COHERENT INC
Form 10-K/A
January 27, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 1

(Mark One)

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

For the Fiscal Year Ended October 1, 2005

or

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

Commission File Number: 0-5255

COHERENT, INC.

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

5100 Patrick Henry Drive, Santa Clara, California 95054

(Address of principal executive offices) (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
None	None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.01 par value

Common Stock Purchase Rights

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ý No o

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

As of December 1, 2005, 31,303,762 shares of common stock were outstanding. The aggregate market value of the voting shares (based on the closing price reported by the NASDAQ National Market System on April 1, 2005) of Coherent, Inc., held by nonaffiliates was $771,907,983. For purposes of this disclosure, shares of common stock held by persons who own 5% or more of the outstanding common stock and shares of common stock held by each officer and director have been excluded in that such persons may be deemed to be affiliates as that term is defined under the Rules and Regulations of the Act. This determination of affiliate status is not necessarily conclusive.

DOCUMENTS INCORPORATED BY REFERENCE

None.

EXPLANATORY NOTE

This Annual Report on Form 10-K/A (Form 10-K/A) is being filed as Amendment No. 1 to the Registrant s Annual Report on Form 10-K for the fiscal year ended October 1, 2005 filed with the Securities and Exchange Commission for the purposes of including information that was to be incorporated by reference from the Registrant s definitive proxy statement pursuant to Regulation 14A of the Securities and Exchange Act of 1934 and to correct a typographical error in Note 17, Segment Information in the Notes to the Consolidated Financial Statements. The typographical error was the transposition of the amount of sales in fiscal 2005 to unaffiliated customers in Europe, other and Asia-Pacific, other under the Geographic Information subheading of Note 17. The corrected amounts are set forth in this Form 10-K/A. The Registrant will not file its proxy statement within 120 days of its fiscal year ended October 1, 2005 and is therefore amending and restating the following items contained herein in their entirety.

PART I.

This Annual Report contains forward-looking statements. These forward-looking statements include, without limitation, statements regarding our future:

net sales;

results of operations;

gross profits;

research and development projects and expenses;

selling, general and administrative expenses;

warranty reserves;

legal proceedings;

claims against third parties for infringement of our proprietary rights;

liquidity and sufficiency of existing cash, cash equivalents and short-term investments for near-term requirements;

development and acquisition of new technology and intellectual property;

write-downs for excess or obsolete inventory;

competitors and competitive pressures;

growth of applications for our products and increase of market share;

obtain components and materials in a timely manner;

identify alternative sources of supply for components;

achieve adequate manufacturing yields;

impact of recent acquisitions;

leverage of power and energy management products into our next generation products;

compliance with environmental regulations;

participation in the bio-agent detection market;

leveraging of our technology portfolio and application engineering;

optimize our leadership position in existing markets;

collaborative customer and industry relationships;

enhancing our market position through our existing technology, as well as developing new technologies;

emphasis on supply chain management;

use of financial market instruments;

simplifications of our foreign legal structure and reduction of our presences in certain countries; and

focus on long-term improvement of return on invested capital.

In addition, we include forward-looking statements under the Our Strategy and Future Trends sections set forth below in Business.

You can identify these and other forward-looking statements by the use of the words such as may, will, could, would, should, expects, p anticipates, estimates, intends, potential, projected, continue, or the negative of such terms, or other comparable terminology. Forward-lo statements also include the assumptions underlying or relating to any of the foregoing statements.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below in Business, Management s Discussion and Analysis of Financial Condition and Results of Operations and under the heading Risk Factors. All forward-looking statements included in this 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.

ITEM 1. BUSINESS

GENERAL

Business Overview

Our fiscal year ends on the Saturday closest to September 30. Fiscal years 2005, 2004 and 2003 ended on October 1, October 2 and September 27, respectively. Fiscal year 2004 included 53 weeks, whereas fiscal years 2005 and 2003 included 52 weeks. For convenience, we use September 30 as our fiscal year-end dates throughout this Annual Report in order to correspond to the accompanying consolidated financial statements.

We are one of the world s leading suppliers of photonics-based solutions in a broad range of commercial and scientific research applications. We design, manufacture and market lasers, precision optics 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 have two operating segments: Electro-Optics and Lambda Physik, both of which work with customers to provide cost-effective photonics-based solutions. Our Electro-Optics segment focuses on markets such as semiconductor and related manufacturing, graphic arts and display, materials processing, Original Equipment Manufacturer (OEM) laser components and instrumentation, and scientific research and government programs. Coherent Lambda Physik GmbH (Lambda Physik), our wholly-owned subsidiary with headquarters located in Göttingen, Germany, focuses on markets using lasers for the production of thin-film transistors (TFT) used in flat panel displays, ink jet printers, medical OEMs, automotive, environmental research, scientific research, materials processing and micro-machining applications.

We were originally incorporated in California on May 26, 1966 and reincorporated in Delaware on October 1, 1990.

Additional information about Coherent, Inc. (referred to herein as the Company, we, our, or Coherent) is available on our web site at www.coherent.com. We make available, free of charge on our web site, access to our Annual Report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after we file them electronically with or furnish them to the Securities and Exchange Commission (SEC). Information contained on our web site is not part of this Annual Report or our other filings with the SEC.

INDUSTRY BACKGROUND

The word laser is an acronym for light amplification by stimulated emission of radiation. A laser emits an intense beam of light with some unique and highly useful properties. Most important, a laser is orders of magnitude higher in brightness than any lamp. This means that the beam can be focused to a very small and intense spot, useful for applications requiring very high power densities for cutting and other materials processing procedures. The laser s high spatial resolution is also useful for microscopic imaging and inspection applications. Laser light can also be very monochromatic all the beam energy is confined to a narrow wavelength band, which can be important in biomedical and other medical-related applications. Some lasers also produce highly polarized outputs while other lasers have unique phase properties that can be used to create ultrafast outputa series of pulses with pulse durations as short as 100 femtoseconds (i.e., 10^{-13} seconds)

There are many types of lasers and one way of classifying them is by the material used to create the lasing action. This can be in the form of a gas, liquid, semiconductor or solid-state crystal. We manufacture all of these types of lasers. Lasers can also be classified by their output wavelength: ultraviolet, visible, infrared or wavelength tunable. We also manufacture all of these laser types. There are also many options in terms of pulsed output versus continuous wave, pulse duration, output power, beam dimensions, etc. In fact, each application has its specific requirements in terms of laser performance. The broad technical depth at Coherent enables us to offer a diverse product line characterized by lasers targeted at growth opportunities and key technology applications. In all cases, we aim to be the supplier of first choice by offering a high-value combination of superior technical performance and high reliability.

Photonics is now taking its place alongside electronics as a critical enabling technology for the twenty-first century. In the field of photonics, the laser is the undisputed workhorse. Consequently, the role of the laser is incredibly far-reaching in an ever more diverse set of applications. Growth in these applications stems from two sources. First, there are many applications where the laser is displacing conventional technology because it can do the job faster, better or more economically. Second, there are also new applications where the laser is the enabling tool that makes the work possible.

Key laser applications include: microtechnologies and nanotechnology; semiconductor inspection; microlithography; measurement, test and repair of electronic circuits; medical and biotechnology; consumer electronics; industrial process and quality control; materials processing; imaging and printing; graphic arts display; and research and development. In particular, ultraviolet (UV) lasers are profiting from the trend towards miniaturization, which is a driver of innovation and growth in many markets. The short wavelength of lasers that emit light in the UV spectral region make it possible to produce extremely small structures with maximum precision consistent with the latest state-of-the-art technology.

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.

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 that 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.

Emphasize supply chain management We will continue to focus on operational efficiency through an emphasis on supply chain management with the explicit intent of improving gross margins and increasing inventory turns.

Focus on long-term improvement of Return on Invested Capital We will continue to focus on long-term improvement of return on invested capital.

APPLICATIONS

Our products address a broad range of applications that we group into the following markets: microelectronics, graphic arts and display, materials processing, OEM components and instrumentation, and scientific research and government programs.

Microelectronics

The use of semiconductors has expanded beyond computer systems to a wide array of applications including telecommunications and data communication systems, automotive products, consumer goods, medical products, household appliances, industrial automation and control systems. In response to market demands and expectations, semiconductor manufacturers are continually seeking to improve their process and design technologies in order to manufacture smaller, more powerful and more reliable devices at a lower cost per function. The market for lasers is expanding because they deliver advances in all these areas.

We support four major segments of the microelectronics industry: semiconductor front-end manufacturing, back-end fabrication through state-of the-art PCB (printed circuit board) manufacturing, flat panel displays (FPDs), and emerging technologies.

Microelectronics Front-end manufacturing

The term front-end manufacturing refers to the production of semiconductor wafers containing a large number of circuits.

Photomask manufacturing

These circuits are created by a process called microlithography, which relies on a high-resolution photomask made of quartz and chrome. The mask, which is conceptually similar to a negative in photography, is used in lithography systems to make numerous copies of the pattern image on semiconductor wafers. Our *Innova® Sabre* ion lasers, *NovaTex* excimer lasers, and *Rega* ultrafast lasers are all used in the fabrication, inspection and repair of these masks.

Semiconductor inspection, metrology, testing and wafer yield management

As semiconductor device geometries decrease in size, devices become increasingly susceptible to smaller defects during each phase of the manufacturing process and these defects can negatively impact yield. One of the semiconductor industry s responses to the increasing vulnerability of semiconductor devices to smaller defects has been to use defect detection and inspection techniques that are closely linked to the manufacturing process. For example, automated laser-based inspection systems are now used to detect and locate defects as small as 0.1 micron, which may not be observable by conventional optical microscopes.

Detecting the presence of defects is only the first step in preventing their recurrence. After detection, defects must be examined in order to identify their size, shape and the process step in which the defect occurred. This examination is called defect classification. Identification of the sources of defects in the lengthy and complex semiconductor manufacturing process has become essential for maintaining high yield production. Semiconductor manufacturing has become an around-the-clock operation and it is important for products used for inspection, measurement and testing to be reliable and to have long lifetimes.

Our *Azure* , *Paladin* , *Vitesse* , and *Verdi* lasers are used to detect defects in semiconductor chips and printed circuit boards. Our *Innova iLine* argon ion laser is used to inspect patterned wafers and our *Vector* laser is used to repair defects that may occur in the photomask or semiconductor device.

The semiconductor fabrication process typically creates numerous patterned layers on each wafer device. Laser-based systems have been developed to measure the characteristics of metal or opaque layers in order to determine the functionality and conformance of these devices. Our *Vitesse* laser generates an ultrafast laser light pulse that produces a localized temperature rise in the materials, which generates a sound wave, a portion of which is reflected back to the surface. By measuring the returning echoes, the laser system can detect layer thickness, adhesion and composition.

Microelectronics Semiconductor assembly, testing & advanced packaging

Wafer scribing and singulation

After a wafer is patterned, there are then a host of other processes, referred to as back-end processing, which finally result in a packaged encapsulated silicon chip. Ultimately, these chips are then assembled into circuits. The advent of high-speed logic and high-memory content devices has caused chip manufacturers to look for alternative technologies to improve performance and lower process costs. In terms of materials, this search includes new types of wafers based on low-k dielectrics and thinner silicon. Our *AVIA* lasers are providing fast economic methods of cutting and scribing these wafers while delivering higher yields than traditional mechanical methods.

Microvia drilling

These same trends are also driving integration and miniaturization, blurring the traditional lines between formerly discrete applications such as assembly and PCB fabrication. Lasers are playing several enabling roles in this integration and miniaturization. For instance, lasers are now the only economically practical method for drilling microvias in chip assemblies and in both rigid and flexible printed circuit boards. These microvias are tiny interconnects that are essential for enabling high-density circuitry commonly used in mobile handsets and advanced computing systems. Our *AVIA* and *Diamond* carbon-dioxide (CO_2) lasers are being used in this application. The ability of these pulsed lasers to operate at very high repetition rates translates into faster drilling speeds and increased throughput in many materials processing applications.

Other applications also merit mention here. For instance, the high density of the latest circuit boards is reaching the limits of conventional technologies, causing wider adoption of laser direct-write methods. Our *Paladin* laser is used for this application. Our lasers are also being increasingly used to trim (selectively cut) components in order to finely adjust their performance. Our *Vector* and *Prisma* lasers are used for this purpose.

Microelectronics Flat panel display manufacturing

The high-volume consumer market is driving the production of flat panel displays in applications such as digital cameras, personal digital assistants (PDAs), mobile telephones, car navigation systems, laptop computers and television monitors. There are several types of established and emerging FPDs based on quite different technologies, including plasma (PDP), liquid crystal (LCD) and organic polymers (OLED). Lasers have found applications in each of these technologies given that the laser provides a higher process speed, better yield, lower cost and/or superior display brightness and resolution.

ELA and SLS

Several display types require a high-density pattern of silicon TFTs. If this silicon is polycrystalline, the performance is greatly enhanced. In the past, these polysilicon layers could only be produced on expensive thermal glass at high temperatures. However, excimer-based processes, such as excimer laser annealing (ELA) and sequential lateral solidification (SLS), have allowed high-volume production of low-temperature polysilicon (LTPS) on conventional glass substrates. Our excimer lasers provide an invaluable solution for both ELA and SLS because they are the only industrial-grade excimers with the high pulse energy these methods require. The current state-of-the-art product for this application is our *Lambda SX-C* laser.

Our *AVIA* and *Diamond* lasers are also used in other production processes for FPDs. These processes include cutting, patterning, marking and yield improvement.

Microelectronics Emerging technologies

Numerous areas of microelectronics can be grouped as emerging technologies. Some of these are transitioning to volume production in the present timeframe while others are more forward-looking.

Solar cell technology is one area that is seeing increased interest. Historically, this has been a niche energy source because it could not compete with the low cost of other energy sources, most notably fossil fuels. But today s higher fuel costs have led to heightened interest in solar panels. Our lasers, such as *AVIA* and *Prisma,* are already being used in the production of solar panels for scribing and isolation purposes.

The hydrogen cell is another emerging technology currently attracting attention. Originally used in spacecrafts, this could provide a clean alternative power source for automobiles if performance, capacity and cost issues can be successfully addressed. Laser micromachining is likely to play a key role here and our *AVIA* , *Prisma* and *Diamond* lasers are already being used in this area.

Graphic arts and display

Historically, the printing industry has depended upon silver-halide films and chemicals to engrave printing plates. This chemical engraving process requires several time-consuming steps. In recent years, we have worked closely with professionals in the printing industry to design semiconductor and diode-pumped lasers for alternative computer-to-plate processes. As a result, our *Compass* lasers and some of our semiconductor lasers are now widely used for computer-to-plate printing, an environmentally friendly process that saves production time by writing directly to plates. These applications benefit from the high slope efficiency and high-temperature performance that characterize our semiconductor lasers.

There are numerous other applications in the graphic arts and display markets where our lasers are now playing key roles. For instance, in the area of printing, our *Diamond* K and G series lasers are used in the engraving of Anilox rollers for flexo-plate and screen-printing and our *CUBE* violet lasers are used in the imaging of offset plates for computer-to-plate printing

In a completely different part of this market, our *Innova* ion lasers, *AZURE*, and *Paladin* DPSS (diode-pumped solid-state) lasers are used to write data on master disks that are used to mass-produce compact discs and digital videodiscs for consumer use.

One of our lasers that have proved particularly successful in this applications segment is the *Sapphire™ 460.* It is now used for several graphic arts applications, including photo finishing, film writing and the emerging area of laser projection used for cinema and television. In some of these applications, the *Sapphire 460* is displacing air-cooled ion lasers. This solid-state laser is preferred over these legacy gas lasers because it is 90% smaller, consumes 98% less power and dissipates 98% less heat.

Materials processing

Lasers are widely accepted today as part of many important manufacturing applications. While many laser companies have developed high-power lasers for the increasingly competitive area of metal processing, we have chosen to concentrate our efforts on developing compact, low-to-medium power lasers specifically for the growing area of nonmetals processing, precision micromachining and laser marking.

Micromachining and cutting

This area includes such applications as the cutting and joining of plastics using both our *Diamond* and semiconductor lasers; the cutting, perforating and scoring of paper and packaging materials; and various cutting and patterning applications in the textile industry. In the specific area of textiles and clothing, our *Diamond* lasers have seen a return to strength in 2005. These lasers service older applications, such as cutting complex shapes in leather for footwear, as well as newer applications such as creating detailed fade patterns on designer denims.

At the opposite end of the size and wavelength spectrum, our *AVIA* ultraviolet lasers are now being used extensively for micromachining a wide range of materials (and in a wide range of industries) including silicon, glass and plastics. These technically important materials are being laser processed to produce medical devices, micro-electromechanical systems (MEMS) and in flat panel display and semiconductor manufacturing. Silicon and glass are also cut and scribed using our *Diamond* lasers, sometimes in a novel process that combines the heat of the laser with cold-water spray to produce exceptionally high edge quality and strength.

Laser marking and coding

Laser marking and coding are generally considered part of the precision materials processing applications segment and we are also a leading supplier in this area. Applications are growing rapidly in several areas of this segment where the laser is displacing ink-jet coding due to both aesthetic and environmental pressures. The optimum choice of laser depends on both the material being marked, whether it is a surface mark (engraved) or a sub-surface mark, and the specific economics of the application. We now provide lasers for all-important marking applications. Our fiscal 2005 acquisition of TuiLaser has served to significantly expand our product offering and market share in marking and coding. A notable example is the use of our solid-state *Prisma* lasers to create high-quality, gray-scale images for ID cards.

Many marking applications rely on a (scanned) moving laser spot to directly write an alphanumeric mark or barcode. Another method is to use the large cross-section beam from an excimer laser to image a photomask of the intended mark. Our *LPXPro* excimer lasers provide the perfect solution for these photomask applications because of their high-duty-cycle operation and exceptional reliability.

Excimer-based processes

The unique properties of excimer lasers have enabled a diverse range of material transformation applications. Examples include drilling and ablating materials to create stents and disposable drug delivery catheters for the medical marketplace. Frequently, our excimer lasers are also used to mark these same products. Other materials processing applications for our excimer lasers include stripping thin wires in disk drives, cleaning bare semiconductor wafers and writing fiber Bragg gratings for optical telecommunications and sensing purposes.

Low-friction surfaces for greener diesel engines

A particularly interesting and environmentally friendly application is the use of our excimer lasers to treat the cylinder liners in high-performance diesel engines. Since its development in 2002, this process has proved so successful that it is now used by a major European automobile manufacturer for several production models. This process delivers a unique surface finish that lowers friction, increases fuel efficiency, and lowers emissions.

OEM components and instrumentation

Instrumentation is one of our more mature commercial applications. Representative applications within this market include flow cytometry, high-throughput screening for pharmaceutical discovery, genomic and proteomic analyses, Raman spectroscopy, forensics, veterinary science and bio-threat detection. Specifically, our *Sapphire, Compass* and *CUBE* lasers are used in several bio-instrumentation applications including DNA sequencing, flow cytometry and drug discovery. Our *Innova* ion lasers serve bio-instrument manufacturers for applications such as cell sorting, DNA and protein sequencing,

as well as drug and clinical screening.

We also support the laser-based instrumentation market with a range of laser-related components, including diode lasers for optical pumping, optics, optical coatings and harmonic generation modules. Some of our OEM component business is also to other, less integrated laser manufacturers participating in OEM markets such as materials processing, scientific, and medical.

Flow cytometry

Flow cytometry is a laser-based micro-fluorescence technique for analyzing single cells or populations of cells in a heterogeneous mixture, including blood samples. Its numerous applications include cell biology, immunology, reproductive biology, oncology and infectious disease such as Acquired Immune Deficiency Syndrome (AIDS). Flow cytometry is both a powerful research method and an indispensable mainstream clinical diagnostic and prognostic tool. Commercially available instruments typically count cells according to six or more simultaneous discriminating factors at analysis speeds of thousands of cells per second. Many instruments also have the capability to selectively sort individual cells for subsequent analysis or cell culture. The recent design trend in flow cytometry is toward more compact, powerful and reliable instruments. As a result, our *Sapphire*, *Compass* and *CUBE* lasers are the preferred solid-state solutions in the current generation of cutting-edge instrumentation.

DNA sequencing

Laser-based instrumentation revolutionized DNA sequencing, providing automation and data acquisition rates that would be impossible by any other method. This technology played a key role in the human genome project. Today, DNA sequencing continues to be a dynamic area as researchers track and analyze specific genes responsible for various diseases. Our *Sapphire*, *Compass* and *CUBE* lasers are preferred lasers in this market.

Drug Discovery - Genomics and Proteomics

High-speed automation is also essential to the growth of genomics and proteomics, which now enable drug discovery to proceed at very high throughput rates. Over a million compounds can now be screened in weeks instead of years. A challenge to manufacturers of analytical devices is to produce instruments of increasing complexity and capability, while at the same time minimizing their size. This is particularly important where several instruments may be deployed in a single location for parallel processing. Our *Sapphire*, *Compass* and *CUBE* lasers are used in instrument techniques such as micro-array scanning, lab-on-a-chip and fluorescence correlation spectroscopy.

Raman spectroscopy

Raman spectroscopy is a non-contact technique in which a laser beam is used to interrogate the composition of samples. This technique can give unique information about constituent components and their precise concentration, as well as information about crystalline forms (polymorphs), which are particularly important in the pharmaceutical industry. Laser-enabled Raman instruments are useful for process monitoring, environmental monitoring, and biomedical applications. Our *Innova* and *Compass* product lines are widely deployed in Raman applications, both at the commercial and scientific level. Exciting new research at the university level also suggests that our powerful tunable deep-UV source, the *Indigo* , will prove to be a very useful tool in deciphering protein secondary structure.

Bio-agent detection

A number of laser-based techniques for point source and standoff detection of pathogens or other bio-toxins are being explored in the government and private sectors. Systems of this type could be deployed to guard military facilities, major sporting events or other large gatherings of citizens, as well as vital infrastructure components, such as subways, airports or industrial hubs. We have a number of laser systems under evaluation for such applications and are well positioned to actively participate in this segment.

Forensics

Lasers have been used in criminal forensics for a number of decades. Applications include latent fingerprint detection and trace evidence illumination and identification. In the past, laser usage was often limited to forensics labs due to the physical size and complexities of the lasers. Portable models seldom generated enough output for use in high ambient light conditions or for large-scale sweeps of the crime scene. However, now due to recent advances in optical output versus physical size, forensic scientists have the capability to bring an unprecedented level of latent fingerprint and trace evidence detection

directly to the crime scene. Our compact solid-state *Tracer* laser system, based on OPS (optically pumped semiconductor) technology, directly addresses the needs of large-scale criminal investigation organizations by providing a superior combination of high brightness and portability to bear on the most difficult forensic analysis.

Medical OEM

We sell a variety of components and lasers to medical laser companies in end-user applications such as ophthalmology, aesthetic, surgical, therapeutic and dentistry. *Innova* ion laser tubes and our *GEM* series CO_2 lasers are widely used in ophthalmic, aesthetic and surgical markets. Additionally, our *Compass* and *Sapphire* series of lasers are used in the retinal scanning market in diagnostic imaging systems.

Our fiscal 2005 acquisition of TuiLaser, a recognized leader of high-reliability excimer lasers for Lasik and PRK refractive surgery methods with the *ExiStar*^{TM} excimer laser platform has given us a leading position in this important excimer application segment.

Scientific research and government programs

We are widely recognized as a technology innovator and the scientific market has historically provided an ideal test market for our leading-edge innovations. These have included ultrafast lasers, diode-pumped solid-state lasers, continuous-wave (CW) systems and water-cooled gas lasers. Many of the innovations and products pioneered in the scientific marketplace have gone on to become commercial successes for both our OEM customers and us.

Our installed base of scientific lasers includes tens of thousands of lasers. Not surprisingly, these lasers are used in a wide range of applications spanning virtually every branch of science and engineering. These applications include biology (multiphoton and confocal microscopy), physics (atomic and molecular spectroscopy, atom cooling, non-linear optics, X-ray generation, solid-state and semiconductor studies), chemistry (quantum control, time-resolved and Raman spectroscopy) and engineering (material processing, remote sensing and metrology).

Multi-Photon Excitation (MPE) microscopy

MPE microscopy is an imaging method used mainly by biologists to create optical microscopy images of cells and sub-cellular structures and processes. Importantly, MPE can actually image live samples without damaging these samples, thus enabling the interplay of physiology and structure to be studied at the cellular level. Related to confocal microscopy, MPE can only be performed using the unique properties of an ultrafast laser. Because many MPE researchers have limited laser expertise, we now support this market with our *Chameleon* tunable ultrafast laser, which is a hands-free easy to use closed-box laser.

Ultrafast research

Ultrafast lasers generate pulses as short as picoseconds (10^{-12} seconds) and tens of femtoseconds (10^{-15} seconds). This pulse generation allows chemical reactions and other processes to be studied at high temporal resolution. Because of this very short pulse duration, ultrafast lasers also deliver very high peak power, which can be used to generate many exotic effects. Some of these effects are now finding their way into mainstream applications. An example of this is the use of ultrafast pulses for cold micromachining. Our *Mira* titanium:sapphire (Ti:S) modelocked laser, *RegA* Ti:S high-repetition rate regenerative amplifier, and *Mira-OPO* synchronously pumped optical parametric oscillator are all examples of ultrafast laser systems used for research applications. Our *Legend* Ti:S regenerative amplifier, *Hidra* multipass amplifier, and *Evolution* diode-pumped solid-state pump laser are other examples of ultrafast lasers that support these leading-edge applications with even higher peak powers.

Optical pumping

Several of the lasers that we supply to the research market require optical pumping. That is to say, they require another laser as their power source, as opposed to power from an electrical outlet. Examples include our *Mira, RegA* and *899* lasers. Our diode-pumped *Verdi* laser has established itself as the benchmark in reliability as the pump source for these lasers. Some of our customers are also performing research on new types of lasers and new laser materials. These investigational laser setups often require optical pumping at green wavelengths and the *Verdi* is the preferred pump source here as well.

Spectroscopy

Spectroscopy is a scientific field in which processes or materials are studied as a function of wavelength. Many types of

spectroscopy require a tunable laser source. Our *MBR* and *899* CW tunable lasers provide unsurpassed resolution and stability for high-resolution spectroscopy applications, while our *Mira*, *Mira-OPO* and *Chameleon* lasers are preferred sources for spectroscopy in the ultrafast domain.

Custom high-power applications

Our custom scientific laser group provides unique high-energy ultrafast systems with peak powers up to 50 terrawatts. These custom products are used for a variety of physics and chemistry applications, including X-ray generation and non-linear optics. They are also used in conjunction with large accelerators to study high-energy particle physics. We have also supplied these high-energy lasers for use in generating proton beams for cancer irradiation.

Infrared and far-infrared research

We also support a wide range of research applications in the infrared (IR) and far-infrared (FIR) domains with both standard and custom waveguide CO_2 lasers and far-infrared lasers. Research applications for these products include sensing, communications, military programs and terahertz (THz) generation. An example of a standard FIR product is our *SIFIR-50*, a THz laser system.

FUTURE TRENDS

Microelectronics

After several years of process development, lasers are now used in mass production applications because these laser-based fabrication and testing methods are faster, deliver superior end products, increase yields, and/or cut production costs. This is reflected in our strong microelectronics sales during fiscal 2005. Moreover, we anticipate this trend to continue, driven primarily by the increasing sophistication of consumer electronic goods and their convergence via the internet, resulting in increasing demand for more bandwidth and memory. Although this market has historically been cyclical in nature, we believe that the future will see a strong and overarching trend of increased adoption of solid-state, CO_2 and excimer lasers as all these lasers enable both next-generation performance improvements and reduced process costs. In particular, we expect future demands in the advanced packaging market to steadily shift towards the use of ultraviolet laser-based tools, as these are the only commercial technologies capable of providing the high spatial resolution critical for next-generation chip-scale and wafer-level packages.

Graphic arts and display

This is a well-established market for diode lasers with three routes to market for our products direct diodes applications, diodes within our solid-state systems, and diodes sold into other solid-state laser systems. The ongoing improvements in diode laser performance are enabling the direct use of diode lasers to gain more acceptance, reducing costs for end users in this applications segment. We believe this trend will continue to accelerate in 2006, in what will be an increasingly important market for our diode lasers.

Materials processing

The market for low to medium power lasers used in industrial material processing continues to expand, driven by the need for cost-effective manufacturing solutions for cutting, joining, marking and engraving of non-metal materials. A number of application areas are performing well. These include marking/coding, flat bed cutting and engraving, and, in Asia, the production of capital equipment for apparel and leather goods manufacture. Several factors are enabling us to gain market share in the materials process market. First, we have developed an expanded portfolio of wavelengths, enabling optimum marking solutions for virtually every non-metal material type. At the same time, the reliability of these products has been achieved at even higher levels, lowering the cost of ownership. In addition, the acquisition of TuiLaser has brought the *Prisma* family of lasers, which fill an important niche in the power spectrum. *Prisma* lasers are the leading choice for coding images in the fast-growing ID card market and these lasers, which complement our existing offerings, will allow us to offer a more complete portfolio of products to our existing laser source customers and OEMs.

Scientific research and government programs

We expect modest growth rates in the scientific research market for fiscal 2006, with applications in ultrashort pulses and in bio-research being the drivers of this anticipated expansion.

