

NEWPORT CORP
Form 10-Q
May 14, 2009

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549**

FORM 10-Q

(Mark One)

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

For the quarterly period ended April 4, 2009

OR

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

For the transition period from _____ to _____

Commission File Number: 000-01649

NEWPORT CORPORATION

(Exact name of registrant as specified in its charter)

Nevada

*(State or other jurisdiction of
incorporation or organization)*

94-0849175

(IRS Employer Identification No.)

1791 Deere Avenue, Irvine, California 92606

(Address of principal executive offices) (Zip Code)

(949) 863-3144

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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As of May 1, 2009, 36,160,268 shares of the registrant's sole class of common stock were outstanding.

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FORM 10-Q
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NEWPORT CORPORATION
Consolidated Statements of Operations
(In thousands, except per share data)
(Unaudited)

| | Three Months Ended | |
|--|---------------------------|---------------------------|
| | April 4, 2009 | March 29, 2008 |
| Net sales | \$ 89,536 | \$ 115,243 |
| Cost of sales | 55,229 | 69,132 |
| Gross profit | 34,307 | 46,111 |
| Selling, general and administrative expenses | 27,487 | 29,791 |
| Research and development expense | 9,355 | 11,444 |
| Operating income (loss) | (2,535) | 4,876 |
| Interest and other expense, net | (2,119) | (1,719) |
| Income (loss) before income taxes | (4,654) | 3,157 |
| Income tax provision | 164 | 668 |
| Net income (loss) | \$ (4,818) | \$ 2,489 |
| Net income (loss) per share: | | |
| Basic | \$ (0.13) | \$ 0.07 |
| Diluted | \$ (0.13) | \$ 0.07 |
| Shares used in per share calculations: | | |
| Basic | 36,066 | 36,539 |
| Diluted | 36,066 | 36,594 |

See accompanying notes.

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NEWPORT CORPORATION
Consolidated Balance Sheets
(In thousands, except share and per share data)
(Unaudited)

| | April 4, 2009 | January 3, 2009 |
|--|--------------------------|----------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 75,932 | \$ 74,874 |
| Marketable securities | 65,809 | 73,546 |
| Accounts receivable, net of allowance for doubtful accounts of \$1,581 and \$1,642 as of April 4, 2009 and January 3, 2009, respectively | 64,441 | 75,258 |
| Notes receivable, net | 3,606 | 6,610 |
| Inventories, net | 102,591 | 98,833 |
| Deferred income taxes | 12,824 | 13,456 |
| Prepaid expenses and other current assets | 10,332 | 10,740 |
| Total current assets | 335,535 | 353,317 |
| Property and equipment, net | 58,036 | 60,245 |
| Goodwill | 68,540 | 68,540 |
| Deferred income taxes | 2,707 | 2,555 |
| Intangible assets, net | 26,029 | 26,696 |
| Investments and other assets | 13,007 | 13,550 |
| | \$ 503,854 | \$ 524,903 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Short-term obligations | \$ 9,591 | \$ 14,089 |
| Accounts payable | 22,905 | 24,636 |
| Accrued payroll and related expenses | 15,865 | 21,827 |
| Accrued expenses and other current liabilities | 25,915 | 29,258 |
| Total current liabilities | 74,276 | 89,810 |
| Long-term debt | 136,291 | 135,478 |
| Obligations under capital leases, less current portion | 1,150 | 1,220 |
| Accrued pension liabilities | 10,188 | 10,652 |
| Other liabilities | 22,558 | 22,546 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, par value \$0.1167 per share, 200,000,000 shares authorized; 36,160,268 and 36,048,634 shares issued and outstanding as of April 4, 2009 and January 3, 2009, respectively | 4,220 | 4,207 |

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| | | |
|--|------------|------------|
| Capital in excess of par value | 407,695 | 407,047 |
| Accumulated other comprehensive income | 4,642 | 6,291 |
| Accumulated deficit | (157,166) | (152,348) |
| Total stockholders' equity | 259,391 | 265,197 |
| | \$ 503,854 | \$ 524,903 |

See accompanying notes.

