows from financing activities: | | |
| Short-term borrowings | 64,815 | 7,602 |
| Repayments of short-term borrowings | (65,718) | (29,240) |
| Proceeds from long-term borrowings | — | 740,685 |
| Repayments of long-term borrowings | (169,286) | (88,826) |
| Cash paid to subsidiaries' minority shareholders | — | (816) |
| Issuance of common stock under employee stock option and purchase plans | 10,574 | 8,111 |
| Net settlement of restricted common stock | (36,292) | (15,690) |

| | | |
|---|---|---|
| Repurchase of common stock | (100,000 ) | — |
| Debt issuance costs | — | (26,367 ) |
| Net cash provided by (used in) financing activities | (295,907 ) | 595,459 |
| Effect of exchange rate changes on cash, cash equivalents and restricted cash | (3,379 ) | 11,170 |
| Net increase (decrease) in cash, cash equivalents and restricted cash | (210,809 ) | 131,544 |
| Cash, cash equivalents and restricted cash, beginning of period | 457,087 | 354,347 |
| Cash, cash equivalents and restricted cash, end of period | $246,278 | $485,891 |
| | | |
| Non-cash investing and financing activities: | | |
| Unpaid property and equipment purchases | $5,353 | $1,950 |
| Use of previously owned equity shares in acquisition | $— | $20,685 |

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the condensed consolidated balance sheets that sum to the total of the same amounts shown in the condensed consolidated statements of cash flows.

7

Table of Contents

| | June 30, 2018 | July 1, 2017 |
|---|---|---|
| Cash and cash equivalents | $232,458 | $472,307 |
| Restricted cash, current | 1,082 | 1,060 |
| Restricted cash, non-current | 12,738 | 12,524 |
| Total cash, cash equivalents, and restricted cash shown in the condensed consolidated statement of cash flows | $246,278 | $485,891 |

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 consolidated financial statements and notes thereto filed by Coherent, Inc. on Form 10-K for the fiscal year ended September 30, 2017. In the opinion of management, all adjustments necessary for a fair presentation of financial condition and results of operation as of and for the periods presented have been made and include only normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year or any other interim periods. Our fiscal year ends on the Saturday closest to September 30 and our third fiscal quarters include 13 weeks of operations in each fiscal year presented. Fiscal year 2018 and 2017 both include 52 weeks.

The consolidated financial statements include the accounts of Coherent, Inc. and its direct and indirect subsidiaries (collectively, the "Company", "we", "our", "us" or "Coherent"). Intercompany balances and transactions have been eliminated

On November 7, 2016, we acquired Rofin-Sinar Technologies, Inc. and its direct and indirect subsidiaries ("Rofin"). On March 8, 2018, we acquired privately held O.R. Lasertechnologie GmbH ("OR Laser"). The significant accounting policies of Rofin and OR Laser have been aligned to conform to those of Coherent, and the consolidated financial statements include the results of Rofin and OR Laser as of their acquisition dates.

The preparation of consolidated financial statements in conformity with Generally Accepted Accounting Principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## 2. RECENT ACCOUNTING STANDARDS

### Adoption of New Accounting Pronouncement

In October 2016, the Financial Accounting Standards Board (the "FASB") issued amended guidance that improves the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. Under the new guidance, an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The new standard is required to be adopted in the first quarter of our fiscal 2019. We elected to early adopt the amended guidance in the first quarter of fiscal 2018. The effect of adoption is a decrease in our opening retained earnings by $6.1 million with a comparable decrease to our non-current prepaid income tax balance.

In March 2016, the FASB issued amended guidance that simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. Under the new guidance, an entity recognizes all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement. This change eliminates the notion of the APIC pool and significantly reduces the complexity and cost of accounting for excess tax benefits and tax deficiencies. Upon our adoption in the first quarter of fiscal 2018, we recognized a windfall tax benefit as a cumulative effect adjustment increase to our opening retained earnings of $19.8 million together with a comparable increase in deferred tax assets. With adoption occurring at the beginning of fiscal 2018, we recognized excess tax benefits from stock award exercises and restricted stock unit vesting as a discrete tax benefit, which reduced the provision for income taxes for the three and nine months ended June 30, 2018 by $0.0 million and $12.8 million, respectively. The adoption also changed the calculation of fully diluted shares outstanding for the three and nine months ended June 30, 2018. The excess tax benefits have been excluded from the calculation of assumed proceeds in our calculation of diluted weighted average shares under the new standard. Our diluted weighted average shares outstanding for the three and nine months ended June 30, 2018 increased by 49,176 and 80,657 shares, respectively, due to adoption of the new standard. Additionally, effective in the first quarter of fiscal 2018, excess tax benefits are classified as an operating activity in the statement of cash

Table of Contents

flows instead of as a financing activity where they were previously presented. We adopted this guidance on a prospective basis and, accordingly, prior periods have not been adjusted. We have elected to not estimate forfeitures expected to occur to determine the amount of compensation cost to be recognized in each period. The remaining provisions of this amended guidance did not have a material impact on our consolidated financial statements.

Recently Issued Accounting Pronouncements

In February 2018, the FASB issued amended guidance to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments also require certain disclosures about stranded tax effects. The new standard will become effective for our fiscal year 2020, which begins on September 29, 2019. We are currently assessing the impact of this amended guidance.

In August 2017, the FASB issued amended guidance to address the current limitation on how an entity can designate the hedged risk in certain cash flow and fair value hedging relationships pursuant to U.S. GAAP. This amendment better aligns an entity’s risk management activities and financial reporting for hedging relationships through changes to both designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendment made specific improvements on hedge accounting for risk components in hedging relationships involving nonfinancial risk and interest rate risk for cash flow hedges of forecasted purchases or sales of a nonfinancial asset, cash flow hedges of interest rate risk of variable-rate financial instruments and fair value hedges of interest rate risk. Upon adoption, for cash flow and net investment hedges existing, an entity should apply a cumulative-effect adjustment related to eliminating the separate measurement of ineffectiveness to other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the beginning of the fiscal year that an entity adopts the amendment. The amended presentation and disclosure guidance is required only prospectively. The new standard will become effective for our fiscal year 2020 which begins on September 29, 2019. We are currently assessing the impact of this amended guidance.

In May 2016, accounting guidance was issued to clarify the not yet effective revenue recognition guidance issued in May 2014. This additional guidance does not change the core principle of the revenue recognition guidance issued in May 2014, rather, it provides clarification of accounting for collections of sales taxes as well as recognition of revenue (i) associated with contract modifications, (ii) for non-cash consideration, and (iii) based on the collectability of the consideration from the customer. The guidance also specifies when a contract should be considered “completed” for purposes of applying the transition guidance. The effective date and transition requirements for this guidance are the same as the effective date and transition requirements for the guidance previously issued in 2014, which is effective for our fiscal year 2019, which begins on September 30, 2018. We have elected to not adopt the standard earlier. The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). We plan to adopt the standard using the modified retrospective method. ASU 2014-09 will be applied to all contracts that are not completed as of September 30, 2018 and all new contracts entered into by the Company subsequent to September 30, 2018. All prior period financial statements and disclosures will be presented in accordance with Topic 605. We have established a cross-functional team to implement the new standard with respect to the recognition of revenue from contracts with customers. Based on our evaluation, we do not expect a material change to our current revenue recognition practices under the new guidance and the adoption of ASU 2014-09 in our fiscal year 2019 will not have a material impact on the Company’s financial statements.

In February 2016, the FASB issued accounting guidance that modifies lease accounting for lessees to increase transparency and comparability by recording lease assets and liabilities for operating leases and disclosing key information about leasing arrangements. The new standard will become effective for our fiscal year 2020, which begins on September 29, 2019. We will adopt the new guidance utilizing the modified retrospective transition method. We have reviewed the requirements of this standard and have formulated a plan for implementation. We are currently working on accumulating a complete population of leases from all of our locations and have selected a software repository to track all of our lease agreements and to assist in the reporting and disclosure requirements required by the standard. We will continue to assess and disclose the impact that this new guidance will have on our consolidated financial statements, disclosures and related controls, when known.

Table of Contents

3. BUSINESS COMBINATIONS

Fiscal 2018 Acquisitions

OR Laser

On March 8, 2018, we acquired OR Laser for approximately $47.4 million, excluding transaction costs. OR Laser produces laser-based material processing equipment for a variety of uses, including additive manufacturing, welding, cladding, marking, engraving and drilling. OR Laser's operating results have been included in our Industrial Lasers & Systems segment. See Note 17, "Segment Information."

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

| | |
|---|---|
| Tangible assets: | |
| Cash | $1,936 |
| Accounts receivable | 3,973 |
| Inventories | 2,360 |
| Prepaid expenses and other assets | 630 |
| Property and equipment | 1,515 |
| Liabilities assumed | (5,119 ) |
| Deferred tax liabilities | (4,517 ) |
| Intangible assets: | |
| Existing technology | 14,100 |
| Non-competition | 200 |
| Backlog | 100 |
| Customer relationships | 700 |
| Trademarks | 50 |
| Goodwill | 31,456 |
| Total | $47,384 |

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.

The identifiable intangible assets are being amortized over their respective preliminary useful lives of 1 to 8 years. The fair value of the acquired intangibles was determined using the income approach. In performing these valuations, the key underlying probability-adjusted assumptions of the discounted cash flows were projected revenues, gross margin expectations and operating cost estimates. The valuations were based on the information that was available as of the acquisition date and the expectations and assumptions that have been deemed reasonable by our management. There are inherent uncertainties and management judgment required in these determinations. This acquisition resulted in a purchase price that exceeded the estimated fair value of tangible and intangible assets, which was allocated to goodwill.

We believe the amount of goodwill relative to identifiable intangible assets relates to several factors including: (1) potential buyer-specific synergies related to the development of new technologies related primarily to the additive manufacturing business and (2) the potential to leverage our sales force to attract new customers and revenue and cross-sell to existing customers.

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

We expensed $0.1 million and $0.5 million of acquisition-related costs as selling, general and administrative expenses in our condensed consolidated statement of operations for the three and nine months ended June 30, 2018, respectively.

Fiscal 2017 Acquisitions

Rofin

11

Table of Contents

On November 7, 2016, we completed our acquisition of Rofin pursuant to the Merger Agreement dated March 16, 2016. Rofin is one of the world's leading developers and manufacturers of high-performance industrial laser sources and laser-based solutions and components. Rofin's operating results have been included primarily in our Industrial Lasers & Systems segment. See Note 17, "Segment Information."

As a condition of the acquisition, we were required to divest and hold separate Rofin's low power $CO_2$ laser business based in Hull, United Kingdom (the "Hull Business"), and had reported this business separately as a discontinued operation until its divestiture. We completed the divestiture of the Hull Business on October 11, 2017, after receiving approval for the terms of the sale from the European Commission. See Note 19, "Discontinued Operations and Sale of Assets Held for Sale."

The total purchase consideration has been allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on a valuation analysis.

The total purchase consideration allocated to net assets acquired was approximately $936.3 million and consisted of the following (in thousands):

| | |
|---|---|
| Cash consideration to Rofin's shareholders | $904,491 |
| Cash settlement paid for Rofin employee stock options | 15,290 |
| Total cash payments to Rofin shareholders and option holders | 919,781 |
| Add: fair value of previously owned Rofin shares | 20,685 |
| Less: post-merger stock compensation expense | (4,152 ) |
| Total purchase price to allocate | $936,314 |

The acquisition was an all-cash transaction at a price of $32.50 per share of Rofin common stock. We funded the payment of the aggregate consideration with a combination of our available cash on hand and the proceeds from the Euro Term Loan described in Note 9, "Borrowings." The total payment of $15.3 million due to the cancellation of options held by employees of Rofin was allocated between total estimated merger consideration of $11.1 million and post-merger stock-based compensation expense of $4.2 million based on the portion of the total service period of the underlying options that had not been completed by the merger date.

We recognized a gain of $5.4 million in the first quarter of fiscal 2017 on the increase in fair value from the date of purchase for the shares of Rofin we owned before the acquisition.

Under the acquisition method of accounting, the total estimated acquisition consideration is allocated to the acquired tangible and intangible assets and assumed liabilities of Rofin based on their fair values as of the acquisition date. Any excess of the acquisition consideration over the fair value of assets acquired and liabilities assumed is allocated to goodwill. We concluded that all such goodwill will not be deductible for tax purposes.

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

Table of Contents

| | |
|---|---|
| Cash, cash equivalents and short-term investments | $163,425 |
| Accounts receivable | 90,877 |
| Inventory | 189,869 |
| Prepaid expenses and other assets | 15,362 |
| Assets held-for-sale, current | 29,545 |
| Property and equipment | 125,723 |
| Other assets | 31,854 |
| Intangible assets: | |
| Existing technology | 169,029 |
| In-process research and development | 6,000 |
| Backlog | 5,600 |
| Customer relationships | 39,209 |
| Trademarks | 5,699 |
| Patents | 300 |
| Goodwill | 298,170 |
| Current portion of long-term obligations | (3,633) |
| Current liabilities held for sale | (7,001) |
| Accounts payable | (21,314) |
| Other current liabilities | (68,242) |
| Long-term debt | (11,641) |
| Other long-term liabilities | (122,517) |
| Total | $936,314 |

The fair value write-up of acquired finished goods and work-in-process inventory was $26.4 million, which was amortized over the expected period during which the acquired inventory was sold, or 6 months. Accordingly, for fiscal 2017, we recorded $26.4 million of incremental cost of sales associated with the fair value write-up of inventory acquired in the merger with Rofin. The fair value write-up of inventory acquired was fully amortized in fiscal 2017.

The fair value write-up of acquired property, plant and equipment of $36.0 million will be amortized over the useful lives of the assets, ranging from 3 to 31 years. Property, plant and equipment is valued at its value-in-use, unless there was a known plan to dispose of the asset.

The acquired existing technology, backlog, trademarks and patents are being amortized on a straight-line basis, which approximates the economic use of the asset, over their estimated useful lives of 3 to 5 years, 6 months, 3 years, and 5 years, respectively. Customer relationships are being amortized on an accelerated basis utilizing free cash flows over periods ranging from 5 to 10 years. The useful lives of in-process research and development will be defined in the future upon further evaluation of the status of these applications. The fair value of the acquired intangibles was determined using the income approach. In performing these valuations, the key underlying probability-adjusted assumptions of the discounted cash flows were projected revenues, gross margin expectations and operating cost estimates. The valuations were based on the information that was available as of the acquisition date and the expectations and assumptions that have been deemed reasonable by our management. There are inherent uncertainties and management judgment required in these determinations. This acquisition resulted in a purchase price that exceeded the estimated fair value of tangible and intangible assets, which was allocated to goodwill.

We believe the amount of goodwill relative to identifiable intangible assets relates to several factors including: (1) potential buyer-specific synergies related to market opportunities for a combined product offering and (2) the potential to leverage our sales force to attract new customers and revenue and cross-sell to existing customers.

In-process research and development ("IPR&D") consists of two projects that had not yet reached technological feasibility as of the date of the acquisition. 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

Table of Contents

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. One project was completed in December 2017 and amortization for that project began in the quarter ending March 31, 2018. The other project has not been completed as of June 30, 2018, but is expected to be completed in fiscal 2019.

We expensed $17.6 million of acquisition-related costs as selling, general and administrative expenses in our condensed consolidated statements of operations in fiscal 2017.

The results of this acquisition were included in our consolidated operations beginning on November 7, 2016. The amount of continuing Rofin net sales and net loss from continuing operations included in our condensed consolidated statements of operations for the three months ended July 1, 2017 was approximately $116.5 million and $6.5 million, respectively. The amount of continuing Rofin net sales and net loss from continuing operations included in our condensed consolidated statements of operations for the nine months ended July 1, 2017 was approximately $301.6 million and $36.4 million, respectively.

Unaudited Pro Forma Information (in thousands, except per share data)

The following unaudited pro forma financial information presents our combined results of operations as if the acquisition of Rofin and the related issuance of our Euro Term Loan had occurred on October 4, 2015. The unaudited pro forma financial information is not necessarily indicative of what our condensed consolidated results of operations actually would have been had the acquisition been completed on October 4, 2015. In addition, the unaudited pro forma financial information does not attempt to project the future results of operations of the combined company. The actual results may differ significantly from the pro forma results presented here due to many factors.

| | Three Months Ended July 1, 2017 | Nine Months Ended July 1, 2017 |
|---|---|---|
| Total net sales | $472,027 | $1,294,841 |
| Net income | $64,558 | $159,260 |
| Net income per share: | | |
| Basic | $2.63 | $6.51 |
| Diluted | $2.60 | $6.44 |

The unaudited pro forma financial information above includes the net income of Rofin's low power $CO_2$ laser business based in Hull, United Kingdom, which was recorded as a discontinued operation in the three and nine months ended July 1, 2017. See Note 19, "Discontinued Operations and Sale of Assets Held for Sale."