OEM components and instrumentation

The instrumentation market is seeing a gradual migration from the use of mature laser technologies, such as water-cooled ion

lasers, to new technologies, primarily based on solid-state and semiconductors. Using our unique portfolio of solid-state and semiconductor lasers, and our patented OPS technology, we are able to both assist and stimulate this transition. Furthermore, this trend is helping in the development of new applications such as security and clinical diagnostics. These applications are likely to require an increased number of lasers, however, the majority of these activities are still in the research and development stage and we expect only moderate impacts on the laser industry in fiscal 2006, with increases expected in future years. Nevertheless, we anticipate greater future opportunities in microscopy, flow cytometry, lab-on-a-chip and DNA sequencing based on our product enhancements and evolving market developments.

PRODUCTS

We design, manufacture and market lasers, precision optics and related accessories for a diverse group of customers. The following table shows selected products together with their applications, the markets they serve and the technologies upon which they are based.

Market Segment	Application	Products	Technology
Microelectronics	Photomask writing	SabreFreD	Frequency doubled ion
		Innova	Ion
		NovaTex	Excimer
	Semiconductor inspection and metrology	Vitesse	Ultrafast
		Compass series	DPSS
		Enterprise	Ion, DPSS, OPS
		AZURE, Indigo	DPSS
		Sapphire	OPS
	Marking	Avia	DPSS
	Flat panel display (TFT annealing)	Lambda STEEL series	Excimer
	Advanced packaging and interconnects	Avia	DPSS
		Diamond & Gem Series	CO_2
		FAP family	Semiconductor
	DUV lithography	NovaLine	Excimer
		LithoTex	Excimer
Graphic arts and display	Computer-to-plate printing	Single-stripe diodes	Semiconductor
		Fiber coupled diodes	Semiconductor
		Diode bars	Semiconductor
		Compass series	DPSS
	Writing data to master disks	Innova family	Ion
		AZURE	DPSS
		Radius	Semiconductor
	Entertainment	Innova family	Ion
		Viper	DPSS
	Photo finishing	Sapphire	OPS
		Compass	DPSS
	Laser projection	Sapphire	OPS
Materials processing	Marking, welding, engraving, cutting and drilling	FAP family	Semiconductor
		Diamond	CO_2
	Automotive diesel engine production	Lambda STEEL series	Excimer
	Rapid prototyping	Avia	DPSS

Market Segment	Application	Products	Technology
OEM components and instrumentation	Confocal microscopy	Enterprise Sapphire	Ion OPS
	DNA sequencing	Compass Sapphire	DPSS OPS
	Flow cytometry/cell sorting	Innova family Compass Sapphire Radius	Ion DPSS OPS Laser Diode Module
	Drug discovery	Innova family Compass Sapphire Radius	Ion DPSS OPS Laser Diode Module
	Raman spectroscopy	Innova family Compass	Ion DPSS
	Forensics	Incriminator Innova family	DPSS Ion
	Laser Doppler velocimetry	Verdi Innova family	DPSS Ion
	Bio-agent detection	Compass, AVIA Radius	DPSS Laser Diode Module
OEM components and instrumentation	Fluorescence spectroscopy	Innova family Compass Sapphire Radius	Ion DPSS OPS Laser Diode Module
	Medical (OEM)	OPTex, COMPex Diode bars Innova family Compass Sapphire Diamond	Excimer Semiconductor Ion DPSS OPS CO_2
Scientific research and government programs	Pump source for solid-state lasers	FAP family, Diode bars Diode bars	Semiconductor Semiconductor
	Pump source for Ultrafast and CW Tunable lasers	Verdi, Vitesse, Evolution	DPSS
	Regenerative amplification	Legend Terawatt	DPSS Ultrafast
	Multiphoton excitation microscopy	Mira, Chameleon	Ultrafast
	Pollution analysis	COMPexPro	Excimer
	Metrology (measuring technology)	OPTexPro COMPexPro	Excimer Excimer

Market Segment	Application	Products	Technology
Scientific research and government programs (continued)	Spectroscopy	COMPexPro Chameleon, Indigo Mira, RegA, OPO 899, MBR, MBD Innova family ScanMatePro	Excimer DPSS Ultrafast CW Tunable Ion Pulsed Dyelaser
	Physical chemistry	COMPexPro	Excimer
	Photochemistry	COMPexPro	Excimer
	Laser diagnostics and measurement	Modemaster Fieldmaster Labmaster	Diagnostics Diagnostics Diagnostics
	Thermal imaging	Infrared optics	Optical fabrication and coating
	Optical components	Optics for lasers	Optical fabrication and coating

We design, manufacture and market a wide variety of lasers and optical components and instruments, some of which are described below. In addition to products we provide, we invest routinely in the core technologies needed to create substantial differentiation for our products in the marketplace. Our semiconductor, optics and crystal facilities all maintain an external customer base providing value added solutions. We direct significant engineering efforts to producing unique solutions targeted for internal consumption. These investments, once integrated into our broader product portfolio provide our customers with uniquely differentiated solutions and the opportunity to substantially enhance the performance, reliability and capability of the products we offer.

Semiconductor lasers

Semiconductor lasers use the same principles as more conventional types of lasers but miniaturize the entire assembly into a monolithic structure using semiconductor wafer fabrication processes. The advantages of this type of laser include smaller size, longer life, enhanced reliability and greater efficiency. We manufacture a wide range of semiconductor laser products with wavelengths ranging from 650nm to 1000nm and output powers ranging from less than 1 W for individual emitters to 60 W for bars, to several hundred watts for stacked bars. These products are available in various forms of complexity including the following: bar diodes on heat sinks, fiber-coupled single emitters and bars, stacked bars and fully integrated modules and microprocessor-controlled units that contain power supplies and active coolers. Our infrared semiconductor lasers, which are manufactured from proprietary materials grown in our facility in Tampere, Finland, differ from most other lasers in that they contain no aluminum in the active region. This provides our lasers with longer lifetimes and the ability to operate at broader temperature ranges.

Our OPS laser is a semiconductor chip that is pumped by a semiconductor laser. A wide range of wavelengths can be achieved by varying the materials used in this device and doubling the frequency of the laser beam. The OPS is a compact, rugged, high power, single-mode laser. Our frequency doubled OPS lasers are all solid-state devices operating continuously in the blue region of the optical spectrum and are particularly well suited to the bio-instrumentation and graphic art markets.

Another primary application for our semiconductor lasers is for use in computer-to-plate printing machines. These machines contain a series of semiconductor lasers that are used to direct the printing of computer images directly to paper without the need for film or developing chemicals.

Our semiconductor lasers are also used in machine-processing applications such as soldering connections on printed circuit boards and welding flat panel displays and in medical applications for the treatment of the wet classical form of age-related macular degeneration and hair removal. They are also used as the pump laser in DPSS laser systems that are manufactured by us and several of our competitors.

Diode-pumped solid-state lasers

DPSS lasers use semiconductor lasers to pump a crystal to produce a laser beam. By changing the energy, optical components and the types of crystals used in the laser, different wavelengths and types of laser light can be produced.

The efficiency, reliability, longevity and relatively low cost of DPSS lasers make them ideally suited for a wide range of OEM and end-user applications, particularly those requiring 24-hour operations. Our DPSS systems are compact and self-contained sealed units. Unlike conventional tools and other lasers, our DPSS lasers require minimal maintenance since they do not have internal controls or components that require adjusting and cleaning to maintain consistency. They are also less affected by environmental changes in temperature and humidity, which can alter alignment and inhibit performance in many systems.

We manufacture a variety of types of DPSS lasers for different applications including semiconductor inspection; advanced packaging and interconnects; repair, test and measurement; computer-to-plate printing; writing data to master disks; entertainment; photo finishing: marking, welding, engraving, cutting and drilling; drug discovery; forensics; laser Doppler velocimetry; bio-agent detection; medical; rapid prototyping; DNA sequencing; flow cytometry; laser pumping and spectroscopy.

SALES AND MARKETING

We market our products domestically through a direct sales force. Our foreign sales are made principally to customers in Europe, Japan and other Asia-Pacific countries. We sell internationally through direct sales personnel located in Japan, the United Kingdom, Germany, Italy, Austria, France, Belgium, the Netherlands and the People s Republic of China, as well as through independent representatives in other parts of the world. Foreign sales accounted for 65% of our total net sales in fiscal 2005 and 61% in both fiscal 2004 and fiscal 2003. Sales made to independent representatives and distributors are generally priced in U.S. dollars. Foreign sales that we make directly to customers are generally priced in local currencies and are therefore subject to currency exchange fluctuations. Foreign sales are also subject to other normal risks of foreign operations such as protective tariffs, export and import controls and political instability. Our products are broadly distributed and no one customer accounted for more than 10% of total net sales during fiscal 2005, 2004 or 2003.

We maintain a customer support and field service staff in major markets within the United States, Europe, Japan and other Asia-Pacific countries. This organization works closely with customers, customer groups and independent representatives in servicing equipment, training customers to use our products and exploring additional applications of our technologies.

We typically provide one-year parts and service warranties on our lasers, laser-based systems, optical and laser components and related accessories and services. Warranties on some of our products and services may be shorter or longer than one year. Warranty reserves, as reflected on our consolidated balance sheets, have generally been sufficient to cover product warranty repair and replacement costs.

RESEARCH AND DEVELOPMENT

We are committed to the development of new products, as well as the improvement and refinement of existing products, including better cost-of-ownership. Our development efforts are focused on designing and developing products, services and solutions that anticipate customers changing needs and emerging technological trends. Our efforts are also focused on identifying the areas where we believe we can make valuable contributions. Research and development expenditures for fiscal 2005 were $57.5 million, or 11.1% of net sales compared to $62.7 million, or 12.7% of net sales for fiscal 2004 and $51.0 million, or 12.6% of net

sales, for fiscal 2003. We work closely with customers, both individually and through our sponsored seminars, to develop products to meet customer application and performance needs. In addition, we are working with leading research and educational institutions to develop new photonics-based solutions.

MANUFACTURING

Strategies

One of our core manufacturing strategies is to tightly control our supply of key parts, components and assemblies. We believe this is essential in order to maintain high quality products and enable rapid development and deployment of new products and technologies.

Committed to quality and customer satisfaction, we design and produce many of our own components and sub-assemblies in order to retain quality control. We provide customers with 24-hour technical expertise and quality that is ISO certified at our

principal manufacturing sites. In June 2003, we transferred our printed circuit board manufacturing activities in Auburn, California, to a global electronics contract manufacturer, Venture, which has factories in North America, Asia and Europe. We also completed the restructuring of our CO_2 operations, resulting in the consolidation of all CO_2 manufacturing operations at our Bloomfield, Connecticut location. In fiscal 2004, Lambda Physik consolidated the manufacturing operations of its German subsidiary into its Göttingen facility.

We have designed and implemented proprietary manufacturing tools, equipment and techniques in an effort to provide products that differentiate us from our competitors. These proprietary manufacturing techniques are utilized in a number of our product lines including both ion and CO_2 laser production, optics fabrication, optics coating and assembly operations, as well as the wafer growth for our semiconductor laser product family.

Raw materials or sub-components required in the manufacturing process are generally available from several sources. However, we currently purchase several key components and materials, including exotic materials and crystals, used in the manufacture of our products from sole source or limited source suppliers. Some of these suppliers are relatively small private companies that may discontinue their operations at any time. We typically purchase our components and materials through purchase orders and we have no guaranteed supply arrangement with any of these suppliers. We may fail to obtain these supplies in a timely manner in the future. We may experience difficulty identifying alternative sources of supply for certain components used in our products. Once identified, we would experience further delays from evaluating and testing the products of these potential alternative suppliers. Furthermore, financial or other difficulties faced by these suppliers or significant changes in demand for these components or materials could limit their availability. 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, would impair our ability to meet scheduled product deliveries to our customers and could cause customers to cancel orders.

We rely exclusively on our own production capability to manufacture certain strategic components, crystals, optics and optical systems, semiconductor lasers, lasers and laser-based systems. Because we manufacture, package and test these components, products and systems at our own facilities, and such items may not be readily available from other sources, any interruption in our manufacturing would adversely affect our business. In addition, our failure to achieve adequate manufacturing yields at our manufacturing facilities may materially and adversely affect our operating results and financial condition.

Operations

Our Electro-Optical products are manufactured at sites in Santa Clara and Auburn, California; Portland, Oregon; East Hanover, New Jersey; Bloomfield, Connecticut; Lübeck, Germany; Leicester, England; Glasgow, Scotland; Munich, Germany; and Tampere, Finland. Our ion lasers, a portion our DPSS lasers (*Verdi*, *Avia* and *Vitesse),* semiconductor lasers, and ultrafast scientific lasers are manufactured in Santa Clara, California and Glasgow, Scotland. Our CO_2 lasers are manufactured in Bloomfield, Connecticut. Our optical component products are manufactured at our facilities in Auburn, California and Leicester, England. Our laser instrumentation products and test and measurement equipment are manufactured in Portland, Oregon. We manufacture exotic crystals in East Hanover, New Jersey. We make DPSS lasers at our Santa Clara, California and Lübeck, Germany facilities, including the *315M* and *501Q* lasers. Our facility in Tampere, Finland grows the aluminum-free materials that are incorporated into our semiconductor lasers. We make a range of advanced solid-state lasers used in developing applications including scientific research and semiconductor test equipment in Glasgow, Scotland. Our excimer laser products are manufactured in Lübeck and Munich, Germany.

INTELLECTUAL PROPERTY

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We currently hold more than approximately 400 U.S. and foreign patents and we have approximately 75 additional pending patent applications that have been filed. The issued patents cover various products in all of the major markets that we serve.

For a discussion of risks attendant to intellectual property rights, see Risk Factors Risks Related to our Buisness We may not be able to protect our proprietary technology, which could adversely affect our competitive advantage and We could become subject to litigation regarding intellectual property rights, which could seriously harm our business in Item 1A, which is incorporated herein by reference.

COMPETITION

Competition in the various photonics markets in which we provide products is very intense. We compete against a number of

companies including Newport Corporation; Excel Technology, Inc.; JDS Uniphase Corp.; Rofin-Sinar Technologies, Inc. and Cymer, Inc.; as well as other smaller companies. We compete globally based on our broad product offering, reliability, cost, and performance advantages for the widest range of commercial and scientific research applications. Other considerations by our customers include warranty, global service and support and distribution.

BACKLOG

At September 30, 2005, our backlog of orders scheduled for shipment (generally within one year) was approximately $194.1 million compared to $154.6 million at September 30, 2004 and $127.7 million at September 30, 2003. Orders used to compute backlog are generally cancelable without substantial penalties. Historically, the rate of cancellation experienced by us has not been significant. Backlog at September 30, 2005 was higher than backlog at September 30, 2004 in both our Electro-Optics and Lambda Physik operating segments. Backlog at September 30, 2004 was higher than backlog at September 30, 2003 in both our Electro-Optics and Lambda Physik operating segments.

EMPLOYEES

As of September 30, 2005, we had 2,189 full-time employees. Approximately 365 of our employees are involved in research and development; 1,301 of our employees are involved in operations, manufacturing, service and quality assurance; and 523 of our employees are involved in sales, marketing, finance, legal and other administrative functions. Our success will depend in large part upon our ability to attract and retain employees. We face competition in this regard from other companies, research and academic institutions, government entities and other organizations. We consider our relations with our employees to be good.

ACQUISITIONS

On November 10, 2005, we acquired the assets of privately held Iolon, Inc. of San Jose, California for approximately $4.9 million in cash. Iolon designs and manufactures optical components including widely tunable lasers and filters. We intend to utilize the acquired technology in our core portfolio, especially for products in the instrumentation and display markets.

On June 13, 2005, we acquired privately held TuiLaser AG (Munich, Germany), a designer and manufacturer of excimer and advanced solid-state lasers, for approximately $26.0 million (net of cash acquired of $7.7 million). TuiLaser s advanced solid-state laser business is included in our Electro-Optics segment while its excimer laser business is included in our Lambda Physik segment. The operating results of TuiLaser have been included in our consolidated financial statements from the date of acquisition.

In fiscal 2003, we initiated a tender offer to purchase the 5,250,000 (39.62%) outstanding shares of our Lambda Physik subsidiary owned by other shareholders for approximately $10.50 per share. Through the end of fiscal 2004, we purchased a total of 4,588,500 outstanding shares for approximately $49.0 million, resulting in a total ownership percentage of 95.01%. During fiscal 2005, we acquired the remaining 661,500 outstanding shares for approximately $11.8 million, resulting in our full ownership of Lambda Physik.

During fiscal 2003, we acquired Molectron Detector, Inc. (Molectron) of Portland, Oregon and Positive Light, Inc. (PLI) of Los Gatos, California for approximately $11.5 million and $38.9 million in cash, respectively. Molectron designs and manufactures laser test and measurement equipment used across all photonics-based applications and markets. The acquisition of Molectron has enabled us to leverage their well-regarded power and energy management products into our next generation products in both the scientific research and commercial markets. PLI designs and manufactures advanced solid-state lasers for the scientific research and industrial markets. The acquisition of PLI has enabled us to gain market share in the scientific research and industrial markets through additional product and service offerings.

RESTRUCTURINGS AND CONSOLIDATION

In the first quarter of fiscal 2006, we executed the merger of our wholly owned Lambda Physik Co., Ltd. subsidiary into our Coherent Japan, Inc. subsidiary, with Coherent Japan, Inc. continuing as the surviving corporation. Coherent Japan, Inc. is a wholly owned subsidiary of Coherent.

In fiscal 2004, our Lambda Physik subsidiary initiated and completed plans to restructure its manufacturing sites in Göttingen, Germany, to optimize operating efficiency. As a result, we recognized a charge of $1.1 million ($1.0 million net of minority interest) in fiscal 2004 related to these initiatives.

In fiscal 2003, we undertook several initiatives aimed at both changing business strategy and improving operational efficiencies. Changes in business strategy included the termination of the activities of our Coherent Telecom Actives Group (CTAG). In order to improve operational efficiencies, we outsourced the production of printed circuit boards, reassessed the planned utilization of certain long-lived assets at various operating sites and consolidated the activities of a foreign subsidiary. As a direct result of these initiatives, we recognized $31.1 million in restructuring, impairment and other charges in fiscal 2003. These initiatives are discussed further in Management s Discussion and Analysis of Financial Condition and Results of Operations.

GOVERNMENT REGULATION

Environmental regulation

Our operations are subject to various federal, state and local environmental protection regulations governing the use, storage, handling and disposal of hazardous materials, chemicals, various radioactive materials and certain waste products. In the United States, we are subject to the federal regulation and control of the Environmental Protection Agency. Comparable authorities are involved in other countries. We believe that compliance with federal, state and local environmental protection regulations will not have a material adverse effect on our capital expenditures, earnings and competitive and financial position.

Although we believe that our safety procedures for using, handling, storing and disposing of such materials comply with the standards required by federal and state laws and regulations, we cannot completely eliminate the risk of accidental contamination or injury from these materials. 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.

We may face potentially increasing complexity in our product designs and procurement operations as we adjust to new and upcoming requirements relating to the materials composition of our products that will apply to specified electronics products put on the market in the European Union as of July 1, 2006 (Restriction of Hazardous Substances in Electrical and Electronic Equipment Directive). We could face significant costs and liabilities in connection with product take-back legislation. The European Union has finalized the Waste Electrical and Electronic Equipment Directive, which make producers of electrical goods financially responsible for specified collection, recycling, treatment and disposal of past and future covered products.

SEGMENT INFORMATION

Financial information relating to segment operations for the fiscal years ended September 30, 2005, 2004 and 2003, is set forth in Note 17, Segment Information of our Notes to Consolidated Financial Statements.

FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

Financial information relating to foreign and domestic operations for the fiscal years ended September 30, 2005, 2004 and 2003, is set forth in Note 17, Segment Information of our Notes to Consolidated Financial Statements.

ITEM 1A. RISK FACTORS

Risks Related to our Business

We may experience quarterly and annual fluctuations in our net sales and operating results in the future, which may result in volatility in our stock price.

Our net sales and operating results may vary significantly from quarter to quarter and from year to year in the future. A number of factors, many of which are outside of our control, may cause these variations, including:

general economic uncertainties;

fluctuations in demand for, and sales of, our products or prolonged downturns in the industries that we serve;

ability of our suppliers to produce and deliver components and parts, including sole or limited source components, in a timely manner, in the quantity and quality desired and at the prices we have budgeted;

timing or cancellation of customer orders and shipment scheduling;

fluctuations in our product mix;

foreign currency fluctuations;

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;

rate of market acceptance of our new products;

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;

level of capital spending of our customers;

potential obsolescence of our inventory; and

costs related to acquisitions of technology or businesses.

In addition, we often recognize a substantial portion of our sales in the last month of the quarter. Our expenses for any given quarter are typically based on expected sales and if sales are below expectations in any given quarter, the adverse impact of the shortfall on our operating results may be magnified by our inability to adjust spending quickly enough to compensate for the shortfall. We also base our manufacturing on

our forecasted product mix for the quarter. If the actual product mix varies significantly from our forecast, we may not be able to fill some orders during that quarter, which would result in delays in the shipment of our products. Accordingly, variations in timing of sales, particularly for our higher priced, higher margin products, can cause significant fluctuations in quarterly operating results.

Due to these and other factors, 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 common stock to fall. In addition, over the past several years, the stock market has experienced extreme price and volume fluctuations that have affected the stock prices of many technology companies. 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 and the accounting profession, may have a material adverse affect on the market price of our stock in the future.

We are exposed to risks associated with worldwide economic slowdowns and related uncertainties.

Concerns about consumer and investor confidence, volatile corporate profits and reduced capital spending, international conflicts, terrorist and military activity, civil unrest and pandemic illness could cause a slowdown in customer orders or cause customer order cancellations. In addition, political and social turmoil related to international conflicts and terrorist acts may put further pressure on economic conditions in the United States and abroad. Unstable political, social and economic conditions make it difficult for our customers, our suppliers and us to accurately forecast and plan future business activities. In particular, it is difficult to develop and implement strategy, sustainable business models and efficient operations, as well as effectively manage supply chain relationships. If such conditions persist, our business, financial condition and results of operations could suffer.

We depend on sole source or limited source suppliers for some of the key components and materials, including exotic materials and crystals, in our products, which make us susceptible to supply shortages or price fluctuations that could

adversely affect our business.

We currently purchase several key components and materials used in the manufacture of our products from sole source or limited source suppliers. Some of these suppliers are relatively small private companies that may discontinue their operations at any time. We typically purchase our components and materials through purchase orders and we have no guaranteed supply arrangement with any of these suppliers. We may fail to obtain these supplies in a timely manner in the future. We may experience difficulty identifying alternative sources of supply for certain components used in our products. We would experience further delays while identifying, evaluating and testing the products of these potential alternative suppliers. Furthermore, financial or other difficulties faced by these suppliers or significant changes in demand for these components or materials could limit their availability. 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, would impair our ability to meet scheduled product deliveries to our customers and could cause customers to cancel orders.

We rely exclusively on our own production capability to manufacture certain strategic components, optics and optical systems, crystals, semiconductor lasers, lasers and laser-based systems. Because we manufacture, package and test these components, products and systems at our own facilities, and such components, products and systems are not readily available from other sources, any interruption in manufacturing would adversely affect our business. 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.

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

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

We have historically been the industry s high quality, high priced supplier of laser systems. We have, in the past, experienced decreases in the average selling prices of some of our products. We anticipate that as competing products become more widely available, the average selling price of our products may decrease. If we are unable to offset the anticipated decrease in our average selling prices 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 our products. Furthermore, as average selling prices of our current products decline, we must develop and introduce new products and product enhancements with higher margins. If we cannot maintain our gross margins, our operating results could be seriously harmed, particularly if the average selling prices 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 generally continue to be smaller in size and have lower average selling prices (ASPs), so over time, we have to sell more units to maintain revenue levels.

Over the last three fiscal years, our research and development expenses have been in the range of 11% to 13% of net sales. 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 effectively transfer production processes, 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 sales that could harm our financial condition and results of operations.

For fiscal years 2005, 2004 and 2003, 65%, 61% and 61%, respectively, of our net sales were derived from customers outside of the Untied States. We anticipate that foreign sales will continue to account for a significant portion of our revenues in the foreseeable future. A global economic slowdown could have a negative effect on various foreign markets in which we operate. This may cause us to reduce our presence in certain countries, which may negatively affect the overall level of business in such countries. The majority of our foreign sales occurs through our foreign sales subsidiaries and the remainder of our foreign sales result from exports to foreign distributors, resellers and customers. Our foreign operations and sales are subject to a number of risks, including:

- longer accounts receivable collection periods;
- the impact of recessions 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; and
- preference for locally produced products.

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

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

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We cannot assure you that our patent applications will be approved, that any patents that may be issued will protect our intellectual property or that any issued patents will not 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.

We could become subject to litigation regarding intellectual property rights, which could seriously harm our business.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. 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. 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, our business may be seriously harmed. We do not have insurance to cover potential claims of this type.

We may, in the future, initiate claims or litigation against third parties for infringement of our proprietary rights to protect these rights or to determine the scope and validity of our proprietary rights or the proprietary rights of competitors. These claims could result in costly litigation and the diversion of our technical and management personnel.

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

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

Our future success depends upon the continued services of our executive officers and other key engineering, sales, marketing, manufacturing and support personnel, any of whom may leave, which could harm our business.

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

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 customer s 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 revenue to offset those 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 companies, including Newport Corporation; Excel Technology, Inc.; JDS Uniphase Corp.; Rofin-Sinar Technologies, Inc.; and Cymer, Inc., 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 that have more cash reserves 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 competitors 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 market 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. As a result of the foregoing factors, we expect that competitive pressures may result in price reductions, reduced margins and loss of market share.

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 revenues.

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 technical complexity of our products, 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 such yields or product reliability, our business, operating results, financial condition and customer relationships would be adversely affected. We provide warranties on certain of our product sales, and allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires us to make estimates of product return rates and expected costs to repair or replace the products under warranty. We currently establish warranty reserves based on historical warranty costs for each product line. If actual return rates and/or repair and replacement costs differ significantly from our estimates, adjustments to recognize additional cost of sales may be required in future periods.

Our customers may discover defects in our products after the products have been fully deployed and operated under 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;

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 and engineering resources; and

legal actions by our customers.

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

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 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, some of our suppliers may need at least six 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 increased reliance on contract manufacturing may adversely impact our financial results and operations.

Our manufacturing strategy includes relying heavily on sourcing from contract manufacturers, including some performed at international sites located in Asia. Our ability to resume internal manufacturing operations for certain products in a timely manner has been 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. The inability of any contract manufacturer to meet our cost, quality, performance and availability standards could adversely impact our financial condition or results of operations. 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.

The inability to continue to reduce expenses and contain our costs could harm our operating results.

We are continuing efforts to reduce our expense structure. Additional measures to contain costs and reduce expenses may be undertaken if revenues and market conditions do not continue to improve. A number of factors could preclude us from successfully bringing costs and expenses in line with our revenues, such as our inability to accurately forecast business activities or deterioration of our revenues. If we are unable to continue to reduce expenses and contain our costs, this could harm our operating results.

If we fail to manage our growth effectively, our business could be disrupted, which could 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. We continue to expand the scope of our operations domestically and internationally. The growth in sales, combined with the challenges of managing geographically-dispersed operations, has placed, and our anticipated growth in future operations will continue to place, a significant strain on our management systems and resources. The failure to effectively manage our growth could disrupt our business and harm our operating results.

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 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;

incur debt;

assume liabilities; or

incur expenses related to in-process research and development, impairment of goodwill and amortization.

These purchases also involve numerous risks, including:

problems combining the acquired operations, technologies or products;

unanticipated costs or liabilities;

diversion of management s attention from our core businesses;

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

potential loss of key employees, particularly those of the purchased organizations.

We cannot assure you that we will be able to successfully integrate any businesses, products, technologies or personnel that we might acquire in the future, which may harm our business.

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 Tampere, Finland, site and 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.

The adoption of certain environmental regulations will require us to redesign some of our products if we are to continue to be able to sell them in Europe.

The European Union has enacted The Restriction on Hazardous Substances in Electronic Equipment (ROHS) and Waste Electrical and Electronic Equipment (WEEE) directives that will require us to redesign some of our products if we are to continue selling them in Europe. We have launched a major program to bring our products into compliance with ROHS and WEEE, but there can be no guarantee that we will be successful. Failure to comply can result in the inability to sell non-compliant products into Europe, a market currently accounting for approximately one-third of our revenues, which would have a material adverse affect on our business and financial results.

Private companies outside of Europe, most notably in Japan, are undertaking similar green initiatives. Noncompliance would result in similar risks.

If our facilities were to experience catastrophic loss, our operations would be seriously harmed.

Our facilities could be subject to a catastrophic loss from fire, flood, earthquake 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 at any of our facilities could disrupt our operations, delay production, shipments and revenue 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.

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

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

the ability of our board of directors to alter our bylaws without stockholder approval;

limiting the ability of stockholders to call special meetings;

limiting the ability of our stockholders to act by written consent; 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.

Our common shares rights agreement permits the holders of rights to purchase shares of our common stock to exercise the stock purchase rights following an acquisition of or merger by us with another corporation or entity, following a sale of 50% or more of our consolidated assets or earning power, or the acquisition by an individual or entity of 20% or more of our common stock. Our successor or acquirer is required to assume all of our obligations and duties under the common shares rights agreement, including in certain circumstances the issuance of shares of its capital stock upon exercise of the stock purchase rights. The existence of our common shares rights agreement may have the effect of delaying, deferring or preventing a change of control and, as a consequence, may discourage potential acquirers from making tender offers for our shares.

Changes in tax rates or tax liabilities could affect future results.