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NEWPORT CORPORATION
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

| | Three Months Ended | |
|--|---------------------------|---------------------------|
| | April 4, 2009 | March 29, 2008 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | \$ (4,818) | \$ 2,489 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 5,331 | 5,067 |
| Amortization of discount on convertible subordinated notes | 1,129 | 1,299 |
| Provision for losses on inventories | 1,833 | 1,557 |
| Stock-based compensation expense | 449 | 757 |
| Provision for doubtful accounts, net | 69 | 151 |
| Deferred income taxes, net | (568) | 65 |
| Increase (decrease) in cash due to changes in: | | |
| Accounts and notes receivable | 11,758 | (3,669) |
| Inventories | (7,462) | (4,133) |
| Prepaid expenses and other assets | 151 | (2,400) |
| Accounts payable | (1,062) | 449 |
| Accrued payroll and related expenses | (5,767) | (652) |
| Accrued expenses and other liabilities | (3,135) | 412 |
| Other long-term liabilities | 216 | (70) |
| Net cash (used in) provided by operating activities | (1,876) | 1,322 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (1,224) | (5,481) |
| Purchase of marketable securities | (5,082) | (14,232) |
| Proceeds from the sale of marketable securities | 12,826 | 8,369 |
| Net cash (used in) provided by investing activities | 6,520 | (11,344) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Repayment of long-term debt and obligations under capital leases | (30) | (15) |
| Short-term borrowings, net of repayments | (3,179) | 2,929 |
| Proceeds from the issuance of common stock under employee plans | 212 | 910 |
| Purchases of common stock and restricted stock units | | (11,450) |
| Net cash used in financing activities | (2,997) | (7,626) |
| Impact of foreign exchange rate changes on cash balances | (589) | 1,439 |
| Net increase (decrease) in cash and cash equivalents | 1,058 | (16,209) |
| Cash and cash equivalents at beginning of period | 74,874 | 88,737 |
| Cash and cash equivalents at end of period | \$ 75,932 | \$ 72,528 |

Supplemental disclosures of cash flow information:

Cash paid during the period for:

| | | |
|-------------------|----------|----------|
| Interest | \$ 1,937 | \$ 2,321 |
| Income taxes, net | \$ 1,056 | \$ 264 |

See accompanying notes.

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NEWPORT CORPORATION
Notes to Consolidated Financial Statements
April 4, 2009

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements include the accounts of Newport Corporation and its wholly owned subsidiaries (collectively referred to as the Company) and have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions of Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal and recurring accruals) considered necessary for a fair presentation have been included. All intercompany transactions and balances have been eliminated in consolidation.

The accompanying consolidated financial statements do not include certain footnotes and financial presentations normally required under generally accepted accounting principles (GAAP) and, therefore, should be read in conjunction with the consolidated financial statements and related notes contained in the Company's Annual Report on Form 10-K for the year ended January 3, 2009. The results for the interim periods are not necessarily indicative of the results the Company will have for the full year ending January 2, 2010. The January 3, 2009 balances reported herein are derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended January 3, 2009.

Certain prior period amounts have been reclassified to reflect the Company's retrospective implementation of Financial Accounting Standards Board (FASB) Staff Position (FSP) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. See Note 8 for additional detail.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

In April 2009, the FASB issued a series of Staff Positions related to the application of fair value measurements, disclosing fair value measurements and recognizing other than temporary impairments. FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides guidance for estimating the fair value of an asset or liability when the volume or level of trading activity has significantly decreased. In addition, FSP FAS 157-4 requires companies to disclose inputs and valuation techniques used in interim and annual periods and any changes in valuation techniques and related inputs. FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, requires public companies to include the disclosures required by Statement of Financial Accounting Standards (SFAS) No. 107, *Disclosures about Fair Value of Financial Instruments*, in interim filings. FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, amends the guidance for recognizing an other-than-temporary impairment on debt securities. If a company intends to sell a debt security or if it is more likely than not that a company will be required to sell a debt security prior to its anticipated recovery, an other-than-temporary impairment is considered to have occurred. If a company determines it does not intend to sell a debt security and it is not more likely than not that the company will be required to sell the debt security before its anticipated recovery, then only credit losses, if any, would be recorded as an other-than-temporary impairment through earnings and all other impairments would be recorded through other comprehensive income. Companies are also required to disclose the methodology and significant inputs used to calculate credit losses and provide a rollforward of credit losses. In addition, FSP FAS 115-2 and FAS 124-2 requires the disclosures required by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, be made on a quarterly basis. All of the FSPs issued in April 2009 must be applied prospectively and will be effective for interim and annual periods ending after June 15, 2009, and early adoption for periods ending after March 15, 2009 is permitted if all three FSPs are adopted early. The Company will adopt these FSPs in its second fiscal quarter of 2009, and the Company does not expect that such adoption will have a material impact on its financial position or results of operations.