The unaudited pro forma financial information above reflects the following material adjustments:

- Incremental amortization and depreciation expense related to the estimated fair value of identifiable intangible assets and property, plant and equipment from the purchase price allocation.
- The exclusion of amortization of inventory step-up to its estimated fair value from the three and nine months ended July 1, 2017.
- The exclusion of revenue adjustments as a result of the reduction in customer deposits and deferred revenue related to its estimated fair value from the nine months ended July 1, 2017.
- Incremental interest expense and amortization of debt issuance costs related to our Euro Term Loan and Revolving Credit Facility (as defined in Note 9, "Borrowings").

- The exclusion of acquisition costs incurred by both Coherent and Rofin from the three and nine months ended July 1, 2017.
- The exclusion of a stock-based compensation charge related to the acceleration of Rofin options from the nine months ended July 1, 2017.
- The exclusion of a gain on business combination for our previously owned shares of Rofin from the nine months ended July 1, 2017.
- The exclusion of a foreign exchange gain on forward contracts related to our debt commitment and debt issuance from the nine months ended July 1, 2017.
- The estimated tax impact of the above adjustments.

Table of Contents

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 June 30, 2018 and September 30, 2017, we did not have any assets or liabilities valued based on Level 3 valuations.

We measure the fair value of outstanding debt obligations for disclosure purposes on a recurring basis. As of June 30, 2018, the current and long-term portion of long-term obligations of $6.4 million and $422.3 million, respectively, are reported at amortized cost. These outstanding obligations are classified as Level 2 as they are not actively traded and are valued using a discounted cash flow model that uses observable market inputs. Based on the discounted cash flow model, the fair value of the outstanding debt approximates amortized cost.

Financial assets and liabilities measured at fair value as of June 30, 2018 and September 30, 2017 are summarized below (in thousands):

| | June 30, 2018 | | | September 30, 2017 | | |
|---|---|---|---|---|---|---|
| | Aggregate Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Aggregate Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) |
| Assets: | | | | | | |
| Cash equivalents: | | | | | | |
| Money market fund deposits | $24,277 | $ 24,277 | $ — | $61,811 | $ 61,811 | $ — |
| U.S. Treasury and agency obligations (1) | — | — | — | 14,986 | — | 14,986 |
| Commercial paper (1) | — | — | — | 21,991 | — | 21,991 |
| Short-term investments: | | | | | | |
| U.S. Treasury and agency obligations (1) | — | — | — | 21,087 | — | 21,087 |
| Corporate notes and obligations (1) | — | — | — | 11,423 | — | 11,423 |
| Prepaid and other assets: | | | | | | |
| Foreign currency contracts (2) | 3,191 | — | 3,191 | 1,270 | — | 1,270 |
| Money market fund deposits — Deferred comp and supplemental plan (3) | 701 | 701 | — | 285 | 285 | — |
| Mutual funds — Deferred comp and supplemental plan (3) | 20,392 | 20,392 | — | 17,585 | 17,585 | — |
| Total | $48,561 | $ 45,370 | $ 3,191 | $150,438 | $ 79,681 | $ 70,757 |
| Liabilities: | | | | | | |
| Other current liabilities: | | | | | | |
| Foreign currency contracts (3) | (1,213 ) | — | (1,213 ) | (1,475 ) | — | (1,475 ) |
| Total | $47,348 | $ 45,370 | $ 1,978 | $148,963 | $ 79,681 | $ 69,282 |

(1) 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.

Table of Contents

(2) 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. See Note 6, "Derivative Instruments and Hedging Activities."

(3) 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):

| | June 30, 2018 | | | |
|---|---|---|---|---|
| | Cost Basis | Unrealized Gains | Unrealized Losses | Fair Value |
| Cash and cash equivalents | $232,458 | $ — | $ — | $232,458 |

| | September 30, 2017 | | | |
|---|---|---|---|---|
| | Cost Basis | Unrealized Gains | Unrealized Losses | Fair Value |
| Cash and cash equivalents | $443,066 | $ — | $ — | $443,066 |
| | | | | |
| Short-term investments: | | | | |
| Available-for-sale securities: | | | | |
| U.S. Treasury and agency obligations | $21,074 | $ 13 | $ — | $21,087 |
| Corporate notes and obligations | 11,390 | 34 | (1) | 11,423 |
| Total short-term investments | $32,464 | $ 47 | $ (1) | $32,510 |

There were no unrealized gains or losses at June 30, 2018.

The amortized cost and estimated fair value of available-for-sale investments in debt securities as of June 30, 2018 and September 30, 2017 classified as short-term investments on our condensed consolidated balance sheet were as follows (in thousands):

| | June 30, 2018 | | September 30, 2017 | |
|---|---|---|---|---|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| Investments in available-for-sale debt securities due in less than one year | $ — | $ — | $30,214 | $ 30,251 |
| | $ — | $ — | $2,250 | $ 2,259 |

Investments in available-for-sale debt securities due in one to five years [1]

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

During the three and nine months ended June 30, 2018, we received proceeds totaling $24.5 million and $26.9 million, respectively, from the sale of available-for-sale securities and realized no gross gains or losses. During the three and nine

Table of Contents

months ended July 1, 2017, we received proceeds totaling $0.0 million and $0.1 million, respectively, from the sale of available-for-sale securities and realized no gross gains or losses.

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 rates at each respective date.

On August 1, 2016, we purchased forward contracts totaling 670.0 million Euro, with a value date of November 30, 2016, to limit our foreign exchange risk related to the commitment of our Euro Term Loan (denominated in Euros) in an amount of the Euro equivalent of $750.0 million to finance the U.S. dollar payment for our acquisition of Rofin. In the fourth quarter of fiscal 2016, we recognized an unrealized loss of $2.2 million on these forward contracts. In the first quarter of fiscal 2017, we settled these forward contracts at a net gain of $9.1 million, resulting in a realized gain of $11.3 million in the first quarter of fiscal 2017.

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):

| | U.S. Notional Contract Value | | U.S. Fair Value | |
|---|---|---|---|---|
| | June 30, 2018 | September 30, 2017 | June 30, 2018 | September 30, 2017 |
| Euro currency hedge contracts | | | | |
| Purchase | $ 122,343 | $ 109,641 | $(359 ) | $ (1,397 ) |
| Sell | $ (5,492 ) | $ — | $72 | $ — |
| Japanese Yen currency hedge contracts | | | | |
| Sell | $ (24,052 ) | $ (25,126 ) | $459 | $ 591 |
| South Korean Won currency hedge contracts | | | | |
| Sell | $ (36,772 ) | $ (28,996 ) | $1,204 | $ 551 |
| Chinese RMB currency hedge contracts | | | | |
| Purchase | $ 6,589 | $ — | $(222 ) | $ — |
| Sell | $ (49,399 ) | $ (13,744 ) | $1,415 | $ 128 |
| Singapore Dollar currency hedge contracts | | | | |
| Purchase | $ 33,351 | $ 3,668 | $(598 ) | $ (4 ) |

| | | | | |
|---|---|---|---|---|
| Other foreign currency hedge contracts | | | | |
| Purchase | $ 2,783 | $ — | $ (34 ) | $ — |
| Sell | $ (3,508 ) | $ (2,971 ) | $ 41 | $ (74 ) |

17

Table of Contents

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, "Fair Values."

During the three and nine months ended June 30, 2018, we recognized a loss of $4.6 million and a loss of $6.2 million, respectively, in other income (expense) for derivative instruments not designated as hedging instruments. During the three and nine months ended July 1, 2017, we recognized a gain of $5.6 million and a gain of $15.0 million, respectively, in other income (expense) for derivative instruments not designated as hedging instruments.

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. We had no cash flow hedges outstanding at June 30, 2018 or September 30, 2017. 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.

During the three and nine months ended June 30, 2018 and July 1, 2017, we did not have any activities related to designated cash flow hedges.

Master Netting Arrangements

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. The impact of netting derivative assets and liabilities is not material to our financial position for any of the periods presented. 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.

## 7. GOODWILL AND INTANGIBLE ASSETS

During the nine months ended June 30, 2018, we noted no indications of impairment or triggering events to cause us to review goodwill for potential impairment. We will conduct our annual goodwill testing during the fourth fiscal quarter.

The changes in the carrying amount of goodwill by segment for the period from September 30, 2017 to June 30, 2018 are as follows (in thousands):

| | OEM Laser Sources | Industrial Lasers & Systems | Total |
|---|---|---|---|
| Balance as of September 30, 2017 | $102,178 | $315,516 | $417,694 |
| Additions (see Note 3) | — | 31,456 | 31,456 |
| Translation adjustments and other | (1,143) | (3,941) | (5,084) |
| Balance as of June 30, 2018 | $101,035 | $343,031 | $444,066 |

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

18

Table of Contents

| | June 30, 2018 | | | September 30, 2017 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net | Gross Carrying Amount | Accumulated Amortization | Net |
| Existing technology | $203,343 | $(83,460) | $119,883 | $208,341 | $(66,793) | $141,548 |
| Patents | — | — | — | 330 | (58) | 272 |
| Customer relationships | 50,393 | (20,347) | 30,046 | 51,687 | (14,259) | 37,428 |
| Trade name | 5,888 | (3,317) | 2,571 | 6,171 | (1,824) | 4,347 |
| In-process research & development | 4,864 | — | 4,864 | 6,432 | — | 6,432 |
| Total | $264,488 | $(107,124) | $157,364 | $272,961 | $(82,934) | $190,027 |

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

Amortization expense for intangible assets for the nine months ended June 30, 2018 and July 1, 2017 was $45.6 million and $44.3 million, respectively. The change in the accumulated amortization also includes $2.4 million (decrease) and $2.1 million (increase) of foreign exchange impact for the nine months ended June 30, 2018 and July 1, 2017, respectively.

At June 30, 2018, estimated amortization expense for the remainder of fiscal 2018, the next five succeeding fiscal years and all fiscal years thereafter are as follows (in thousands):

| | Estimated Amortization Expense |
|---|---|
| 2018 (remainder) | $ 14,700 |
| 2019 | 56,129 |
| 2020 | 48,811 |
| 2021 | 17,058 |
| 2022 | 5,593 |
| 2023 | 3,054 |
| Thereafter | 7,155 |
| Total (excluding IPR&D) | $ 152,500 |

8. BALANCE SHEET DETAILS

Inventories consist of the following (in thousands):

| | June 30, 2018 | September 30, 2017 |
|---|---|---|
| Purchased parts and assemblies | $139,956 | $ 114,285 |
| Work-in-process | 188,420 | 159,784 |
| Finished goods | 166,591 | 140,738 |
| Total inventories | $494,967 | $ 414,807 |

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

| | June 30, 2018 | September 30, 2017 |
|---|---|---|
| Prepaid and refundable income taxes | $39,261 | $ 28,712 |
| Other taxes receivable | 17,967 | 15,327 |
| Prepaid expenses and other assets | 31,262 | 26,229 |

| | | |
|---|---|---|
| Total prepaid expenses and other assets | $88,490 | $ 70,268 |

Other assets consist of the following (in thousands):

Table of Contents

| | June 30, 2018 | September 30, 2017 |
|---|---|---|
| Assets related to deferred compensation arrangements | $35,382 | $ 31,008 |
| Deferred tax assets | 72,616 | 82,691 |
| Other assets | 7,631 | 12,942 |
| Total other assets | $115,629 | $ 126,641 |

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

| | June 30, 2018 | September 30, 2017 |
|---|---|---|
| Accrued payroll and benefits | $49,443 | $ 72,327 |
| Deferred revenue | 22,559 | 65,237 |
| Warranty reserve | 35,912 | 36,149 |
| Accrued expenses and other | 35,348 | 34,215 |
| Current liabilities held for sale (See Note 19) | — | 7,021 |
| Customer deposits | 15,023 | 20,052 |
| Total other current liabilities | $158,285 | $ 235,001 |

Components of the reserve for warranty costs during the first nine months of fiscal 2018 and 2017 were as follows (in thousands):

| | Nine Months Ended | |
|---|---|---|
| | June 30, 2018 | July 1, 2017 |
| Beginning balance | $36,149 | $15,949 |
| Additions related to current period sales | 41,681 | 27,854 |
| Warranty costs incurred in the current period | (39,434 ) | (23,422 ) |
| Accruals resulting from acquisitions | 179 | 14,314 |
| Adjustments to accruals related to foreign exchange and other | (2,663 ) | (712 ) |
| Ending balance | $35,912 | $33,983 |

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

| | June 30, 2018 | September 30, 2017 |
|---|---|---|
| Long-term taxes payable | $54,530 | $ 35,866 |
| Deferred compensation | 38,898 | 34,160 |
| Deferred tax liabilities | 37,947 | 45,373 |
| Deferred revenue | 5,151 | 4,765 |
| Asset retirement obligations liability | 4,437 | 5,382 |
| Defined benefit plan liabilities | 39,968 | 39,454 |
| Other long-term liabilities | 1,045 | 1,390 |
| Total other long-term liabilities | $181,976 | $ 166,390 |

## 9. BORROWINGS

With the March 8, 2018 acquisition of OR Laser, we assumed several term loans having an aggregate principal amount of $1.9 million as of March 31, 2018. In the three months ended June 30, 2018, we paid off $1.2 million of principal on these loans. The remaining aggregate principal amount was $0.6 million at June 30, 2018.

20

Table of Contents

On November 4, 2016, we repaid the outstanding balance, plus accrued interest, on our former domestic line of credit and terminated the $50.0 million credit facility with Union Bank of California. We assumed two term loans having an aggregate principal amount of $15.3 million as of November 7, 2016 and several lines of credit totaling approximately $18.1 million with the completion of the Rofin acquisition.

On November 7, 2016 (the "Closing Date"), we entered into a Credit Agreement by and among us, Coherent Holding BV & Co. K.G. (formerly Coherent Holding GmbH), as borrower (the "Borrower"), and certain of our direct and indirect subsidiaries from time to time party thereto, as guarantors, the lenders from time to time party thereto, Barclays Bank PLC, as administrative agent and an L/C Issuer, Bank of America, N.A., as an L/C Issuer, and MUFG Union Bank, N.A., as an L/C Issuer (the "Credit Agreement"). The Credit Agreement provided for a 670.0 million Euro senior secured term loan facility (the "Euro Term Loan") and a $100.0 million senior secured revolving credit facility (the "Revolving Credit Facility") with a $30.0 million letter of credit sublimit and a $10.0 million swing line sublimit. The Borrower may increase the aggregate revolving commitments or borrow incremental term loans in an aggregate principal amount not to exceed the sum of $150.0 million and an amount that would not cause the senior secured net leverage ratio to be greater than 2.75 to 1.00, subject to certain conditions, including obtaining additional commitments from the lenders then party to the Credit Agreement or new lenders. On November 7, 2016, the Borrower borrowed the full 670.0 million Euros under the Euro Term Loan and its proceeds were used to finance the acquisition of Rofin and pay related fees and expenses. On November 7, 2016, we also used 10.0 million Euros of the capacity under the Revolving Credit Facility for the issuance of a letter of credit.

The terms of the Credit Agreement require the Borrower to prepay the term loans in certain circumstances, including from excess cash flow beyond a threshold amount, from the receipt of proceeds from certain dispositions or from the incurrence of certain indebtedness, and from extraordinary receipts resulting in net cash proceeds in excess of $10.0 million in any fiscal year. The Borrower has the right to prepay loans under the Credit Agreement in whole or in part at any time without premium or penalty, subject to customary breakage costs. Revolving loans may be borrowed, repaid and reborrowed until the fifth anniversary of the Closing Date, at which time all outstanding revolving loans must be repaid. The Euro Term Loan matures on the seventh anniversary of the Closing Date, at which time all outstanding principal and accrued and unpaid interest on the Euro Term Loan must be repaid.

In the first and second quarters of fiscal 2018 and during fiscal 2017, we made voluntary principal payments of 75.0 million Euros, 60.0 million Euros and 150.0 million Euros, respectively, on the Euro Term Loan. As of June 30, 2018, the outstanding principal amount of the Euro Term Loan was 373.3 million Euros. As of June 30, 2018, the outstanding principal amount of the Revolving Credit Facility was 10.0 million Euros.