As a global company, we are subject to taxation in the United States and various other countries. Significant judgment is required to determine worldwide tax liabilities. Our future tax rates could be affected by changes in the composition of earnings in countries with differing tax rates, changes in the valuation of our deferred tax assets and liabilities, or changes in the tax laws. For example, recent U.S. legislation governing taxation of extraterritorial income (ETI) repealed certain export subsidies that were prohibited by the World Trade Organization and enacted different tax provisions. These new tax provisions are not expected to fully offset the loss of the repealed tax provisions and, as a result, our U.S. tax liability may increase. In addition, we are subject to regular examination of our income tax returns by the Internal Revenue Service 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 than the treatment reflected in our historical income tax provisions and accruals, which could materially and adversely affect our results of operations.

Compliance with changing regulation of corporate governance and public disclosure may create uncertainty regarding compliance matters.

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. In addition, it has become more difficult and could be more expensive for us to obtain director and officer liability insurance. Further, our board members, chief executive officer and chief financial officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which could harm our business.

Risks related to our industry

Our market is unpredictable and characterized by rapid technological changes and evolving standards, 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 market is subject to rapid change, it is difficult to predict its potential size or future growth rate. Our success in generating revenues in this market 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, laser systems and precision optics; and

our ability to accurately predict and develop our products to meet industry standards.

For our fiscal years ended September 30, 2005, 2004 and 2003, our research and development costs were $57.5 million (11% of net sales), $62.7 million (13% of net sales) and $51.0 million (13% of net sales), respectively. We cannot assure you that our expenditures for research and development will result in the introduction of new products or, if such products are introduced, that those products will achieve sufficient market acceptance. Our failure to address rapid technological changes in our markets could adversely affect our business and results of operations.

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

Our net sales depend in part on the demand for our products by semiconductor equipment companies. The semiconductor market has 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 this market severely limits our ability to predict our business prospects or financial results in this market.

During industry downturns, our revenues from this market will 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 this market, 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 this market 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.

During industry downturns, our revenues from this market will decline suddenly and significantly. Our abil

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

At September 30, 2005, our primary locations were as follows:

	Description	Use	Term
Electro-Optics:			
Santa Clara, CA	8.5 acres of land, 200,000 square foot building	Corporate headquarters, manufacturing, R&D	Owned
Santa Clara, CA	11 acres of land, 216,000 square foot building	Office	Owned
Auburn, CA	4 buildings, total of 256,231 square feet	Office, manufacturing	Owned buildings, land leases expiring from 2021 through 2046
San Jose, CA	28,800 square foot building	Office, manufacturing	Leased through February 2007
Portland, OR	33,040 square foot building	Office, manufacturing	Leased through December 2008
East Hanover, NJ	30,000 square foot building	Office, manufacturing	Leased through October 2012
Bloomfield, CT	48,046 square-foot building	Office, manufacturing	Leased through April 2013
Dieburg, Germany	31,306 square foot building	Office	Leased through December 2012
Lübeck, Germany	32,507 square foot building	Office, manufacturing	Leased through June 2007 with renewal option
Lübeck, Germany	21,980 square feet	Office, manufacturing	Leased through December 2009 with option to purchase building
Leicester, England	2 buildings totaling 34,537 square feet	Office, manufacturing	Leased through December 2007
Tampere, Finland	5 acres of land, 40,970 square foot building	Office, manufacturing	Owned
Glasgow, Scotland	2 acres of land, 30,000 square foot building	Office, manufacturing	Owned
Tokyo, Japan	17,550 square foot building	Office	Leased through April 2007
Lambda Physik:			
Göttingen, Germany	7.6 acres of land, 4 buildings totaling 119,500 square feet	Office, manufacturing	Owned
Munich, Germany	58,449 square-foot building	Office, manufacturing	Leased through December 2010
Fort Lauderdale, FL	27,868 square-foot building	Office	Leased through December 2008
Yokohama, Japan	7,080 square-foot building	Office	Leased through October 2007

We maintain sales and service offices under varying leases expiring from 2006 through 2019 in the United States, Japan, Korea, China, Germany, France, Italy, the United Kingdom and the Netherlands.

We consider our facilities to be both suitable and adequate to provide for current and near term requirements.

ITEM 3. LEGAL PROCEEDINGS

Certain claims and lawsuits have been filed or are pending against us. In the opinion of management, all such matters have been adequately provided for, are without merit, or are of such kind that if disposed of unfavorably, would not have a material adverse effect on our consolidated results of operations or financial position.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is quoted on the NASDAQ National Market under the symbol COHR. The following table sets forth the high and low closing prices for each quarterly period during the past two fiscal years as reported on the NASDAQ National Market.

	Years Ended September 30,			
	2005		2004	
	High	Low	High	Low
First quarter	$ 32.27	$ 22.86	$ 27.90	$ 21.23
Second quarter	$ 34.00	$ 28.41	$ 30.73	$ 23.72
Third quarter	$ 37.75	$ 30.68	$ 29.85	$ 24.44
Fourth quarter	$ 38.68	$ 29.13	$ 27.89	$ 24.26

The number of stockholders of record as of December 1, 2005 was 1,492. No cash dividends have been declared or paid since Coherent was founded and we have no present intention to declare or pay cash dividends. Our agreements with certain financial institutions restrict the payment of dividends on our Common Stock. See Note 9, Short-term Borrowings in our Notes to Consolidated Financial Statements.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data for each of the last five fiscal years have been derived from our audited financial statements. The following selected consolidated financial data reflects our former Medical segment as discontinued operations. See Note 3, Discontinued Operations in our Notes to Consolidated Financial Statements.

The information set forth below is not necessarily indicative of results of future operations and should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and Notes to Consolidated Financial Statements.

Consolidated financial data	Year Ended Sept. 30, 2005(5)	Sept. 30, 2004(4)	Sept. 30, 2003(3)	Sept. 30, 2002(2)	Sept. 30, 2001(1)
	(In thousands, except per share data)				
Net sales	$ 516,252	$ 494,954	$ 406,235	$ 397,324	$ 477,945
Gross profit	$ 217,669	$ 207,403	$ 148,591	$ 161,147	$ 200,179
Income (loss) from continuing operations	$ 39,861	$ 17,142	$ (46,788)	$ (71,982)	$ 25,476
Income (loss) from continuing operations per share (6):					
Basic	$ 1.30	$ 0.57	$ (1.59)	$ (2.50)	$ 0.92
Diluted	$ 1.28	$ 0.56	$ (1.59)	$ (2.50)	$ 0.88
Shares used in computation (6):					
Basic	30,756	30,179	29,448	28,786	27,709
Diluted	31,241	30,544	29,448	28,786	28,817
Total assets	$ 798,290	$ 757,326	$ 705,195	$ 800,342	$ 871,747
Long-term obligations	$	$ 14,215	$ 27,911	$ 43,345	$ 58,159
Other long-term liabilities	$ 50,437	$ 49,128	$ 29,008	$ 55,860	$ 53,097
Minority interest in subsidiaries	$	$ 5,402	$ 7,475	$ 49,602	$ 49,367
Stockholders equity	$ 636,266	$ 584,052	$ 539,688	$ 553,328	$ 595,525

(1) Includes a $5.8 million after-tax charge for write-offs of inventory and open purchase commitments in our Lambda Physik segment. Also includes a $1.6 million after-tax charge for the write-off of purchased in-process research and development (IPR&D) associated with the acquisitions of DEOS and MicroLas.

(2) Includes a $79.2 million after-tax impairment charge on our Lumenis common stock; a $6.7 million after-tax asset impairment charge resulting primarily from a decision to cease most of our activities related to the telecom passives

component market; a $3.0 million tax benefit relating to a refund of prior year taxes; a $1.0 million after-tax gain on sale of real estate; a $0.7 million after-tax and minority interest royalty revenues; and a $0.7 million after-tax and minority interest non-recurring favorable inventory adjustment.

(3) Includes a $10.2 million impairment charge on our Lumenis common stock; a $9.2 million after-tax charge related to the termination of activities in our Telecom-Actives group; a $7.9 million after-tax charge for the write-down of manufacturing facilities and equipment to net realizable value due to excess capacity and consolidation of operations; a $6.3 million charge for the write-off of purchased IPR&D associated with our acquisition of Positive Light, Inc and step acquisition of Lambda Physik; a $5.6 million valuation allowance against Lambda Physik s deferred tax assets; a $2.7 million after-tax impairment charge to write down our Lincoln, California facility to net realizable value; a $2.3 million after-tax charge to write down our loan to Picometrix, Inc. (Picometrix) to net realizable value; a $1.8 million, net of minority interest, impairment charge to write off goodwill associated with Lambda Physik s lithography business; severance costs at Lambda Physik of $1.3 million, after-tax and net of minority interest; a $1.0 million after-tax charge related to early lease termination costs associated with our Santa Clara, California facility; a $2.1 million tax benefit relating to a refund of prior years taxes; a customer contract settlement fee of $2.0 million, after-tax and net of minority interest received by Lambda Physik; and a gain of $1.5 million related to the sale of 5.2 million shares of Lumenis, Ltd.

(4) Fiscal 2004 included 53 weeks, whereas all other fiscal years presented included 52 weeks. Includes $3.9 million of net sales from Picometrix, which was consolidated under Financial Accounting Standards Board Interpretation No. 46R; additionally, Picometrix s net income of $0.5 million was eliminated through minority interest. Fiscal 2004 also includes a $0.6 million after-tax gain on the sale of certain technology and a $2.0 million after-tax recovery on the sale of a previously impaired note receivable.

(5) Includes a $4.1 million after-tax charge related to excess inventories as a result of the accelerated decommissioning of lithography lasers in Lambda Physik, a $2.7 million (net of minority interest of $0.1 million) after-tax charge associated with our decision to discontinue future product development and investments in the semiconductor lithography market within our Lambda Physik operating segment and a charge of $1.6 million for IPR&D related to our purchase of TuiLaser. Fiscal 2005 also includes tax benefits of $1.4 million for increased use of export tax incentives and research and development (R&D) tax credits, $9.6 million for the reversal of a deferred tax valuation allowance related to our Lambda Physik segment and $0.5 million related to federal tax law changes enacted during fiscal 2005.

(6) See Note 2, Significant Accounting Policies in our Notes to Consolidated Financial Statements for an explanation of the determination of the number of shares used in computing income (loss) per share.

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with our Consolidated Financial Statements and related notes included in Item 8, Financial Statements and Supplementary Data in this Annual Report. This discussion contains forward-looking statements, which involve risk and uncertainties. Our actual results could differ materially from those anticipated in the forward looking statements as a result of certain factors, including but not limited to those discussed in Risk Factors and elsewhere in this Annual Report. See Special Note Regarding Forward Looking Statements at the beginning of this Annual Report.

KEY PERFORMANCE INDICATORS

The following is a summary of some of the quantitative performance indicators (as defined below) that may be used to assess our results of operations and financial condition:

	Year Ended September 30,		
	2005	2004	2003
	(Dollars in thousands)		
Bookings - Electro-Optics	$ 426,851	$ 427,906	$ 337,976
Bookings - Lambda Physik	$ 118,277	$ 93,912	$ 67,493
Net Sales - Electro-Optics	$ 408,347	$ 409,293	$ 324,308
Net Sales - Lambda Physik	$ 107,905	$ 85,661	$ 81,927
Gross Profit as a Percentage of Net Sales - Electro-Optics	46.9%	44.2%	39.2%
Gross Profit as a Percentage of Net Sales - Lambda Physik	24.0%	30.9%	26.2%
Research and Development as a Percentage of Net Sales	11.1%	12.7%	12.6%
Income (Loss) from Continuing Operations Before Income Taxes and Minority Interest	$ 41,431	$ 27,251	$ (58,406)
Cash Provided by Continuing Operating Activities	$ 92,688	$ 69,126	$ 21,332
Days Sales Outstanding in Receivables	61.1	70.4	64.8
Days Sales Outstanding in Inventories	71.6	76.2	88.7
Capital Spending as a Percentage of Net Sales	3.4%	9.4%	6.3%

Definitions and analysis of these performance indicators are as follows:

Bookings

Bookings represent orders expected to be shipped within 12 months. Bookings are generally cancelable by our customers without substantial penalty and, historically, we have not experienced a significant rate of cancellation. Bookings for a period are calculated by adding current period net sales to the increase or decrease in ending backlog during the period.

In our Electro-Optics segment, fiscal 2005 bookings decreased 0.2% from fiscal 2004. Decreases in current year bookings, compared to fiscal 2004, in the scientific and government programs, microelectronics and OEM components and instrumentation markets were offset by increases in the graphic arts and display and materials processing markets. Fiscal 2004 bookings increased 26.6% from fiscal 2003, with increases in the microelectronics, scientific and government programs, OEM components and instrumentation and materials processing markets, partially offset by decreases in the graphic arts and display market.

Bookings in the scientific and government programs market decreased in fiscal 2005, but remained solid. Within the research market, our *Chameleon* product line continues to do well with record bookings in the fourth quarter of fiscal 2005, fueled by the release of the *Chameleon Ultra* early in the fourth quarter. The *Chameleon Ultra* is the highest performing laser for power and wavelength tenability in its class. These performance characteristics are critically important for applications like biological imaging as they influence detection resolution and sensitivity. On a geographical basis, the European and U.S. markets were slower, while the Asian market was stronger, particularly among the Pacific rim countries.

Although microelectronics bookings decreased from fiscal 2004, they still continue to be strong as a direct result of our prior investment decisions. Today, a significant portion of our revenue is derived from sales to customers investing in emerging manufacturing technologies. This has allowed us to withstand recent downturns in capacity-driven demand. Our advanced packaging market experienced strong demand for ultraviolet lasers used in direct imaging of printed circuit boards and orders for lasers used in silicon drilling for the semiconductor back-end and glass cutting for flat panel displays also increased. During the third quarter of fiscal 2005, we launched a number of new products at LASER 2005 in Munich including our new *AVIA 355-20*™. It is the first all-solid-state Q-switched laser to offer 20W of 355nm ultraviolet output at 100 kHz. The

combination of high power and high pulse rate translates directly into higher processing speeds for microelectronics applications such as via drilling, processing low-k dielectrics, large-area solar cell scribing and chip singulation. In the TFT annealing market, our excimer lasers remain the industry standard, but could soon be joined by our high-power solid-state green lasers. The interest in green lasers has increased due to the depth of penetration (i.e. more of the bulk amorphous material is converted to the performance-enhancing crystalline structure), the smaller footprint and reduced power consumption of solid-state lasers as well as the potential for much longer operating lifetimes. The use of green light also relaxes demand on optical components, such as mirrors and lenses, when compared to ultraviolet light. All of these lead to reduced manufacturing costs for flat panel producers.

Bookings in the OEM components and instrumentation market decreased from the prior year due primarily to delays in new product releases by a few customers. On the product front, we introduced the *Compass 115M*™, a low power, continuous wave, 532nm laser optimized for OEM applications in bioinstrumentation and inspection. This laser enables a new generation of economical instrumentation at lower power levels than our prior *Compass* models, but with a 30% cost reduction over these earlier models. Typical applications in bioinstrumentation for the *Compass 115M* include flow-cytometry, confocal microscopy and spectroscopy.

Bookings in the graphic arts and display market increased significantly, with most of the increase occurring in the fourth quarter. The significant upswing was due, in large part, to an annual purchase of a recently released product platform. The new device architecture is a multiple element semiconductor laser, which facilitates rapid exposure of high volume printing plates. We view this platform as transformational and envision future versions playing a role in other markets including microelectronics, instrumentation and materials processing.

Bookings in the materials processing market increased year-over-year as photonic applications continue to drive capabilities and yield improvements. Demand was strongest for technologies used in marking and engraving for product identification, lot coding and consumer safety. The geographic distribution of orders was more balanced in fiscal 2005. The Asian market, particularly China, had a very strong first half of fiscal 2005. The growth cooled in the second half due to credit tightening and trade quotas on Chinese textile exports. The U.S. and European markets picked up in the second half as manufacturers sought to right size their capacity models. We continue to view the materials processing market as one of the highest growth areas over the next decade.

In our Lambda Physik segment, fiscal 2005 bookings increased 25.9% from fiscal 2004. Bookings increased primarily in the industrial and scientific and medical markets. Fiscal 2004 bookings increased 39.1% from fiscal 2003, with bookings increases in the industrial and scientific and medical markets partially offset by decreases in the lithography market.

Fiscal 2005 industrial bookings increased due to higher service business and solid orders in the TFT market. We continue to make advances in the TFT market with the introduction of the new *LSX* series. The first laser in the series, the *LSX315C*, provides substantial optical performance improvement over its predecessor in terms of pulse-to-pulse stability and timing. Additionally, tube lifetime and serviceability have been improved. During the third fiscal quarter of 2005, we introduced the new *COMPexPro*™ *1000* excimer laser, which combines the economy of a mid-sized laser platform with the high repetition rate and long lifetime previously available only from high-end products. The high repetition rate of this new laser enables increased process speed for a number of micromachining, drilling, direct write and inspection applications such as drilling ink jet nozzles and inspecting semiconductor photomasks. We continue to drive significantly lower cost of ownership for our customers, which is particularly beneficial for those customers running continuous applications that can easily consume several billion pulses per year.

Bookings in the scientific and medical market increased significantly. Medical OEM orders reached an all-time high and led all segments within our excimer business primarily due to the acquisition of TuiLaser. Annual purchase contracts from several accounts and new technology platforms were the drivers of growth and we also saw broad geographic participation. On the scientific side, we are beginning to reap the benefits of the sales force integration we launched earlier in 2005. We are also experiencing renewed interest from the scientific market stemming from laser-assisted deposition of exotic materials. While still in a research mode, these techniques could rapidly migrate into the commercial realm.

Net Sales

Net sales include sales of lasers, precision optics, related accessories and service contracts. Net sales for fiscal 2005 decreased 0.2% in our Electro-Optics segment and increased 26.0% in our Lambda Physik segment from fiscal 2004. Net sales for fiscal 2004 increased 26.2% in our Electro-Optics segment and 4.6% in our Lambda Physik segment from fiscal 2003. For a more complete description of the reasons for changes in net sales refer to the Results of Operations section of this Annual 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 fiscal 2005 increased from 44.2% to 46.9% in our Electro-Optics segment and decreased from 30.9% to 24.0% in our Lambda Physik segment from fiscal 2004. Gross profit percentage in fiscal 2004 increased from 39.2% to 44.2% in our Electro-Optics segment and increased from 26.2% to 30.9% in our Lambda Physik segment from fiscal 2003. For a more complete description of the reasons for changes in gross profit refer to the Results of Operations section of this Annual 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 decreased from 12.7% in fiscal 2004 to 11.1% in fiscal 2005 and increased from 12.6% in fiscal 2003 to 12.7% in fiscal 2004. For a more complete description of the reasons for changes in R&D percentage refer to the Results of Operations section of this Annual Report.

Net Cash Provided by Continuing Operating Activities

Net cash provided by continuing operating activities shown on our Consolidated Statements of Cash Flows primarily represents the excess of cash collected from billings to our customers and other receipts, including tax refunds, over cash paid to our vendors for expenses and inventory purchases to run our business. This amount represents cash generated by current operations to pay for equipment, technology, and other investing activities, to repay debt, fund acquisitions and for other financing purposes. We believe this is an important performance indicator since cash generation over the long term is essential to maintaining a healthy business and providing funds to help fuel growth. We believe generating positive cash from operations is an indication that our products are achieving a high level of customer satisfaction and we are appropriately monitoring our expenses, inventory levels and cash collection efforts.

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 360 days for years. This indicates how well we are managing our collection of receivables, with lower DSO in receivables resulting in more cash flow available. The more money we have tied up in receivables, the less money we have available for research and development, acquisitions, expansions, marketing and other activities to grow our business. Our DSO in receivables for fiscal 2005 decreased 9.3 days from fiscal 2004 to 61.1 days. The improvement in DSO in receivables is primarily due to improved collections, including the centralization of U.S. credit departments and lower Japanese longer term receivables.

Days Sales Outstanding in Inventories

We calculate DSO in inventories as net inventories at the end of the period divided by net sales of the period and then multiplied by the number of days in the period, using 360 days for years. This indicates how well we are managing our inventory levels, with lower DSO in inventories resulting in more cash flow available. 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 DSO in inventories for fiscal 2005 decreased 4.6 days from fiscal 2004 to 71.6 days. The improvement in DSO in inventories is primarily due to a $6.8 million charge for excess Lambda Physik inventories in fiscal 2005 (4.8 days) and better management of inventory levels in relation to sales volumes.

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. This indicates the extent to which we are expanding or modernizing our operations, including investments in technology. Management monitors capital spending levels as this assists management in measuring our cash flows, net of capital expenditures. Our capital spending percentage decreased from 9.4% in fiscal 2004 to 3.4% in fiscal 2005 and increased from 6.3% in fiscal 2003 to 9.4% in fiscal 2004, primarily due to the purchase of our previously leased facility in Santa Clara, California, in the first quarter of fiscal 2004. We anticipate that capital spending for fiscal 2006 will be approximately 5% of net sales.

SIGNIFICANT EVENTS

In December 2004, our Lambda Physik subsidiary decided to discontinue future product development and investments in the semiconductor lithography market. As a result, during the first quarter of fiscal 2005, we recognized a charge of $3.1 million (net of minority interest of $0.1 million) primarily related to recognizing write-downs of excessive and obsolete inventories, exiting certain purchase commitments and charges related to government grants. We anticipate this decision will also result in re-deployment of a portion of Lambda s lithography future R&D dollars into the most promising growth areas of Lambda Physik s Industrial and Scientific/Medical markets.

On June 3, 2003, we initiated a tender offer to purchase the 5,250,000 (39.62%) outstanding shares of our Lambda Physik subsidiary owned by other shareholders (the minority interest) for approximately $10.50 per share. Through the end of fiscal 2004, we purchased a total of 4,588,500 outstanding shares for approximately $49.0 million, resulting in a total ownership percentage of 95.01% (inclusive of shares previously owned). During the second quarter of fiscal 2005, we acquired the remaining 661,500 outstanding shares for approximately $11.8 million, resulting in our full ownership of Lambda Physik.

In fiscal 2005, we recorded a reduction of $11.6 million of valuation allowance on Lambda Physik s deferred tax assets as we believe that it is more likely than not that we will be able to realize these assets. In accordance with SFAS No. 109 Accounting for Income Taxes, $1.4 million of the reversal was applied against intangible assets, $0.6 million was applied against goodwill recognized from the final step acquisition of Lambda Physik and the remaining $9.6 million was recorded as a tax benefit during the second quarter of fiscal 2005.

On June 13, 2005, we acquired privately held TuiLaser AG (Munich, Germany), a designer and manufacturer of excimer and advanced solid-state lasers, for approximately $26.0 million (net of cash acquired of $7.7 million). As a result of the acquisition, we expect to increase our product offerings and market share, as well as capitalize on operational synergies. The operating results of TuiLaser have been included in our consolidated financial statements from the date of acquisition.

On July 8, 2005, our wholly owned Lambda Physik subsidiary completed the sale of its fifty percent joint venture interest in XTREME Technologies GmbH to USHIO, Inc. of Tokyo, Japan for approximately $3.9 million. We recognized a gain of $1.1 million during the fourth quarter of fiscal 2005 resulting from the sale. The transaction is in line with our previously communicated decision to discontinue future product development and investments in the semiconductor lithography market.

During the fourth quarter of fiscal 2005, we recognized an after-tax charge of $4.1 million related to excess inventories as a result of the accelerated decommissioning of lithography lasers, following a decision that we will no longer offer lithography service contracts after December 31, 2005.

In September 2005, our Board of Directors authorized a share repurchase program of up to 1.5 million shares of our common stock. These purchases may be made from time to time in both open market and private transactions, as conditions warrant. The repurchase program is expected to remain in effect through September 30, 2007, unless earlier terminated or completed. During the year ended September 30, 2005, no purchases were made under this program.

RESULTS OF OPERATIONS YEARS ENDED SEPTEMBER 30, 2005, 2004 AND 2003

Fiscal 2004 included 53 weeks, whereas fiscal 2005 and fiscal 2003 included 52 weeks.

Consolidated Summary

	Year Ended September 30,		
	2005	2004	2003
	(As a percentage of net sales)		
Net sales	100.0%	100.0%	100.0%
Cost of sales	57.8%	58.1%	63.4%
Gross profit	42.2%	41.9%	36.6%
Operating expenses:			
Research and development	11.1%	12.7%	12.6%
In-process research and development	0.3%		1.6%
Selling, general and administrative	22.4%	23.2%	26.1%
Restructuring, impairment and other charges (recoveries)	(0.0)%	(0.7)%	8.6%
Amortization of intangible assets	1.4%	1.4%	1.3%
Total operating expenses	35.2%	36.6%	50.2%
Income (loss) from operations	7.0%	5.3%	(13.6)%
Other income (expense):			
Interest and dividend income	1.0%	0.5%	1.3%
Interest expense	(0.4)%	(0.6)%	(1.0)%
Foreign exchange gain (loss)	0.0%	0.1%	(0.4)%
Write-down of Lumenis investment			(2.5)%
Other net	0.4%	0.2%	1.8%
Total other income (expense), net	1.0%	0.2%	(0.8)%
Income (loss) from continuing operations before income taxes and minority interest	8.0%	5.5%	(14.4)%
Provision (benefit) for income taxes	0.3%	2.1%	(1.8)%
Income (loss) from continuing operations before minority interest	7.7%	3.4%	(12.6)%
Minority interest in subsidiaries losses	0.0%	0.0%	1.0%
Income (loss) from continuing operations	7.7%	3.4%	(11.6)%
Gain on disposal of Medical segment		0.1%	0.2%
Net income (loss)	7.7%	3.5%	(11.4)%

Refer to Item 6 Selected Financial Data for a description of significant events that impacted the results of operations for fiscal years 2005, 2004 and 2003.

Net Sales

The following table sets forth, for the periods indicated, the amount of net sales for our operating segments and their relative percentages of total net sales.

	Year Ended September 30,					
	2005		2004		2003	
	Amount	Percentage of total net sales	Amount	Percentage of total net sales	Amount	Percentage of total net sales
	(Dollars in thousands)					
Consolidated:						
Domestic	$ 179,223	34.7%	$ 192,877	39.0%	$ 157,171	38.7%
Foreign	337,029	65.3%	302,077	61.0%	249,064	61.3%
Total	$ 516,252	100.0%	$ 494,954	100.0%	$ 406,235	100.0%
Electro-Optics:						
Domestic	$ 164,435	31.8%	$ 181,405	36.7%	$ 142,310	35.0%
Foreign	243,912	47.3%	227,888	46.0%	181,998	44.8%
Total	$ 408,347	79.1%	$ 409,293	82.7%	$ 324,308	79.8%
Lambda Physik:						
Domestic	$ 14,788	2.9%	$ 11,472	2.3%	$ 14,861	3.7%
Foreign	93,117	18.0%	74,189	15.0%	67,066	16.5%
Total	$ 107,905	20.9%	$ 85,661	17.3%	$ 81,927	20.2%

Consolidated

During fiscal 2005, net sales increased by $21.3 million, or 4%, compared to fiscal 2004. The increase was a result of increased sales volumes in the Lambda Physik segment, partially offset by slightly decreased sales volumes in the Electro-Optics segment. We anticipate that our Electro-Optics microelectronics and material processing markets will show the greatest growth potential in the future as feature sizes continue to shrink and new materials are introduced. The graphic arts market should also exhibit significant growth based upon the release of a highly differentiated product platform in this market. The scientific research and OEM components and instrumentation markets are projected to show more modest growth. Lambda Physik s growth in fiscal 2005 was led by strength in the industrial market and the acquisition of TuiLaser in the medical market and we believe these markets will continue to be strong in fiscal 2006.

During fiscal 2004, net sales increased by $88.7 million, or 22%, compared to fiscal 2003. The increase was a result of increased sales volumes in both operating segments.

Electro-Optics

Electro-Optics net sales decreased by $0.9 million, or less than 1.0%, in fiscal 2005 from fiscal 2004. Sales decreases in the scientific research and government programs and microelectronics markets were offset by increases in the graphic arts and display and OEM components and instrumentation markets and were impacted favorably by the strengthening of the Euro, Yen and Pound Sterling against the U.S. dollar (4.3%, 1.4% and 2.9% of appreciation against the U.S. dollar, respectively). Net sales within the scientific research and government programs lines of business decreased by $2.9 million, or 3%, compared to fiscal 2004, primarily as a result of the consolidation of Picometrix ($3.9 million) for six months in fiscal 2004. Microelectronics application sales decreased $1.4 million, or 1%, compared to fiscal 2004, primarily due to weakness in the semiconductor equipment and consumer electronics markets. Sales in the graphic arts and display applications increased $2.6 million, or 10%, from fiscal 2004 due to a stronger demand in reprographics applications. OEM components and instrumentation application sales increased $0.9 million, or 1%. Although we experienced increases in orders received over the past several quarters and we continue to have a sizeable backlog of orders, current market conditions make it difficult to predict future orders.