Loans under the Credit Agreement bear interest, at the Borrower's option, at a rate equal to either (i)(x) in the case of calculations with respect to U.S. Dollars or certain other alternative currencies, the London interbank offered rate (the "LIBOR") or (y) in the case of calculations with respect to the Euro, the euro interbank offered rate ("EURIBOR" and, together with LIBOR), the "Eurocurrency Rate") or (ii) a base rate (the "Base Rate") equal to the highest of (x) the federal funds rate, plus 0.50%, (y) the prime rate then in effect and (z) the Eurocurrency Rate for loans denominated in U.S. dollars applicable to a one-month interest period, plus 1.0%, in each case, plus an applicable margin. The applicable margin for Euro Term Loan borrowed as Eurocurrency Rate loans, is 3.50% initially, and following the first anniversary of the Closing Date ranges from 3.50% to 3.00% depending on the consolidated total gross leverage ratio at the time of determination. For Euro Term Loan borrowed as Base Rate loans, the applicable margin initially is 2.50%, and following the first anniversary of the Closing Date ranges from 2.50% to 2.00% depending upon the consolidated total gross leverage ratio at the time of determination. The applicable margin for revolving loans borrowed as Eurocurrency Rate loans, ranges from 4.25% to 3.75%, and for revolving loans borrowed as Base Rate loans, ranges from 3.25% to 2.75%, in each case, based on the consolidated total gross leverage ratio at the time of determination. Interest on Base Rate Loans is payable quarterly in arrears. Interest on Eurocurrency Rate loans is payable at the end of the applicable interest period (or at three month intervals if the interest period exceeds three months). Interest periods for Eurocurrency Rate loans may be, at the Borrower's option, one, two, three or six months.

On May 8, 2017, we entered into Amendment No. 1 and Waiver (the "Repricing Amendment") to the Credit Agreement to, among other things, (i) reduce the applicable interest rate margins with respect to the Euro Term Loans to 1.25% for Euro Term Loans maintained as Base Rate loans and 2.25% for Euro Term Loans maintained as Eurocurrency Rate loans, with stepdowns to 1.00% and 2.00%, respectively, available after May 8, 2018 if the consolidated total gross leverage ratio for Coherent and its restricted subsidiaries is less than 1.50:1.00 and (ii) extend the period during which a prepayment premium may be required for a repricing transaction until six months after the effective date of the Repricing Amendment. In connection with the execution of the Repricing Amendment, we paid arrangement fees of approximately $0.5 million in fiscal 2017, as well as certain fees and expenses of the administrative agent and the lenders, in accordance with the terms of the Credit Agreement.

As our consolidated total gross leverage ratio for Coherent and its restricted subsidiaries was less than 1.50:1.00 as of March 31, 2018, on May 8, 2018, the applicable interest rate margins with respect to the Euro Term Loans were stepped down to 1.00% for Euro Term Loans maintained as Base Rate loans and 2.00% for Euro Term Loans maintained as Eurocurrency Rate loans.

The Credit Agreement requires the Borrower to make scheduled quarterly payments on the Euro Term Loan of 0.25% of the original principal amount of the Euro Term Loan, with any remaining principal payable at maturity. A commitment fee accrues on any unused portion of the revolving loan commitments under the Credit Agreement at a rate of 0.375% or 0.5% depending on the consolidated total gross leverage ratio at any time of determination. The Borrower is also obligated to pay other customary fees for a credit facility of this size and type.

On the Closing Date, we and certain of our direct and indirect subsidiaries, as guarantors, provided an unconditional guaranty of all obligations of the Borrower and the other loan parties arising under the Credit Agreement, the other loan documents and under swap contracts and treasury management agreements with the lenders or their affiliates (with certain limited exceptions). The Borrower and the guarantors have also granted security interests in substantially all of their assets to secure such obligations.

The Credit Agreement contains customary affirmative covenants, including covenants regarding the payment of taxes and other obligations, maintenance of insurance, reporting requirements and compliance with applicable laws and regulations, and negative covenants, including covenants limiting the ability of us and our subsidiaries to, among other things, incur debt, grant liens, make investments, make certain restricted payments, transact with affiliates, and sell assets. The Credit Agreement also requires us and our subsidiaries to maintain a senior secured net leverage ratio as of the last day of each fiscal quarter of less of than or equal to 3.50 to 1.00. The Credit Agreement contains customary events of default that include, among other things, payment defaults, cross defaults with certain other indebtedness, violation of covenants, inaccuracy of representations and warranties in any material respect, change in control of us and the Borrower, judgment defaults, and bankruptcy and insolvency events. If an event of default exists, the lenders may require the immediate payment of all Obligations, as defined in the Credit Agreement, and may exercise certain other rights and remedies provided for under the Credit Agreement, the other loan documents and applicable law. The acceleration of such obligations is automatic upon the occurrence of a bankruptcy and insolvency event of default. We were in compliance with all covenants at June 30, 2018.

We incurred $28.5 million of debt issuance costs related to the Euro Term Loan and $0.5 million of debt issuance costs to the original lenders related to the Repricing Amendment, which are included in short-term borrowings and current portion of long-term obligations and long-term obligations in the condensed consolidated balance sheets and will be amortized to interest expense over the seven year life of the Euro Term Loan using the effective interest method, adjusted to accelerate amortization related to voluntary repayments. We incurred $2.3 million of debt issuance costs in connection with the Revolving Credit Facility which were capitalized and included in prepaid expenses and other assets and other assets in the condensed consolidated balance sheets and will be amortized to interest expense using the straight-line method over the contractual term of five years of the Revolving Credit Facility.

Additional sources of cash available to us were international currency lines of credit and bank credit facilities totaling $27.9 million as of June 30, 2018, of which $21.2 million was unused and available. These unsecured international credit facilities were used in Europe and Japan during the first nine months of fiscal 2018. As of June 30, 2018, we had utilized $6.1 million of the international credit facilities as guarantees in Europe and $0.6 million of the international credit facilities as borrowings in Japan.

Short-term borrowings and current portion of long-term obligations consist of the following (in thousands):

Table of Contents

| | June 30, 2018 | September 30, 2017 |
|---|---|---|
| Current portion of Euro Term Loan [1] | $ 4,445 | $ 3,230 |
| 1.3% Term loan due 2024 | 1,454 | 1,477 |
| 1.0% State of Connecticut term loan due 2023 | 373 | 371 |
| OR Laser loans | 158 | — |
| Line of credit borrowings | 646 | — |
| Total short-term borrowings and current portion of long-term obligations | $ 7,076 | $ 5,078 |

(1) Net of debt issuance costs of $3.4 million and $4.7 million at June 30, 2018 and September 30, 2017, respectively.

Long-term obligations consist of the following (in thousands):

| | June 30, 2018 | September 30, 2017 |
|---|---|---|
| Euro Term Loan due 2024 [1] | $412,716 | $ 578,356 |
| 1.3% Term loan due 2024 | 7,635 | 8,865 |
| 1.0% State of Connecticut term loan due 2023 | 1,500 | 1,780 |
| OR Laser loans | 434 | — |
| Total long-term obligations | $422,285 | $ 589,001 |

(1) Net of debt issuance costs of $13.8 million and $20.4 million at June 30, 2018 and September 30, 2017, respectively.

Contractual maturities of our debt obligations as of June 30, 2018 are as follows (in thousands):

| | Amount |
|---|---|
| 2018 (remainder) | $2,559 |
| 2019 | 9,728 |
| 2020 | 9,727 |
| 2021 | 9,720 |
| 2022 | 9,712 |
| 2023 | 9,575 |
| Thereafter | 394,801 |
| Total | $445,822 |

## 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.

Table of Contents

Determining Fair Value

The fair values of shares purchased under the Employee Stock Purchase Plan ("ESPP") for the three and nine months ended June 30, 2018 and July 1, 2017, respectively, were estimated using the following weighted-average assumptions:

| | Employee Stock Purchase Plan | | | |
|---|---|---|---|---|
| | Three Months Ended | | Nine Months Ended | |
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Expected life in years | 0.5 | 0.5 | 0.5 | 0.5 |
| Expected volatility | 50.5 % | 34.5 % | 50.2 % | 30.8 % |
| Risk-free interest rate | 1.80 % | 0.85 % | 1.45 % | 0.62 % |
| Expected dividend yield | — % | — % | — % | — % |
| Weighted average fair value per share | $59.73 | $47.36 | 68.83 | $32.30 |

There were no stock options granted during the three and nine months ended June 30, 2018 and July 1, 2017.

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 1000 Index and could range from no units to a maximum of twice the initial award units. The weighted average fair value for these performance units was determined using a Monte Carlo simulation model incorporating the following weighted average assumptions:

| | Nine Months Ended | |
|---|---|---|
| | June 30, 2018 | July 1, 2017 |
| Risk-free interest rate | 1.7 % | 1.3 % |
| Volatility | 37.0 % | 31.0 % |
| Weighted average fair value | $315.05 | $163.17 |

We recognize the estimated cost of these awards, as determined under the simulation model, over the related service period of approximately 3 years, 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 and nine months ended June 30, 2018 and July 1, 2017 (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Cost of sales | $1,168 | $880 | $3,174 | $2,618 |
| Research and development | 838 | 639 | 2,378 | 2,289 |
| Selling, general and administrative | 6,577 | 5,373 | 18,517 | 18,323 |

| | | | | |
|---|---|---|---|---|
| Income tax benefit | (1,034 ) | (1,851 ) | (3,818 ) | (5,155 ) |
| | $7,549 | $5,041 | $20,251 | $18,075 |

As a result of our acquisition of Rofin on November 7, 2016, we made a payment of $15.3 million due to the cancellation of options held by employees of Rofin. The payment was allocated between total estimated merger consideration of $11.1 million and post-merger stock-based compensation expense of $4.2 million, recorded in the three months ended December 31, 2016, based on the portion of the total service period of the underlying options that have not been completed by the merger date.

Table of Contents

During the three and nine months ended June 30, 2018, $1.2 million and $3.5 million, respectively, was capitalized into inventory for all stock plans, $1.2 million and $3.2 million, respectively, was amortized to cost of sales and $1.5 million remained in inventory at June 30, 2018. During the three and nine months ended July 1, 2017, $0.9 million and $2.6 million, respectively, was capitalized into inventory for all stock plans, $0.9 million and $2.4 million, respectively, was amortized to cost of sales and $1.1 million remained in inventory at July 1, 2017.

At June 30, 2018, the total compensation cost related to unvested stock-based awards granted to employees under our stock plans but not yet recognized was approximately $43.6 million. We do not estimate forfeitures. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 1.5 years.

Stock Awards Activity

The following table summarizes the activity of our time-based and performance restricted stock units for the first nine months of fiscal 2018 (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 September 30, 2017 | 399 | $ 118.83 | 176 | $ 105.34 |
| Granted | 98 | 255.64 | 78 | 315.05 |
| Vested [(1)] | (213) | 88.43 | (95 ) | 70.57 |
| Forfeited | (6 ) | 116.70 | — | — |
| Nonvested stock at June 30, 2018 | 278 | $ 155.03 | 159 | $ 155.76 |

(1)Service-based restricted stock units vested during the fiscal year. Performance-based restricted stock 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 appealed this decision to the Federal Court of Justice, the highest civil jurisdiction court in Germany. On March 27, 2018, the Federal Court of Justice dismissed Imra's appeal effectively ending the case in favor of Coherent.

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.

On November 7, 2016, we entered into a Credit Agreement, which was amended on May 8, 2017. See Note 9, “Borrowings” for further discussion of the issuance of the financing.

## 12. STOCK REPURCHASES

Table of Contents

On February 6, 2018, our board of directors authorized a buyback program authorizing the Company to repurchase up to $100.0 million of our common stock from time to time through January 31, 2019. During the three and nine months ended June 30, 2018, we repurchased and retired 574,946 shares of outstanding common stock under this plan at an average price of $173.91 per share for a total of $100.0 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):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Weighted average shares outstanding—basic | 24,658 | 24,537 | 24,684 | 24,460 |
| Dilutive effect of employee stock awards | 219 | 286 | 287 | 281 |
| Weighted average shares outstanding—diluted | 24,877 | 24,823 | 24,971 | 24,741 |
| | | | | |
| Net income from continuing operations | $66,970 | $62,871 | 174,175 | 135,757 |
| Loss from discontinued operations, net of income taxes | — | (1,754) | (2) | (2,387) |
| Net income | $66,970 | $61,117 | $174,173 | 133,370 |

A total of 114,489 and 25,864 potentially dilutive securities have been excluded from the diluted share calculation for the three and nine months ended June 30, 2018, respectively, as their effect was anti-dilutive.

A total of 0 and 0 potentially dilutive securities have been excluded from the diluted share calculation for the three and nine months ended July 1, 2017, respectively, as their effect was anti-dilutive.

## 14. OTHER INCOME (EXPENSE)

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Foreign exchange gain (loss) | $(2,605) | $(2,439) | $(8,015) | $7,928 |
| Gain on deferred compensation investments, net | 353 | 1,136 | 2,929 | 2,831 |
| Other | (1,080) | 573 | (695) | 112 |
| Other—net | $(3,332) | $(730) | $(5,781) | $10,871 |

## 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.

Table of Contents

On December 22, 2017, the Tax Cuts and Jobs Act (the “Tax Act”) was enacted. The Tax Act contains significant changes to U.S. tax law, including lowering the U.S. corporate income tax rate to 21.0% and implementing a territorial tax system. Since we have a September year-end, the lower U.S. corporate income tax rate will be phased in. Our U.S. federal blended tax rate will be approximately 24.5% for our fiscal year ending September 29, 2018 and 21.0% for subsequent fiscal years.

The reduction of the U.S. corporate income tax rate adjusts our U.S. deferred tax assets and liabilities to the lower U.S. federal tax rate of 21.0%. There are also certain transitional impacts of the Tax Act. As part of the transition to the new territorial tax system, the Tax Act imposes a one-time deemed repatriation tax on our foreign subsidiaries’ historical earnings. These transitional impacts resulted in a provisional net charge of $41.7 million for the quarter ended December 30, 2017. This is comprised of an estimated deemed repatriation tax charge of $48.7 million less a previously recorded deferred tax liability of $20.3 million for anticipated repatriation of our investment in a foreign subsidiary, plus an estimated deferred tax remeasurement charge of $13.3 million.

The Tax Act changes are broad and complex. The final calculation of impacts of the Tax Act may materially differ from the above provisional estimates. Among other things, this may be due to changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, any changes in accounting standards for income taxes or related interpretations in response to the Tax Act, or any updates or changes to estimates we have utilized to calculate the transitional impacts. The Securities Exchange Commission has issued guidance under Staff Accounting Bulletin No. 118 directing taxpayers to record impacts of the Tax Act as “provisional” when it does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete the accounting under ASC 740. The guidance allows for a measurement period of up to one year after the enactment date of the Tax Act to finalize the recording of the related tax impacts. In the current quarter the IRS issued several notices clarifying the provisions of the Tax Act and the IRS is expected to issue more clarifying guidance in the future. The provisional amounts have not been modified since the quarter ended December 30, 2017 estimates. We currently anticipate finalizing and recording any resulting adjustments by the end of our current fiscal year ending September 29, 2018.

The Tax Act also includes provisions for Global Intangible Low-Taxed Income (“GILTI”) wherein taxes on foreign income are imposed in excess of a deemed return on tangible assets of foreign corporations. In general, this income will effectively be taxed at a 10.5% tax rate reduced by any available current year foreign tax credits. This provision is effective for taxable years beginning after December 31, 2017. Because of the complexity of the new GILTI tax rules, we continue to evaluate this provision of the Tax Act including the associated forecast of GILTI and the application of ASC 740, Income Taxes. Under U.S. GAAP, we are allowed to make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the “period cost method”) or (2) factoring such amounts into our measurement of our deferred taxes (the “deferred method”). Our selection of an accounting policy with respect to the new GILTI tax rules will depend, in part, on analyzing our global income to determine whether we expect to have future U.S. inclusions in taxable income related to GILTI and, if so, what the impact is expected to be. Whether we expect to have future U.S. inclusions in taxable income related to GILTI depends on not only our current structure and estimated future results of global operations, but also our intent and ability to modify our structure. We are currently in the process of analyzing our structure and, as a result, are not yet able to reasonably estimate the effect of this provision of the Tax Act. Therefore, we have not made any adjustments related to potential GILTI tax in our financial statements and have not made a policy decision regarding whether to record deferred tax on GILTI.

Our effective tax rates on income from continuing operations before income taxes for the three and nine months ended June 30, 2018 were 27.9% and 38.9%, respectively. Our effective tax rate for the three months ended June 30, 2018 was higher than the effective U.S. federal blended tax rate of 24.5% primarily due to the impact of income subject to foreign tax rates that are higher than the U.S. tax rates. This amount is partially offset by the benefit of foreign tax credits, the benefit of federal research and development tax credits, the benefit of a domestic manufacturing deduction under IRC Section 199 and the Singapore tax exemption. Our effective tax rate for the nine months ended June 30, 2018 was higher than the effective U.S. federal blended tax rate of 24.5% primarily due to the Tax Act one-time mandatory deemed repatriation transition tax, the impact of income subject to foreign tax rates that are higher than the U.S. tax rates, the remeasurement of deferred tax assets and liabilities based on the newly enacted U.S. federal tax rate of 21.0%, stock-based compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m). These amounts are partially offset by the excess tax benefits from stock award exercises and restricted stock unit vesting, the benefit of foreign tax credits, the benefit of federal research and development tax credits, the benefit of a domestic manufacturing deduction under IRC Section 199 and the Singapore tax exemption.

Our effective tax rates on income from continuing operations before income taxes for the three and nine months ended July 1, 2017 were 32.1% and 32.4%, respectively. Our effective tax rates for the three and nine months ended July 1, 2017 were lower than the U.S. federal rate of 35.0% primarily due to differences related to the benefit of income subject to

Table of Contents

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. These amounts were partially offset by Rofin transaction costs not deductible for tax purposes, tax costs of Rofin restructuring, ASC 740-10 (formerly FIN48) tax liabilities for transfer pricing, stock-based compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m).

We adopted ASU No. 2016-09 in the first quarter of fiscal 2018. As a result of adopting the new standard, excess tax benefits from equity-based compensation are now reflected in the condensed consolidated statements of operations as a component of the provision for income taxes. The adoption of ASU No. 2016-09 resulted in a decrease in our provision for income taxes of $0.0 million and $12.8 million for the three and nine months ended June 30, 2018, respectively, due to the recognition of excess tax benefits for options exercised and the vesting of equity awards.

## 16. DEFINED BENEFIT PLANS

Components of net periodic cost were as follows for the three and nine months ended June 30, 2018 and July 1, 2017 (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Service cost | $424 | $566 | $1,251 | $1,409 |
| Interest cost | 194 | 279 | 549 | 729 |
| Expected return on plan assets | (99) | (184) | (297) | (490) |
| Amortization of prior service cost | 64 | 19 | 166 | 50 |
| Amortization of prior net loss | — | 139 | — | 370 |
| Amortization of unrecognized gain from OCI | (503) | — | (1,117) | — |
| Recognized net actuarial loss | (69) | 387 | (26) | 845 |
| Net periodic pension cost | $11 | $1,206 | $526 | $2,913 |

## 17. SEGMENT INFORMATION

At June 30, 2018, we were organized into two reporting segments, OEM Laser Sources (“OLS”) and Industrial Lasers & Systems (“ILS”), based upon our organizational structure and how the chief operating decision maker (“CODM”) receives and utilizes information provided to allocate resources and make decisions. This segmentation reflects the go-to-market strategies and synergies for our broad portfolio of laser technologies and products. While both segments deliver cost-effective, highly reliable photonics solutions, the OLS business segment is focused on high performance laser sources and complex optical sub-systems, typically used in microelectronics manufacturing, medical diagnostics and therapeutic medical applications, as well as in scientific research. Our ILS business segment delivers high performance laser sources, sub-systems and tools primarily used for industrial laser materials processing, serving important end markets like automotive, machine tool, consumer goods and medical device manufacturing. Rofin’s operating results have been included primarily in our ILS segment. OR Laser’s operating results have been included in our ILS segment.

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

Our Chief Executive Officer has been identified as the CODM, as he assesses the performance of the segments and decides how to allocate resources to the segments. Income from continuing operations is the measure of profit and loss that our CODM uses to assess performance and make decisions. As assets are not a measure used to assess the performance of the company by the CODM, asset information is not tracked or compiled by segment and is not available to be reported in our disclosures. Income from operations represents the net sales less the cost of sales and direct operating expenses incurred within the operating segments as well as allocated expenses such as shared sales and manufacturing costs. We do not

Table of Contents

allocate to our operating segments certain operating expenses which we manage separately at the corporate level. These unallocated costs include stock-based compensation and corporate functions (certain research and development, management, finance, legal and human resources) and are included in the results below under Corporate and other in the reconciliation of operating results. Management does not consider unallocated Corporate and other costs in its measurement of segment performance.

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Net sales: | | | | |
| OEM Laser Sources | $315,538 | $309,925 | $958,333 | $825,805 |
| Industrial Lasers & Systems | 166,804 | 154,182 | 482,692 | 407,208 |
| Total net sales | $482,342 | $464,107 | $1,441,025 | $1,233,013 |
| | | | | |
| Income (loss) from continuing operations: | | | | |
| OEM Laser Sources | $117,948 | $120,586 | $362,785 | $307,046 |
| Industrial Lasers & Systems | (292) | (1,493) | 2,093 | (29,571) |
| Corporate and other | (17,132) | (18,516) | (54,370) | (63,609) |
| Total income from continuing operations | 100,524 | 100,577 | 310,508 | 213,866 |
| Total other income (expense), net | (7,625) | (7,942) | (25,635) | (13,025) |
| Income from continuing operations before income taxes | $92,899 | $92,635 | $284,873 | $200,841 |

Major Customers

We had one customer during the three and nine months ended June 30, 2018 that accounted for 30.0% and 28.4%, respectively, of net sales. The same customer accounted for 28.2% and 25.3% of net sales for the three and nine months ended July 1, 2017, respectively. The customer purchased primarily from our OLS segment.

We had one customer that accounted for 30.9% and 19.0% of accounts receivable at June 30, 2018 and September 30, 2017, respectively. We had another customer that accounted for 10.0% of accounts receivable at September 30, 2017. The customers purchased primarily from our OLS segment.

## 18. RESTRUCTURING CHARGES

In the first quarter of fiscal 2017, we began the implementation of planned restructuring activities in connection with the acquisition of Rofin. These activities primarily relate to exiting our legacy high power fiber laser product line, change of control payments to Rofin officers, the exiting of two product lines acquired in the acquisition of Rofin, realignment of our supply chain due to segment reorganization and consolidation of sales and distribution offices as well as certain manufacturing sites. These activities resulted in charges primarily for employee termination, other exit related costs associated with the write-off of property and equipment and inventory and early lease termination costs.

The following table presents our current liability as accrued on our balance sheets for restructuring charges. The table sets forth an analysis of the components of the restructuring charges and payments and other deductions made against the accrual for the first three and nine months of fiscal 2018 and 2017 (in thousands):

Table of Contents

| | Severance Related | Asset Write-Offs | Other | Total |
|---|---|---|---|---|
| Balances, September 30, 2017 | $ 1,301 | $ — | $— | $1,301 |
| Provision | 629 | 430 | 105 | 1,164 |
| Payments and other | (755 ) | (430 ) | (105 ) | (1,290 ) |
| Balances, December 30, 2017 | 1,175 | — | — | 1,175 |
| Provision | 599 | 9 | 118 | 726 |
| Payments and other | (841 ) | (9 ) | (118 ) | (968 ) |
| Balances, March 31, 2018 | 933 | — | — | 933 |
| Provision | 306 | 1,221 | (334 ) | 1,193 |
| Payments and other | (415 ) | (1,221 ) | 523 | (1,113 ) |
| Balances, June 30, 2018 | $ 824 | $ — | $189 | $1,013 |

| | Severance Related | Asset Write-Offs | Other | Total |
|---|---|---|---|---|
| Balances, October 1, 2016 | $ — | $ — | $— | $— |
| Provision | 2,703 | 4,359 | — | 7,062 |
| Payments and other | (344 ) | (4,359 ) | — | (4,703 ) |
| Balances, December 31, 2016 | 2,359 | — | — | 2,359 |
| Provision | 319 | (45 ) | 283 | 557 |
| Payments and other | (892 ) | 45 | (104 ) | (951 ) |
| Balances, April 1, 2017 | 1,786 | — | 179 | 1,965 |
| Provision | 1,115 | 82 | 303 | 1,500 |
| Payments and other | (1,793 ) | (82 ) | (130 ) | (2,005 ) |
| Balances, July 1, 2017 | $ 1,108 | $ — | $352 | $1,460 |

At June 30, 2018, $1.0 million of accrued restructuring costs were included in other current liabilities. The current year severance related costs are primarily comprised of severance pay for employees being terminated due to the consolidation of certain manufacturing sites. The current year asset write-offs are primarily comprised of inventory and equipment write-offs due to consolidation of certain manufacturing sites. The severance related costs in the first three and nine months of fiscal 2017 are primarily comprised of severance pay for employees being terminated due to the transition of activities out of Rofin including change of control payments to Rofin officers and the consolidation of sales and distribution offices. The asset write-offs in the first three and nine months of fiscal 2017 are primarily comprised of write-offs of inventory and equipment due to exiting our legacy high power fiber laser product line and inventory write-offs due to the exit of other Rofin product lines.

By segment, $1.0 million and $2.0 million of restructuring costs were incurred in the ILS segment and $0.2 million and $1.1 million were incurred in the OLS segment in the three and nine months ended June 30, 2018, respectively. $1.5 million and $8.6 million of restructuring costs were incurred in the ILS segment and $0.0 million and $0.5 million were incurred in the OLS segment in the three and nine months ended July 1, 2017, respectively. Restructuring charges are recorded in cost of sales, research and development and selling, general and administrative expenses in our condensed consolidated statements of operations.

## 19. DISCONTINUED OPERATIONS AND SALE OF ASSETS HELD FOR SALE

### Discontinued Operations

Discontinued operations are from the Hull Business that we acquired as part of our acquisition of Rofin. As a condition of the acquisition, we were required to divest and hold separate the Hull Business and reported this business separately as a discontinued operation until its divestiture. We completed the divestiture of the Hull Business on

October 11, 2017, after receiving approval for the terms of the sale from the European Commission. As a result of the divestiture, we recorded a loss in discontinued operations of $2,000 in the first quarter of fiscal 2018. The results from discontinued operations in the

30

Table of Contents

first quarter of fiscal 2018 to the date of divestiture (October 11, 2017) were immaterial and were not included in our condensed consolidated results of operations.

For financial statement purposes, the results of operations for this discontinued business have been segregated from those of the continuing operations and are presented in our consolidated financial statements as discontinued operations and the net assets of the remaining discontinued business have been presented as current assets and current liabilities held for sale.

The results of discontinued operations for the three and nine months ended June 30, 2018 and July 1, 2017 are as follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Net sales | $— | $7,920 | $— | $20,296 |
| Cost of sales | — | 5,349 | — | 14,337 |
| Operating expenses | — | 2,771 | — | 6,924 |
| Impairment loss | — | 1,249 | — | 1,249 |
| Other expense | — | 5 | — | 173 |
| Loss from discontinued operations | — | (1,454) | — | (2,387) |
| Loss on disposal of discontinued operations | — | — | (2) | — |
| Total loss on discontinued operations | — | (1,454) | (2) | (2,387) |
| Income tax expense (benefit) | — | 300 | — | — |
| Net loss from discontinued operations | $— | $(1,754) | $(2) | $(2,387) |

Assets Held for Sale

Due to the divestiture of the Hull Business on October 11, 2017, there are no assets or liabilities related to the Hull Business classified as held for sale as of June 30, 2018. Current assets and current liabilities classified as held for sale as of September 30, 2017 related to the Hull Business are as follows (in thousands):

| | September 30, 2017 |
|---|---|
| Cash | $ 33 |
| Accounts receivable | 6,931 |
| Inventories | 5,586 |
| Prepaid expenses and other assets | 607 |
| Property and equipment | 10,705 |
| Intangible assets | 11,400 |
| Total current assets held for sale | $ 35,262 |
| | |
| Accounts payable | $ 1,129 |
| Other current liabilities | 4,875 |
| Total current liabilities held for sale | $ 6,004 |

In the fourth quarter of fiscal 2017, management decided to sell several entities that we acquired in the Rofin acquisition. Although the sale was not completed as of the end of fiscal 2017, we recorded a non-cash impairment charge of $2.9 million to operating expense in our results of operations in the fourth quarter of fiscal 2017 to reduce our carrying value in these entities to fair value. In the first and second quarters of fiscal 2018, we recorded additional non-cash impairment charges (recoveries) of $0.3 million and $(0.5) million, respectively, to operating expense in our results of operations to reduce our carrying value in these entities to fair value. On April 27, 2018, we completed the sale of these entities acquired in the Rofin acquisition in exchange for cash of $6.3 million and we recognized an additional loss on the sale of $0.5 million in the third quarter of fiscal 2018, for a net loss of $0.3 million in the nine months ended June 30, 2018.

Due to the sale of these entities acquired in the Rofin acquisition on April 27, 2018, there are no assets or liabilities related to these entities classified as held for sale as of June 30, 2018. Current assets and current liabilities classified as held for sale as of September 30, 2017 related to continuing operations are as follows (in thousands):

| | September 30, 2017 |
|---|---|
| Accounts receivable | $ 1,668 |
| Inventories | 5,202 |
| Prepaid expenses and other assets | 472 |
| Property and equipment | 457 |
| Intangible assets | 1,187 |
| Total current assets held for sale | $ 8,986 |
| | |
| Accounts payable | $ 189 |
| Other current liabilities | 828 |
| Total current liabilities held for sale | $ 1,017 |

## 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, laser-based technologies and laser-based system solutions in a broad range of commercial, industrial and scientific 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 reporting segments: OEM Laser Sources ("OLS") and Industrial Lasers & Systems ("ILS"), based on the organizational structure of the company and how the chief operating decision maker ("CODM") receives and utilizes information provided to allocate resources and make decisions. This segmentation reflects the go-to-market strategies and synergies for our broad portfolio of laser technologies and products. While both segments deliver cost-effective, highly reliable photonics solutions, the OLS business segment is focused on high performance laser sources and complex optical sub-systems typically used in microelectronics manufacturing, medical diagnostics and therapeutic medical applications, as well as in scientific research. Our ILS business segment delivers high performance laser sources, sub-systems and tools primarily used for industrial laser materials processing, serving important end markets like automotive, machine tool, consumer goods and medical device manufacturing.

Income from operations is the measure of profit and loss that our 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, Materials Processing, OEM Components and Instrumentation and Scientific Research and Government Programs.

Table of Contents

## 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.
- 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 expense, major restructuring costs and certain other non-operating income and expense items, such as costs related to our acquisition of Rofin. Key initiatives to reach our goals for EBITDA improvements include utilization of our Asian manufacturing locations, optimizing our supply chain and continued leveraging of our infrastructure.
- Optimize our leadership position in existing markets—There are a number of markets where we have historically been at the forefront of technological development and product deployment and from which we have derived a substantial portion of our revenues. We plan to optimize our financial returns from these markets.
- Maintain and develop additional strong collaborative customer and industry relationships—We believe that the Coherent brand name and reputation for product quality, technical performance and customer satisfaction will help us to further develop our loyal customer base. We plan to maintain our current customer relationships and develop new ones with customers who are industry leaders and work together with these customers to design and develop innovative product systems and solutions as they develop new technologies.
- Develop and acquire new technologies and market share—We will continue to enhance our market position through our existing technologies and develop new technologies through our internal research and development efforts, as well as through the acquisition of additional complementary technologies, intellectual property, manufacturing processes and product offerings.

## 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, business combinations, accounting for long-lived assets (including goodwill and intangible assets), inventory valuation, warranty reserves, stock-based compensation and accounting for income taxes. See Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for our fiscal year ended September 30, 2017.