During fiscal 2004, Electro-Optics net sales increased by $85.0 million, or 26%, compared to fiscal 2003. Sales increased across all five primary markets: microelectronics, scientific research and government programs, OEM components and instrumentation, materials processing and graphic arts and display and were impacted favorably by the strengthening of the Euro, Yen and Pound Sterling against the U.S. dollar (12.0%, 9.4% and 11.8% of appreciation against the U.S. dollar, respectively). Microelectronics application sales increased $51.4 million, or 95%, compared to fiscal 2003, primarily due to improving fundamentals in the semiconductor equipment and consumer electronics markets. Net sales within the scientific research and government programs lines of business improved by $16.4 million, or 16%, compared to fiscal 2003, primarily as a result of the increase in sales from our acquisition of PLI ($7.2 million), increased sales from new scientific products and the consolidation of Picometrix ($3.9 million) for six months in fiscal 2004. OEM components and instrumentation application sales increased $8.6 million, or 9%, primarily due to significantly increased bioinstrumentation volumes. Materials processing application sales increased $8.3 million, or 16%, primarily due to strong orders for marking, engraving and textile processing. Sales in the graphic arts and display applications increased $0.3 million, or 1%, from fiscal 2003.

In fiscal 2005, 2004 and 2003, no customers accounted for greater than 10% of Electro-Optics net sales.

Lambda Physik

Lambda Physik net sales increased by $22.2 million, or 26%, in fiscal 2005 from fiscal 2004. Net sales increased primarily due to increased medical application sales volumes of $11.0 million, or 218%, due to the acquisition of TuiLaser in the third quarter and higher demand with medical OEM customers, higher sales volumes of $8.8 million, or 17%, in the industrial market due to increases in the flat panel, service and ink jet system business and current year systems sales resulting from our joint venture with Xtreme in the lithography market. Fiscal 2005 also includes the favorable impact of the strengthening of the Euro and Yen against the U.S. dollar ($1.9 million).

During fiscal 2004, Lambda Physik net sales increased by $3.7 million, or 5%, compared to fiscal 2003. Net sales increased primarily due to the strengthening of the Euro and Yen against the U.S. dollar, higher sales volumes in the industrial market due to increases in the flat panel and ink jet system business and increased demand with medical OEM customers, partially offset by lower systems sales volumes in the lithography market.

In fiscal 2005 and 2004, one customer accounted for 26% and 31%, respectively, of Lambda Physik s net sales. In fiscal

2003, one customer accounted for 18% of Lambda Physik s net sales while another customer accounted for 11% of Lambda Physik s net sales.

Gross Profit

Consolidated

The consolidated gross profit rate increased by 0.3% to 42.2% in fiscal 2005 from 41.9% in fiscal 2004. The increase in the gross profit rate was primarily due to more favorable product margins in our Electro-Optics segment (3.0%) resulting from fiscal 2005 cost reduction initiatives, as well as a more favorable product mix towards lower volumes of lower margin OEM components products and lower warranty costs from improved product quality (0.7%) in both segments. These increases were partially offset by higher inventory charges in our Lambda Physik segment (1.2%) resulting from the charge for excess lithography service inventory; a less favorable product mix in Lambda Physik (0.9%) due to shipments of low margin EUV lithography systems, which were partially offset by higher margins on scientific and medical business due to TuiLaser s contributions; and more unfavorable Electro-Optics variances (0.8%) resulting from higher rework costs and lower sales of fully reserved inventories.

Our consolidated gross profit rates have been and will continue to be affected by a variety of factors including foreign and domestic sales mix, manufacturing efficiencies, excess and obsolete inventory write-downs, warranty costs, pricing by competitors or suppliers, new product introductions, production volume, customization and reconfiguration of systems and foreign currency fluctuations. We anticipate that consolidated gross margins for the first quarter of fiscal 2006 will be in the range of 44.5% to 45.5%. We expect gross profit in Electro-Optics to increase by two to four percentage points by the end of fiscal 2006 over the fourth quarter of fiscal 2004 gross profit rate (46.0%).

The consolidated gross profit rate increased by 5.3% to 41.9% in fiscal 2004 from 36.6% in fiscal 2003. The increase in the gross profit rate was primarily due to more effective leveraging of manufacturing overhead (2.6%) due to higher sales volumes and consolidation of manufacturing operations; more favorable manufacturing variances (0.8%) resulting from outsourcing the manufacture of certain components and the sale of previously written down inventories; and favorable product mix (0.8%) with lower shipments of low margin OEM components products, higher ASPs on scientific products and higher shipments of higher margin microelectronics products in the Electro-Optics segment as well as higher sales of Lambda Physik s high margin industrial systems. These increases were partially offset by lower ASPs in Electro-Optics bioinstrumentation market, lower sales of high margin lithography systems in our Electro-Optics segment, higher sales of lower margin medical and scientific products in the Lambda Physik segment, lower warranty expenses (0.6%) in Lambda Physik s lithography business and lower additional inventory provisions (0.5%) in our Electro-Optics segment.

Electro-Optics

The gross profit rate increased by 2.7% to 46.9% of net sales in fiscal 2005 from 44.2% in fiscal 2004. The increase was primarily due to higher product margins (3.9%) resulting from fiscal 2005 cost reduction initiatives and favorable product mix towards lower volumes of lower margin CO_2 and optics products and lower warranty costs (0.2%) due to improved product reliability, partially offset by more unfavorable variances (1.0%) for rework in our diode-pumped solid state and semiconductor businesses and higher other costs (0.4%) due to higher inventory write-downs, partially offset by lower freight costs and royalty expense.

The gross profit rate increased by 5.0% to 44.2% of net sales in fiscal 2004 from 39.2% in fiscal 2003. The increase was primarily due to more effective leveraging of manufacturing overhead (2.7%) due to higher sales volumes and consolidation of manufacturing operations, more favorable manufacturing variances (0.9%) resulting from outsourcing the manufacture of certain components and the sale of previously written down inventories, favorable product mix (0.6%) with lower shipments of lower margin OEM components products, higher ASPs on scientific products and higher shipments of higher margin microelectronic products, partially offset by lower ASPs in the bioinstrumentation market and lower additional inventory provisions (0.6%).

Lambda Physik

The gross profit rate decreased by 6.9% to 24.0% in fiscal 2005 from 30.9% in fiscal 2004. The decrease in gross profit rate was due to higher inventory write-downs (5.6%) primarily due to charges for excess lithography inventory and write-downs of slow-moving lithography consumables and decreased product margins (4.5%). Product margins decreased due to higher sales of low margin EUV systems partially offset by higher margins in the medical business due to the contributions of TuiLaser, higher margins in the scientific business and higher margins in the industrial market in Asia. These decreases in

margin were partially offset by lower warranty costs due to improving quality (2.7%).

The gross profit rate increased by 4.7% to 30.9% in fiscal 2004 from 26.2% in fiscal 2003. The increase in gross profit rate was due to lower warranty expenses (3.2%) primarily in the lithography business and changes in mix (1.5%) with higher sales of high margin TFT and ink jet industrial systems, partially offset by lower sales of high margin lithography systems and higher sales of lower margin medical and scientific products.

Operating Expenses

	Year Ended September 30,					
	2005		2004		2003	
	Amount	Percentage of total net sales	Amount	Percentage of total net sales	Amount	Percentage of total net sales
	(Dollars in thousands)					
Research and development	$ 57,545	11.1%	$ 62,705	12.7%	$ 51,025	12.6%
In-process research and development	1,577	0.3%			6,338	1.6%
Selling, general and administrative	115,827	22.4%	115,043	23.2%	106,147	26.1%
Restructuring, impairment and other charges (recoveries)	(61)	(0.0)%	(3,093)	(0.7)%	35,163	8.6%
Amortization of intangible assets	7,019	1.4%	6,698	1.4%	5,147	1.3%
Total operating expenses	$ 181,907	35.2%	$ 181,353	36.6%	$ 203,820	50.2%

Research and development

Fiscal 2005 research and development (R&D) expenses decreased $5.2 million, or 8%, from fiscal 2004. The decrease was primarily due to the decision to discontinue future product development and investments in the semiconductor lithography market during the first fiscal quarter of 2005 ($11.2 million), higher net reimbursements from customers ($1.7 million) for development projects in our Electro-Optics segment and the consolidation of Picometrix under FIN 46R ($1.3 million) in fiscal 2004, partially offset by increased project spending on supplies, labor and equipment in our Electro-Optics segment ($3.4 million) primarily for green-related activities and the development of a new product platform for the graphic arts and display market, increased spending on Lambda industrial projects ($3.3 million) and the acquisition of TuiLaser ($1.3M). These increases include the impact of the strengthening of the Euro and Yen against the U.S. dollar ($1.2 million). We anticipate R&D expenses to be in the range of 12.5% to 13.0% of net sales in the first quarter of fiscal 2006, including the impact of stock compensation expense.

Fiscal 2004 R&D expenses increased $11.7 million, or 23%, from fiscal 2003. The increase is primarily due to increased labor and material spending related to new projects in our Electro-Optics ($5.1 million) and Lambda Physik ($2.3 million) segments, the impact of the strengthening of the Euro against the U.S. dollar ($3.0 million) and the consolidation of Picometrix under FIN 46R ($1.3 million). Fiscal 2003 research and development expenses included $1.9 million for our CTAG operating segment, which was terminated in the first quarter of fiscal 2003.

In-process research and development

Fiscal 2005 IPR&D expense of $1.6 million resulted from our acquisition of TuiLaser in the third quarter. Fiscal 2003 IPR&D expense of $6.3 million resulted from our acquisition of PLI ($4.4 million) and our acquisition of an additional 34% of the minority interest ownership of Lambda Physik ($1.9 million). The values assigned to purchased IPR&D were determined by identifying research projects in areas for which technological feasibility were not established and that had no alternative future use. The values were determined by estimating the costs to develop the acquired in-process technologies into commercially viable products, estimating the resulting net cash flows from such projects, and discounting the net cash flows back to their present value.

Selling, general and administrative

Fiscal 2005 selling, general and administrative (SG&A) expenses increased by $0.8 million, or 1%, from fiscal 2004. The

increase was primarily due to higher consulting and depreciation expense related to our investments in information technology systems ($3.3 million), higher consulting and audit costs related to Sarbanes-Oxley compliance ($2.4 million), the acquisition of TuiLaser ($1.3 million), the strengthening of the Euro and Yen against the U.S. dollar ($1.3 million) and higher marketing expenses for tradeshows ($0.7 million), partially offset by lower headcount related sales expenses and lower sales commissions ($3.7 million), lower headcount related administrative and marketing expenses ($2.5 million), lower facilities expenses due to building remodeling and consolidations in fiscal 2004 ($1.0 million) and the consolidation of Picometrix under FIN 46R in fiscal 2004 ($0.8 million). We anticipate SG&A expenses will be approximately 23% to 24% of net sales in the first quarter of fiscal 2006, including the impact of stock compensation expense.

Fiscal 2004 SG&A expenses increased by $8.9 million, or 8%, from fiscal 2003. The increase was primarily due to the strengthening of the Euro and Yen against the U.S. dollar ($2.8 million), higher consulting and depreciation expense related to our investments in information technology systems ($2.1 million), higher headcount related expenses ($1.4 million), higher facilities expenses due to building remodeling and consolidations ($1.4 million), higher legal, audit and tax consulting expenses ($1.1 million), higher sales commissions due to higher sales volumes ($0.9 million), the consolidation of Picometrix under FIN 46R ($0.8 million), higher marketing communications expenses ($0.5 million), partially offset by the fiscal 2003 severance costs in our Lambda Physik segment ($2.5 million).

Restructuring, impairment and other charges

In fiscal 2005, restructuring, impairment and other charges were due to adjustments to the estimated contractual obligation for lease and other facility costs of a previously vacated building, net of estimated sublease income.

In fiscal 2004, restructuring, impairment and other charges were primarily due to a $3.2 million recovery on the sale of our note receivable from Picometrix.

In fiscal 2003, restructuring, impairment and other charges consisted of: (1) a $14.8 million charge related to the termination of our CTAG operations for the write-down of equipment to net realizable value; an accrual for the estimated contractual obligation for lease and other facility costs of the building formerly occupied by CTAG, net of sublease income; and the write-down of our option to purchase Picometrix; (2) $9.6 million of charges relating to manufacturing facilities and equipment due to excess capacity and consolidation of operations; (3) a $3.7 million charge to write-down the value of our note receivable from Picometrix to net realizable value; (4) a $3.1 million charge to write-down our Lincoln, California land, buildings and improvements and equipment to their estimated net realizable value; (5) a charge of $2.4 million due to the write-off of goodwill associated with Lambda Physik s lithography business; and (6) $1.7 million of early lease termination costs relating to our operating lease for our facility in Santa Clara, California, partially offset by the recovery of $0.1 million in excess of estimated net realizable value for assets previously impaired and classified as held for sale.

Amortization of intangible assets

Amortization of intangible assets increased $0.3 million, or 5%, from fiscal 2004 to fiscal 2005 primarily due to the amortization of intangibles related to our TuiLaser acquisition partially offset by completion of amortization of certain intangibles related to our Positive Light acquisition and to technology sold in the second quarter of fiscal 2004.

Amortization of intangible assets increased $1.6 million, or 30%, from fiscal 2003 to fiscal 2004 primarily due to the acquisition of an additional 34.6% of the outstanding shares of our Lambda Physik subsidiary ($0.9 million) and our fiscal 2003 acquisition of PLI ($0.7 million).

Other income (expense)

Other income, net, increased $4.5 million from fiscal 2004 to fiscal 2005. The increase was primarily due to higher interest income ($2.6 million) as a result of higher returns and higher cash balances, lower interest expense ($1.2 million) primarily due to principal payments made on our Star notes and higher capitalized interest, lower losses from Lambda Physik s investment in a joint venture ($1.2 million) and a gain on our sale of that joint venture ($1.1 million) and higher investment gains, net of expenses, associated with our deferred compensation plans ($0.8 million), partially offset by a gain of $1.2 million in fiscal 2004 related to the sale of certain technology and less favorable foreign currency exchange net gains ($0.6 million).

Other income, net, was $1.2 million in fiscal 2004 compared to net expense of $3.2 million in fiscal 2003. This change was primarily due to the fiscal 2003 $10.2 million other-than-temporary write-down of our investment in Lumenis common stock, $2.4 million more favorable foreign currency exchange net gains and a gain of $1.2 million in fiscal 2004 related to the sale

39

of certain technology, partially offset by a $4.4 million settlement fee received by Lambda Physik relating to the cancellation of a customer contract in fiscal 2003, $2.8 million lower interest and dividend income due to lower interest rates and lower cash balances, a gain of $1.5 million in fiscal 2003 on our sale of Lumenis shares, and $0.5 million lower investment gains, net of expenses, associated with our deferred compensation plans.

Income taxes

The effective tax rate on income from continuing operations (before minority interest) for fiscal 2005 of 4.2% was lower than the statutory rate of 35.0% primarily due to a benefit of $9.6 million related to the reversal of deferred tax valuation allowances at Lambda Physik and benefits from increased use of export tax incentives and R&D tax credits, including benefits of federal tax law changes enacted in the first quarter of fiscal 2005, partially offset by the non-deductibility of $1.6 million in IPR&D related to the TuiLaser acquisition. The effective annual tax rate for fiscal 2006 is expected to be approximately 33%, which reflects the expiration of the federal R&D tax credit on December 31, 2005 and the impact of stock compensation expense.

The effective tax rate on income from continuing operations (before minority interest) for fiscal 2004 of 37.8% was higher than the statutory rate of 35.0% primarily due to fiscal 2004 s additional valuation allowance provision related to losses at Lambda Physik and higher state income taxes, net of federal taxes, partially offset by benefits from R&D tax credits, the benefit realized related to amounts previously written off related to our Scotland operations for which no benefit was originally recorded and the benefit from lower foreign tax rates.

The effective tax rate on loss from continuing operations (before minority interest) for fiscal 2003 of 12.6% differed from the statutory rate of 35.0% primarily due to: (1) valuation allowance provisions related to capital loss limitations with respect to losses recorded on the write-down of Lumenis stock and the impairment of the Lincoln, California facility; (2) valuation allowances recorded on deferred tax assets at Lambda Physik; and (3) the nondeductibility of IPR&D and goodwill impairment charges; partially offset by benefits from R&D tax credits and state income taxes, net of federal benefits.

Minority interest in subsidiaries earnings (losses)

Minority interest in subsidiaries losses was flat at $0.2 million in fiscal 2005 and fiscal 2004. In fiscal 2005, minority interest in subsidiaries losses related to our Lambda Physik subsidiary, which we completed the purchase of in the second quarter of fiscal 2005. In fiscal 2004, minority interest in subsidiaries losses related to our Lambda Physik subsidiary ($0.7 million) partially offset by the consolidation of Picometrix s earnings in accordance with FIN 46R ($0.5 million).

Minority interest in subsidiaries losses decreased $4.0 million from $4.2 million in fiscal 2003 to $0.2 million in fiscal 2004, primarily due to our acquisition of additional shares of Lambda Physik during fiscal 2003 and 2004 ($3.5 million) and the consolidation of Picometrix s earnings in accordance with FIN 46R ($0.5 million).

At September 30, 2005, we owned 100% of Lambda Physik and we are no longer considered the primary beneficiary of Picometrix as we sold our note receivable from Picometrix in fiscal 2004. As a result, we do not expect to record any minority interest in subsidiaries earnings (losses) in future periods.

FINANCIAL CONDITION

Liquidity and capital resources

Sources and Uses of Cash

Historically, our primary source of cash has been provided through operations. Other recent sources of cash include proceeds received from the sale of stock through employee stock option and purchase plans, as well as through debt borrowings. Our historical uses of cash have primarily been for capital expenditures, acquisitions of businesses and payments of principal and interest on outstanding debt obligations. Supplemental information pertaining to our historical sources and uses of cash is presented as follows and should be read in conjunction with our Consolidated Statements of Cash Flows and notes thereto:

	Year Ended September 30,		
	2005	2004	2003
	(in thousands)		
Net cash provided by operating activities	$ 92,688	$ 69,126	$ 21,332
Sales of shares under employee stock plans	15,286	7,793	13,161
Capital expenditures	(17,625)	(46,634)	(25,678)
Acquisition of businesses, net of cash acquired	(37,979)	(2,737)	(94,880)
Net payments on debt borrowings	(15,231)	(14,399)	(34,295)

Net cash provided by operating activities increased by $23.6 million in fiscal 2005 compared to fiscal 2004 and increased by $47.8 million in fiscal 2004 compared to fiscal 2003. The increase in cash provided by operating activities in fiscal 2005 was primarily due to better collections of accounts receivable and higher operating earnings, partially offset by higher income tax refunds received in fiscal 2004. The increase in cash provided by operating activities in fiscal 2004 was primarily due to the reclassification of our short-term investments from trading securities to available-for-sale securities (resulting in a change in classification of net investments from the operating section to the investing section in the statement of cash flows) and income tax refunds received in fiscal 2004, partially offset by increased trade receivables. We believe that cash provided by operating activities will be adequate to cover our working capital needs, debt service requirements 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 borrowings under our bank credit facilities or other sources of capital. We continue to follow our strategy to further strengthen our financial position by primarily using available cash flow to fund operations.

We intend to continue pursuing acquisition opportunities at prices we believe are reasonable based upon market conditions. However, we cannot accurately predict the timing, size and success of our acquisition efforts or our associated potential capital commitments. Furthermore, we cannot assure you that we will be able to acquire businesses on terms acceptable to us. We expect to fund future acquisitions through unrestricted cash balances, cash flows from operations, additional borrowings or 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 from time to time and the willingness of potential sellers to accept it as full or partial payment.

Additional sources of cash available to us were a multi-currency line of credit and bank credit facilities totaling $45.2 million as of September 30, 2005, of which $44.3 million was unused and available. These credit facilities were used in Europe during fiscal 2005. Our domestic lines of credit include a $12.5 million unsecured revolving account from Union Bank of California, which expires January 31, 2007. No amounts have been drawn upon our domestic lines of credit as of September 30, 2005.

Our ratio of current assets to current liabilities was 4.4:1 at September 30, 2005 compared to 4.3:1 at September 30, 2004. The increase in our ratio from September 30, 2004 to September 30, 2005 is primarily due to increases in short-term investments and cash and cash equivalents, partially offset by decreases in accounts receivable. Our cash position, short-term investments, working capital and debt obligations are as follows:

	September 30,	
	2005	2004
Cash and cash equivalents	$ 97,507	$ 87,659
Short-term investments	133,407	83,075
Working capital	380,134	345,643
Total debt obligations	12,736	27,915

Debt Obligations and Restricted Cash, Cash Equivalents and Short-term Investments

In September 2003, we amended the notes used to finance our acquisition of Star Medical (Star notes) to eliminate all financial covenant requirements. In place of the covenants, the amendment requires that we place cash and short-term investment balances in an amount equal to 120% of the principal balance in a restricted collateral account. At September 30, 2005, $15.2 million of current restricted cash and cash equivalents were related to the Star notes (see Note 10 Long-Term Obligations in our Notes to Consolidated Financial Statements).

Our $12.5 million unsecured revolving account agreement from Union Bank of California is subject to standard covenants related to financial ratios and tangible net worth. As of September 30, 2005, we were not in compliance with the tangible net worth covenant and the line of credit was not available to us. In November 2005, we amended the agreement to, among other things, reduce the tangible net worth requirement.

As part of our tender offer to purchase the remaining outstanding shares of Lambda Physik, we were required by local regulations to have funds available for the offer in an account located in Germany. As of September 30, 2005, we had $1.2 million restricted for remaining close out costs associated with our purchase of the remaining outstanding shares of Lambda Physik, which are included in non-current restricted cash, cash equivalents and short-term investments on our consolidated balance sheets.

Contractual Obligations and Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements as defined by Regulation S-K. The following summarizes our contractual obligations at September 30, 2005 and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Long-term debt payments	$ 12,736	$ 12,736	$	$	$
Operating lease payments	24,090	6,698	8,473	3,948	4,971
Purchase commitments with suppliers	10,318	10,318			
Purchase obligations	5,351	5,351			
Total	$ 52,495	$ 35,103	$ 8,473	$ 3,948	$ 4,971

Because of the uncertainty as to the timing of such payments, we have excluded cash payments related to our contractual obligations for our deferred compensation plans aggregating $25,120,000 at September 30, 2005.

Changes in financial condition

Cash provided by operating activities in fiscal 2005 was $92.7 million, which included net income from continuing operations of $39.9 million, depreciation and amortization of $35.3 million, cash provided by operating assets and liabilities of $27.2 million, IPR&D expense of $1.6 million and other items aggregating $1.6 million, partially offset by other decreases in net deferred tax assets of $12.9 million.

Cash used in investing activities in fiscal 2005 of $81.0 million included $50.3 million, net, used to purchase available-for-sale securities, $25.8 million, net of cash acquired, used to purchase TuiLaser, $17.6 million used to acquire property and equipment, invest in information technology and improve buildings, $12.2 million used to purchase the remaining shares of Lambda Physik, other of $2.4 million and $1.3 million used to pay premiums on life insurance, partially offset by a $23.0 million decrease in restricted cash due to a Star note payment and for the purchase of the remaining shares of Lambda Physik, $3.9 million from the sale of Lambda Physik s interest in a joint venture, $0.9 million in distributions from deferred compensation plan arrangements and $0.8 million provided by proceeds from dispositions of property and equipment.

Cash provided by financing activities in fiscal 2005 of $0.9 million included $15.3 million generated from our employee stock option and stock purchase plans, $0.4 million from collection of notes receivable from stock sales and an increase in cash overdraft of $0.4 million, partially offset by net debt repayments of $15.2 million.

Changes in exchange rates in fiscal 2005 used $2.8 million, primarily due to the strengthening of the Euro and Japanese Yen in relation to the U.S. dollar.

RECENT ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, Inventory Costs (SFAS 151), an amendment of Accounting Research Bulletin No. 43, Chapter 4. SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not believe that the adoption of SFAS 151 will have a material effect on our results of operations or consolidated financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R). SFAS 123R eliminates the alternative of applying the intrinsic value measurement provisions of Accounting Principles Board (APB) Opinion 25 to stock compensation awards issued to employees. Rather, the new standard requires enterprises to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to the adoption of SFAS 123R. SFAS 123R will be effective for our first quarter of fiscal 2006. We expect that the new standard will result in significant stock-based compensation expense.

The pro forma effects on net income and earnings per share as if we had applied the fair value recognition provisions of original SFAS 123 on stock compensation awards (rather than applying the intrinsic value measurement provisions of APB 25) are disclosed in Note 2 of our Notes to Consolidated Financial Statements. Although such pro forma effects of applying original SFAS 123 may be indicative of the effects of adopting SFAS 123R, the provisions of these two statements differ in

some important aspects. The actual effects of adopting SFAS 123R will be dependent on numerous factors including, but not limited to, the valuation model chosen by us to value stock-based awards; the assumed award forfeiture rate; the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period; and the transition method. We plan to use the modified prospective application method upon our adoption of SFAS 123R. Accordingly, SFAS 123R will be applied to new awards and to awards modified, repurchased, or cancelled after the effective date. Compensation cost for the portion of awards for which the requisite service has not been rendered (such as unvested options) that are outstanding as of the date of adoption is recognized as the remaining requisite services are rendered. The compensation cost relating to unvested awards at the date of adoption is based on the grant-date fair value of those awards as calculated for pro forma disclosures under the original SFAS 123 as adjusted for the effect of estimated forfeiture rates.

In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143 (FIN 47). FIN 47 clarifies that conditional asset retirement obligations meet the definition of liabilities and should be recognized when incurred if their fair values can be reasonably estimated. The Interpretation is effective no later than December 31, 2005 and the cumulative effect of initially applying FIN 47 will be recognized as a change in accounting principle. We are in the process of evaluating the expected effect of FIN 47 on our consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS 154 requires retrospective application to prior period financial statements for changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle should be recognized in the period of the accounting change. SFAS 154 further requires a change in depreciation, amortization or depletion method for long-lived, non-financial assets to be accounted for as a change in accounting estimate effected by a change in accounting principle. SFAS 154 will become effective for our first quarter of fiscal 2006.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of these 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 financial statements and the reported amounts of revenues and expenses during the reporting period. We have identified the following as the items that require the most significant judgment and often involve complex estimation: revenue recognition, accounting for long-lived assets (including goodwill and intangible assets), inventory valuation, warranty reserves and accounting for income taxes.

Revenue Recognition

We recognize revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists, the product has been delivered or the service has been rendered, the price is fixed or determinable and collection is probable. Revenue from product sales is recorded when all of the foregoing conditions are met and risk of loss and title passes to the customer. Our products typically include a one-year warranty and the estimated cost of product warranty claims (based on historical experience) is recorded at the time the sale is recognized. Sales to customers are generally not subject to any price protection or return rights.

The vast majority of our sales are made to original equipment manufacturers (OEMs), distributors, resellers and end-users in the non-scientific market. Sales made to these customers do not require installation of the products by us and are not subject to other post-delivery obligations, except in occasional instances where we have agreed to perform installation or provide training. In those instances, we defer revenue related to installation services or training until these services have been rendered. We allocate revenue from multiple element arrangements to the various elements based upon relative fair values, which is determined based on the price charged for each deliverable on a standalone basis.

Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognized for any reporting period could be adversely affected. Failure to obtain anticipated orders due to delays or cancellations of orders could have a material adverse effect on our revenue. In addition, pressures from customers to reduce our prices or to modify our existing sales terms may result in material adverse effects on our revenue in future periods.

Our sales to distributors, resellers and end-user customers typically do not have customer acceptance provisions and only

certain of our sales to OEM customers have customer acceptance provisions. Customer acceptance is generally limited to performance under our published product specifications. For the few product sales that have customer acceptance provisions because of higher than published specifications, (1) the products are tested and accepted by the customer at our site or by the customer s acceptance of the results of our testing program prior to shipment to the customer, or (2) the revenue is deferred until customer acceptance occurs.

Sales to end-users in the scientific market typically require installation and, thus, involve post-delivery obligations, however our post-delivery installation obligations are not essential to the functionality of our products. We defer revenue related to installation services until completion of these services.

For most products, training is not provided; therefore, no post-delivery training obligation exists. In cases where training is provided, it is typically priced separately and recognized as revenue after these services have been provided.

Long-Lived Assets

We evaluate long-lived assets whenever events or changes in business circumstances or our planned use of assets indicate that their carrying amounts may not be fully recoverable or that their useful lives are no longer appropriate. Reviews are performed to determine whether the carrying values of assets are impaired based on comparison to either the discounted expected future cash flows (in the case of goodwill) or to the undiscounted expected future cash flows (for all other long-lived assets). If the comparison indicates that impairment exists, the impaired asset is written down to its fair value. Significant management judgment is required in the forecast of future operating results that are used in the preparation of expected discounted and undiscounted cash flows.

In fiscal 2003, we recorded a goodwill impairment charge of $2.4 million ($1.8 million net of minority interest) related to Lambda Physik s lithography business as a result of significant changes in the economic outlook for this business. At September 30, 2005, we had $110.3 million of goodwill and purchased intangible assets on our consolidated balance sheet, the value of which we believe is reasonable based on the estimated future cash flows of the associated products and technologies.

During fiscal 2003, we recorded a charge of $6.5 million for the write-down of equipment and leasehold improvements resulting primarily from management s decision to cease most of our activities related to the telecom actives and passives components markets.

During fiscal 2003, we also recorded a charge of $3.1 million to write down the value of land, buildings and improvements and equipment at our Lincoln, California facility to net realizable value.

During fiscal 2003, we recorded a charge of $6.2 million to write down the value of equipment and building improvements at our operating sites in Auburn, California; Tampere, Finland and Barendrecht, the Netherlands to net realizable value, as well as a charge of $3.4 million to write-down long-lived assets at our facility located on Glasgow, Scotland to net realizable value.

At September 30, 2005, we had $155.3 million of property and equipment on our consolidated balance sheet.