## 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 June 30, 2018 | July 1, 2017 | Change | % Change |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Net sales—OEM Laser Sources | $315,538 | $309,925 | $5,613 | 1.8 % |
| Net sales—Industrial Lasers & Systems | $166,804 | $154,182 | $12,622 | 8.2 % |
| Gross profit as a percentage of net sales—OEM Laser Sources | 52.3 % | 53.8 % | (1.5 )% | (2.8 )% |
| Gross profit as a percentage of net sales—Industrial Lasers & Systems | 26.6 % | 26.9 % | (0.3 )% | (1.1 )% |
| Research and development as a percentage of net sales | 7.1 % | 6.6 % | 0.5 % | 7.6 % |
| Income from continuing operations before income taxes | $92,899 | $92,635 | $264 | 0.3 % |
| Net cash provided by operating activities | $194 | $90,923 | $(90,729) | (99.8 )% |
| Days sales outstanding in receivables | 63.0 | 53.9 | 9.1 | 16.9 % |
| Annualized third quarter inventory turns | 2.2 | 2.6 | (0.4 ) | (15.4 )% |
| Capital spending as a percentage of net sales | 4.4 % | 3.4 % | 1.0 % | 29.4 % |
| Net income from continuing operations as a percentage of net sales | 13.9 % | 13.6 % | 0.3 % | 2.2 % |
| Adjusted EBITDA as a percentage of net sales | 29.1 % | 30.6 % | (1.5 )% | (4.9 )% |

| | Nine Months Ended June 30, 2018 | July 1, 2017 | Change | % Change |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Net sales—OEM Laser Sources | $958,333 | $825,805 | $132,528 | 16.0 % |
| Net sales—Industrial Lasers & Systems | $482,692 | $407,208 | $75,484 | 18.5 % |
| Gross profit as a percentage of net sales—OEM Laser Sources | 53.1 % | 53.3 % | (0.2 )% | (0.4 )% |
| Gross profit as a percentage of net sales—Industrial Lasers & Systems | 27.9 % | 22.3 % | 5.6 % | 25.1 % |
| Research and development as a percentage of net sales | 7.0 % | 7.1 % | (0.1 )% | (1.4 )% |
| Income from continuing operations before income taxes | $284,873 | $200,841 | $84,032 | 41.8 % |
| Net cash provided by operating activities | $132,993 | $285,282 | $(152,289) | (53.4 )% |
| Capital spending as a percentage of net sales | 4.6 % | 3.7 % | 0.9 % | 24.3 % |
| Net income from continuing operations as a percentage of net sales | 12.1 % | 11.0 % | 1.1 % | 10.0 % |
| Adjusted EBITDA as a percentage of net sales | 29.6 % | 29.5 % | 0.1 % | 0.3 % |

Net Sales

Net sales include sales of lasers, laser tools, related accessories and service. Net sales for the third quarter of fiscal 2018 increased 1.8% in our OLS segment and increased 8.2% in our ILS segment from the same quarter one year ago. Net sales for the first nine months of fiscal 2018 increased 16.0% in our OLS segment and increased 18.5% in our ILS segment from the same period one year ago. For a description of the reasons for changes in net sales refer to the "Results of Operations" section of this quarterly report.

Gross Profit as a Percentage of Net Sales

Gross profit as a percentage of net sales ("gross profit percentage") is calculated as gross profit for the period divided by net sales for the period. Gross profit percentage in the third quarter of fiscal 2018 decreased to 52.3% from 53.8% in our OLS

segment and decreased to 26.6% from 26.9% in our ILS segment from the same quarter one year ago. Gross profit percentage in the first nine months of fiscal 2018 decreased to 53.1% from 53.3% in our OLS segment and increased to 27.9% from 22.3% in our ILS segment from the same period one year ago. For a description of the reasons for changes in gross profit refer to the “Results of Operations” section of this quarterly report.

Research and Development as a Percentage of Net Sales

Research and development as a percentage of net sales (“R&D percentage”) is calculated as research and development expense for the period divided by net sales for the period. Management considers R&D percentage to be an important indicator in managing our business as investing in new technologies is a key to future growth. R&D percentage increased to 7.1% for the third quarter of fiscal 2018 from 6.6% for the same quarter one year ago and decreased to 7.0% for the first nine months of fiscal 2018 from 7.1% for 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 third quarter of fiscal 2018 increased to 63.0 days from 53.9 days compared to the same quarter one year ago. The increase was primarily due to a significantly higher concentration of sales in the last month of the quarter of ELA tools used in the Asian flat panel display market. Additionally, a large amount of receivables from this market was collected in the beginning of July 2018.

Annualized Third Quarter Inventory Turns

We calculate annualized third quarter inventory turns as the cost of sales during the third quarter annualized and divided by net inventories at the end of the third quarter. This indicates how well we are managing our inventory levels, with higher inventory turns resulting in more working capital availability and a higher return on our investments in inventory. The more money we have tied up in inventory, the less money we have available for research and development, acquisitions, expansion, marketing and other activities to grow our business. Our annualized inventory turns for the third quarter of fiscal 2018 decreased to 2.2 from 2.6 turns compared to the same quarter a year ago primarily due to inventory increases to support demand for both sales and service of our large ELA tools and their increased installed base as well as sales of our high power fiber laser systems.

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 us in measuring our cash flows, net of capital expenditures. Our capital spending percentage increased to 4.4% for the third quarter of fiscal 2018 from 3.4% for the third quarter of fiscal 2017, and increased to 4.6% for the first nine months of fiscal 2018 from 3.7% for the first nine months of fiscal 2017 in each case primarily due to investments made to expand our manufacturing capacity in several manufacturing sites in Germany and South Korea, higher purchases of production-related assets and higher spending on information technology infrastructure and office consolidations to support our integration of Rofin. These increases were partially offset by higher revenues in the fiscal 2018 periods.

Adjusted EBITDA as a Percentage of Net Sales

Table of Contents

We define adjusted EBITDA as operating income adjusted for depreciation, amortization, stock compensation expense, major restructuring costs and certain other non-operating income and expense items, such as costs related to our acquisitions. Key initiatives to reach our goals for EBITDA improvements include utilization of our Asian manufacturing locations, optimizing 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 from continuing operations as a percentage of net sales to our adjusted EBITDA as a percentage of net sales:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Net income from continuing operations as a percentage of net sales | 13.9% | 13.5% | 12.1% | 11.0 % |
| Income tax expense | 5.4 % | 6.4 % | 7.7 % | 5.3 % |
| Interest and other income (expense), net | 1.7 % | 2.0 % | 2.0 % | 1.3 % |
| Depreciation and amortization | 5.9 % | 5.8 % | 5.9 % | 6.1 % |
| Restructuring charges | 0.2 % | 0.3 % | 0.2 % | 0.7 % |
| Purchase accounting step-up | 0.1 % | 1.0 % | — % | 2.2 % |
| Gain on business combination | — % | — % | — % | (0.4 )% |
| Impairment and other charges | 0.1 % | — % | — % | — % |
| Costs related to acquisitions | — % | 0.1 % | — % | 1.4 % |
| Stock-based compensation | 1.8 % | 1.5 % | 1.7 % | 1.9 % |
| Adjusted EBITDA as a percentage of net sales | 29.1% | 30.6% | 29.6% | 29.5 % |

SIGNIFICANT EVENTS

Acquisitions and divestitures

On April 27, 2018, we completed the sale of several entities that we acquired in the Rofin acquisition. See Note 19, "Discontinued Operations and Sale of Assets Held for Sale" in the Notes to Condensed Consolidated Financial Statements.

On March 8, 2018, we acquired privately held O.R. Lasertechnologie GmbH and certain assets of its U.S.-based affiliate (collectively "OR Laser") for approximately $47.4 million, excluding transaction costs. OR Laser produces laser-based material processing equipment for a variety of uses, including additive manufacturing, welding, cladding, marking, engraving and drilling. See Note 3, "Business Combinations" in the Notes to Condensed Consolidated Financial Statements.

On November 7, 2016, we completed our acquisition of Rofin pursuant to the Merger Agreement dated March 16, 2016. Rofin is one of the world's leading developers and manufacturers of high-performance industrial laser sources and laser-based solutions and components. As a condition of the acquisition, we were required to divest and hold separate Rofin's low power $CO_2$ laser business based in Hull, United Kingdom (the "Hull Business"), and reported this business separately as a discontinued operation until its divestiture. We completed the divestiture of the Hull Business on October 11, 2017, after receiving approval for the terms of the sale from the European Commission. See Note 19, “Discontinued Operations and Assets Held for Sale” in the Notes to Condensed Consolidated Financial Statements.

Stock repurchases

On February 6, 2018, our board of directors authorized a buyback program authorizing the Company to repurchase up to $100.0 million of our common stock from time to time through January 31, 2019. During the three and nine months ended

Table of Contents

June 30, 2018, we repurchased and retired 574,946 shares of outstanding common stock under this plan at an average price of $173.91 per share for a total of $100.0 million.

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:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Net sales | 100.0 % | 100.0 % | 100.0 % | 100.0 % |
| Cost of sales | 56.8 % | 55.4 % | 55.5 % | 57.2 % |
| Gross profit | 43.2 % | 44.6 % | 44.5 % | 42.8 % |
| Operating expenses: | | | | |
| Research and development | 7.1 % | 6.6 % | 7.0 % | 7.1 % |
| Selling, general and administrative | 14.6 % | 15.6 % | 15.3 % | 17.7 % |
| Gain on business combination | — % | — % | — % | (0.4 )% |
| Impairment and other charges | 0.1 % | — % | — % | — % |
| Amortization of intangible assets | 0.5 % | 0.8 % | 0.6 % | 1.1 % |
| Total operating expenses | 22.3 % | 23.0 % | 22.9 % | 25.5 % |
| Income from operations | 20.9 % | 21.6 % | 21.6 % | 17.3 % |
| Other income (expense), net | (1.6 )% | (1.6 )% | (1.8 )% | (1.0 )% |
| Income from continuing operations before income taxes | 19.3 % | 20.0 % | 19.8 % | 16.3 % |
| Provision for income taxes | 5.4 % | 6.4 % | 7.7 % | 5.3 % |
| Net income from continuing operations | 13.9 % | 13.6 % | 12.1 % | 11.0 % |

Net income from continuing operations for the third quarter of fiscal 2018 was $67.0 million ($2.69 per diluted share). This included $10.9 million after-tax amortization of intangible assets, $7.5 million of after-tax stock-based compensation expense, $0.9 million of after-tax restructuring costs, $0.6 million impairment and other charges, $0.3 million after-tax amortization of purchase accounting inventory and favorable lease step up and $0.1 million of after-tax acquisition costs. Net income from continuing operations for the third quarter of fiscal 2017 was $62.9 million ($2.53 per diluted share) including $10.9 million after-tax amortization of intangible assets, $5.0 million of after-tax stock-based compensation expense, $3.2 million after-tax amortization of purchase accounting inventory step-up, $1.1 million of after-tax restructuring costs and $0.3 million of after tax costs related to our acquisition of Rofin.

Net income from continuing operations for the first nine months of fiscal 2018 was $174.2 million ($6.98 per diluted share). This included $32.6 million after-tax amortization of intangible assets, $20.3 million of after-tax stock-based compensation expense, $2.3 million of after-tax restructuring costs, $0.8 million impairment and other charges, $0.6 million after-tax amortization of purchase accounting inventory and favorable lease step up, $0.5 million of after-tax acquisition costs, $41.7 million of tax charges due to the U.S. Tax Cuts and Jobs Act transition tax and deferred tax remeasurement and $12.8 million of tax benefit from the adoption of new rules for accounting for excess tax benefits and tax deficiencies for employee stock-based compensation. Net income from continuing operations for the first nine months of fiscal 2017 was $135.8 million ($5.49 per diluted share) including $31.2 million after-tax amortization of intangible assets, $19.0 million after-tax amortization of purchase accounting inventory step-up, $18.1 million of after-tax stock-based compensation expense, $17.4 million of after tax costs related to our acquisition of Rofin, $6.1 million of after-tax restructuring costs, $1.8 million after-tax interest expense on the commitment of our term loan to finance our acquisition of Rofin, a $3.4 million after-tax gain on our sale of owned Rofin shares and $7.1 million after-tax foreign exchange gain on forward contracts associated with our foreign exchange risk related to the commitment of our Euro Term Loan and the issuance of the Euro Term Loan to finance our acquisition of Rofin.

NET SALES

Table of Contents

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 | | | |
|---|---|---|---|---|
| | June 30, 2018 | | July 1, 2017 | |
| | Amount | Percentage of total net sales | Amount | Percentage of total net sales |
| Consolidated: | | | | |
| Microelectronics | $262,308 | 54.4 % | $241,842 | 52.1 % |
| Materials processing | 132,905 | 27.6 % | 142,614 | 30.7 % |
| OEM components and instrumentation | 55,690 | 11.5 % | 50,061 | 10.8 % |
| Scientific and government programs | 31,439 | 6.5 % | 29,590 | 6.4 % |
| Total | $482,342 | 100.0 % | $464,107 | 100.0 % |

| | Nine Months Ended | | | |
|---|---|---|---|---|
| | June 30, 2018 | | July 1, 2017 | |
| | Amount | Percentage of total net sales | Amount | Percentage of total net sales |
| Consolidated: | | | | |
| Microelectronics | $791,792 | 54.9 % | $628,498 | 51.0 % |
| Materials processing | 396,188 | 27.5 % | 364,788 | 29.6 % |
| OEM components and instrumentation | 157,869 | 11.0 % | 151,650 | 12.3 % |
| Scientific and government programs | 95,176 | 6.6 % | 88,077 | 7.1 % |
| Total | $1,441,025 | 100.0 % | $1,233,013 | 100.0 % |

Quarterly

Net sales for the third quarter of fiscal 2018 increased by $18.2 million, or 4%, compared to the third quarter of fiscal 2017, with increases in the microelectronics, OEM components and instrumentation and scientific and government programs markets, partially offset by decreases in the materials processing market. The acquisition of OR Laser on March 8, 2018 added $3.8 million in net sales to the materials processing market (machine tool applications) in the ILS segment in the third quarter of fiscal 2018.

The increase in the microelectronics market of $20.5 million, or 8%, was primarily due to higher shipments related to ELA tools used in the flat panel display market and higher revenues from consumable parts as well as higher shipments related to semiconductor, solar and advanced packaging applications. In microelectronics, we expect that total (including systems and service) flat panel display revenues will reach a current peak in fiscal 2018 and decrease in fiscal 2019 (services revenue is expected to grow and is expected to partially offset the expected decrease in systems revenue) before beginning to recover in fiscal 2020. We also expect continued strength during fiscal 2019 in the semiconductor capital equipment market. Due to our diversity of product offerings, we expect the expected decrease in flat panel display revenues in fiscal 2019 will be largely, but not fully, offset by growth in our other markets. The increase in the OEM components and instrumentation market of $5.6 million, or 11%, was due primarily to higher shipments for bio-instrumentation applications. Within OEM components and instrumentation applications, we are seeing strong demand in the bio-instrumentation market, particularly in flow cytometry and sequencing applications, strength in defense spending for directed-energy programs and in satellite optics as well as higher demand for consumables in the medical market, in dental applications and in eye disease management. Sales in the scientific and government programs market increased $1.8 million, or 6%, due to higher demand for advanced research applications used by university and government research groups, particularly in the U.S. and Asia. We expect demand in the scientific and government programs market to continue to fluctuate from quarter to quarter. Sales in the materials processing market decreased $9.7 million, or 7%, primarily due to lower shipments for materials processing, consumer goods and medical applications, partially offset by higher shipments for automotive and machine tool applications. We expect fiscal 2019 growth

Table of Contents

in multiple materials processing applications, with the two largest growth opportunities in fiber lasers and components for cutting and welding and in laser-based tools for electronics, automotive and medical device manufacturing.

Year-to-date

Net sales for the first nine months of fiscal 2018 increased by $208.0 million, or 17%, compared to the first nine months of fiscal 2017, with significant increases in the microelectronics market and smaller increases in the materials processing, scientific and government programs and OEM components and instrumentation markets. The increase is partially due to the inclusion of a full nine months of Rofin net sales in the first nine months of fiscal 2018 compared to the inclusion of Rofin's net sales only after the November 7, 2016 acquisition date in the first nine months of fiscal 2017. In addition, net sales in the first nine months of fiscal 2018 include $5.1 million of sales from the acquisition of OR Laser after the March 8, 2018 acquisition date.

The increase in the microelectronics market of $163.3 million, or 26%, was primarily due to higher shipments related to ELA tools used in the flat panel display market and higher revenues from consumable parts as well as higher shipments related to semiconductor, advanced packaging and solar applications. Sales in the materials processing market increased $31.4 million, or 9%, primarily due to the inclusion of a full nine months of Rofin net sales in the first nine months of fiscal 2018, higher shipments for marking applications and the inclusion of four months of OR Laser net sales. Sales in the scientific and government programs market increased $7.1 million, or 8%, due to higher demand for advanced research applications used by university and government research groups, particularly in Asia. The increase in the OEM components and instrumentation market of $6.2 million, or 4%, was due primarily to higher shipments for bio-instrumentation applications, which were partially offset by lower shipments for military applications.

Segments

We are organized into two reportable operating segments: OLS and ILS. While both segments deliver cost-effective, highly reliable photonics solutions, OLS is focused on high performance laser sources and complex optical sub-systems, typically used in microelectronics manufacturing, medical diagnostics and therapeutic medical applications, as well as in scientific research. ILS delivers high performance laser sources, sub-systems and tools primarily used for industrial laser materials processing, serving important end markets like automotive, machine tool, consumer goods and medical device manufacturing.

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 | | | | | |
|---|---|---|---|---|---|---|
| | June 30, 2018 | | | July 1, 2017 | | |
| | Amount | Percentage of total net sales | | Amount | Percentage of total net sales | |
| Consolidated: | | | | | | |
| OEM Laser Sources (OLS) | $315,538 | 65.4 | % | $309,925 | 66.8 | % |
| Industrial Lasers & Systems (ILS) | 166,804 | 34.6 | % | 154,182 | 33.2 | % |
| Total | $482,342 | 100.0 | % | $464,107 | 100.0 | % |

| | Nine Months Ended | | |
|---|---|---|---|
| | June 30, 2018 | | July 1, 2017 | |
| | Amount | Percentage of total | Amount | Percentage of total |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | net sales | | | net sales | |
| Consolidated: | | | | | | |
| OEM Laser Sources (OLS) | $958,333 | 66.5 | % | $825,805 | 67.0 | % |
| Industrial Lasers & Systems (ILS) | 482,692 | 33.5 | % | 407,208 | 33.0 | % |
| Total | $1,441,025 | 100.0 | % | $1,233,013 | 100.0 | % |

Quarterly

Net sales for the third quarter of fiscal 2018 increased by $18.2 million, or 4%, compared to the third quarter of fiscal 2017, with increases of $5.6 million, or 2%, in our OLS segment and $12.6 million, or 8%, in our ILS segment.

The increase in our OLS segment sales was primarily due to higher shipments of ELA tools used in the flat panel display market including higher revenues from consumable parts and higher shipments for advanced packaging applications, which were partially offset by lower shipments for materials processing applications. The increase in our ILS segment sales was primarily due to higher shipments for microelectronics and bio-instrumentation applications.

Year-to-date

Net sales for the first nine months of fiscal 2018 increased by $208.0 million, or 17%, compared to the first nine months of fiscal 2017, with increases of $132.5 million, or 16%, in our OLS segment and $75.5 million, or 19%, in our ILS segment.

The increase in our OLS segment sales was primarily due to higher shipments of ELA tools used in the flat panel display market and higher revenues from consumable parts as well as higher shipments for scientific and government program, bio-instrumentation, advanced packaging, semiconductor and solar applications. These increases were partially offset by lower shipments for materials processing applications. The increase in our ILS segment sales was primarily due to higher shipments for materials processing applications including a full nine months of Rofin net sales and four months of OR Laser net sales in the first nine months of fiscal 2018 as well as higher shipments for microelectronics applications.

GROSS PROFIT

Consolidated

Our gross profit percentage decreased by 1.4% to 43.2% in the third quarter of fiscal 2018 from 44.6% in the third quarter of fiscal 2017 and increased by 1.7% to 44.5% in the first nine months of fiscal 2018 from 42.8% in the same period one year ago.

The 1.4% third quarter decrease in gross profit percentage included a 0.8% favorable net impact of lower purchase accounting adjustments compared to the third quarter of fiscal 2017. In the third quarter of fiscal 2017, we took a larger charge (0.9%) for amortization of inventory step-up related to our acquisition of Rofin compared to the charge in the third quarter of fiscal 2018 related to our acquisition of OR Laser. This favorable net impact also included the favorable impact of lower amortization of intangibles (0.1%) as a percentage of sales due to significantly increased sales volumes and was partially offset by our acquisition of OR Laser in the second quarter of fiscal 2018. Excluding the favorable net impact of lower purchase accounting adjustments, gross profit percentage decreased 2.2% compared to the third quarter of fiscal 2017, primarily due to unfavorable product margins including warranty costs (1.8%) as a percentage of sales and higher other costs (0.4%) primarily due to higher inventory provisions for excess and obsolete inventory in certain business units. The unfavorable product margins and warranty costs included the impact from higher warranty events in both segments, with the largest impact for fiber lasers. In addition, unfavorable mix in the microelectronics market and the unfavorable impact of the stronger Euro were partially offset by the impact from the better leverage of manufacturing costs on higher volumes.

The 1.7% increase in gross profit percentage during the first nine months of fiscal 2018 was primarily due to the 2.0% favorable net impact of purchase accounting adjustments compared to the first nine months of fiscal 2017. In the first nine months of fiscal 2017, we took a larger charge (2.1%) for amortization of inventory step-up related to our acquisition of Rofin compared to the charge in the first nine months of fiscal 2018 related to our acquisition of OR Laser. This favorable net impact was partially offset by the unfavorable impact of higher amortization of intangibles

(0.1%) as a percentage of sales due to the inclusion of a full nine months of amortization of our Rofin intangibles in the first nine months of fiscal 2018 and our acquisition of OR Laser in the second quarter of fiscal 2018 net of the impact of the significantly increased sales volumes. Also contributing to the increase in gross profit percentage were lower restructuring charges (0.2%) for inventory write-offs, primarily in our ILS segment. The remaining 0.5% deterioration in gross profit percentage was due to the impact from higher warranty events in both segments, with the largest impact from fiber lasers, partially offset by better leverage of manufacturing costs on higher volumes and favorable mix in the materials processing market net of unfavorable mix in the microelectronics market and the unfavorable impact of the stronger Euro.

Our gross profit percentage 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 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 volatility of the Euro.

Table of Contents

OEM Laser Sources

The gross profit percentage in our OLS segment decreased by 1.5% to 52.3% in the third quarter of fiscal 2018 from 53.8% in the third quarter of fiscal 2017. The gross profit percentage in our OLS segment decreased by 0.2% to 53.1% in the first nine months of fiscal 2018 from 53.3% in the same period one year ago.

The 1.5% third quarter decrease in gross profit percentage was primarily due to unfavorable product margins (1.0%) as a result of unfavorable mix within flat panel display systems sold as well as the unfavorable impact of the stronger Euro partially offset by better leverage of manufacturing costs on higher volumes. Also contributing to the decrease in gross profit percentage were increased warranty and installation costs as a percentage of sales (0.4%) due to higher installation costs for flat panel display applications and higher warranty events in the microelectronics market and higher other costs (0.4%) due to higher inventory provisions for excess and obsolete inventory in certain business units and higher freight and duty costs as a percentage of sales. These unfavorable impacts were partially offset by lower intangibles amortization (0.3%) as a percentage of sales.

The 0.2% decrease in gross profit percentage during the first nine months of fiscal 2018 was primarily due to increased warranty and installation costs as a percentage of sales (0.4%) due to higher warranty events in the microelectronics and scientific and government programs markets, primarily in China, and higher installation costs for flat panel display applications as well as unfavorable product margins (0.2%). The unfavorable product margins were due to unfavorable mix within flat panel display applications for both systems and service as well as other microelectronics applications and the unfavorable impact of the stronger Euro, all of which were partially offset by better leverage of manufacturing costs on higher volumes. These unfavorable impacts were partially offset by lower other costs (0.2%) due to lower inventory provisions for excess and obsolete inventory as a percentage of sales in certain business units and the impact of significantly higher sales and lower intangibles amortization (0.2%) as a percentage of sales.

Industrial Lasers & Systems

The gross profit percentage in our ILS segment decreased by 0.3% to 26.6% in the third quarter of fiscal 2018 from 26.9% in the third quarter of fiscal 2017. The gross profit percentage in our ILS segment increased by 5.6% to 27.9% in the first nine months of fiscal 2018 from 22.3% in the in the same period one year ago.

The 0.3% third quarter decrease in gross profit percentage included a 2.2% favorable net impact of lower purchase accounting adjustments compared to the third quarter of fiscal 2017. In the third quarter of fiscal 2017, we took a larger charge (2.7%) for amortization of inventory step-up related to our acquisition of Rofin compared to the charge in the third quarter of fiscal 2018 related to our acquisition of OR Laser, which was partially offset by the unfavorable impact of higher amortization of intangibles (0.5%) as a percentage of sales due to our acquisition of OR Laser in the second quarter of fiscal 2018. Partially offsetting the favorable net impact of lower purchase accounting adjustments were higher restructuring charges (0.5%) for inventory write-offs. Excluding the 1.7% favorable net impact of lower purchase accounting adjustments and higher restructuring costs, gross profit percentage decreased 2.0% compared to the third quarter of fiscal 2017, primarily due to unfavorable product margins including warranty costs (1.8%) as a percentage of sales and higher other costs (0.2%) primarily due to higher inventory provisions for excess and obsolete inventory. The unfavorable product margins and warranty costs included the impact from higher warranty events, particularly for fiber lasers, and the unfavorable impact of the stronger Euro and were partially offset by the impact from the better leverage of manufacturing costs on higher volumes.

The 5.6% increase in gross profit percentage during the first nine months of fiscal 2018 was primarily due to 6.3% lower amortization of inventory step-up (6.4% in the first nine months of fiscal 2017 related to our acquisition of Rofin compared to 0.1% in the first nine months of fiscal 2018 related to our acquisition of OR Laser) as well as lower restructuring charges (0.6%) related to the implementation of planned restructuring activities in connection with the acquisition of Rofin, which was primarily related to the exit from Coherent's legacy high power fiber laser product line net of higher service inventory write-offs. Partially offsetting the improvement, intangibles amortization increased as a percentage of sales (0.6%) due to the inclusion of a full nine months of amortization for the Rofin acquisition in the first nine months of fiscal 2018 and the acquisition of OR Laser in the second quarter of fiscal 2018. Excluding the 6.3% favorable net impact of lower purchase accounting adjustments and lower restructuring costs, gross profit percentage decreased 0.7% compared to the first nine months of fiscal 2017 primarily due to higher other costs (0.5%) and unfavorable product margins including warranty costs (0.2%) as a percentage of sales. Product costs were more unfavorable with higher warranty events in materials processing applications partially offset by the impact from favorable mix and the better leverage of manufacturing costs on higher volumes.

Table of Contents

OPERATING EXPENSES:

| | Three Months Ended | | | | | |
|---|---|---|---|---|---|---|
| | June 30, 2018 | | | July 1, 2017 | | |
| | Amount | Percentage of total net sales | | Amount | Percentage of total net sales | |
| | (Dollars in thousands) | | | | | |
| Research and development | $34,303 | 7.1 | % | $30,483 | 6.6 | % |
| Selling, general and administrative | 70,291 | 14.6 | % | 72,383 | 15.6 | % |
| Impairment and other charges | 611 | 0.1 | % | — | — | % |
| Amortization of intangible assets | 2,607 | 0.5 | % | 3,743 | 0.8 | % |
| Total operating expenses | $107,812 | 22.3 | % | $106,609 | 23.0 | % |

| | Nine Months Ended | | | | | |
|---|---|---|---|---|---|---|
| | June 30, 2018 | | | July 1, 2017 | | |
| | Amount | Percentage of total net sales | | Amount | Percentage of total net sales | |
| | (Dollars in thousands) | | | | | |
| Research and development | $100,478 | 7.0 | % | $88,103 | 7.1 | % |
| Selling, general and administrative | 220,874 | 15.3 | % | 218,602 | 17.7 | % |
| Gain on business combination | — | — | % | (5,416 ) | (0.4 | )% |
| Impairment and other charges | 766 | — | % | — | — | % |
| Amortization of intangible assets | 8,163 | 0.6 | % | 13,060 | 1.1 | % |
| Total operating expenses | $330,281 | 22.9 | % | $314,349 | 25.5 | % |

Research and development

Quarterly

Research and development ("R&D") expenses increased $3.8 million, or 13%, during the third fiscal quarter ended June 30, 2018 compared to the same quarter one year ago. The increase was primarily due to $3.2 million higher spending on R&D activities, with higher spending on materials and lower spending on headcount including lower variable compensation as well as the unfavorable impact of foreign exchange rates (primarily the stronger Euro). There were also increases of $0.5 million in incremental spending due to the acquisition of OR Laser in the second quarter of fiscal 2018 and $0.2 million for higher stock-based compensation expense, with a decrease of $0.1 million for lower charges for increases in deferred compensation plan liabilities.

On a segment basis as compared to the prior year period, OLS R&D spending increased $1.8 million primarily due to higher net spending on R&D activities including the unfavorable impact of foreign exchange rates. ILS spending increased $1.5 million primarily due to the unfavorable impact of foreign exchange rates, higher net spending on R&D activities and the acquisition of OR Laser. Corporate and other spending increased $0.5 million due to higher headcount spending in our Advanced Research Business unit and higher stock-based compensation partially offset by lower headcount spending including lower variable compensation and lower charges for increases in deferred compensation plan liabilities.

Year-to-date

R&D expenses increased $12.4 million, or 14%, during the first nine months of fiscal 2018 compared to the same period one year ago. The increase was primarily due to $8.5 million higher spending on R&D activities, the inclusion of a full nine months of Rofin R&D expenses ($3.2 million) in fiscal 2018 and $0.7 million in incremental spending due to the acquisition of OR Laser in the second quarter of fiscal 2018. The higher spending on R&D activities includes higher spending on headcount and materials as well as the unfavorable impact of foreign exchange rates (primarily the stronger Euro), net of lower restructuring charges for our exit from our legacy Coherent high power fiber laser product line in the first quarter of fiscal 2017.

Table of Contents

On a segment basis as compared to the prior year period, OLS R&D spending increased $5.9 million primarily due to higher net spending on R&D activities including the unfavorable impact of foreign exchange rates. ILS spending increased $5.9 million primarily due to the inclusion of a full nine months of Rofin expenses and higher spending on R&D activities including the unfavorable impact of foreign exchange rates, which was partially offset by lower restructuring costs and the acquisition of OR Laser. Corporate and other spending increased $0.6 million primarily due to higher headcount spending in our Advanced Research Business unit.

Selling, general and administrative

Quarterly

Selling, general and administrative (“SG&A”) expenses decreased $2.1 million, or 3%, during the third fiscal quarter ended June 30, 2018 compared to the same quarter one year ago. The decrease was primarily due to $1.9 million lower variable spending (net of the unfavorable impact of foreign exchange rates) including lower restructuring costs due to a gain on the sale of a building in the third quarter of fiscal 2018 and lower spending on legal, consulting and infrastructure related to integration activities, compliance with the terms of the Credit Agreement and patents. In addition, SG&A expenses decreased due to $1.6 million lower payroll spending due to lower variable compensation, which was partially offset by higher spending on severance, salaries and benefits and the unfavorable impact of foreign exchange rates, $0.6 million lower charges for increases in deferred compensation plan liabilities and $0.3 million due to lower financial advisory, consulting and legal costs related to acquisitions. The decreases were offset by $1.2 million higher stock-based compensation expense and $1.1 million higher incremental spending due to the acquisition of OR Laser in the second quarter of fiscal 2018.

On a segment basis as compared to the prior year period, OLS expenses decreased $1.0 million primarily due to lower spending on variable compensation, legal (patents) and infrastructure related to integration activities partially offset by the unfavorable impact of foreign exchange rates and higher spending on salaries and benefits. ILS spending increased $0.7 million primarily due to the impact of unfavorable foreign exchange rates, the acquisition of OR Laser and higher other variable spending to support higher sales partially offset by lower variable compensation and lower restructuring costs due to a gain on the sale of a building. Corporate and other spending decreased $1.8 million primarily due to lower spending on legal, consulting and infrastructure related to integration activities and compliance with the terms of the Credit Agreement, lower variable compensation and lower charges for the deferred compensation plan, all of which was partially offset by higher stock-based compensation expense.

Year-to-date

SG&A expenses increased $2.3 million, or 1%, during the first nine months of fiscal 2018 compared to the same period one year ago. The increase was primarily due to the inclusion of a full nine months of Rofin SG&A expenses ($8.0 million) in fiscal 2018, $5.7 million higher payroll spending primarily due to the unfavorable impact of foreign exchange rates and higher spending on salaries, benefits and commissions net of lower variable compensation and lower severance restructuring costs. In addition, SG&A expenses increased due to $4.1 million higher other variable spending (including the unfavorable impact of foreign exchange rates) on legal, consulting and infrastructure related to integration activities; higher spending on legal and consulting related to compliance with the terms of the Credit Agreement; and higher other variable spending in support of higher sales partially offset by lower restructuring costs due to a gain on the sale of a building in the third quarter of fiscal 2018. SG&A expenses also increased due to $1.6 million higher incremental spending due to the acquisition of OR Laser in the second quarter of fiscal 2018. The increases were offset by $17.1 million lower financial advisory, consulting and legal costs related to acquisitions. Stock-based compensation expense was flat with higher expense for new grants offset by the $3.4 million charge recorded in the first quarter of fiscal 2017 due to the acceleration of Rofin options.

On a segment basis as compared to the prior year period, OLS expenses increased $7.1 million primarily due to higher payroll and other variable spending (including the unfavorable impact of foreign exchange rates) as well as spending relating to a historical Rofin business unit that is included in our OLS segment. ILS spending increased $10.7 million primarily due to the inclusion of a full nine months of Rofin expenses, the unfavorable impact of foreign exchange rates, higher other variable spending and the acquisition of OR Laser partially offset by lower payroll spending including lower severance restructuring and variable compensation costs. Corporate and other spending decreased $15.5 million primarily due to lower financial advisory, consulting and legal costs related to our acquisition of Rofin and lower payroll spending including lower variable compensation partially offset by higher other spending on legal, consulting and infrastructure related to integration activities.