It is reasonably possible that the estimates of anticipated future net revenue, the remaining estimated economic life of the products and technologies, or both, could differ from those used to assess the recoverability of these assets. In that event, additional impairment charges or shortened useful lives of certain long-lived assets may be required.

Inventory Valuation

We record our inventory at the lower of cost (computed on a first-in, first-out basis) or market. We write-down our inventory to its estimated market value based on assumptions about future demand and market conditions. Inventory write-downs are generally recorded within guidelines set by management when the inventory for a device exceeds 12 months of its demand and when individual parts have been in inventory for greater than 12 months. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required which could materially affect our future results of operations. We write-down our demo inventory by amortizing the cost of demo inventory over a twenty month period starting from the fourth month after it is placed in service. During the year ended September 30, 2005, we recorded additional inventory write-downs of $6.8 million as a result of the accelerated decommissioning of lithography lasers and $1.7 million related to our decision to discontinue future product development and investments in the semiconductor lithography market within our Lambda Physik subsidiary. During the year ended September 30, 2003, we

recorded $2.7 million of additional inventory write-downs due to a decrease in anticipated future demand and significant changes in the economic outlook for Lambda Physik s lithography business. Due to rapidly changing forecasts and orders, additional write-downs for excess or obsolete inventory, while not currently expected, could be required in the future. In the event that alternative future uses of fully written down inventories are identified, we may experience better than normal profit margins when such inventory is sold. Differences between actual results and previous estimates of excess and obsolete inventory could materially affect our future results of operations.

Warranty Reserves

We provide warranties on certain of our product sales (generally one year) and allowances for estimated warranty costs are recorded at the time of sale. The determination of such allowances requires us to make estimates of product return rates and expected costs to repair or replace the products under warranty. We currently establish warranty reserves based on historical warranty costs for each product line. If actual return rates and/or repair and replacement costs differ significantly from our estimates, adjustments to recognize additional cost of sales may be required in future periods.

Income Taxes

As part of the process of preparing our consolidated financial statements, we are required to estimate our income tax provision (benefit) in each of the jurisdictions in which we operate. This process involves us estimating our current income tax provision (benefit) together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets.

We record a valuation allowance to reduce our deferred tax assets to an amount that more likely than not will be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the allowance for the deferred tax asset would increase income in the period such determination was made. Likewise, should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the allowance for the deferred tax asset would be charged to income in the period such determination was made.

During fiscal 2005, our valuation allowance on deferred tax assets decreased by $11.9 million, including $11.6 million released against deferred tax assets at Lambda Physik. During fiscal 2004, our valuation allowance on deferred tax assets increased by $1.9 million, including $3.8 million against deferred tax assets at Lambda Physik, partially offset by the utilization of $1.8 million of our capital loss carryforwards in the U.S. During fiscal 2003, our valuation allowance on deferred tax assets increased by $14.6 million, including $7.8 million against deferred tax assets at Lambda Physik and increased allowances related to net capital loss carryforwards in the U.S. In making the determination to record the valuation allowance, management considered the likelihood of future taxable income and feasible and prudent tax planning strategies to realize deferred tax assets. In the future, if we determine that we expect to realize more or less of the deferred tax assets, an adjustment to the valuation allowance will affect income in the period such determination is made.

Federal income taxes have not been provided for on a portion of the unremitted earnings of foreign subsidiaries either because such earnings are intended to be permanently reinvested or because foreign tax credits are available to offset any planned distributions of such earnings. We are currently assessing the potential impact of the provisions recently enacted as part of the American Jobs Creation Act of 2004.

ITEM 7A. 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 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 and uniformly by 10% from levels at September 30, 2005, the fair value of the portfolio, based on quoted market prices, would decline by an immaterial amount. 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 September 30, 2005, the fair value of our available-for-sale debt securities was $147.7 million, of which, $16.3 million was classified as cash and cash equivalents and $131.4 million was classified as short-term investments.

At September 30, 2005, we had fixed rate long-term debt of approximately $12.7 million and a hypothetical 10% increase in interest rates would not have a material impact on the fair market value of this debt based on pricing models using current interest rates. We do not hedge any interest rate exposures.

Foreign currency exchange risk

We maintain operations in various countries outside of the United States and foreign subsidiaries that manufacture and sell our products in various global markets. A majority of our sales are transacted in U.S. dollars. However, we do generate revenues in other currencies, primarily the Euro and Yen. As a result, our earnings and cash flows 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 twelve 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.

We do not anticipate any material adverse effect on our 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.

A hypothetical 10% appreciation of the forward adjusted U.S. dollar to September 30, 2005 market rates would increase the unrealized value of our forward contracts by $2.4 million. Conversely, a hypothetical 10% depreciation of the forward adjusted U.S. dollar to September 30, 2005 market rates would decrease the unrealized value of our forward contracts by $2.9 million.

The following table provides information about our foreign exchange forward contracts at September 30, 2005. 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. notional fair value represents the contracted amount valued at September 30, 2005 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. Notional Fair Value
Fair Value Hedges:			
Euro	1.2346	$ (24,816)	$ (24,357)
British Pound Sterling	1.8146	$ 1,688	$ 1,646
Japanese Yen	109.4150	$ (4,869)	$ (4,703)
Canadian Dollar	1.2088	$ 786	$ 820
Korean Won	1,015.0000	$ 148	$ 144

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Item 15 (a) for an index to the Consolidated Financial Statements and Supplementary Financial Information, which are attached hereto and incorporated by reference herein.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

On May 5, 2004, Lambda Physik AG (Lambda), a majority owned subsidiary of Coherent, Inc. (Coherent) dismissed Ernst & Young AG Wirtschaftsprüfungsgesellschaft (Ernst & Young), which had previously served as Lambda s independent accountants, and engaged Deloitte & Touche GmbH as its new independent accountants.

The reports of Ernst & Young on the financial statements of Lambda for the fiscal year 2003 contained no adverse opinion or

disclaimer of opinion and was not qualified or modified as to uncertainty, audit scope or accounting principle. In connection with its audits of Lambda for fiscal year 2003 and through May 5, 2004, there were no disagreements with Ernst & Young on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of Ernst & Young, would have caused Ernst & Young to make reference thereto in their report on the financial statements for such years. During fiscal year 2003 and through May 5, 2004, there were no reportable events as that term is defined in Item 304(a)(1)(v) of Regulation S-K.

Lambda has furnished to Ernst & Young the statements made in this Item 9 and has requested that Ernst & Young furnish it with a letter addressed to the Commission stating whether or not it agrees with such statements. A copy of such letter, dated May 10, 2004, was filed as Exhibit 16.1 to Form 8-K filed on May 10, 2004, and is incorporated by reference herein.

ITEM 9A. 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 the end of the period covered by this Annual Report (Evaluation Date). The controls evaluation was done 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 such that the information relating to the Company, including our consolidated subsidiaries, required to be disclosed in our Securities and Exchange Commission (SEC) reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to the Company s management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management s Report on Internal Control Over Financial Reporting

Management, including our Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company. 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 in the United States. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. 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 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 re being made only in accordance with proper authorizations of management; 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 s annual assessment of the effectiveness of our internal control over financial reporting as of September 30, 2005 excluded the acquisition of TuiLaser AG that was completed on June 13, 2005. The acquisition of TuiLaser AG represented approximately 2% and 6% of total revenue and assets, respectively, of the related consolidated financial statement amounts for, and as of, the fiscal year ended September 30, 2005.

Management assessed the effectiveness of our internal control over financial reporting as of September 30, 2005, utilizing the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on the assessment by management, we determined that our internal control over financial reporting was effective as of September 30, 2005. Management s assessment of the effectiveness of our internal control over financial reporting as of September 30, 2005 has been audited by Deloitte & Touche LLP, our independent registered public accounting firm, as stated in their report which appears below.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended September 30, 2005 that has materially affected, or is reasonable likely to materially affect, our internal control over financial reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Coherent, Inc.:

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting, that Coherent, Inc. and its subsidiaries (collectively, the Company) maintained effective internal control over financial reporting as of September 30, 2005, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in Management s Report, management s assessment of the effectiveness of internal control over financial reporting as of September 30, 2005 excluded the acquisition of TuiLaser AG that was completed on June 13, 2005. The acquisition of TuiLaser AG represented approximately 2% and 6% of total revenue and assets, respectively, of the related consolidated financial statement amounts for, and as of, the fiscal year ended September 30, 2005. Accordingly, our audit did not include the internal control over financial reporting at TuiLaser AG. The Company s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel 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. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that the Company maintained effective internal control over financial reporting as of September 30, 2005, is fairly stated, in all material respects, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2005, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended September 30, 2005, and our report dated December 15, 2005 expressed an unqualified opinion on those consolidated financial statements.

/s/ DELOITTE & TOUCHE LLP
San Jose, California
December 15, 2005

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Directors

The names of the directors of Coherent, Inc. (the Company) and certain information about them are set forth below.

Name	Age	Director Since	Principal Occupation
Bernard J. Couillaud, PhD	61	1996	Chairman of the Board of Directors, Retired President and Chief Executive Officer
Henry E. Gauthier	65	1983	Vice Chairman of the Board of Directors; Gauthier Consulting - Principal
John R. Ambroseo, PhD	44	2002	President and Chief Executive Officer
Charles W. Cantoni (2)(3)	70	1983	Retired President and Chief Executive Officer of Alara, Inc.
John H. Hart (1)(3)	60	2000	Retired Sr. Vice President and Chief Technical Officer, 3Com Corp.
Lawrence Tomlinson (1)(2)	65	2003	Retired Senior Vice President and Treasurer of Hewlett-Packard Co.
Robert J. Quillinan	58	2001	Retired Executive Vice President, Chief Financial Officer
Garry W. Rogerson, PhD (1)(2)	53	2004	President and Chief Executive Officer of Varian, Inc.
Sandeep Vij (3)	40	2004	Vice President of Worldwide Marketing for Xilinx Inc.

(1) Member of the Compensation Committee.

(2) Member of the Audit Committee.

(3) Member of the Governance and Nominating Committee.

Except as set forth below, each of the nominees has been engaged in his principal occupation set forth above during the past five years. There is no family relationship between any of our directors or executive officers. The Board of Directors has determined that all of the directors on the Board of Directors, other than Drs. Ambroseo and Couillaud and Mr. Quillinan, are independent directors under the marketplace rules of the Nasdaq Stock Market.

Dr. Couillaud has served as Chairman of the Board of Directors since October 2002 and as a member of the Board of Directors since July 1996. He served as our President and Chief Executive Officer from July 1996 through September 2002. He served as Vice President and General Manager of Coherent Laser Group from March 1992 to July 1996. From July 1990 to March 1992, he served as Manager of the Advanced Systems Business Unit, and from September 1987 to 1990, he served as Director of Research and Development for the Coherent Laser Group. From November 1983, when he joined Coherent, to September 1987, Dr. Couillaud held various managerial positions. Dr. Couillaud received his PhD in Physics from Bordeaux University, Bordeaux, France.

Mr. Gauthier has served as Vice Chairman of the Board of Directors since October 2002. He served as Chairman of the Board of Directors from February 1997 to October 2002. Mr. Gauthier retired as President of the Company on July 1, 1996. From February 1, 2005 through April 21, 2005, Mr. Gauthier served as President of Reliant Technologies, Inc., a manufacturer of medial laser systems. Since July 1996 Mr. Gauthier has served as a principal at Gauthier Consulting.

Dr. Ambroseo has served as our President and Chief Executive Officer as well as a member of the Board of Directors since October 2002. Dr. Ambroseo served as our Chief Operating Officer from June 2001 through September 2002. Dr. Ambroseo served as our Executive Vice President and as President and General Manager of the Coherent Photonics Group from September 2000 to June 2001. From September 1997 to September 2000, Dr. Ambroseo served as our Executive Vice President and as President and General Manager of the Coherent Laser Group. From March 1997 to September 1997, Dr. Ambroseo served as our Scientific Business Unit Manager. From August 1988, when Dr. Ambroseo joined us, until March 1997, he served as a Sales Engineer, Product Marketing Manager, National Sales Manager and Director of European Operations. Dr. Ambroseo received his PhD in Chemistry from the University of Pennsylvania.

Mr. Cantoni was President and Chief Executive Officer of Alara, Inc., a privately held company manufacturing products for the medical imaging market, from August 2003 until December 2004. From June 1998 until July 2003 he was the owner of Cantoni Consulting, a company providing management and medical marketing consulting services. Prior to founding Cantoni Consulting, Mr. Cantoni was Vice President of Quinton Instruments, Inc., a manufacturer of medical instrumentation products, a position he held from October 1994 until June 1998.

Mr. Hart retired from 3Com Corporation in September 2000. From September 2000 until September 2001 he was a Fellow at 3Com. In September of 2000, he retired as Senior Vice President and Chief Technical Officer of 3Com Corporation, a

position he had held since August 1996. From the time Mr. Hart joined 3Com in September 1990 until July 1996, he was Vice President and Chief Technical Officer. Prior to joining 3Com, Mr. Hart worked for Vitalink Communications Corporation for seven years, where his most recent position was Vice President of Network Products. Mr. Hart serves on the board of directors of PLX Technologies, Inc., an I/O interconnect silicon company and Clearspeed Technology, PLC, a fabless semiconductor company.

Mr. Tomlinson retired from Hewlett-Packard Co. in June 2003. Prior to retiring from Hewlett-Packard Co., from 1993 to June 2003 Mr. Tomlinson served as its Treasurer, from 1996 to 2002 he was also a Vice President of Hewlett- Packard Co. and from 2002 to June 2003 was also a Senior Vice President of Hewlett-Packard Co. Mr. Tomlinson is a member of the board of directors of Salesforce.com, Inc. and Therma-Wave, Inc.

Mr. Quillinan retired in May 2003. He has served as our Executive Vice President, Mergers and Acquisitions from April 2002 through April 2003 and as a member of our Board of Directors since June 2001. Mr. Quillinan served as our Executive Vice President and Chief Financial Officer from July 1984 through March 2002. Mr. Quillinan served as Vice President and Treasurer from March 1982 to July 1984 and as Corporate Controller from May 1980 to March 1982. Mr. Quillinan received his MS degree in Accounting from Clarkson University and is a certified public accountant.

Dr. Rogerson has been President and Chief Executive Officer of Varian, Inc., a major supplier of scientific instruments and consumable laboratory supplies, vacuum products and services and contract electronic manufacturing services, since 2002 and 2004, respectively. Dr. Rogerson served as the Varian s Chief Operating Officer from 2002 to 2004, as Senior Vice President, Scientific Instruments from 2001 to 2002, and as Vice President, Analytical Instruments from 1999 to 2001. Dr. Rogerson also serves on the board of directors of Varian, Inc.

Mr. Vij has held the position of Vice President of Worldwide Marketing for Xilinx Inc., a programmable logic device company, where he is responsible for worldwide marketing activities across all divisions, products, end markets, partners, channels and geographies since 2001. From 1997 to 2001, he served as Vice President and General Manager of the General Products Division at Xilinx where he held profit and loss responsibility for the Spartan Series FPGA s (Field Programmable Gate Arrays). Mr. Vij joined Xilinx in 1996 as Director of FPGA marketing.

Executive Officers

Set forth below is the name, age, position and a brief account of the business experience of each of our executive officers:

Name	Age	Office Held
John R. Ambroseo, PhD	44	President and Chief Executive Officer
Helene Simonet	53	Executive Vice President and Chief Financial Officer
Paul Meissner, PhD	42	Executive Vice President of Global Business Operations
Luis Spinelli	57	Executive Vice President and Chief Technology Officer
Ron Victor	61	Executive Vice President, Human Resources
Dennis C. Bucek	60	Senior Vice President, Treasurer and Assistant Secretary
Scott H. Miller	51	Senior Vice President and General Counsel

Dr. Ambroseo s biographical information can be found above under Item 10. Directors and Executive Officers of the Registrant Directors.

Ms. Simonet has served as our Executive Vice President and Chief Financial Officer since April 2002. Ms. Simonet served as Vice President of Finance of our former Medical Group and Vice President of Finance, Photonics Division from December 1999 to April 2002. Prior to joining Coherent, she spent over twenty years in senior finance positions at Raychem Corporations Division and Corporate organizations, including Vice President of Finance of the Raynet Corporation. Her last assignment was that of Chief Information Officer for Raychem. Ms. Simonet has both a Master s and Bachelor degree from the University of Leuven, Belgium.

Dr. Meissner joined the Company in July 2004 and serves as our Executive Vice President of Global Business Operations. Dr. Meissner has over fifteen years of technology leadership experience with the majority of those years having been spent in the semiconductor capital equipment industry. Prior to joining the Company, Dr. Meissner was Vice President and General Manager for KLA-Tencor Corporation from 2003. Prior to joining KLA-Tencor, he spent nine years (1994-2003) with Applied Materials Inc. in a number of senior management positions leading to his appointment as Vice President and General Manager of their Thermal Systems and Modules Group. His last assignment at Applied Materials was as Vice President of Strategy and New Business Development. Dr. Meissner holds an undergraduate degree from the University of California,

Berkeley in materials science and engineering, and he obtained both his masters and doctorate degrees in materials science and engineering from Stanford University.

Mr. Spinelli has served as our Executive Vice President and Chief Technology Officer since March 2004. Mr. Spinelli joined the Company in May 1985 and has since held various engineering and managerial positions, including his most recent position as Vice President for Corporate Research and Chairman of the Company s Technical Advisory Board (since October 2002). Mr. Spinelli led the Company s Advanced Research Unit from its inception in 1998, whose charter is to identify and evaluate new and emerging technologies of interest for the Company across a range of disciplines in the laser field. Mr. Spinelli has been instrumental in the development of a number of the Company s technologies and products and is a named inventor of 19 patents in various areas of laser technology. Mr. Spinelli holds a degree in Electrical Engineering from the University of Buenos Aires, Argentina with post-graduate work at the Massachusetts Institute of Technology.

Mr. Victor has served as our Executive Vice President of Human Resources since May 2000. From August 1999 to May 2000, he was our Corporate Vice President of Human Resources. He was Vice President of Human Resources for the Coherent Medical Group from September 1997 to August 1999. Between November 1996 and September 1997, he was Vice President Human Resources for Netsource Communication, Inc., an internet advertisement and communication company. From November 1995 to November 1996, Mr. Victor served as Vice President of Human Resources for Micronics Computers, Inc., a manufacturer of computer components. Between January 1982 and September 1995 he was a Vice President of Human Resources at Syntex, a pharmaceutical company. Mr. Victor received a BA degree from American International College and a MA degree from Springfield College.

Mr. Bucek has served as our Senior Vice President, Treasurer and Assistant Secretary since August 1985. He received his BA degree from Mankato State University and is a certified public accountant.

Mr. Miller has served as our General Counsel since October 1988 and as Senior Vice President since March 1994. Mr. Miller received a BA degree in Economics from UCLA and a JD from Stanford Law School.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act) requires the Company s officers and directors, and persons who own more than ten percent of a registered class of the Company s equity securities to file reports of ownership and changes in ownership with the Securities and Exchange Commission (the SEC). Such officers, directors and ten-percent stockholders are also required by SEC rules to furnish the Company with copies of all forms that they file pursuant to Section 16(a). Based solely on its review of the copies of such forms received by the Company, and on written representations from certain reporting persons that no other reports were required for such persons, the Company believes that, during fiscal 2005, its officers and directors complied with all applicable Section 16(a) filing requirements.

Audit Committee Information

The Board has determined that directors Cantoni, Tomlinson and Rogerson are audit committee financial experts as that term is defined in Item 401(h) of Regulation S-K of the Securities Act of 1933, as amended. All of the members of the Audit Committee are independent as defined under rules promulgated by the SEC and qualify as independent directors under the marketplace rules of the Nasdaq Stock Market.

Code of Ethics

The Company has adopted a Code of Ethics that qualifies as a code of ethics within the meaning of Item 406(b) of Regulation S-K promulgated under the Securities Act of 1933. The Code of Ethics has been posted on the Company s web site at www.coherent.com.

ITEM 11. EXECUTIVE COMPENSATION

Summary Compensation

The following table shows, as to the Chief Executive Officer and each of the other four most highly compensated executive officers whose salary plus bonus exceeded $100,000 serving as an executive officer as of September 30, 2005 and one other former executive officer who was not serving as an executive officer as of September 30, 2005, information concerning compensation awarded to, earned by or paid for services to the Company in all capacities during the last three fiscal years (to the extent that such person was the Chief Executive Officer and/or executive officer, as the case may be, during any part of such fiscal year):

Summary Compensation Table

Name	Year	Salary ($)	Bonus ($)	Awards Options (#)		All Other Compensation ($)	
John R. Ambroseo, PhD	2005	$ 506,629	$ 622,477	110,000	(1)	$ 130,556	(2)
President and Chief Executive Officer	2004	465,437	424,567	150,000		104,689	
	2003	431,853	229,429	150,000		24,429	
Helene Simonet	2005	$ 329,000	$ 287,876	33,000	(3)	$ 22,382	(4)
Executive Vice President and Chief Financial Officer	2004	291,699	166,927	70,000		19,543	
	2003	274,237	95,014	75,000		18,015	
Scott H. Miller	2005	$ 227,094	$ 214,030	11,300	(5)	$ 17,021	(6)
Senior Vice President and General Counsel	2004	211,162	74,757	10,000		13,723	
	2003	205,005	23,942	20,000		12,590	
Vittorio Fossati-Bellani (7)	2005	$ 231,549	$ 190,845			$ 33,615	(8)
Executive Vice President and Chief Marketing Office	2004	280,010	148,554			20,114	
	2003	280,010	46,429	40,000		20,114	
Luis Spinelli (9)	2005	$ 237,554	$ 151,871	15,000	(10)	$ 35,348	(11)
Executive Vice President and Chief Technology Officer	2004	$ 218,477	$ 85,630	40,000		14,061	
Paul L. Meissner (12)	2005	$ 252,710	$ 160,931	22,000	(13)	$ 2,936	(14)
Executive Vice President of Global Business Operations	2004	$ 43,272	$ 40,000	45,000		$ 104	

(1) Includes an aggregate total of 20,000 shares in unvested Restricted Stock holdings, valued at $585,600 as of September 30, 2005.

(2) Includes $30,348 contributed by the Company under defined contribution plans, $1,157 in life insurance benefits, a $84,136 buyout of accrued vacation, $4,915 imputed income, and $10,000 of debt forgiveness.

(3) Includes an aggregate total of 8,000 shares in unvested Restricted Stock holdings, valued at $234,240 as of September 30, 2005.

(4) Includes $20,704 contributed by the Company under defined contribution plans and $1,678 in life insurance benefits.

(5) Includes an aggregate total of 2,300 shares in unvested Restricted Stock holdings, valued at $67,344 as of September 30, 2005.

(6) Includes $13,552 contributed by the Company under defined contribution plans, $1,118 in life insurance benefits, and $2,351 Imputed Income.

(7) Mr. Fossati-Bellani retired as an Executive Officer April 3, 2005.

(8) Includes $18, 016 contributed by the Company under defined contribution plans, $2,137 in life insurance benefits, and $13,462 buyout of accrued vacation.

(9) Mr. Spinelli became an executive officer in March 2004.

(10) Includes an aggregate total of 3,000 shares in unvested Restricted Stock holdings, valued at $87,840 as of September 30, 2005.

(11) Includes $14,746 contributed by the Company under defined contribution plans, $2,198 in life insurance benefits, $11,299 buyout of accrued vacation, and $7,105 patent award.

(12) Mr. Meissner was elected an executive officer in July 2004.

(13) Includes an aggregate total of 4,000 shares in unvested Restricted Stock holding, valued at $117,120 as of September 30, 2005.

(14) Includes $2,389 contributed by the Company under defined contribution plans and $548 in life insurance benefits.

Stock Option Grants and Exercises

The following table shows, as to the individuals named in the Summary Compensation Table above, information concerning stock options granted during the fiscal year ended September 30, 2005:

Option Grants in Last Fiscal Year

	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (3)	
Name	**Number of Securities Underlying Options Granted (#) (1)**	**% of Total Options Granted to Employees In Fiscal Year (2)**	**Exercise Price ($/sh)**	**Expiration Date**		
					5% ($)	**10% ($)**
John R. Ambroseo, PhD	90,000	17.46	33.71	4/7/11	1,031,816	2,340,839
Helene Simonet	25,000	4.85	33.71	4/7/11	286,616	650,233
Scott H. Miller	9,000	1.75	33.71	4/7/11	103,182	234,084
Vittorio Fossati-Bellani						
Luis Spinelli	12,000	2.33	33.71	4/7/11	137,575	312,112
Paul L. Meissner	18,000	3.49	33.71	4/7/11	206,363	468,168

(1) The Company s 1995 Stock Plan and 2001 Stock Plan (collectively, the Option Plans) provide for the grant of options, stock purchase rights, stock appreciation rights, performance shares, performance units and deferred stock units to officers, employees and consultants of the Company. Options granted under the Option Plans may be either nonstatutory options or incentive stock options. The exercise price is determined by the Board of Directors or its Compensation Committee and, in the case of incentive stock options, may not be less than 100% of the fair market value of the common stock on the date of grant (110% in the case of grants to 10% shareholders). The options expire not more than six years from the date of grant and may be exercised only while the optionee is employed by the Company or within such period of time after termination of employment as is determined by the Board or its Committee at the time of grant. The Board of Directors may determine when options granted may be exercisable.

(2) The Company granted options to purchase an aggregate of 332,540 shares to all employees other than executive officers and granted options to purchase an aggregate of 183,000 shares to all executive officers as a group (7 persons), during fiscal 2005.

(3) This column sets forth hypothetical gains or option spreads for the options at the end of their respective ten-year terms, as calculated in accordance with the rules of the SEC. Each gain is based on an arbitrarily assumed annualized rate of compound appreciation of the market price at the date of grant of 5% and 10% from the date the option was granted to the end of the option term. The 5% and 10% rates of appreciation are specified by the rules of the SEC and do not represent the Company s estimate or projection of future common stock prices. The Company does not necessarily agree that this method properly values an option. Actual gains, if any, on option exercises are dependent on the future performance of the Company s common stock and overall market conditions.

The following table shows, as to the individuals named in the Summary Compensation Table above, information concerning stock options exercised during the fiscal year ended September 30, 2005 and the value of unexercised options at such date:

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values

Name	Shares Acquired on Exercise (#)	Value Realized ($)(1)	Number of Securities Underlying Unexercised Options/SARs at September 30, 2005 (#)(2)		Value of Unexercised In-the-Money Options at September 30, 2005 ($)(3)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
John R. Ambroseo, PhD	22,000	312,544	465,500	390,000	143,500	1,713,500
Helene Simonet	5,000	26,875	153,333	146,667	91,791	847,184
Scott H. Miller	8,000	162,840	43,333	35,667	9,566	209,334
Vittorio Fossati-Bellani			166,000	40,000		380,400
Luis Spinelli	2,000	29,300	38,333	63,667	38,266	314,284
Paul L. Meissner			15,000	48,000	40,500	81,000

(1) The value realized is calculated based on the closing sale price of the Company s common stock as reported by the Nasdaq National Market on the date of exercise minus the exercise price of the option, and does not necessarily indicate that the optionee sold such stock.

(2) The Company s 2001 Stock Plan provides for the grant of Stock Appreciation Rights, but no such rights were granted during the fiscal year ended September 30, 2005.

(3) The market value of underlying securities is based on the difference between the closing sale price of the Company s common stock on September 30, 2005 of $29.28 (as reported by Nasdaq National Market) and the exercise price per share.

Director Compensation

In fiscal year 2005, members of the Board of Directors who were not employees of the Company received $20,000 plus $2,000 per board meeting attended plus $1,000 per committee meeting attended. The Chairman of the Audit Committee received $3,000 per Audit Committee meeting attended. All members of the Board of Directors who were not employees of the Company were reimbursed for their expenses incurred in attending such meetings.

The Company s 1990 Directors Stock Option Plan (the Directors Option Plan) was adopted by the Board of Directors on December 8, 1989 and was approved by the stockholders on March 29, 1990. The Directors Option Plan terminated on December 8, 1999 and no further options will be granted under this plan.

One non-employee director has been granted options to purchase 65,000 shares of the Company s common stock under the Directors Option Plan at a weighted average exercise price of $11.62 per share. One non-employee director has been granted options to purchase 30,000 shares of the Company s common stock under such plan at a weighted average exercise price of $21.33 per share. As of the fiscal year ended September 30, 2005, options have been granted to purchase 295,000 shares under the Directors Option Plan.

The Company s 1998 Directors Stock Option Plan (the 1998 Directors Plan) was adopted by the Board of Directors on November 24, 1998 and was approved by the stockholders on March 17, 1999. The 1998 Directors Plan was amended by the stockholders on March 23, 2003. As of January 20, 2006, 150,000 shares were reserved for issuance thereunder. Under the terms of the 1998 Directors Plan, the number of shares reserved for issuance thereunder is increased each year by the number of shares necessary to restore the total number of shares reserved to 150,000 shares. The 1998 Director s Plan replaced the Directors Option Plan which expired on December 8, 1999. The 1998 Directors Plan provides for the automatic and non-discretionary grant of a non-statutory stock option to purchase 30,000 shares of the Company s common stock to each non-employee director on the date on which such person becomes a director. Thereafter, each non-employee director will be automatically granted a non-statutory stock option to purchase 12,000 shares of common stock on the date of and immediately following each Annual Meeting of Stockholders at which such non-employee director is reelected to serve on the Board of Directors, if, on such date, he or she has served on the Board for at least three months. Such plan provides that the exercise price shall be equal to the fair market value of the common stock on the date of grant of the options. The Board of Directors has approved amendments to the 1998 Directors Plan which will go into effect if approved by the Company s stockholders at the annual meeting of stockholders to be held in March 2006.