Gain on business combination

Table of Contents

On November 7, 2016, we acquired Rofin at a price of $32.50 per share of Rofin common stock (See Note 3, "Business Combinations" in the Notes to Condensed Consolidated Financial Statements). We recognized a gain of $5.4 million in the first quarter and nine months of fiscal 2017 on the increase in fair value from the date of purchase for the shares of Rofin we owned prior to the acquisition.

Impairment and other charges

In the fourth quarter of fiscal 2017, management decided to sell several entities that we acquired in the Rofin acquisition. Although the sale of the entities was not completed until the third quarter of fiscal 2018, we recorded non-cash impairment charges (recoveries) of $0.3 million and ($0.5 million) to operating expense in our results of operations in the first and second quarters of fiscal 2018, respectively. These charges, in addition to the $2.9 million recorded to operating expense in our results of operations in the fourth quarter of fiscal 2017, reduced our carrying value of these entities to fair value as of the end of the first and second quarters of fiscal 2018. Upon the sale of the entities on April 27, 2018 (See Note 19, "Discontinued Operations and Sale of Assets Held for Sale" in the Notes to Condensed Consolidated Financial Statements), we recognized an additional loss of $0.5 million in the third quarter of fiscal 2018.

In the second and third quarters of fiscal 2018, we also recorded impairment charges of $0.4 million and $0.1 million, respectively, to reduce the carrying value of a building to its fair value.

Amortization of intangible assets

Amortization of intangible assets decreased $1.1 million and $4.9 million in the three and nine months ended June 30, 2018 compared to the same periods last year. The quarterly decrease was primarily due to the completion of the amortization of backlog intangibles from our acquisition of Rofin in fiscal 2017 ($0.9 million lower in the comparable quarter) and $0.3 million lower amortization of customer relationships intangibles from our acquisition of Rofin in fiscal 2017, as those are amortized on an accelerated basis, which were partially offset by the unfavorable impact of foreign exchange rates. The year-to-date decrease was primarily due to the completion of the amortization of backlog intangibles from our acquisition of Rofin in fiscal 2017 ($5.5 million lower in the comparable nine months), which was partially offset by the inclusion of a full nine months of Rofin amortization expenses in fiscal 2018, the unfavorable impact of foreign exchange rates and amortization of intangibles related to our acquisition of OR Laser in the second and third quarters of fiscal 2018.

OTHER INCOME (EXPENSE) — NET

Other income (expense), net, changed by $0.3 million to other expense of $7.6 million in the third quarter of fiscal 2018 from other expense of $7.9 million in the third quarter of fiscal 2017. Other income (expense), net, changed by $12.6 million to other expense of $25.6 million in the first nine months of fiscal 2018 from other expense of $13.0 million in the first nine months of fiscal 2017.

The third fiscal quarter decrease in net other expense was primarily due to $2.8 million lower interest expense, which was partially offset by $0.8 million lower gains, net of expenses, on our deferred compensation plan assets as well as $1.7 million higher other net expense comprised of numerous small items. Interest expense decreased due to lower interest on the Euro Term Loan due to paydown of principal and an interest rate reduction.

The increase for the first nine months of fiscal 2018 in net other expense was primarily due to $16.0 million lower foreign exchange net gains resulting primarily from a gain in the first quarter of fiscal 2017 of $11.3 million on forward contracts associated with our foreign exchange risk related to the commitment of our Euro Term Loan, the issuance of the Euro Term Loan to finance the acquisition of Rofin and the impact of changing rates on cash conversions. The lower foreign exchange gains were offset by $3.2 million lower interest expense due to lower interest on the Euro Term Loan resulting from our paydown of principal and an interest rate reduction as well as the fiscal 2017 interest on the commitment of the Euro Term loan to fund our acquisition of Rofin, which were partially offset by higher amortization of debt issuance costs related to the Euro Term loan.

INCOME TAXES

On December 22, 2017, the Tax Cuts and Jobs Act (the “Tax Act”) was enacted. The Tax Act changes are broad and complex. The final transitional impacts of the Tax Act may materially differ from the estimates provided elsewhere in this report. Among other things, this may be due to changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, any changes in accounting standards for income taxes or related interpretations in response to the Tax Act, or any updates or changes to estimates we have utilized to calculate the transitional impacts. Additionally, longstanding international tax norms that determine each country's jurisdiction to tax cross-border international trade are evolving as a result of the Base Erosion and Profit Shifting reporting requirements ("BEPS") recommended by the G8, G20 and Organization for Economic Cooperation and Development ("OECD"). As these and other tax laws and related regulations change, our financial results could be materially impacted. Given the unpredictability of these possible changes and their potential interdependency, it is very difficult to assess whether the overall effect of such potential tax changes would be cumulatively positive or negative for our earnings and cash flow. Such changes could, however, adversely impact our financial results.

As discussed in Note 15, "Income Taxes" in the Notes to Condensed Consolidated Financial Statements, the Tax Act resulted in a provisional charge of $41.7 million for the quarter ended December 30, 2017. This is comprised of an estimated deemed repatriation tax charge of $48.7 million less a previously recorded deferred tax liability of $20.3 million for anticipated repatriation of our investment in a foreign subsidiary, plus the estimated deferred tax remeasurement charge of $13.3 million.

Our effective tax rates on income from continuing operations before income taxes for the three and nine months ended June 30, 2018 were 27.9% and 38.9%, respectively. Our effective tax rate for the three months ended June 30, 2018 was higher than the effective U.S. federal blended tax rate of 24.5% primarily due to the impact of income subject to foreign tax rates that are higher than the U.S. tax rates. This amount is partially offset by the benefit of foreign tax credits, the benefit of federal research and development tax credits, the benefit of a domestic manufacturing deduction under IRC Section 199 and the Singapore tax exemption. Our effective tax rate for the nine months ended June 30, 2018 was higher than the effective U.S. federal blended tax rate of 24.5% primarily due to the Tax Act one-time mandatory deemed repatriation transition tax, the impact of income subject to foreign tax rates that are higher than the U.S. tax rates, the remeasurement of deferred tax assets and liabilities based on the newly enacted U.S. federal tax rate of 21.0%, stock-based compensation not deductible for tax purposes and limitations on the deductibility of compensation under IRC Section 162(m). These amounts are partially offset by the excess tax benefits from stock award exercises and restricted stock unit vesting, the benefit of foreign tax credits, the benefit of federal research and development tax credits, the benefit of a domestic manufacturing deduction under IRC Section 199 and the Singapore tax exemption.

Our effective tax rates on income from continuing operations before income taxes for the three and nine months ended July 1, 2017 were 32.1% and 32.4%, respectively. Our effective tax rates for the three and nine months ended July 1, 2017 were lower than the U.S. federal 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. These amounts are partially offset by Rofin transaction costs not deductible for tax purposes, tax costs of Rofin restructuring, ASC 740-10 (formerly FIN48) tax liabilities for transfer pricing, 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 June 30, 2018, we had assets classified as cash and cash equivalents and short-term investments, in an aggregate amount of $232.5 million, compared to $475.6 million at September 30, 2017. This decrease was primarily due to the paydown of debt under our Euro Term Loan and the repurchase of $100.0 million of our common stock. In addition, at June 30, 2018, we had $13.8 million of restricted cash. At June 30, 2018, approximately $158.4 million of our cash and securities was held in certain of our foreign subsidiaries and branches, $140.9 million of which was denominated in currencies other than the U.S. dollar. At June 30, 2018, we had approximately $157.7 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 are needed for and distributed to our operations in the United States, we may be subject to additional foreign withholding taxes and certain state taxes. The amount of the U.S. and foreign taxes due would depend on the amount and manner of repatriation, as well as the location from where the funds are repatriated. Historically, we have considered substantially all foreign profits as being permanently invested in our foreign operations, and we had no intent to repatriate those funds. We are continuing to review our policy in light of the changes contained in the Tax Act. 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.

See “Part I, Item 3. Quantitative and Qualitative Disclosures About Market Risk” below for more information about risks and trends related to foreign currencies.

Table of Contents

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 from our Euro Term Loan used to finance our acquisition of Rofin, 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 acquisitions of businesses and technologies, the repurchase of our common stock, capital expenditures and debt issuance costs. 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:

| | Nine Months Ended | |
|---|---|---|
| | June 30, 2018 | July 1, 2017 |
| | (in thousands) | |
| Net cash provided by operating activities | $132,993 | $285,282 |
| Acquisition of businesses, net of cash acquired | (45,448 ) | (740,481 ) |
| Sales of shares under employee stock plans | 10,574 | 8,111 |
| Net settlement of restricted common stock | (36,292 ) | (15,690 ) |
| Repurchase of common stock | (100,000 ) | — |
| Borrowings, net of repayments | (170,189 ) | 630,221 |
| Debt issuance costs | — | (26,367 ) |
| Capital expenditures | (65,990 ) | (45,352 ) |
| Proceeds from sale of discontinued operation (the Hull Business) | 25,000 | — |
| Proceeds from sales of other entities | 6,250 | — |

Net cash provided by operating activities decreased by $152.3 million for the first nine months of fiscal 2018 compared to the same period one year ago. The decrease in cash provided by operating activities was primarily due to lower cash flows from deferred revenue and payroll accruals as well as the timing of shipments of large systems, which were partially offset by higher net income and higher cash flows due to non-cash expenses for amortization, stock-based compensation and depreciation. 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 revolving credit facility 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 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 to consider 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, if any, through additional borrowings (as in our acquisition of Rofin), existing cash balances and cash flows from operations (as in our acquisition of OR Laser). If required, we will 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.

The aggregate consideration paid by us to the former Rofin stockholders in the first quarter of fiscal 2017 was approximately $904.5 million, excluding related transaction fees and expenses. We also paid $15.3 million due to the cancellation of options held by employees of Rofin. We incurred approximately $26.4 million of debt issuance costs in fiscal 2017. In fiscal 2017, we made debt principal payments $178.1 million, including voluntary prepayments of $170.7 million, recorded interest expense on the Euro Term Loan of $23.5 million, recorded $7.2 million amortization of debt issuance costs and recorded interest expense of $2.7 million for the commitment of the Euro Term Loan. In the first nine months of fiscal 2018, we made debt principal payments $168.1 million, including voluntary prepayments of $162.1 million, recorded interest expense on the Euro Term Loan of $11.8 million and recorded $8.3 million amortization of debt issuance costs.

On March 8, 2018, we acquired privately held OR Laser for approximately $47.4 million, excluding transaction costs.

Table of Contents

On April 27, 2018, we completed the sale of several entities that we acquired in the Rofin acquisition for approximately $6.3 million.

On February 6, 2018, our board of directors authorized a buyback program authorizing the Company to repurchase up to $100.0 million of our common stock from time to time through January 31, 2019. During the three and nine months ended June 30, 2018, we repurchased and retired 574,946 shares of outstanding common stock at an average price of $173.91 per share for a total of $100.0 million. See Note 12, "Stock Repurchases" in the Notes to Condensed Consolidated Financial Statements.

Additional sources of cash available to us were international currency lines of credit and bank credit facilities totaling $27.9 million as of June 30, 2018, of which $21.2 million was unused and available. These unsecured international credit facilities were used in Europe and Japan during the first nine months of fiscal 2018. As of June 30, 2018, we had utilized $6.1 million of the international credit facilities as guarantees in Europe and $0.6 million as borrowings in Japan.

Our ratio of current assets to current liabilities increased to 3.3:1 at June 30, 2018 compared to 3.1:1 at September 30, 2017. The increase in our ratio was primarily due to lower deferred income and higher inventories, which were partially offset by lower cash and cash equivalents. Our cash and cash equivalents, short-term investments and working capital are as follows:

| | June 30, 2018 | September 30, 2017 |
|---|---|---|
| | (in thousands) | |
| Cash and cash equivalents | $232,458 | $ 443,066 |
| Short-term investments | — | 32,510 |
| Working capital | 802,401 | 892,519 |

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 operating lease payments, asset retirement obligations, long-term debt payments, pension 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 September 30, 2017. There have been no material changes in contractual obligations outside of the ordinary course of business since September 30, 2017. Information regarding our other financial commitments at June 30, 2018 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 nine months of fiscal 2018 was $133.0 million, which included net income of $174.2 million, depreciation and amortization of $92.6 million, stock-based compensation expense of $24.1 million and net decreases in deferred tax assets of $18.4 million partially offset by cash used by operating assets and liabilities of $177.4 million (primarily increases in inventories, decreases in deferred income and increases in accounts receivable net of higher income taxes payable and higher accounts payable). Cash provided by operating activities during the first nine months of fiscal 2017 was $285.3 million, which included net income of $133.4 million, cash provided by operating assets and liabilities of $53.8 million (primarily increases in deferred income, taxes payable and accounts payable net of decreases in accounts receivable), depreciation and amortization of $78.8 million, stock-based compensation expense of $19.1 million, non-cash restructuring charges of $4.4 million, net decreases in deferred tax assets of $2.0 million and $0.1 million other partially offset by the $5.4 million gain on business combination and $0.9 million net cash flows used by discontinued operations.

Cash used in investing activities during the first nine months of fiscal 2018 was $44.5 million, which included $63.3 million, net of proceeds from dispositions, used to acquire property and equipment and purchase and upgrade buildings and $45.4 million net of cash acquired to purchase OR Laser partially offset by $32.5 million net sales of available-for-sale securities, $25.0 million proceeds from the sale of discontinued operations and $6.3 million proceeds from the sale of other entities. Cash used in investing activities during the first nine months of fiscal 2017 was $760.4 million, which included $740.5 million net of cash acquired to purchase Rofin, $44.4 million, net of proceeds from dispositions, used to acquire property and equipment and purchase and upgrade buildings and $0.6 million net cash flows used by discontinued operations partially offset by $25.1 million net sales of available-for-sale securities.

Cash used in financing activities during the first nine months of fiscal 2018 was $295.9 million, which included $170.2 million net debt payments, $100.0 million repurchases of our common stock and $36.3 million outflows due to net settlement of

Table of Contents

restricted stock units partially offset by $10.6 million generated from our employee stock option and purchase plans. Cash provided by financing activities during the first nine months of fiscal 2017 was $595.5 million, which included $630.2 million net borrowings and $8.1 million generated from our employee stock option and purchase plans partially offset by $26.4 million debt issuance costs, $15.6 million outflows due to net settlement of restricted stock and $0.8 million payments to subsidiary minority shareholders.

Changes in exchange rates during the first nine months of fiscal 2018 resulted in a decrease in cash balances of $3.4 million. Changes in exchange rates during the first nine months of fiscal 2017 resulted in an increase in cash balances of $11.2 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.

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 June 30, 2018, 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 June 30, 2018, we had no available-for-sale debt securities.

We are exposed to market risks related to fluctuations in interest rates related to our Euro Term Loan. As of June 30, 2018, we owed $434.3 million on this loan with an interest rate of 2.75%. We performed a sensitivity analysis on the outstanding portion of our debt obligation as of June 30, 2018. Should the current average interest rate increase or decrease by 10%, the resulting annual increase or decrease to interest expense would be approximately $1.2 million as of June 30, 2018.

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 the foregoing currencies and 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, because of our significant manufacturing operations in Europe, a weakening Euro is advantageous and a strengthening Euro is disadvantageous to our 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” in the Notes to Condensed Consolidated Financial Statements.

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 June 30, 2018, approximately $158.4 million of our cash, cash equivalents and short-term investments were held outside the U.S. in certain of our foreign operations, $140.9 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.

Table of Contents

The following table provides information about our foreign exchange forward contracts at June 30, 2018. 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 June 30, 2018 rates.

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 | 1.1670 | $ (116,851 ) | $ 287 |
| Japanese Yen | 108.5928 | $ 24,052 | $ (459 ) |
| British Pound | 1.3311 | $ 1,568 | $ (19 ) |
| South Korean Won | 1,077.9146 | $ 36,772 | $ (1,204 ) |
| Chinese Renminbi | 6.4384 | $ 42,810 | $ (1,193 ) |
| Singapore Dollar | 1.3393 | $ (33,351 ) | $ 598 |
| Malaysian Ringgit | 3.9970 | $ 1,940 | $ (22 ) |
| Canadian Dollar | 1.2966 | $ (800 ) | $ 14 |
| Swiss Franc | 0.9837 | $ (1,983 ) | $ 20 |

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 June 30, 2018 ("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 has been no change in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting during the three months ended June 30, 2018. We continue to integrate Rofin into our systems and control environment as of June 30, 2018.

### 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.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information with respect to this item may be found in Note 11, “Commitments and Contingencies” in Notes to 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” of our Annual Report on Form 10-K for the fiscal year ended September 30, 2017 and the risk of our businesses described elsewhere in this quarterly 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.

RISKS RELATED TO THE MERGER WITH ROFIN

We may not be able to integrate the business of Rofin successfully with our own, realize the anticipated benefits of the merger or manage our expanded operations, any of which would adversely affect our results of operations.

We have devoted, and expect to continue to devote significant management attention and resources to integrating our business practices with those of Rofin. Such integration efforts are costly due to the large number of processes, policies, procedures, locations, operations, technologies and systems to be integrated, including purchasing, accounting and finance, sales, service, operations, payroll, pricing, marketing and employee benefits. Integration expenses could, particularly in the short term, exceed the savings we expect to achieve from the elimination of duplicative expenses and the realization of economies of scale, which could result in significant charges to earnings that we cannot currently quantify. Potential difficulties that we may encounter as part of the integration process include the following:

- the inability to successfully combine our business with Rofin in a manner that permits the combined company to achieve the full synergies and other benefits anticipated to result from the merger;
- complexities associated with managing the combined businesses, including difficulty addressing possible differences in corporate cultures and management philosophies and the challenge of integrating products, services, complex and different information technology systems (including different Enterprise Management Systems), control and compliance processes, technology, networks and other assets of each of the companies in a cohesive manner;
- diversion of the attention of our management; and
- the disruption of, or the loss of momentum in, our business or inconsistencies in standards, controls, procedures or policies, any of which could adversely affect our ability to maintain relationships with customers, suppliers, employees and other constituencies or our ability to achieve the anticipated benefits of the merger, or could reduce our earnings or otherwise adversely affect our business and financial results.

Following the merger, the size and complexity of the business of the combined company has increased significantly. Our future success depends, in part, upon our ability to manage this expanded business, which will pose substantial challenges for management, including challenges related to the management and monitoring of new operations and associated increased costs and complexity. There can be no assurances that we will be successful or that we will realize the expected synergies and benefits anticipated from the merger.

Charges to earnings resulting from the application of the purchase method of accounting to the Rofin acquisition may adversely affect our results of operations.

In accordance with generally accepted accounting principles, we have accounted for the Rofin acquisition using the purchase method of accounting. Under the purchase method of accounting, we allocated the total purchase price of Rofin’s net tangible and identifiable intangible assets based upon their estimated fair values at the acquisition date. The excess of the purchase price over net tangible and identifiable intangible assets was recorded as goodwill. We have incurred and will continue to incur additional depreciation and amortization expense over the useful lives of certain of the net tangible and intangible assets

Table of Contents

acquired in connection with the acquisition. In addition, to the extent the value of goodwill or intangible assets with indefinite lives becomes impaired, we may be required to incur material charges relating to the impairment of those assets. These depreciation, amortization and potential impairment charges could have a material impact on our results of operations.

Our indebtedness following the merger is substantially greater than our indebtedness prior to the merger. This increased level of indebtedness could adversely affect us, including by decreasing our business flexibility, and will increase our borrowing costs.

In November 2016 we entered into the Credit Agreement which provided for a 670 million Euro term loan, all of which was drawn, and a $100 million revolving credit facility, under which a 10 million Euro letter of credit was issued. As of June 30, 2018, 373.3 million Euros were outstanding under the term loan and 10.0 million Euros were outstanding under the revolving credit facility. We may incur additional indebtedness in the future by accessing the revolving credit facility and/or entering into new financing arrangements. Our ability to pay interest and repay the principal of our current indebtedness is dependent upon our ability to manage our business operations and the ongoing interest rate environment. There can be no assurance that we will be able to manage any of these risks successfully. The Credit Agreement contains customary affirmative covenants, including covenants regarding the payment of taxes and other obligations, maintenance of insurance, reporting requirements and compliance with applicable laws and regulations, and negative covenants, including covenants limiting the ability of us and our subsidiaries to, among other things, incur debt, grant liens, make investments, make certain restricted payments, transact with affiliates, and sell assets. The Credit Agreement also requires us and our subsidiaries to maintain a senior secured net leverage ratio as of the last day of each fiscal quarter of less of than or equal to 3.50 to 1.00. The Credit Agreement contains customary events of default that include, among other things, payment defaults, cross defaults with certain other indebtedness, violation of covenants, inaccuracy of representations and warranties in any material respect, change in control of us and Coherent Holding BV & Co. K.G. (formerly Coherent Holding GmbH), judgment defaults, and bankruptcy and insolvency events. If an event of default exists, the lenders may require the immediate payment of all obligations and exercise certain other rights and remedies provided for under the Credit Agreement, the other loan documents and applicable law. The acceleration of such obligations is automatic upon the occurrence of a bankruptcy and insolvency event of default. There can be no assurance that we will have sufficient financial resources or we will be able to arrange financing to repay our borrowings at such time.

Our substantially increased indebtedness and higher debt-to-equity ratio as a result of the merger in comparison to that prior to the merger will have the effect, among other things, of reducing our flexibility to respond to changing business and economic conditions and will increase our borrowing costs. In addition, the amount of cash required to service our increased indebtedness levels and thus the demands on our cash resources will be greater than the amount of cash flows required to service our indebtedness or that of Rofin individually prior to the merger. The increased levels of indebtedness could also reduce funds available for our investments in product development as well as capital expenditures, dividends, share repurchases and other activities and may create competitive disadvantages for us relative to other companies with lower debt levels.

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;

Table of Contents

- 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 in the Microelectronics market;
- 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 RMB and the US dollar as compared to other currencies;
- commodity pricing;
- interpretation and impact of the recently enacted and aforementioned U.S. tax law, the Tax Cuts and Jobs Act;
- introductions of new products and product enhancements by our competitors, entry of new competitors into our markets, pricing pressures and other competitive factors;
- our ability to develop, introduce, manufacture and ship new and enhanced products in a timely manner without defects;
- our ability to manage our manufacturing capacity across our diverse product lines and that of our suppliers, including our ability to successfully expand our manufacturing capacity in various locations around the world;
- our ability to successfully internally transfer products as part of our integration efforts;
- our reliance on contract manufacturing;
- our reliance in part upon the ability of our OEM customers to develop and sell systems that incorporate our laser products;
- our customers' ability to manage their susceptibility to adverse economic conditions;
- 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, including with respect to Rofin's historical business, which has traditionally experienced a reduction in sales during the first half of its fiscal year as compared to the second half of its fiscal year;
- jurisdictional capital and currency controls negatively impacting our ability to move funds from or to an applicable jurisdiction;

- 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;

Table of Contents

- 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 and scientific research 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, including recently instituted or proposed changes in trade policies by the U.S. presidential administration and any corresponding retaliatory actions by affected countries;
- costs and expenses from litigation;
- 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;
- negative impacts related to the "Brexit" vote by the United Kingdom, particularly with regard to sales from our Glasgow, Scotland facility to other jurisdictions and purchases of supplies from outside the United Kingdom by such facility;
- negative impacts related to the recent independence movement in Catalonia, Spain, particularly with regard to holding and operating some of our foreign entities in an efficient manner from a tax, business and legal perspective;
- negative impacts related to government instability in any jurisdiction in which we operate, such as the recent difficulties in forming a governing coalition in Germany;
- the future impact of legislation, rulemaking, and changes in accounting, tax, defense procurement, export policies; and

- distraction of management related to acquisition, integration 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.

Table of Contents

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 the key components and materials, including exotic materials, certain cutting-edge optics and crystals, used in our products, which make us susceptible to supply shortages or price fluctuations that could adversely affect our business, particularly our ability to meet our customers' delivery requirements.

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. In particular, from time-to-time our customers require us to ramp up production and/or accelerate delivery schedules of our products. Our key suppliers may not have the ability to increase their production in line with our customers' demands. This can become acute during times of high growth in our customers' businesses. Our failure to timely receive these key components and materials would likely cause delays in the shipment of our products, which would likely negatively impact both our customers and our business. 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. 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 non-cancelable purchase orders or otherwise assume liability for a large amount of the ordered supplies, which limits 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 that are at the cutting-edge of available technologies and change frequently to meet rapidly evolving market demands. By their very nature, the types of components used in such products can be difficult and unpredictable to manufacture and may only be available from a single supplier, which increases the risk that we may not obtain such components in a timely manner. Identifying alternative sources of supply for certain components could be difficult and costly, result in management distraction in assisting our current and future suppliers to meet our and our customers' technical requirements, and cause delays in shipments of our products while we identify, evaluate and test the products of alternative suppliers. Any such delay in shipment would result in a delay or cancelation of our ability to convert such order into revenues. 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.

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, fiber, lasers and laser-based systems. We also manufacture certain large format optics. 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.

Table of Contents

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 the first, second and third quarters of fiscal 2018, Advanced Process Systems Corporation, an integrator in the flat panel display market based in South Korea, contributed more than 10% of our revenue. Given macroeconomic conditions, varying consumer demand and technical process limitations at manufacturers, our customers may seek to reschedule or cancel orders. 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, and rescheduled or canceled orders by our customers. This could negatively impact our backlog, timing of net sales and results of operations.

As of June 30, 2018, flat panel display systems represented 52% of our backlog. Since our backlog includes higher average selling price flat panel display systems compared to other products in our backlog, 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 our excimer laser annealing tools used in the flat panel display market, 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.

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.

Table of Contents

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.

Worldwide economic conditions and related uncertainties 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 future sales decline or remain flat. 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 in recent years. 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 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 that has affected the banking system and financial markets in recent years could result in tighter credit markets, and lower levels of liquidity in some financial markets. There could be a number of follow-on effects from a 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 "Part I, Item 3. Quantitative and Qualitative Disclosures about Market Risk."

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 and to manage our manufacturing capacity to meet customer demands. 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

Table of Contents

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 each of the three and nine months ended June 30, 2018, 84% of our net sales were derived from customers outside of the United States. For fiscal 2017, fiscal 2016 and fiscal 2015, 83%, 76%, and 73%, 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;

- 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, including recently instituted or proposed changes in trade policies by the U.S. presidential administration and any corresponding retaliatory actions by affected countries;
- compliance with applicable United States and foreign anti-corruption laws;
- less than favorable contract terms;
- reduced ability to enforce contractual obligations;

Table of Contents

- 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 including, in particular, any such conflicts on the Korean peninsula, 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.

If we are unable to protect our proprietary technology, our competitive advantage could be harmed.

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 concluded patent-related litigation between IMRA America, Inc. (“Imra”) and IPG Photonics Corporation and in Imra’s concluded patent-related 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 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, which 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 Novanta Inc., IPG Photonics Corporation, Lumentum Holdings Inc., MKS Instruments, 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 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. Such vertical integration could reduce the market opportunity for 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.

Table of Contents

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, including OR Laser in March 2018 and Rofin in November 2016, 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:

- 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.

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 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. As a public company our stock price fluctuates for a variety of different reasons, some of which may be related to broader industry and/or market factors. As a result, from time-to-time we may be subject to the risk of litigation due to the fluctuation in stock price or other governance or market-related factors. 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.

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:

- interpretation and impact of the recently enacted and aforementioned U.S. tax law, the Tax Cuts and Jobs Act (the "Tax Act");
- changes in our current and future global structure based on the Rofin acquisition and restructuring that involved significant movement of U.S. and foreign entities and our ability to maintain favorable tax treatment as a result of various Rofin restructuring efforts and business activities;
- the outcome of discussions with various tax authorities regarding intercompany transfer pricing arrangements;

- changes that involve other acquisitions, restructuring or an increased investment in technology outside of the United States to better align asset ownership and business functions with revenues and profits;

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

- the resolution of issues arising from tax audits with various tax authorities, and in particular, the outcome of the German tax audits of our tax returns for fiscal years 2010-2015;

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

Table of Contents

- 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;
- changes in available tax credits;
- changes in share-based compensation;
- changes in other tax laws or the interpretation of such tax laws, including the Base Erosion Profit Shifting (“BEPS”) action plan implemented by the Organization for Economic Co-operation and Development (“OECD”); and
- changes in generally accepted accounting principles.

As indicated above, we are 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. 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 from the treatment reflected in our historical income tax provisions and accruals, which could materially and adversely affect our operating results and financial condition.

From time to time the United States, foreign and state governments make substantive changes to tax rules and the application of rules to companies. For example, the Tax Act has a significant impact on the taxation of Coherent including the U.S. tax treatment of our foreign operations. Under the Tax Act, foreign earnings are now deemed to be repatriated and we therefore recorded a provisional tax amount for the deemed repatriation transitional tax liability. We also recorded a provisional tax amount for the remeasurement of certain deferred tax assets and liabilities based on the reduction of the U.S. federal tax rate under the Tax Act. These provisional tax amounts result in a higher effective tax rate for our second quarter of fiscal year 2018. The provisional tax amounts recorded are based on our reasonable estimate of the liabilities and we need to fully complete our assessment of them which may require additional information. We are still evaluating the tax provisions related to Global Intangible Low-Taxed Income (“GILTI”) and we have not made a policy election on how to account for the GILTI provisions of the Tax Act as allowed by the U.S. generally accepted accounting standards. Our selection of an accounting policy with respect to the new GILTI tax rules will depend, in part, on analyzing our global income to determine whether we expect to have future U.S. inclusions in taxable income related to GILTI and, if so, what is the anticipated impact.

The recent U.S. tax law changes are subject to further interpretations from the U.S. federal and state governments and regulatory organizations, such as Treasury Department and/or the Internal Revenue Service. Updated guidance and interpretations could change the provisional tax liabilities or the accounting treatment of them. A significant portion of the additional provisions for income taxes we have made due to the enactment of the Tax Act is payable by us over a period of up to eight years. As a result, our cash flows from operating activities could be adversely impacted until the additional tax provisions are paid in full.

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 tariffs and duties, affecting the import or export of products could negatively affect our business, financial condition and results of operations.

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 regulation of encryption technology and regulation of imports or exports, or our failure to obtain required import or export licenses or other approvals for our products, could harm our international and domestic sales and adversely affect our net sales.

The U.S. presidential administration has recently instituted or proposed changes in trade policies that include the negotiation or termination of trade agreements, the imposition of higher tariffs on imports into the United States, economic sanctions on individuals, corporations or countries and other government regulations affecting trade between the United States and other countries where we conduct our business. These policy changes and proposals could require time-consuming and expensive alterations to our business operations and may result in greater restrictions and economic disincentives on international trade, which could negatively impact our competitiveness in jurisdictions around the world as well as lead to an increase in costs in our supply chain. Given that we are a multinational corporation, with manufacturing located both in the United States and internationally, we may face additional susceptibility to negative impacts from these tariffs or change in trade policies regarding our inter-company trade practices. In addition, new tariffs and other changes in U.S. trade policy could trigger retaliatory actions by affected countries, and certain foreign governments, including the Chinese government, have instituted or are considering imposing trade sanctions on certain U.S. manufactured goods. Such changes by the United States and other countries have the potential to adversely impact U.S. and worldwide economic conditions, our industry and the global demand for our products, and as a result, could negatively affect our business, financial condition and results of operations.

As a multinational corporation, we may be subject to audits by tax, export and customs authorities, as well as other government agencies. For example, we were audited in South Korea for customs duties and value added tax for the period March 2009 to March 2014. We were liable for additional payments, duties, taxes and penalties of $1.6 million, which we paid in the second quarter of fiscal 2016. Any future audits could lead to assessments that could have a material adverse effect on our business or financial position, results of operations, or cash flows.

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;

Table of Contents

- 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.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Sales of Unregistered Securities

Not applicable.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On February 7, 2018, we announced that our board of directors had approved a share repurchase program to permit us to repurchase up to $100.0 million worth of our issued and outstanding common stock in the open market from time to time through January 31, 2019. During the three months ended June 30, 2018, we repurchased and retired 574,946 shares of outstanding common stock under this plan at an average price of $173.91 per share for a total of $100.0 million.

The following table summarizes share repurchase activity for the three months ended June 29, 2018:

| Period | Total Number of Shares Purchased | Average paid price per share | Total Number of Shares Purchased As Part of Publicly Announced Program | Maximum Approximate Dollar Value of Shares That May Yet Be Purchased Under the Program |
|---|---|---|---|---|
| April 1, 2018 - April 30, 2018 | — | $— | — | $ 100,000,000 |
| May 1, 2018 - May 31, 2018 | 574,946 | $173.91 | 574,946 | $ — |
| June 1, 2018 - June 30, 2018 | — | $— | — | $ — |
| Total | 574,946 | $173.91 | 574,946 | |

Table of Contents

ITEM 6. EXHIBITS

| Exhibit No. | Description |
|---|---|
| 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. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

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: August 7, 2018 /s/: JOHN R. AMBROSEO
John R. Ambroseo
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 7, 2018 /s/: KEVIN S. PALATNIK
Kevin S. Palatnik
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)