Two non-employee directors have each been granted options to purchase 42,000 shares of the Company s common stock under such plan at a weighted average exercise price of $29.31 per share. Three non-employee directors have been granted options to purchase 54,000 shares of the Company s common stock under such plan at a weighted average exercise price of $26.73 per share. Two non-employee directors have been granted options to purchase 60,000 shares of the Company s common stock under such plan at a weighted average exercise price of $40.00 per share. One non-employee director has been granted options to purchase 75,000 shares of the Company s common stock under such plan at a weighted average exercise price of $34.48 per share. As of the fiscal year ended September 30, 2005, options have been granted to purchase an aggregate of 530,000 shares under the 1998 Directors Plan.

The following table shows options granted to each director of the Company during the last fiscal year. All options were granted under the 1998 Directors Plan:

Option Grants to Directors During Last Fiscal Year

Name	Number of Options
Bernard J. Couillaud, PhD	12,000
Henry E. Gauthier	12,000
Charles W. Cantoni	12,000
John H. Hart	12,000
Robert J. Quillinan	12,000
Garry W. Rogerson, PhD	12,000
Lawrence Tomlinson	12,000
Sandeep Vij	42,000

As of January 20, 2006, 250,000 shares had been issued on exercise of such options by non-employee directors under the 1990 Directors Plan and 33,500 shares had been issued on exercise were under the 1998 Directors Plan.

The following table shows, as to each non-employee director, information concerning options exercised under the 1998 Directors Plan during the last fiscal year:

Option Grants to Directors During Last Fiscal Year

Name	Shares Acquired on Exercise	Value Realized (1)
Bernard J. Couillaud, PhD		
Henry E. Gauthier	5,000	$ 76,963
Charles W. Cantoni	5,000	77,913
John H. Hart		
Robert J. Quillinan	10,000	72,510
Garry W. Rogerson, PhD		
Lawrence Tomlinson	12,000	65,630
Sandeep Vij		

(1) The value realized is calculated based on the closing sale price of the Company s common stock as reported by the Nasdaq National Market on the date of exercise minus the exercise price and does not necessarily indicate that the optionee sold such stock.

Other Employee Benefit Plans

Employee Retirement and Investment Plan and Supplemental Retirement Plan

Effective January 1, 1979, the Company adopted the Coherent Employee Retirement and Investment Plan (as amended to date, the Retirement and Investment Plan). Coherent employees that work more than twenty hours per week become eligible for participation on their first day of employment. The Company will match employee contributions to the Retirement and Investment Plan, up to a maximum of 6% of the employee s individual earnings, after completing one year of service. The Retirement and Investment Plan qualifies under Section 401(k) of the Internal Revenue Code of 1986, as amended, to permit employees to make contributions to the Retirement and Investment Plan from their pre-tax earnings.

Effective January 1, 1990, the Company adopted the Supplementary Retirement Plan for senior management personnel which permits the participants to contribute up to 24% of their before tax earnings to a trust. The Company will match such contributions up to 6% of the participants earnings less any amounts contributed by the Company to the participant under the Employee Retirement and Investment Plan.

2006 Variable Compensation Plan

On November 29, 2005, the registrant adopted the 2006 Variable Compensation Plan (the 2006 VCP). The 2006 VCP is designed to deliver incentives that are competitive with those received by executives at comparable companies in the marketplace. Its primary objectives are to encourage a high level of performance against business objectives on the part of participants. The 2006 VCP provides for quarterly bonus payments to qualifying employees of the registrant, including its executive officers, based in part upon (i) the participant s salary for the quarter, (ii) the participant s bonus rate, and (iii) the registrant s revenues and profits for the quarter. If certain minimum revenue and profit goals are not obtained in any given quarter, then no quarterly bonus payments will be made under the 2006 VCP with respect to the quarter.

Employee Stock Purchase Plan

The Company s Employee Stock Purchase Plan (the Purchase Plan) was adopted by the Board of Directors and approved by the stockholders in 1980. A total of 6,325,000 shares of common stock have been reserved under the Purchase Plan, and as of the end of fiscal year 2005, 499,780 shares of common stock remained available for issuance thereunder. Eligible employees may authorize payroll deductions up to 10% of their regular base salary to purchase shares at the lower of 85% of the fair market value of the common stock on the date of commencement of the offering or on the last day of the six-month offering period.

Change of Control Severance Plan

Under the terms of the Company s Change of Control Severance Plan, in the event of a Change of Control (as defined therein), the Chief Executive Officer would receive 2.99 times the sum of his Base Pay and Bonus Pay, plus a gross up amount for any excise taxes under Section 280G of the Internal Revenue Code. Company Officer Vice Presidents would receive two times the sum of their Base Pay and Bonus Pay, and Non-Officer Vice Presidents would receive one times the sum of their Base Pay and Bonus Pay. In addition, in such circumstances one hundred percent of Participant s outstanding unvested equity compensation awards would fully vest.

Compensation Committee Interlocks and Insider participation

During the fiscal year ended September 30, 2005, the Compensation Committee of the Board of Directors consisted of directors Hart, Rogerson and Tomlinson. None of the members of the Compensation Committee has been or is an officer of employee of Coherent. None of our executive officers serves on the board of directors or compensation committee of a company that has an executive officer that serves on our board of Directors or Compensation Committee. No member of our Board of Directors is an executive officer of a company in which one of our executive officers serves as a member of the board of directors or compensation committee of that company.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth as of January 20, 2006 certain information with respect to the beneficial ownership of the Company s common stock by (i) any person (including any group as that term is used in Section 13(d)(3) of the Exchange Act known by the Company to be the beneficial owner of more than 5% of the Company s voting securities, (ii) each director

and each nominee for director of the Company, (iii) each of the executive officers named in the Summary Compensation Table appearing herein, and (iv) all executive officers and directors of the Company as a group. The Company does not know of any arrangements, including any pledge by any person of securities of the Company, the operation of which may at a subsequent date result in a change of control of the Company. Unless otherwise indicated, the address of each stockholder in the table below is c/o Coherent, Inc., 5100 Patrick Henry Drive, Santa Clara, California 95054.

Name and Address	Number of Shares (1)	Percent of Total
Franklin Resources, Inc. (2) One Franklin Pkwy. San Mateo, CA 94403	2,643,674	8.51%
Dimensional Fund Advisors (2) 1299 Ocean Ave., 11th Floor Santa Monica, CA 90401	2,150,405	6.93%
PRIMECAP Management Company (2) 225 S. Lake Ave., Suite 400 Pasadena, CA 91101	2,148,950	6.92%
Barclays Global Investors NA (2) 45 Fremont St., 17th Floor San Francisco, CA 94105	1,602,833	5.16%
Babson Capital Management LLD (2) 470 Atlantic Ave. Boston, MA 02210	1,575,641	5.07%
John Ambroseo (3)	528,070	1.70%
Helene Simonet (4)	151,542	*
Scott H. Miller (5)	86,653	*
Vittorio Fossati-Bellani (6)	169,005	*
Luis Spinelli (7)	42,370	*
Paul L. Meissner (8)	20,110	*
Bernard Couillaud, PhD (9)	119,185	*
Charles W. Cantoni (10)	24,000	*
Henry E. Gauthier (11)	77,330	*
John H. Hart (12)	34,000	*
Robert J. Quillinan (13)	60,616	*
Garry W. Rogerson, PhD (14)	10,000	*
Lawrence Tomlinson (15)	2,000	*
Sandeep Vij (16)	13,600	*
All directors and executive officers as a group (15 persons) (17)	1,406,252	4.37%

* Represents less than 1%.

(1) Based upon 31,060,588 shares of Coherent, Inc. common stock outstanding as of January 20, 2006. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission (the SEC) and generally includes voting or investment power with respect to the securities. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, each share of Coherent common stock subject to options held by that person that are currently exercisable or will be exercisable on or before March 21, 2006, are deemed outstanding. Such shares, however, are not deemed outstanding for the purpose of computing the percentage ownership of any other

person.

(2) Based on the most recently filed Schedule 13f or Schedule 13g filed by such person with the SEC.

(3) Includes 465,500 shares issuable upon exercise of options held by Dr. Ambroseo which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(4) Includes 138,333 shares issuable upon exercise of options held by Ms. Simonet which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(5) Includes 43,333 shares issuable upon exercise of options held by Mr. Miller which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(6) Includes 166,000 shares issuable upon exercise of options held by Mr. Vittorio Fossati-Bellani which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(7) Includes 38,333 shares issuable upon exercise of options held by Mr. Spinelli which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(8) Includes 15,000 shares issuable upon exercise of options held by Mr. Meissner which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(9) Includes 92,000 shares issuable upon exercise of options held by Dr. Couillaud which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(10) Includes 19,000 shares issuable upon exercise of options held by Mr. Cantoni which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(11) Includes 19,000 shares issuable upon exercise of options held by Mr. Gauthier which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(12) Includes 29,500 shares issuable upon exercise of options held by Mr. Hart which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(13) Includes 36,000 shares issuable upon exercise of options held by Mr. Quillinan which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(14) Includes 9,000 shares issuable upon exercise of options held by Dr. Rogerson which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(15) Includes 2,000 shares issuable upon exercise of options held by Mr. Tomlinson which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(16) Includes 10,000 shares issuable upon exercise of options held by Mr. Vij which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

(17) Includes an aggregate of 1,144,332 options which are currently exercisable or will become exercisable within 60 days of January 20, 2006.

Equity Compensation Plan Information

The following table provides information as of September 30, 2005 about the Company s equity compensation plans under which shares of our common stock may be issued to employees, consultants or members of our Board of Directors:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	4,785,200	$ 31.6252	4,796,700

Equity compensation plans not approved by security holders				
Total	4,785,200	$	31.6252	4,796,700

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The following table sets forth information with respect to all executive officers and directors of the Company who had indebtedness outstanding during the past fiscal year. This indebtedness arose as a result of the delivery of promissory notes in connection with the exercise of stock options:

Name	New Loans During 2005	Interest Rates	Maturity Date(s)	Largest Amount Outstanding During 2005 (1)	Balance at September 30, 2005
John Ambroseo, PhD		4.75%	1/25/07	$ 323,625	$ 323,625
		8.00%	2/15/08	40,000 (2)	30,000
Scott Miller		6.40-6.71%	4/14/05-5/24/05	365,125	

(1) These loans were entered into prior to the effective date of Section 402 of the Sarbanes-Oxley Act of 2002.

(2) This loan was granted to Dr. Ambroseo on February 15, 1998. Ten percent of the original principal balance of this loan is forgiven each year, so long as Mr. Ambroseo is employed with the Company.

All promissory notes are full recourse and, except for the $30,000 of principal outstanding on the loans to Dr. Ambroseo, are secured by the shares of common stock of the Company issued upon exercise of the options. Interest on stock notes is compounded. Interest on Dr. Ambroseo s note on which $30,000 of principal is outstanding is paid quarterly as a deduction from his Variable Compensation Plan.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The Audit Committee of the Board of Directors has selected Deloitte & Touche LLP, independent public accountants, to audit the financial statements of the Company for the fiscal year ending September 30, 2005. Deloitte & Touche LLP has audited the Company s financial statements since the fiscal year ended September 30, 1976.

Audit and Non-Audit Fees

The following table sets forth fees for services Deloitte & Touche LLP, the member firms of Deloitte Touche Tohmatsu, and their respective affiliates (collectively, Deloitte) provided during fiscal years 2005 and 2004:

	2005	2004
Audit fees (1)	$ 2,497,459	$ 1,404,000

Audit-related fees (2)	$	$ 179,000
Tax fees (3)	$ 202,492	$ 255,000
All other fees (4)	$ 14,100	$ 232,000
Total	$ 2,714,051	$ 2,070,000

(1) Represents fees for professional services provided in connection with the audit of our annual financial statements and review of our quarterly financial statements, advice on accounting matters that arose during the audit and audit services provided in connection with other statutory or regulatory filings. Audit fees for 2005 also included the audit of management s report on the effectiveness of the Company s internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act of 2002.

(2) Represents fees for assurance services related to the audit of the Company s financial statements and for services in connection with audits of the Company s benefit plans.

(3) Represents fees for services provided in connection with the Company s expatriate tax program, domestic and international tax planning, tax due diligence associated with the Company s acquisition activities and international tax compliance.

(4) Represents fees for services provided to the Company not otherwise included in the categories above, including services provided in connection with the Company s expatriate relocation programs, and other miscellaneous items.

The Audit Committee has determined that the provision of non-audit services by Deloitte is compatible with maintaining Deloitte s independence. In accordance with its charter, the Audit Committee approves in advance all audit and non-audit services to be provided by Deloitte. In other cases, the Chairman of the Audit Committee has the delegated authority from the Committee to pre-approve certain additional services, and such pre-approvals are communicated to the full Committee at its next meeting. During fiscal year 2005, 100% of the services were pre-approved by the Audit Committee in accordance with this policy.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) **1. Index to Consolidated Financial Statements**

The following Consolidated Financial Statements of Coherent, Inc. and its subsidiaries are filed as part of this report on Form 10-K:

2. Consolidated Financial Statement Schedules

Financial statement schedules have been omitted because they are either not required, not applicable or the information required to be set forth therein is included in the Consolidated Financial Statements hereto.

3. Exhibits

Exhibit Numbers	
2.1*	**Agreement and Plan of Merger. (Previously filed as Exhibit 2.1 to Form 10-K for the fiscal year ended September 29, 1990)**
3.1*	**Restated and Amended Certificate of Incorporation. (Previously filed as Exhibit 3.1 to Form 10-K for the fiscal year ended September 29, 1990)**
3.2*	**Certificate of Amendment of Restated and Amended Certificate of Incorporation of Coherent, Inc. (Previously filed as Exhibit 3.2 to Form 10-K for the fiscal year ended September 28, 2002)**
3.3*	**Bylaws of Coherent, Inc, as amended (Previously filed as Exhibit 3.2 to Form 10-K for the fiscal year ended September 29, 1990).**
4.1*	**Amended and Restated Common Shares Rights Agreement dated November 2, 1989 between Coherent and the Bank of Boston. (Previously filed as Exhibit 4.1 to Form 8-K filed on November 3, 1989.)**
10.1*	**Productivity Incentive Plan, as amended. (Previously filed as Exhibit 10.19 to Form 10-K for the fiscal year ended October 1, 1988)**

10.2*	**Employee Stock Purchase Plan, as amended. (Previously filed as Exhibit 10.11 to Form 10-K for the fiscal year ended September 29, 2001)**
10.3*	**Coherent Employee Retirement and Investment Plan. (Previously filed as Exhibit 10.23 to Form 8, Amendment No. 1 to Annual Report on Form 10-K for the fiscal year ended September 25, 1982)**

10.4* **1995 Stock Plan and forms of agreement. (Previously filed as Exhibit 10.34 to Form 10-K for the fiscal year ended September 28, 1996)**

10.5* **Note Purchase Agreement by and between Coherent, Inc. and the purchasers of $70 million series notes dated May 18, 1999.**

(Previously filed as Exhibit 10.36 to Form 10-K for the fiscal year ended October 2, 1999)

10.6* **1998 Director Option Plan. (Previously filed as Exhibit 10.37 to Form 10-K for the fiscal year ended September 30, 2000)**

10.7* **Asset Purchase Agreement by and among ESC Medical Systems, Ltd., Energy Systems Holdings, Inc., and Coherent, Inc., dated as of February 25, 2001. (Previously filed as Exhibit 2.1 to Form 8-K filed on March 5, 2001)**

10.8* **First amendment to Asset Purchase Agreement by and among ESC Medical Systems, Ltd., Energy Systems Holdings, Inc., and Coherent, Inc., dated as of April 30, 2001. (Previously filed as Exhibit 4 to Schedule 13 D/A filed on May 10, 2001)**

10.9* **1990 Directors Stock Option Plan. (Previously filed as Exhibit 10.1 to Form S-8 filed on May 1, 1996)**

10.10* **Master Lease and Security Agreement between SMBC Leasing and Finance, Inc. and Coherent, Inc. (Previously filed as Exhibit 10.12 to Form 10-Q for the quarter ended June 29, 2002)**

10.11* **Coherent, Inc. Management Transition Agreement by and between Coherent, Inc. and Bernard J. Couillaud. (Previously filed as Exhibit 10.13 to Form 10-K for the year ended September 28, 2002)**

10.12* **Coherent, Inc. Management Transition Agreement by and between Coherent, Inc. and Robert J. Quillinan. (Previously filed as Exhibit 10.14 to Form 10-K for the year ended September 28, 2002)**

10.13* **2001 Stock Plan (Previously filed as Exhibit 10.14 to Form 10-K for the year ended September 27, 2003)**

10.14* **Master termination agreement dated December 11, 2003 by and among Coherent; SMBC Leasing and Finance, Inc.; Sumitomo Mitsui Banking Corporation and Union Bank of California. (Previously filed as exhibit 10.1 to Form 10-Q for the quarter ended December 27, 2003)**

10.15* **Change of Control Severance Plan, as amended and restated effective February 17, 2005 (Previously filed as Exhibit 10.14 to Form 10-K/A Amendment No. 3 for the year ended October 2, 2004).**

21.1 **Subsidiaries**

23.1 **Consent of Independent Registered Public Accounting Firm-Deloitte & Touche LLP**

23.2 **Consent of Independent Registered Public Accounting Firm-Ernst & Young AG Wirtschaftsprüfungsgesellschaft**

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.**

---

* These exhibits were previously filed with the Commission as indicated and are incorporated herein by reference.

Identifies management contract or compensatory plans or arrangements required to be filed as an exhibit.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: January 27, 2006

/s/ JOHN R. AMBROSEO
By: John R. Ambroseo
President and Chief Executive Officer

STATEMENT OF MANAGEMENT RESPONSIBILITY

Management is responsible for the preparation, integrity, and objectivity of the Consolidated Financial Statements and other financial information included in the Company s 2005 Annual Report on Form 10-K. The Consolidated Financial Statements have been prepared in conformity with U.S. generally accepted accounting principles and reflect the effects of certain estimates and judgments made by management. It is critical for investors and other users of the Consolidated Financial Statements to have confidence that the financial information that we provide is timely, complete, relevant and accurate

Management, with oversight by the Company s Board of Directors, has established and maintains a corporate culture that requires that the Company s affairs be conducted to the highest standards of business ethics and conduct. Management also maintains an effective system of internal control that is designed to provide reasonable assurance that assets are safeguarded and that transactions are properly recorded and executed in accordance with management s authorization. This system is regularly monitored through direct management review, as well as extensive audits conducted by internal auditors throughout the organization.

Our Consolidated Financial Statements as of and for the year ended September 30, 2005 have been audited by Deloitte & Touche LLP, an independent registered public accounting firm. Their audit was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) and included an integrated audit under such standards.

The Audit Committee of the Board of Directors meets regularly with management, the internal auditors and the independent registered accounting firm to review accounting, reporting, auditing and internal control matters. The Audit Committee has direct and private access to both internal and external auditors.

See Item 9A for Management s Report on Internal Control Over Financing Reporting.

We are committed to enhancing shareholder value and fully understand and embrace our fiduciary oversight responsibilities. We are dedicated to ensuring that our high standards of financial accounting and reporting as well as our underlying system of internal controls are maintained. Our culture demands integrity and we have the highest confidence in our processes, internal controls, and people, who are objective in their responsibilities and operate under the highest level of ethical standards.

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

/s/ HELENE SIMONET
Helene Simonet
Executive Vice President and Chief Financial Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Coherent, Inc.:

We have audited the accompanying consolidated balance sheets of Coherent, Inc. and its subsidiaries (collectively, the Company) as of September 30, 2005 and 2004, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended September 30, 2005. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the consolidated financial statements of Lambda Physik AG and subsidiaries (Lambda Physik) for the year ended September 30, 2003, which statements reflect total revenues constituting 20 percent of consolidated total revenues for the year ended September 30, 2003. Such consolidated financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Lambda Physik for the year ended September 30, 2003, is based solely on the report of such other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of September 30, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2005, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of September 30, 2005, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated December 15, 2005 expressed an unqualified opinion on management s assessment of the effectiveness of the Company s internal control over financial reporting and an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ DELOITTE & TOUCHE LLP
San Jose, California
December 15, 2005

Report of Independent Registered Public Accounting Firm

To the Stockholders and the Supervisory Board of Lambda Physik AG:

We have audited the consolidated balance sheet of Lambda Physik AG (a subsidiary of Coherent, Inc.) as of September 30, 2003 (new basis) and the related consolidated statements of operations, cash flows and changes in stockholders equity for the new basis period from July 27, 2003 to September 30, 2003, and the old basis period from October 1, 2002 to July 26, 2003, and for the year ended September 30, 2002 (not presented separately herein) These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above (not presented separately herein) present fairly, in all material respects, the consolidated financial position of Lambda Physik AG at September 30, 2003 (new basis) and the consolidated results of its operations and its cash flows for the new basis period from July 27, 2003, to September 30, 2003, the old basis period from October 1, 2002, to July 26, 2003, and for the year ended September 30, 2002, in conformity with accounting principles generally accepted in the United States.

As described in Note 2 to the financial statements, the Company applied push down accounting on July 26, 2003, to reflect its parent company s basis in the Company s assets and liabilities. Period subsequent to July 26, 2003, are referred to as new basis while those periods prior to July 26, 2003, are referred to as old basis periods.

Ernst & Young AG

Wirtschaftsprüfungsgesellschaft

Hentschel Boelsems

November 5, 2003

Hanover, Germany

COHERENT, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	September 30, 2005	September 30, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 97,507**	$ 87,659
Restricted cash, cash equivalents and short-term investments	**15,467**	15,343
Short-term investments	**133,407**	83,075
Accounts receivable net of allowances of $3,136 in 2005 and $3,745 in 2004	**87,684**	96,825
Inventories	**102,730**	104,698
Prepaid expenses and other assets	**17,034**	19,350
Deferred tax assets	**37,892**	43,222
Total current assets	**491,721**	450,172
Property and equipment, net	**155,316**	166,054
Restricted cash, cash equivalents and short-term investments	**1,220**	23,580
Goodwill	**68,097**	53,104
Intangible assets, net	**42,186**	35,454
Other assets	**39,750**	28,962
Total assets	**$ 798,290**	$ 757,326
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term obligations	**$ 12,736**	$ 13,700
Accounts payable	**18,451**	17,648
Income taxes payable	**16,597**	9,603
Other current liabilities	**63,803**	63,578
Total current liabilities	**111,587**	104,529
Long-term obligations		14,215
Other long-term liabilities	**50,437**	49,128
Minority interest in subsidiaries		5,402
Commitments and contingencies (Note 11)		
Stockholders equity:		
Common stock, par value $.01:		
Authorized 500,000 shares		
Outstanding 31,173 shares in 2005 and 30,392 shares in 2004	**309**	302
Additional paid-in capital	**328,580**	308,236
Deferred stock compensation	**(2,762)**	
Notes receivable from stock sales	**(324)**	(758)
Accumulated other comprehensive income	**30,846**	36,516
Retained earnings	**279,617**	239,756
Total stockholders equity	**636,266**	584,052
Total liabilities and stockholders equity	**$ 798,290**	$ 757,326

See accompanying Notes to Consolidated Financial Statements.

COHERENT, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended September 30,		
	2005	**2004**	**2003**
Net sales	**$ 516,252**	$ 494,954	$ 406,235
Cost of sales	**298,583**	287,551	257,644
Gross profit	**217,669**	207,403	148,591
Operating expenses:			
Research and development	**57,545**	62,705	51,025
In-process research and development	**1,577**		6,338
Selling, general and administrative	**115,827**	115,043	106,147
Restructuring, impairment and other charges (recoveries)	**(61)**	(3,093)	35,163
Amortization of intangible assets	**7,019**	6,698	5,147
Total operating expenses	**181,907**	181,353	203,820
Income (loss) from operations	**35,762**	26,050	(55,229)
Other income (expense):			
Interest and dividend income	**5,085**	2,525	5,371
Interest expense	**(1,839)**	(3,138)	(3,878)
Foreign exchange gain (loss)	**35**	590	(1,815)
Write-down of Lumenis investment			(10,212)
Other net	**2,388**	1,224	7,357
Total other income (expense), net	**5,669**	1,201	(3,177)
Income (loss) from continuing operations before income taxes and minority interest	**41,431**	27,251	(58,406)
Provision (benefit) for income taxes	**1,750**	10,301	(7,377)
Income (loss) from continuing operations before minority interest	**39,681**	16,950	(51,029)
Minority interest in subsidiaries losses, net of taxes	**180**	192	4,241
Income (loss) from continuing operations	**39,861**	17,142	(46,788)
Discontinued operations, net of income taxes (Note 3):			
Gain on disposal of Medical segment		218	642
Net income (loss)	**$ 39,861**	$ 17,360	$ (46,146)
Net income (loss) per basic share:			
Income (loss) from continuing operations	**$ 1.30**	$ 0.57	$ (1.59)
Income from discontinued operations, net of income taxes		0.01	0.02
Net income (loss)	**$ 1.30**	$ 0.58	$ (1.57)
Net income (loss) per diluted share:			
Income (loss) from continuing operations	**$ 1.28**	$ 0.56	$ (1.59)
Income from discontinued operations, net of income taxes		0.01	0.02
Net income (loss)	**$ 1.28**	$ 0.57	$ (1.57)
Shares used in computation:			
Basic	**30,756**	30,179	29,448
Diluted	**31,241**	30,544	29,448

See accompanying Notes to Consolidated Financial Statements.

COHERENT, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Years Ended September 30, 2005, 2004 and 2003

(In thousands)

	Common Stock Shares	Common Stock Par Value	Add. Paid-in Capital	Deferred Stock Comp.	Notes Rec. From Stock Sales	Accum. Other Comp. Income (Loss)	Retained Earnings	Total
Balances, October 1, 2002	**29,042**	**$ 289**	**$ 284,182**	**$**	**$ (2,045)**	**$ 2,360**	**$ 268,542**	**$ 553,328**
Components of comprehensive loss:								
Net loss							(46,146)	(46,146)
Translation adjustment, net of tax						16,719		16,719
Unrealized loss on available for sale securities, net of tax						(780)		(780)
Net gain on derivative instruments, net of tax						110		110
Total comprehensive loss								(30,097)
Issuance of stock options in exchange for services			43					43
Sales of shares under Employee Stock Option Plan	618	6	9,042					9,048
Productivity Incentive Plan distributions	6		123					123
Sales of shares under Employee Stock Purchase Plan	273	3	4,110					4,113
Tax benefit of Employee Stock Option Plan			1,878					1,878
Collection of notes receivable					1,252			1,252
Balances, September 30, 2003	**29,939**	**298**	**299,378**		**(793)**	**18,409**	**222,396**	**539,688**
Components of comprehensive income:								
Net income							17,360	17,360
Translation adjustment, net of tax						17,987		17,987
Unrealized gain on available for sale securities, net of tax						114		114
Net gain on derivative instruments, net of tax						6		6
Total comprehensive income								35,467
Issuance of stock options in exchange for services			26					26
Sales of shares under Employee Stock Option Plan	253	2	3,858					3,860
Sales of shares under Employee Stock Purchase Plan	200	2	3,931					3,933

Tax benefit of Employee Stock Option Plan			1,043					1,043
Collection of notes receivable					35			35
Balances, September 30, 2004	**30,392**	**302**	**308,236**		**(758)**	**36,516**	**239,756**	**584,052**
Components of comprehensive income:								
Net income							39,861	39,861
Translation adjustment, net of tax						(5,391)		(5,391)
Unrealized gain on available for sale securities, net of tax						(287)		(287)
Net gain on derivative instruments, net of tax						8		8
Total comprehensive income								34,191
Issuance of stock options in exchange for services			96					96
Amortization, issuance and forfeitures of restricted stock	83		3,198	(2,762)				436
Sales of shares under Employee Stock Option Plan	484	5	10,839					10,844
Sales of shares under Employee Stock Purchase Plan	214	2	4,440					4,442
Tax benefit of Employee Stock Option Plan			1,771					1,771
Collection of notes receivable					434			434
Balances, September 30, 2005	**31,173**	**$ 309**	**$ 328,580**	**$ (2,762)**	**$ (324)**	**$ 30,846**	**$ 279,617**	**$ 636,266**

See accompanying Notes to Consolidated Financial Statements.

COHERENT, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended September 30,		
	2005	**2004**	**2003**
Cash flows from continuing operating activities:			
Income (loss) from continuing operations	**$ 39,861**	$ 17,142	$ (46,788)
Adjustments to reconcile income (loss) from continuing operations to net cash provided by continuing operating activities:			
Purchased in-process research and development	**1,577**		6,338
Non-cash restructuring, impairment and other charges (recoveries)	**(61)**	(3,093)	26,800
Depreciation and amortization	**28,279**	29,539	29,002
Amortization of intangible assets	**7,019**	6,698	5,147
Stock based compensation	**436**		
Tax benefit from employee stock options	**1,771**	1,043	1,878
Deferred income taxes	**(12,938)**	4,974	897
Minority interest in subsidiaries losses	**(180)**	(192)	(4,241)
Equity in loss of joint ventures	**1,577**	2,817	1,927
Gain on sale of joint venture	**(1,065)**		
Other non-cash expense	**(741)**	81	190
Gain on sale of Lumenis investment		(94)	(1,481)
Write-down of Lumenis investment			10,212
Purchases of short-term trading investments			(210,242)
Proceeds from sales of short-term trading investments			178,241
Issuance of common stock under Productivity Incentive Plan			123
Dividends paid to minority stockholders			(265)
Changes in assets and liabilities, net of effect of acquisitions:			
Accounts receivable	**11,867**	(21,703)	11,835
Inventories	**7,996**	(190)	4,866
Prepaid expenses and other assets	**3,748**	5,791	87
Other assets	**(2,305)**	(470)	(2,155)
Accounts payable	**(612)**	(605)	1,112
Income taxes payable/receivable	**5,811**	29,272	1,224
Other current liabilities	**(4,519)**	(2,940)	3,435
Other long-term liabilities	**5,167**	1,056	3,190
Net cash provided by continuing operating activities	**92,688**	69,126	21,332
Cash flows from continuing investing activities:			
Purchases of property and equipment	**(17,625)**	(46,634)	(25,678)
Proceeds from dispositions of property and equipment	**793**	2,964	12,732
Purchases of available-for-sale securities	**(390,800)**	(347,559)	(178,071)
Proceeds from sales and maturities of available-for-sale securities	**340,468**	323,100	275,835
Proceeds from sale of note receivable from Picometrix		4,000	
Acquisition of businesses and minority interest, net of cash acquired	**(37,979)**	(2,737)	(94,880)
Change in restricted cash, cash equivalents and short-term investments	**22,950**	15,648	(53,506)
Premiums paid for life insurance	**(1,252)**	(944)	(1,018)
Distributions from deferred compensation plan arrangements	**851**	408	119
Investment in joint venture	**(803)**	(4,510)	(1,139)
Proceeds from sale of joint venture	**3,899**		
Other-net	**(1,470)**	1,600	3,048
Net cash used in continuing investing activities	**(80,968)**	(54,664)	(62,558)

	Year Ended September 30,		
	2005	2004	2003
Cash flows from continuing financing activities:			
Long-term debt borrowings	**$ 2**	$ 4	$ 363
Long-term debt repayments	**(14,995)**	(13,875)	(17,990)
Short-term borrowings	**3**		711
Short-term repayments			(16,822)
Cash overdrafts increase (decrease)	**394**	1,748	(232)
Repayments of capital lease obligations	**(241)**	(528)	(557)
Issuance of common stock under employee stock option and purchase plans	**15,286**	7,793	13,161
Collection of notes receivable from stock sales	**434**	35	1,252
Net cash provided by (used in) continuing financing activities	**883**	(4,823)	(20,114)
Net cash provided by discontinued operating activities		218	
Effect of exchange rate changes on cash and cash equivalents	**(2,755)**	1,261	6,863
Net increase (decrease) in cash and cash equivalents	**9,848**	11,118	(54,477)
Cash and cash equivalents, beginning of year	**87,659**	76,541	131,018
Cash and cash equivalents, end of year	**$ 97,507**	$ 87,659	$ 76,541
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	**$ 2,279**	$ 3,469	$ 4,280
Income taxes	**$ 10,276**	$ 7,172	$ 11,194
Cash received during the year for:			
Income taxes	**$ 2,491**	$ 31,329	$ 10,800
Noncash investing and financing activities:			
Net issuances of restricted stock awards	**$ 3,198**		

See accompanying Notes to Consolidated Financial Statements

COHERENT, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Founded in 1966, we provide photonics-based solutions for commercial and scientific research applications. We design and manufacture a diversified selection of photonics products and solutions, primarily lasers, precision optics and related accessories. Headquartered in Santa Clara, California, we have worldwide operations including research and development, manufacturing, sales, service and support capabilities.

2. SIGNIFICANT ACCOUNTING POLICIES

Fiscal Year

Our fiscal year ends on the Saturday closest to September 30. Fiscal years 2005, 2004 and 2003 ended on October 1, October 2, and September 27, respectively. For convenience, the accompanying consolidated financial statements have been shown as ending on September 30 for all fiscal years. Fiscal year 2004 included 53 weeks, whereas fiscal years 2005 and 2003 included 52 weeks. The fiscal years of the majority of our international subsidiaries, including our wholly-owned subsidiary Coherent Lambda Physik GmbH (Lambda Physik), end on September 30. Accordingly, the financial statements of these subsidiaries as of that date and for the years then ended have been used for our consolidated financial statements. Management believes that the impact of the use of different year-ends is immaterial to our consolidated financial statements taken as a whole.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (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.

Basis of Presentation

The consolidated financial statements include the accounts of Coherent, Inc. and its majority-owned subsidiaries (collectively, the Company, we, our, or Coherent). All significant intercompany balances and transactions have been eliminated. Investments in business entities in which we do not have control but have the ability to exercise significant influence over operating and financial policies (generally 20-50% ownership) are accounted for by the equity method.

Certain prior year amounts in the consolidated financial statements and the notes thereto have been reclassified to conform to the fiscal 2005 presentation. Such reclassifications had no impact on net income (loss) or stockholders equity for any years presented.

Discontinued Operations

On April 30, 2001, we completed the sale of our Medical segment to Lumenis, Ltd. (formerly ESC Medical Systems, Ltd.). The disposal of the Medical segment represented the disposal of a business segment under Accounting Principles Board (APB) Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions (APB 30). Accordingly, results of the operations of our Medical segment have been classified as discontinued (see Note 3).

Fair Value of Financial Instruments

The carrying amounts of certain of our financial instruments including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their short maturities. Short-term investments are comprised of available-for-sale securities, which are carried at fair value. Other non-current assets include trading securities related to our deferred compensation plans, which are carried at fair value. The recorded carrying amount of our long-term obligations approximates fair value except for the notes used to finance our acquisition of Star Medical (Star notes), which had a carrying value of $12.6 million and a fair value of $13.1 million at September 30, 2005. The estimated fair value of our long-term debt was determined by calculating the future value of payments based on current market interest rates available to us. Foreign exchange contracts are stated at fair value based on prevailing financial market information.

Cash Equivalents

All highly liquid investments with maturities of three months or less at the time of purchase are classified as cash equivalents.

Concentration of Credit Risk

Financial instruments that may potentially subject us to concentrations of credit risk consist principally of cash equivalents, short-term investments and accounts receivable. At September 30, 2005, the majority of our short-term investments are in federal agency obligations, corporate obligations, state and municipal obligations, bank certificates of deposit and money market funds. Cash equivalents and short-term investments are maintained with several financial institutions and may exceed the amount of insurance provided on such balances. The majority of our accounts receivable are derived from sales to customers for commercial and scientific research applications. We perform ongoing credit evaluations of our customers financial condition and limit the amount of credit extended when deemed necessary but generally require no collateral. We maintain reserves for potential credit losses. Our products are broadly distributed and no one customer accounted for more than 10% of accounts receivable at September 30, 2005 or 2004.

Accounts Receivable Allowances

Accounts receivable allowances reflect our best estimate of probable losses inherent in our accounts receivable balance. We regularly review allowances by considering factors such as historical experience, credit quality, the age of the accounts receivable balances and current economic conditions that may affect a customer s ability to pay. Activity in accounts receivable allowance is as follows (in thousands):

	September 30,		
	2005	**2004**	**2003**
Beginning balance	**$ 3,745**	$ 4,151	$ 4,038
Additions charged to costs and expenses	**2,358**	2,314	3,679
Deductions from reserves	**(2,967)**	(2,720)	(3,566)
Ending balance	**$ 3,136**	$ 3,745	$ 4,151

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market. Inventories are as follows (in thousands):

	September 30,	
	2005	**2004**
Purchased parts and assemblies	**$ 23,778**	$ 28,097
Work-in-process	**48,036**	44,070
Finished goods	**30,916**	32,531
Inventories	**$ 102,730**	$ 104,698

During fiscal 2005, our Lambda Physik subsidiary decided to discontinue future product development and investments in the semiconductor lithography market. As a result, we recognized a charge of $1.7 million related to recognizing write-downs of excessive and obsolete inventories in the first quarter of fiscal 2005. We also recognized a charge of $6.8 million in the fourth quarter of fiscal 2005 related to excess inventories resulting form the accelerated decommissioning of lithography lasers following our decision to no longer offer lithography service contracts after December 31, 2005.

Property and Equipment

Property and equipment are stated at cost and are depreciated or amortized using the straight-line method. Cost, accumulated depreciation and amortization and estimated useful lives are as follows (in thousands):

	September 30,		
	2005	**2004**	**Useful Life**
Land	**$ 19,018**	$ 19,041	
Buildings and improvements	**111,135**	109,622	5-40 years
Equipment, furniture and fixtures	**181,069**	185,373	3-10 years
Leasehold improvements	**10,819**	10,980	Lesser of useful life or terms of lease
	322,041	325,016	
Accumulated depreciation and amortization	**(166,725)**	(158,962)	
Property and equipment, net	**$ 155,316**	$ 166,054	

Long-lived Assets

We account for long-lived assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). Accordingly, we evaluate the carrying value of long-lived assets, including intangible assets, whenever events or changes in business circumstances or our planned use of long-lived assets indicate that their carrying amounts may not be fully recoverable or that their useful lives are no longer appropriate. Reviews are performed to determine whether the carrying values of long-lived assets are impaired based on a comparison to the undiscounted expected future net cash flows. If the comparison indicates that impairment exists, long-lived assets that are classified as held and used are written down to their respective fair values and long-lived assets classified as held for sale are written down to their respective fair values less costs to sell. Significant management judgment is required in the forecast of future operating results that is used in the preparation of expected undiscounted cash flows. See Note 4 for a discussion of impairment charges.

Goodwill

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, (SFAS 142) goodwill is tested for impairment on an annual basis and between annual tests in certain circumstances, and written down when impaired (see Note 7). Under SFAS 142, material amounts of goodwill attributable to each of our reporting units are tested for impairment by comparing their respective fair values with their respective carrying values. Fair value is determined using a discounted cash flow methodology. Absent any impairment indicators, we perform our annual impairment tests during the fourth quarter of each fiscal year.

Intangible Assets

Intangible assets, including acquired existing technology, customer lists, trade name, non-compete agreements, patents, licenses, drawings and order backlog are amortized on a straight-line basis over estimated useful lives of six months to fifteen years.

Revenue Recognition

We recognize revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists, the product has been delivered or the service has been rendered, the price is fixed or determinable and collection is probable. Revenue from product sales is recorded when all of the foregoing conditions are met and risk of loss and title passes to the customer. Our products typically include a one-year warranty and the estimated cost of product warranty claims (based on historical experience) is recorded at the time the sale is recognized. Sales to customers are generally not subject to any price protection or return rights.

The vast majority of our sales are made to original equipment manufacturers (OEMs), distributors, resellers and end-users in the non-scientific market. Sales made to these customers do not require installation of the products by us and are not subject to other post-delivery obligations, except in occasional instances where we have agreed to perform installation or provide training. In those instances, we defer revenue related to installation services or training until these services have been rendered. We allocate revenue from multiple element arrangements to the various elements based upon relative fair values, which is determined based on the price charged for each deliverable on a standalone basis.

Our sales to distributors, resellers and end-user customers typically do not have customer acceptance provisions and only certain of our sales to OEM customers have customer acceptance provisions. Customer acceptance is generally limited to performance under our published product specifications. For the few product sales that have customer acceptance provisions because of higher than published specifications, (1) the products are tested and accepted by the customer at our site or by the customer s acceptance of the results of our testing program prior to shipment to the customer, or (2) the revenue is deferred until customer acceptance occurs.

Sales to end-users in the scientific market typically require installation and, thus, involve post-delivery obligations, however our post-delivery installation obligations are not essential to the functionality of our products. We defer revenue related to installation services until completion of these services.

For most products, training is not provided, therefore, no post-delivery training obligation exists. In cases where training is provided to our customers, it is typically priced separately and recognized as revenue after these services have been provided**.**

Research and Development

Research and development expenses include salaries, contractor and consultant fees, supplies and materials, as well as costs related to other overhead such as depreciation, facilities, utilities and other departmental expenses. The costs we incur with respect to internally developed technology and engineering services are included in research and development expenses as incurred as they do not directly relate to any particular licensee, license agreement or license fee.

We treat third party and government funding of our research and development activity, where we are the primary beneficiary of such work conducted, as a credit to research and development cost. Amounts offset against research and development cost were not material in any of the periods presented.

Foreign Currency Translation

The functional currencies of our foreign subsidiaries are their respective local currencies. Accordingly, gains and losses from the translation of the financial statements of the foreign subsidiaries are reported as a separate component of accumulated other comprehensive income (OCI). Foreign currency transaction gains and losses are included in earnings.

Derivatives

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) as amended, requires that all derivatives, whether designated in hedging relationships or not, be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of the changes in the fair value of the derivative are recorded in OCI and are recognized in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in other income (expense).

Our objective of holding derivatives is to minimize the risks of foreign currency fluctuation by using the most effective methods to eliminate or reduce the impact of these exposures. Principal currencies hedged include the Euro, Yen, British Pound, Canadian Dollar and Korean Won.

For foreign currency forward contracts under SFAS 133, hedge effectiveness is measured by comparing the cumulative change in the hedge contract with the cumulative change in the hedged item, both of which are based on forward rates. For foreign currency option contracts under SFAS 133, hedge effectiveness is asserted when the critical elements representing the total changes in the option s cash flows continue to match the related elements of the hedged forecasted transaction. Should discrepancies arise, effectiveness is measured by comparing the change in option value and the change in value of a hypothetical derivative mirroring the critical elements of the forecasted transaction.

Forwards not designated as hedging instruments under SFAS 133 are also used to hedge the impact of the variability in exchange rates on accounts receivable and collections denominated in certain foreign currencies. Changes in fair value of these derivatives are recognized in other income (expense).

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources and is presented in our Consolidated Statements of Stockholders Equity.

Earnings (Loss) Per Share

Basic earnings (loss) 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 stock options and stock purchase contracts using the treasury stock method. Potentially dilutive shares are excluded from the diluted earnings (loss) per share computation in loss periods.

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

	Year Ended September 30,		
	2005	2004	2003
Weighted average shares outstanding Basic	**30,756**	30,179	29,448
Dilutive effect of employee stock plans	**485**	365	
Weighted average shares outstanding Diluted	**31,241**	30,544	29,448
Income (loss) from continuing operations for basic and diluted earnings per share computation	**$ 39,861**	$ 17,142	$ (46,788)
Income (loss) from continuing operations per share basic	**$ 1.30**	$ 0.57	$ (1.59)
Income (loss) from continuing operations per share diluted	**$ 1.28**	$ 0.56	$ (1.59)

A total of 1,900,000, 3,444,000 and 3,580,000 anti-dilutive weighted average shares have been excluded from the dilutive share calculation at September 30, 2005, 2004 and 2003, respectively.

Stock-Based Compensation

As permitted under SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123), we have elected to account for stock-based compensation awards issued to employees using the intrinsic value measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). Accordingly, under APB 25, no compensation expense has been recorded for stock options granted with exercise prices greater than or equal to the fair value of the underlying common stock at the option grant date.

SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, an Amendment of FASB Statement No. 123 (SFAS 148) amends the disclosure requirements of SFAS 123 to require more prominent disclosures in both annual and interim financial statements regarding the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS 123 requires the disclosure of pro forma net income (loss) and earnings (loss) per share as if we had adopted the fair value method. Under SFAS 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models that require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. For purposes of calculating the effect that SFAS 123 would have had on our net income (loss), the fair value of our options was estimated at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions:

	Employee Stock Option Plans Year Ended September 30,			Employee Stock Purchase Plans Year Ended September 30,		
	2005	2004	2003	**2005**	2004	2003
Expected life in years	**3.4**	4.4	4.5	**0.5**	0.5	0.5
Expected volatility	**44.7%**	70.9%	73.9%	**36.4%**	43.5%	50.7%
Risk-free interest rate	**3.7%**	3.3%	2.7%	**2.3%**	1.4%	1.3%
Expected dividends	**none**	none	none	**none**	none	none

Our calculations are based on a single option valuation approach and forfeitures are recognized as they occur. The following table illustrates the effect on our net income (loss) and net income (loss) per share as if we had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation (in thousands, except per share data):

	Year Ended September 30,		
	2005	**2004**	**2003**
Net income (loss), as reported	**$ 39,861**	**$ 17,360**	$ (46,146)
Add: stock-based employee compensation expense included in reported net income (loss), net of related tax effects	**286**		
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of income taxes	**(11,526)**	**(14,440)**	(17,637)
Pro forma net income (loss)	**$ 28,621**	**$ 2,920**	$ (63,783)
Earnings (loss) per share			
Basic-as reported	**$ 1.30**	**$ 0.58**	$ (1.57)
Basic-pro forma	**$ 0.93**	**$ 0.10**	$ (2.17)
Diluted-as reported	**$ 1.28**	**$ 0.57**	$ (1.57)
Diluted-pro forma	**$ 0.92**	**$ 0.10**	$ (2.17)

Advertising Costs

Advertising costs are expensed as incurred.

Income Taxes

As part of the process of preparing our consolidated financial statements we are required to estimate our income tax provision (benefit) in each of the jurisdictions in which we operate. This process involves estimating our current income tax provision (benefit) together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheets.

We record a valuation allowance to reduce our deferred tax assets to an amount that more likely than not will be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the allowance for the deferred tax asset would increase income in the period such determination was made. Likewise, should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the allowance for the deferred tax asset would be charged to income in the period such determination was made.

Federal income taxes have not been provided for on a portion of the unremitted earnings of foreign subsidiaries either because such earnings are intended to be permanently reinvested or because foreign tax credits are available to offset any planned distributions of such earnings. The total amount of unremitted earnings of foreign subsidiaries for which we have not yet recorded federal income taxes was approximately $103.7 million at September 30, 2005. In addition to federal income taxes (which are not practicably determinable), withholding taxes of approximately

$1.6 million would be payable upon repatriation of such earnings which would result in additional foreign tax credits.

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, Inventory Costs (SFAS 151), an amendment of Accounting Research Bulletin No. 43, Chapter 4. SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. SFAS 151 will be effective for our first quarter of fiscal 2006. We do not believe that the adoption of SFAS 151 will have a material effect on our results of operations or consolidated financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R). SFAS 123R eliminates the alternative of applying the intrinsic value measurement provisions of APB 25 to stock compensation awards issued to employees. Rather, the new standard requires enterprises to measure the cost of employee services received in

exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to the adoption of SFAS 123R. SFAS 123R will be effective for our first quarter of fiscal 2006. We expect that the new standard will result in significant stock-based compensation expense.

The pro forma effects on net income and earnings per share as if we had applied the fair value recognition provisions of original SFAS 123 on stock compensation awards (rather than applying the intrinsic value measurement provisions of APB 25) are disclosed above. Although such pro forma effects of applying original SFAS 123 may be indicative of the effects of adopting SFAS 123R, the provisions of these two statements differ in some important aspects. The actual effects of adopting SFAS 123R will be dependent on numerous factors including, but not limited to, the valuation model chosen by us to value stock-based awards; the assumed award forfeiture rate; the accounting policies adopted concerning the method of recognizing the fair value of awards over the requisite service period; and the transition method. We plan to use the modified prospective application method upon our adoption of SFAS 123R. Accordingly, SFAS 123R will be applied to new awards and to awards modified, repurchased, or cancelled after the effective date. Compensation cost for the portion of awards for which the requisite service has not been rendered (such as unvested options) that are outstanding as of the date of adoption is recognized as the remaining requisite services are rendered. The compensation cost relating to unvested awards at the date of adoption is based on the grant-date fair value of those awards as calculated for pro forma disclosures under the original SFAS 123 as adjusted for the effect of estimated forfeiture rates.

In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143 (FIN 47). FIN 47 clarifies that conditional asset retirement obligations meet the definition of liabilities and should be recognized when incurred if their fair values can be reasonably estimated. The Interpretation is effective no later than December 31, 2005 and the cumulative effect of initially applying FIN 47 will be recognized as a change in accounting principle. We are in the process of evaluating the expected effect of FIN 47 on our consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS 154 requires retrospective application to prior period financial statements for changes in accounting principles, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle should be recognized in the period of the accounting change. SFAS 154 further requires a change in depreciation, amortization or depletion method for long-lived, non-financial assets to be accounted for as a change in accounting estimate effected by a change in accounting principle. SFAS 154 will be effective for our first quarter of fiscal 2006.

3. DISCONTINUED OPERATIONS

On April 30, 2001, we completed the sale of our Medical segment assets to Lumenis, Ltd. (formerly ESC Medical Systems Ltd.) for $100.0 million in cash, $12.9 million in notes receivable and 5,432,099 shares of Lumenis common stock. We estimated the total value of this consideration to be $236.0 million as of the closing of the sale. In fiscal 2002, we reached a purchase price settlement with Lumenis resulting in a gain of $1.9 million (net of income taxes of $1.2 million).

The Lumenis common stock received was unregistered and its trading was subject to restrictions under Rule 144 of the Securities Act of 1933 and other contractual restrictions as defined in the definitive agreement. In the third quarter of fiscal 2002, the market value of our investment in Lumenis had declined from our initial valuation of $124.4 million to $20.2 million. In accordance with SFAS 115, we concluded that this decline was other-than-temporary and recognized an impairment loss to reduce the carrying value of our investment in Lumenis to $20.2

million. In the first quarter of fiscal 2003, the market value of our investment in Lumenis had further declined to $9.9 million. This decline was also deemed to be other-than-temporary and an additional impairment loss of $10.2 million was recognized. We recorded no net tax benefit related to the $10.2 million impairment loss as we recorded a $4.1 million valuation allowance against this capital loss deferred tax asset. Unrealized gains and losses subsequent to the first quarter of fiscal 2003 from the new cost basis were recorded in OCI. In fiscal 2003, we sold 5,217,099 shares of Lumenis common stock for approximately $11.0 million while recognizing a gain of $1.5 million. In fiscal 2004, we sold our remaining shares of Lumenis common stock for approximately $0.5 million while recognizing a gain of $0.1 million.

In fiscal 2004, we recorded a gain of $0.2 million relating to the collection of a previously anticipated uncollectible account receivable. In fiscal 2003, we recorded a gain of $0.6 million relating to the anticipated refund of prior year taxes resulting from the sale.

The results of the operations of the Medical segment have been classified as discontinued in the accompanying consolidated financial statements. Income from discontinued operations consisted of the following (in thousands):

	Year Ended September 30,		
	2005	2004	2003
Gain on disposal	$	$ 363	$ 47
Provision (benefit) for income taxes		145	(595)
Income from discontinued operations, net	$	$ 218	$ 642

4. RESTRUCTURING, IMPAIRMENT AND OTHER CHARGES (RECOVERIES)

During fiscal 2005, 2004 and 2003, we recorded restructuring, impairment and other charges (recoveries) of ($0.1) million, ($3.1) million and $35.2 million, respectively, as follows (in thousands):

	Year Ended September 30,		
	2005	2004	2003
Termination of activities of the Coherent Telecom-Actives Group	$ (61)	$ 174	$ 14,818
Impairment of long-lived assets		(26)	12,672
Goodwill impairment (Note 7)			2,358
(Recovery) impairment of Picometrix note receivable		(3,241)	3,723
Lease termination costs			1,693
Other			(101)
Total	$ (61)	$ (3,093)	$ 35,163

Coherent Telecom-Actives Group

Based on market information and insights regarding the status of our development projects of our Coherent Telecom-Actives Group (CTAG) obtained in the first quarter of fiscal 2003, we determined that our return on investment for at least the next several years would have been unsatisfactory and, therefore, additional investments were no longer justified. As a result, we decided to terminate the activities of CTAG, an operating segment that had been aggregated with our Photonics Group in our Electro-Optics reportable segment. The charge related to the termination of these activities included a $6.5 million write-down of equipment and leasehold improvements to net realizable value; a $6.8 million accrual for the estimated contractual obligation for lease and other facility costs of the building, net of estimated sublease income, in San Jose, California, formerly occupied by CTAG; the $1.4 million write-off of our option to purchase Picometrix; and $0.1 million of other restructuring costs. Fiscal 2005 and 2004 charges are a result of revisions to the estimated contractual obligation for lease and other facility costs, net of estimated sublease income, related to the building formerly occupied by CTAG.

Impairment of Long Lived Assets

In fiscal 2003, the proposed sale of our manufacturing facility located in Lincoln, California met the necessary criteria to be classified as assets held for sale under SFAS 144. Accordingly, the carrying values of the land, buildings and improvements and equipment were adjusted to their respective fair values less costs to sell of $9.0 million and $0.3 million, respectively, and as a result, we recorded an impairment charge of $3.1 million during fiscal 2003. The determinations of fair values were based on quoted market prices and comparable sales of similar assets. In July 2003, we completed the sale of the land, buildings, improvements and equipment and received net proceeds of $9.2 million.

In fiscal 2003, management reassessed the planned utilization of certain long-lived assets of our operating sites in Auburn, California and Tampere, Finland, and determined that excess manufacturing capacity existed at these locations. As a result, management committed to a plan to sell certain equipment with a carrying value of $5.7 million and to dispose of certain building improvements with a carrying value of $1.0 million. The proposed sale of the equipment met the necessary criteria to be classified as assets held for sale under SFAS 144. Accordingly, the carrying value of the equipment was adjusted to its current fair value less costs to sell of $0.8 million. The fair value of the equipment was determined based on comparable sales of similar assets. The building improvements were determined to have no future benefit and were abandoned in fiscal 2003, resulting in an impairment charge of $5.9 million.

In fiscal 2003, management initiated plans to consolidate the activities of our subsidiary located in Glasgow, Scotland in an attempt to increase operating efficiency. Management determined that the carrying value of long-lived assets, consisting primarily of production equipment and buildings located at this subsidiary exceeded their estimated future undiscounted cash

flows. Accordingly, long-lived assets with a carrying value of $6.3 million were written down to their estimated fair value of $2.9 million, resulting in an impairment charge of $3.4 million in fiscal 2003. Additionally, certain long-lived assets that were classified as held for use at our Barendrecht, the Netherlands subsidiary was impaired, resulting in a charge of $0.3 million. The determinations of the fair values assigned to the long-lived assets were based on comparable sales of similar assets and an expected cash flow approach.

Picometrix Note Receivable

In August 2002, we entered into a loan agreement with Picometrix, Inc. (Picometrix) of Ann Arbor, Michigan. Picometrix develops and manufactures ultra high-speed photoreceivers and instrumentation for the telecommunication, data communication and test and measurement markets. Under the loan agreement, we provided Picometrix with $6.0 million of debt financing in exchange for (1) a nine-month option to purchase 100% of the equity of Picometrix for $6.0 million plus a two-year earn-out of up to $25.0 million and (2) the repayment of the $6.0 million of loan principal at maturity and interest at the greater of prime minus 0.5% or 3.0% payable monthly over its term. We originally recorded the purchase option at its fair value of $1.4 million and the note at its fair value of $4.6 million and were amortizing the discount to interest income over the estimated 18-month term of the note. The maturity date of the note varied depending on whether we exercised the option to acquire Picometrix. On November 22, 2002, we terminated our option to purchase Picometrix and recorded a $1.4 million charge to write-off the value assigned to the purchase option. The termination of our purchase option also resulted in the note becoming due in full on May 26, 2003. In the first quarter of fiscal 2003, we evaluated the collectibility of our note receivable from Picometrix, including their ability to make the required interest and principal payments and determined that the estimated net realizable value of the note at December 28, 2002 was $0.9 million. Accordingly, we recorded an impairment charge of $3.7 million during the first quarter of fiscal 2003. In September 2004, we sold our note receivable for $4.0 million resulting in a recovery of approximately $3.2 million of the previous impairment charge recognized.

Lease Termination Cost

In the fourth quarter of fiscal 2003, we were not in compliance with certain financial covenants associated with the operating lease arrangement for our Santa Clara, California facility. In October 2003, we entered into an irrevocable agreement to purchase the facility for $24.6 million and subsequently received a waiver for this violation from the lessor effective as of September 30, 2003. In September 2003, based on a third-party appraisal, we estimated the fair value of the facility to be $24.0 million, including leasehold improvements. As a result, we accrued the $1.7 million excess of our purchase price of $24.6 million plus the carrying value of leasehold improvements of $1.1 million over the fair value of the facility of $24.0 million as an early lease termination cost in the fourth quarter of fiscal 2003. During the first quarter of 2004, we purchased the facility for $24.6 million.

Accrued Restructuring Charges

At September 30, 2005 and 2004, we had $2.5 million and $4.0 million, respectively, accrued as a current liability on our consolidated balance sheet for restructuring charges. The following table sets forth an analysis of the components of the restructuring charges, payments made against the accrual and other provisions (reversals) through September 30, 2005 (in thousands):

		Facilities Related Charges
Balance, September 30, 2003	$	5,528
Provision		237
Reversals		(63)
Deductions		(1,750)
Balance, September 30, 2004	$	3,952
Provision		79
Reversals		
Deductions		(1,534)
Balance, September 30, 2005	$	2,497

The remaining restructuring accrual balance for facilities related charges (net of estimated sublease income) is expected to result in cash expenditures of approximately $1.6 million in fiscal 2006 and $0.9 in fiscal 2007.

Lambda Physik

In fiscal 2004, our Lambda Physik subsidiary initiated and completed plans to restructure its manufacturing sites in Göttingen, Germany. Accordingly, we recognized a charge of $1.1 million ($1.0 million net of minority interest), of which, $1.0 million ($0.9 million net of minority interest) was included in cost of sales and $0.1 million ($0.1 million net of minority interest) was included in operating expenses in fiscal 2004.

5. BUSINESS COMBINATIONS

TuiLaser AG

On June 13, 2005, we acquired privately held TuiLaser AG (Munich, Germany), a designer and manufacturer of excimer and advanced solid-state lasers, for approximately $26.0 million (net of cash acquired of $7.7 million). TuiLaser s advanced solid-state laser business is included in our Electro-Optics segment while its excimer laser business is included in our Lambda Physik segment. The operating results of TuiLaser have been included in our consolidated financial statements from the date of acquisition.

The aggregate purchase price has been allocated to the net assets acquired and in-process research and development (IPR&D) purchased as follows (in thousands):

Tangible assets	$	21,162
In-process research and development		1,577
Goodwill		11,295
Intangible assets:		
Existing technology		8,368
Backlog		2,062
Customer lists		1,819
Non-compete agreements		849
Trade name		364
Deferred tax liabilities		(5,865)
Liabilities assumed		(7,953)
Total	$	33,678

The goodwill recognized from this acquisition resulted primarily from anticipated increases in market share and synergies of combining this entity and was allocated $10.3 million to our Lambda Physik segment and $1.0 million to our Electro-Optics segment. None of the goodwill from this purchase is deductible for tax purposes. The identifiable intangible assets are being amortized over their respective estimated useful lives of one to nine years.

At the date of acquisition, we immediately charged $1.6 million to expense, representing purchased IPR&D related to three development projects that had not yet reached technological feasibility and had, in management s opinion, no alternative future use. The assigned value was determined by estimating the costs to develop the acquired in-process technologies into commercially viable products, estimating the net cash flows from such projects, and discounting the net cash flows back to their present value. Separate projected cash flows were prepared for both the existing as well as the in-process projects. The key assumptions used in the valuation include, among others, the expected completion date of the in-process projects identified as of the acquisition date, the estimated costs to complete the projects, revenue contributions and expense projections assuming the resulting products have entered the market, and the discount rate based on the risks associated with the development life cycle of the in-process technology acquired. The discount rate used in the present value calculations was obtained from a weighted-average cost of capital analysis, adjusted upward to account for the inherent uncertainties surrounding the successful development of the in-process research and development, the expected profitability levels of such technologies, and the uncertainty of technological advances that could potentially impact the estimates. Projected net cash flows for each project were based on estimates of revenues and operating profit (loss) related to such projects. These projects were expected to be commercially viable in fiscal 2006 with $0.1 million of estimated expenditures to complete.

Unaudited pro forma results of operations had the acquisition taken place at the beginning of fiscal 2005 would have resulted in net sales of $536.4 million, net income of $37.9 million, and net income per basic and diluted share of $1.23 and $1.21, respectively. Unaudited pro forma results of operations had the acquisition taken place at the beginning of fiscal 2004 would have resulted in net sales of $524.3 million, net income of $15.8 million, and net income per basic and diluted share of $0.52 and $0.52, respectively.

These unaudited pro forma results are not necessarily indicative of the results that actually would have been obtained had the acquisition been in effect for the periods described or that may be obtained in the future.

Lambda Physik

On June 3, 2003, we initiated a tender offer to purchase the 5,250,000 (39.62%) outstanding shares of our Lambda Physik subsidiary that were owned by other shareholders (the minority interest) for approximately $10.50 per share. During fiscal 2003, we purchased 4,489,823 outstanding shares of Lambda Physik for approximately $47.7 million, resulting in a total ownership percentage of 94.26% (inclusive of shares previously owned) at September 30, 2003. During fiscal 2004, we purchased an additional 98,677 of outstanding shares of Lambda Physik for approximately $1.3 million, resulting in a total ownership percentage of 95.01% (inclusive of shares previously owned) at September 30, 2004. During fiscal 2005, we acquired the remaining 661,500 outstanding shares for approximately $11.8 million, resulting in our full ownership of Lambda Physik. We have accounted for this transaction as a step acquisition using the purchase method.

The difference between the purchase price of the minority interest of $63.7 million (including acquisition costs of $3.0 million) and the carrying value of the minority interest of $56.3 million was recorded as an adjustment of the carrying value of the assets of Lambda Physik (the step acquisition adjustment). The step acquisition adjustment was recorded based on the proportion of the minority interest acquired and was accounted for as follows (in thousands):

	Year Ended September 30,		
	2005	2004	2003
Reduction in carrying value of minority interest acquired	$ 6,267	$ 1,077	$ 48,975
Tangible assets	133	90	1,869
In-process research and development			1,908
Adjustment to existing goodwill of Lambda Physik		(174)	(7,337)
Goodwill	4,970	691	
Deferred tax liabilities	(808)		
Intangible assets:			
Existing technology	1,085	122	2,275
Trade name	367	59	1,107
Backlog	161	14	585
Customer base		5	187
Patents		2	95
Other	13		
Total	$ 12,188	$ 1,886	$ 49,664

Unaudited pro forma results of operations had the minority acquisition taken place at the beginning of fiscal 2003 would have resulted in a net loss of $51.2 million and a net loss per basic and diluted share of $1.74 for fiscal 2003. Since we consolidated the results of Lambda Physik for all years presented, unaudited pro forma net sales does not differ from reported net sales.

At September 30, 2005, we had $1.2 million remaining in an escrow account that will be applied towards remaining close out costs for the acquisition and are included in non-current restricted cash, cash equivalents and short-term investments on our consolidated balance sheet. At September 30, 2004, we had $8.4 million restricted for the sole purpose of acquiring the remaining outstanding shares of Lambda Physik, which were also included in non-current restricted cash, cash equivalents and short-term investments on our consolidated balance sheet.

Picometrix

During the second quarter of fiscal 2004, we evaluated our loan agreement with Picometrix and determined that Picometrix was a variable interest entity as defined by FIN 46 (see Note 4). Furthermore, we concluded that we were the primary beneficiary as defined by FIN 46 and were required to consolidate Picometrix at April 3, 2004. The assets and liabilities of Picometrix were measured at their respective fair values as of April 3, 2004, resulting in the consolidation of $3.5 million of assets, $2.3 million of liabilities and $0.6 million of intangible assets (consisting of existing technology to be amortized over approximately 8 years), partially offset by minority interest of $1.1 million. We were also required to include the results of operations of Picometrix in our consolidated financial statements subsequent to April 3, 2004. As a result, we included net sales of approximately $3.9 million and income from continuing operations of $0.5 million in fiscal 2004. The $0.5 million of income from continuing operations was allocated to the minority interest and accordingly, the consolidation of Picometrix had no impact on our

net income in fiscal 2004. Upon the sale of our note receivable from Picometrix in September 2004,

we concluded that we were no longer considered the primary beneficiary. Accordingly, consolidation of the assets and liabilities of Picometrix was not required under FIN 46 at September 30, 2004.

Positive Light, Inc. (PLI)

On April 1, 2003, we acquired PLI of Los Gatos, California, for approximately $35.0 million in cash (net of cash acquired of $3.9 million). PLI designs and manufactures advanced solid-state lasers for the scientific and industrial markets. The acquisition was accounted for as a purchase and accordingly, the acquired assets and liabilities were recorded at their fair market values at the date of acquisition.

We immediately charged $4.4 million to expense, representing purchased IPR&D related to two development projects that had not yet reached technological feasibility and in management s opinion had no alternative future use. The value assigned to the purchased IPR&D was determined by identifying research projects in areas for which technological feasibility has not been established. The value was determined by estimating the costs to develop the acquired in-process technologies into commercially viable products, estimating the net cash flows from such projects and discounting the net cash flows back to their present value. Separate projected cash flows were prepared for both the existing as well as the in-process projects. The key assumptions used in the valuation included, among others, the expected completion date of the in-process projects identified as of the acquisition date, the estimated costs to complete the projects, revenue contributions and expense projections assuming the resulting products have entered the market, and the discount rate based on the risks associated with the development life cycle of the in-process technology acquired. The discount rate used in the present value calculations was obtained from a weighted-average cost of capital analysis, adjusted upward to account for the inherent uncertainties surrounding the successful development of the in-process research and development, the expected profitability levels of such technologies and the uncertainty of technological advances that could potentially impact the estimates. Projected net cash flows for each project were based on estimates of revenues and operating profit (loss) related to such projects.

The first project was for the development of the first all solid-state, single frequency, 193nm laser source for optical metrology of lithography stepper lenses and detector calibration and had an assigned IPR&D value of $3.0 million. At the date of acquisition, this project was expected to be commercially viable by September 30, 2003, with $0.1 million estimated expenditures to complete. The project was completed prior to September 30, 2003.

The second project was the development of a high repetition rate chirped pulse amplification laser system using a diode pumped ytterbium doped fiber gain media and had an assigned IPR&D value of $1.4 million. At the date of acquisition, this project was expected to be commercially viable by September 30, 2003, with $0.1 million estimated expenditures to complete. At September 30, 2005, the project remained uncompleted. We anticipate that this project will be completed in fiscal 2006, with estimated expenditures to complete of less than $50,000.

Molectron Detector, Inc. (Molectron)

On December 6, 2002, we acquired Molectron of Portland, Oregon for approximately $11.5 million in cash. Molectron designs and manufactures laser test and measurement equipment used across all photonics-based applications and markets. The acquisition was accounted for as a purchase and accordingly, the acquired assets and liabilities were recorded at their fair market values at the date of acquisition.

The aggregate purchase price of PLI and Molectron has been allocated to the net assets acquired and in-process research and development purchased as follows (in thousands):

	PLI	Molectron
Tangible assets	$ 14,329	$ 4,358
In-process research and development	4,430	
Goodwill	18,907	5,511
Intangible assets:		
Existing technology	9,200	5,680

Customer base	920	350
Trade name	180	80
Non-compete agreement	500	
Backlog	110	
Deferred tax liabilities	(3,225)	(2,288)
Liabilities assumed	(6,455)	(2,155)
Total	$ 38,896	$ 11,536

Goodwill recognized for the purchase of PLI and Molectron of $18.9 million and $5.5 million, respectively, was primarily related to anticipated increases in market share and synergies of combining these entities and were assigned to our Electro-Optics operating segment. None of the goodwill for either acquisition is expected to be deductible for tax purposes. The intangible assets including existing technology, customer base, trade name, non-compete agreement and backlog are amortized over their respective estimated useful lives of 1 to 10 years. Pro forma results of operations have not been presented for the acquisitions of PLI and Molectron because the effects of these acquisitions were not material on either an individual or on an aggregate basis.

6. SHORT-TERM INVESTMENTS

We consider all highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents. Marketable short-term investments in debt and equity securities are classified and accounted for as available-for-sale securities and are valued based on quoted market prices. Investments classified as available-for-sale are reported at fair value with unrealized gains and losses, net of related tax, recorded as a separate component of 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):

	September 30, 2005			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$ 114,194	$	$	$ 114,194
Less: restricted cash and cash equivalents				(16,687)
				$ 97,507
Short-term investments:				
Available-for-sale securities:				
Commercial paper	$ 992	$ 8	$	$ 1,000
Certificates of deposit	1,000	8		1,008
U.S. government and agency obligations	53,646	365	(236)	53,775
State and municipal obligations	30,981	370	(23)	31,328
Corporate notes and obligations	46,128	293	(125)	46,296
Total short-term investments	$ 132,747	$ 1,044	$ (384)	133,407
Less: restricted short term-investments				
				$ 133,407

	September 30, 2004			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$ 96,567	$	$	$ 96,567
Less: restricted cash and cash equivalents				(8,908)
				$ 87,659
Short-term investments:				
Available-for-sale securities:				
Commercial paper	$ 4,838	$	$ (1)	$ 4,837
Certificates of deposit	1,150	5	(1)	1,154

U.S. government and agency obligations		71,440		134		(5)	71,569
State and municipal obligations		22,742		153		(47)	22,848
Corporate notes and obligations		12,665		49		(32)	12,682
Total short-term investments	$	112,835	$	341	$	(86)	113,090
Less: restricted short term-investments							(30,015)
							$ 83,075

At September 30, 2005, $1.2 million of cash and cash equivalents were restricted for remaining close out costs associated with our purchase of the remaining outstanding shares of Lambda Physik (see Note 5), $15.2 million were restricted pursuant to our Star notes agreement (see Note 10) and $0.3 million were restricted for other purposes. At September 30, 2004, $8.4 million of cash and cash equivalents were restricted for the purchase of the remaining outstanding shares of Lambda Physik (see Note 5), $0.4 million were restricted pursuant to our Star notes agreement (see Note 10) and $0.1 million were restricted for other purposes. Additionally, $30.0 million of short-term investments were restricted pursuant to our Star notes agreement (see Note 10).

The amortized cost and estimated fair value of available-for-sale investments in debt securities at September 30, 2005 and September 30, 2004, classified as short-term investments (including restricted amounts) on our consolidated balance sheet were as follows (in thousands):

	September 30,			
	2005		2004	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in less than 1 year	**$ 90,865**	**$ 91,509**	$ 101,708	$ 101,979
Due in 1 to 5 years	**36,395**	**36,404**	10,282	10,265
Due in 5 to 10 years				
Due beyond 10 years	**5,487**	**5,494**	845	846
Total investments in available-for-sale debt securities	**$ 132,747**	**$ 133,407**	$ 112,835	$ 113,090

During fiscal 2005, we received proceeds totaling $16.7 million from the sale of available-for-sale securities and realized gross losses of $0.1 million. During fiscal 2004, we received proceeds totaling $35.5 million from the sale of available-for-sale securities and realized gross gains of $0.2 million and gross losses of $0.1 million.

7. GOODWILL AND INTANGIBLE ASSETS

The carrying amount of goodwill attributable to each operating segment is as follows (in thousands):

	September 30,	
	2005	2004
Electro-Optics	$ 36,195	$ 35,270
Lambda Physik	31,902	17,834
Total	$ 68,097	$ 53,104

In fiscal 2003, our Lambda Physik operating segment lowered its forecasted outlook in the lithography business and we determined the significant changes in the economic outlook for this business were an indicator that an impairment test was required under SFAS 142. As a result of our impairment test performed during fiscal 2003, we determined that the goodwill associated with this business was impaired and we recorded a charge of $2.4 million.

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

	September 30, 2005			September 30, 2004		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Existing technology	**$ 45,359**	**$ (14,018)**	**$ 31,341**	$ 36,746	$ (10,018)	$ 26,728
Patents	**8,669**	**(4,365)**	**4,304**	9,005	(3,699)	5,306
Licenses	**4,261**	**(4,261)**		4,261	(4,047)	214
Drawings	**1,181**	**(1,043)**	**138**	1,214	(850)	364
Order backlog	**4,133**	**(2,766)**	**1,367**	1,990	(1,990)	
Customer lists	**3,929**	**(1,309)**	**2,620**	2,106	(992)	1,114
Trade name	**1,958**	**(547)**	**1,411**	1,608	(417)	1,191
Non-compete agreement	**1,840**	**(835)**	**1,005**	911	(374)	537
Total	**$ 71,330**	**$ (29,144)**	**$ 42,186**	$ 57,841	$ (22,387)	$ 35,454

The weighted average remaining amortization period for existing technology, patents, trade name and customer lists are approximately 10 years, 9 years, 8 years and 7 years, respectively. The weighted average remaining amortization period for drawings, non-compete agreements and order backlog are approximately 5 years, 3 years and 1 year, respectively. Amortization expense for intangible assets during fiscal years 2005, 2004 and 2003 was $7.0 million, $6.7 million and $5.1 million, respectively. Estimated amortization expense for the next five fiscal years and all years thereafter are as follows (in thousands):

	Estimated Amortization Expense
2006	$ 8,316
2007	6,506
2008	6,251
2009	5,851
2010	4,845
Thereafter	10,417
Total	$ 42,186

8. BALANCE SHEET DETAILS

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

	September 30, 2005	2004
Prepaid and refundable income taxes	**$ 2,944**	$ 2,538
Prepaid expenses and other	**14,090**	16,812
Total prepaid expenses and other assets	**$ 17,034**	$ 19,350

Other assets consist of the following (in thousands):

	September 30, 2005	2004
Assets related to deferred compensation arrangements (see Note 13)	**$ 20,827**	$ 17,095
Deferred tax assets	**17,134**	6,644
Other assets	**1,789**	5,223
Total other assets	**$ 39,750**	$ 28,962

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

	September 30, 2005	2004
Accrued payroll and benefits	**$ 24,915**	$ 26,532
Accrued expenses and other	**17,939**	14,130
Reserve for warranty	**10,424**	10,638
Customer deposits	**3,043**	4,488

Accrued restructuring charges (Note 4)		**2,497**		3,952
Deferred income		**4,985**		3,838
Total other current liabilities	**$**	**63,803**	$	63,578

We provide warranties on certain of our product sales (generally one year) and allowances for estimated warranty costs are recorded at the time of sale. The determination of such allowances requires us to make estimates of product return rates and expected costs to repair or replace the products under warranty. We currently establish warranty reserves based on historical warranty costs for each product line. If actual return rates and/or repair and replacement costs differ significantly from our estimates, adjustments to recognize additional cost of sales may be required in future periods.

Components of the reserve for warranty costs during fiscal 2005, 2004 and 2003 were as follows (in thousands):

	September 30,		
	2005	**2004**	**2003**
Beginning balance	**$ 10,638**	$ 10,242	$ 8,495
Additions related to current period sales	**14,979**	20,298	12,537
Warranty costs incurred in the current period	**(16,412)**	(19,773)	(11,090)
Accruals resulting from acquisitions	**1,224**		253
Adjustments to accruals related to prior period sales	**(5)**	(129)	47
Ending balance	**$ 10,424**	$ 10,638	$ 10,242

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

	September 30,	
	2005	**2004**
Deferred compensation (see Note 13)	**$ 25,120**	$ 20,500
Deferred tax liabilities	**17,315**	21,223
Deferred income	**3,554**	2,930
Other long-term liabilities	**4,448**	4,475
Total other long-term liabilities	**$ 50,437**	$ 49,128

9. SHORT-TERM BORROWINGS

We maintain lines of credit with several banks worldwide. Our domestic lines of credit consist of a $1.0 million account with Dresdner Bank that has no expiration date and a $12.5 million unsecured revolving account from Union Bank of California, which expires January 31, 2007. Our Union Bank of California agreement is subject to covenants related to financial ratios and tangible net worth. At September 30, 2005, we were not in compliance with the tangible net worth covenant and the line of credit was not available to us. No amounts were outstanding on our Union Bank of California revolving account at September 30, 2005. In November 2005, we amended the agreement to, among other things, reduce the tangible net worth requirement. In addition, we have several foreign lines of credit that allow us to borrow in the applicable local currency. At September 30, 2005, these lines of credit totaled $31.7 million and there were no borrowings against these lines. Our foreign lines of credit are concentrated in Europe and Japan and are principally unsecured. All of our lines of credit generally provide borrowings at the bank reference rate or better, which varies depending on the country where the funds are borrowed.

10. LONG-TERM OBLIGATIONS

The components of long-term obligations are as follows (in thousands):

	September 30,	
	2005	**2004**
Notes payable	**$ 12,736**	$ 27,675
Capital leases		240
	12,736	27,915

Current portion	**(12,736)**	(13,700)
Long-term obligations	**$**	$ 14,215

Notes payable

At September 30, 2005, notes payable consists of $12.6 million ($5.9 million at 6.7% and $6.7 million at 6.9%) to finance our 1999 acquisition of Star Medical and other unsecured notes payable totaling $0.1 million at an interest rate of 1.5%.

The Star notes originally included financial covenants such as maintaining a minimum tangible net worth, minimum consolidated debt to capitalization ratio, fixed charge coverage ratio, as well as non-financial covenants such as providing quarterly statements to the note holders. In September 2003, we amended the agreement to relinquish all financial covenant requirements. In place of the covenants, the amendment required that we place cash and short-term investment balances in an amount equal to 120% of the principal balance in a restricted collateral account (see Note 6). At September 30, 2005, $15.2 million of current restricted cash, cash equivalents and short-term investments were related to the Star notes. At September 30, 2004, $15.2 million and $15.2 million, respectively, of current and non-current restricted cash, cash equivalents and short-term investments were related to the Star notes.

11. COMMITMENTS AND CONTINGENCIES

Commitments

We lease several of our facilities under operating leases. In addition, we lease the land for our Auburn, California manufacturing facilities under long-term fixed leases.

Future minimum payments under our non-cancelable leases and future minimum lease receivables under subleases at September 30, 2005 are as follows (in thousands):

Year Ending September 30,	Operating Leases	Lease Receivables
2006	$ 6,698	$ 1,267
2007	4,932	423
2008	3,541	
2009	2,343	
2010	1,605	
Thereafter	4,971	
Total	$ 24,090	$ 1,690

Rent expense, exclusive of sublease income, was $8.0 million, $8.3 million and $8.6 million in fiscal 2005, 2004 and 2003, respectively. Sublease income was $1.3 million, $1.3 million and $2.3 million for fiscal years 2005, 2004 and 2003, respectively.

In September 1988, we entered into several patent license agreements with Patlex Corporation (Patlex) for certain laser-related patents owned by Dr. Gordon Gould that had been assigned to Patlex. Under the terms of the agreements, we were required to pay royalties to Patlex ranging from 3.5% to 5.0% for specified categories of domestic sales and 2.0% of specified categories for foreign sales, subject to certain exceptions and limitations. Royalty expense under these agreements was $0.2 million, $1.1 million and $0.7 million in fiscal 2005, 2004 and 2003, respectively. The patents expired on various dates through May 2005.

As of September 30, 2005, we had total purchase commitments for inventory of approximately $10.3 million and purchase obligations for fixed assets and services of $5.4 million compared to $20.0 million of purchase commitments for inventory and $6.2 million of purchase obligations for fixed assets and services at September 30, 2004.

Contingencies

Certain claims and lawsuits have been filed or are pending against us. In the opinion of management, all such matters have been adequately provided for, are without merit, or are of such kind that if disposed of unfavorably, would not have a material adverse effect on our consolidated financial position or results of operations.

12. STOCKHOLDERS EQUITY

Each outstanding share of our common stock carries a stock purchase right (right) issued pursuant to a dividend distribution declared by our Board of Directors and distributed to stockholders of record on November 17, 1989. When exercisable, each right entitles the stockholder to buy one share of our common stock at an exercise price of $80. The rights will become exercisable following the tenth day after a person or group announces an acquisition of 20% or more of our common stock or announces commencement of a tender offer, the consummation of which would result in ownership by the person or group of 30% or more of the common stock. We will be entitled to redeem the rights at $.01 per right at any time on or before the 10th day following the acquisition by a person or group of 20% or more of our common stock.

If, prior to redemption of the rights, we are acquired in a merger or other business combination in which we are the surviving corporation, or a person or group acquires 20% or more of our common stock, each right owned by a holder of less than 20% of the common stock will entitle its owner to purchase, at the right s then current exercise price, a number of shares of common stock of Coherent having a fair market value equal to twice the right s exercise price. If we sell more than 50% of our assets or earning power or are acquired in a merger or other business combination in which we are not the surviving corporation, the acquiring person must assume the obligations under the rights and the rights will become exercisable to acquire common stock of the acquiring person at the discounted price.

In September 2005, our Board of Directors authorized a share repurchase program of up to 1.5 million shares of our common

stock. These purchases may be made from time to time in both open market and private transactions, as conditions warrant. The repurchase program is expected to remain in effect through September 30, 2007, unless earlier terminated or completed. During the year ended September 30, 2005, no purchases were made under this program.

13. EMPLOYEE STOCK OPTION AND BENEFIT PLANS

Deferred Compensation Plans

Under our deferred compensation plans (plans), qualified employees are permitted to make compensation deferrals up to established limits set under the plans. Asset investments in Company-owned life insurance contracts held under the plans are recorded at the cash surrender value of the insurance contracts. Asset investments in mutual funds and cash are recorded at their respective fair values. Life insurance premiums loads, policy fees and cost of insurance that are paid from the asset investments and gains and losses from the asset investments for these plans are recorded as components of other income or expenses. Increases in the obligation to plan participants are recorded as operating expenses. At September 30, 2005, the cash surrender value of Company-owned life insurance contracts was $14.6 million and the fair values of mutual funds and cash balances were $7.3 million and $0.1 million, respectively. At September 30, 2005, $20.8 million was recorded as non-current other assets (see Note 8) and $1.2 million was recorded as current assets. Liabilities associated participant balances under our deferred compensation plans are affected by individual contributions and distributions made, as well as gains and losses on the participant s investment allocation election. We do not contribute to participant balances.

Coherent Employee Retirement and Investment Plan

Under the Coherent Employee Retirement and Investment Plan, we match employee contributions to the plan up to a maximum of 6% of the employee s individual earnings. Employees become eligible for participation on their first day of employment and for Company matching contributions after completing one year of service. Our contributions (net of forfeitures) during fiscal 2005, 2004, and 2003 were $3.8 million, $3.7 million and $3.7 million, respectively.

Employee Stock Purchase Plan

We have an Employee Stock Purchase Plan whereby eligible employees may authorize payroll deductions of up to 10% of their regular base salary to purchase shares at the lower of 85% of the fair market value of the common stock on the date of commencement of the offering or on the last day of the six-month offering period. During fiscal 2005, 2004 and 2003, a total of 214,494, 200,282 and 272,868 shares, respectively, were purchased by and distributed to employees at an average price of $20.72, $19.63 and $15.07 per share, respectively.

At September 30, 2005, $2.4 million had been contributed by employees that will be used to purchase a maximum of 87,510 shares in the year ended September 30, 2006 at a price to be determined under the terms of the plan. At September 30, 2005, we had 499,780 shares of our common stock reserved for future issuance under the plan.

Stock Option Plans

We have two Stock Option Plans and two non-employee Directors Stock Option Plans. Under these plans, Coherent may grant options to purchase up to an aggregate of 11,800,000 and 975,000 shares of common stock, respectively. Employee options are generally exercisable between one to three years from the grant date at a price equal to the fair market value of the common stock on the date of the grant and generally vest 25% to 50% annually. Director options are automatically granted to our non-employee directors. Such directors initially receive a stock option for 30,000 shares exercisable over a three-year period. Additionally, the non-employee directors receive an annual grant of 12,000 shares exercisable three years from the date of grant. Grants under employee plans expire between four to six years from the original grant date and grants under director plans expire ten years from the original grant date.

Option activity for all plans is summarized as follows:

	Outstanding Options	
	Number of Shares	Weighted Average Exercise Price Per Share
Outstanding, October 1, 2002	**4,635,900**	**$ 32.09**
Options granted	1,212,900	19.95
Options exercised	(617,200)	14.66
Options canceled	(274,300)	33.36
Outstanding, September 30, 2003	**4,957,300**	**31.22**
Options granted	1,037,900	26.25
Options exercised	(253,100)	15.26
Options canceled	(533,100)	33.69
Outstanding, September 30, 2004	**5,209,000**	**30.75**
Options granted	641,500	32.87
Options exercised	(484,000)	22.40
Options canceled	(581,300)	32.66
Outstanding, September 30, 2005	**4,785,200**	**$ 31.63**

At September 30, 2005, 4,796,700 options were available for future grant under all plans. At September 30, 2005, all outstanding stock options have been issued under plans approved by our shareholders. The following table summarizes information about stock options outstanding at September 30, 2005:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number of Shares	Weighted Average Exercise Price
$18.25 - $19.77	869,500	$ 19.63	3.78	91,700	$ 19.05
$19.85 - $26.41	901,400	25.88	5.02	295,300	25.70
$26.50 - $30.92	987,200	30.31	3.07	806,500	30.57
$30.93 - $33.18	821,800	32.67	2.77	576,300	32.47
$33.24 - $49.88	1,081,700	42.45	2.43	759,400	46.15
$50.00 - $87.13	123,600	67.08	0.68	123,600	67.08
Total	4,785,200	$ 31.63	3.31	2,652,800	$ 36.21

There were 2,373,800 and 1,822,500 options exercisable as of September 30, 2004 and 2003 with weighted average exercise prices of $36.84 and $36.04, respectively. The weighted average estimated fair value of stock options granted in fiscal 2005, 2004 and 2003 was $10.50, $15.31 and $12.08, respectively.

Under one of our Stock Option Plans, certain employees were granted restricted stock awards. Restricted stock awards are independent of option grants and are subject to restrictions. All of the shares of restricted stock outstanding at September 30, 2005 are subject to forfeiture if employment terminates prior to the release of restrictions, generally three years from the date of grant. During that period, ownership of the shares cannot be transferred. Restricted stock has the same cash dividend and voting rights as other common stock and is considered to be currently issued and outstanding. The cost of the awards, determined to be the fair market value of the shares at the date of grant, is expensed ratably over the period the restrictions lapse. We had 96,150 shares of restricted stock outstanding at September 30, 2005. There were no shares of restricted stock outstanding at September 30, 2004 or September 30, 2003. Compensation expense recognized under incentive compensation plans was approximately $0.4 million in fiscal 2005.

Notes Receivable from Stock Sales

Notes receivable from stock sales result from the exercise of stock options for notes. The notes are full recourse promissory notes bearing interest at 4.8% per annum and are collateralized by the stock issued upon exercise of the stock options. Interest is payable annually and principal is due through 2007.

14. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Activity in accumulated other comprehensive income (loss) related to derivatives, net of tax, held by us are as follows (in thousands):

Balance, September 30, 2003	$	(128)
Changes in fair value of derivatives		
Net losses reclassified from OCI		6
Balance, September 30, 2004		(122)
Changes in fair value of derivatives		
Net losses reclassified from OCI		8