In April 2009, the Securities and Exchange Commission (SEC) issued SEC Staff Accounting Bulletin (SAB) 111. SAB 111 amends and replaces SAB Topic 5M, *Miscellaneous Accounting - Other Than Temporary Impairment of Certain Investments in Equity Securities*, to reflect the changes set forth in FSP FAS 115-2 and FAS 124-2, as

described above. SAB 111 is effective upon the adoption of FSP FAS 115-2 and FAS 124-2. The adoption of SAB 111 is not expected to have a material impact on the Company's financial position or results of operations.

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In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. FSP FAS 141(R)-1 amends the guidance in SFAS No. 141 (Revised 2007), *Business Combinations*, to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated. If fair value of such an asset or liability cannot be reasonably estimated, the asset or liability would generally be recognized in accordance with SFAS No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, and the requirement to disclose an estimate of the range of outcomes of recognized contingencies at the acquisition date would not be required. For unrecognized contingencies, entities would only be required to include the disclosures required by SFAS No. 5. Further, FSP FAS 141(R)-1 provides that contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination should be treated as contingent consideration of the acquirer and should be initially and subsequently measured at fair value in accordance with Statement No. 141R. This FSP is effective for annual reporting periods beginning on or after December 15, 2008. The adoption of this FSP will not have an impact on the Company's financial position or results of operations other than in accounting for any contingencies arising from a business combination that may occur after the effective date.

NOTE 3 MARKETABLE SECURITIES AND FAIR VALUE MEASUREMENTS

All marketable securities were classified as available for sale and were recorded at market value using the specific identification method, and unrealized gains and losses are reflected in *accumulated other comprehensive income* in the accompanying consolidated balance sheets. The aggregate fair value of available for sale securities and aggregate amount of unrealized gains and losses for available for sale securities at April 4, 2009 were as follows:

| (In thousands) | Aggregate Fair Value | Aggregate Amount of Unrealized | |
|--|-------------------------|--------------------------------------|----------|
| | | Gains | Losses |
| U.S. government and agency debt securities | \$ 19,328 | 430 | (4) |
| Corporate debt securities | 22,867 | 85 | (334) |
| Equity securities | 15,235 | 161 | |
| Asset-backed securities | 8,379 | 70 | (564) |
| | \$ 65,809 | \$ 746 | \$ (902) |

The aggregate fair value of available for sale securities and aggregate amount of unrealized gains and losses for available for sale securities at January 3, 2009 were as follows:

| (In thousands) | Aggregate Fair Value | Aggregate Amount of Unrealized | |
|--|-------------------------|--------------------------------------|--------|
| | | Gains | Losses |
| U.S. government and agency debt securities | \$ 21,516 | \$ 419 | \$ (4) |
| Corporate debt securities | 18,819 | 26 | (588) |
| Equity securities | 22,054 | 154 | |
| Asset-backed securities | 10,504 | | (938) |
| Certificates of deposit | 653 | 1 | |

\$ 73,546 \$ 600 \$ (1,530)

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NEWPORT CORPORATION
Notes to Consolidated Financial Statements
April 4, 2009

The contractual maturities of available for sale securities were as follows:

| (In thousands) | April 4, 2009 |
|-----------------------|--------------------------|
| 0 1 Year | \$ 37,937 |
| 1 2 Years | 12,609 |
| 2 3 Years | 2,271 |
| 3 5 Years | 5,561 |
| 5 10 Years | 1,522 |
| More than 10 years | 5,909 |
| | \$ 65,809 |

The Company recognized \$2,000 and \$10,000 in gross realized gains on sales of available for sale securities for the three months ended April 4, 2009 and March 29, 2008, respectively.

SFAS No. 157 requires that for any assets and liabilities stated at fair value on a recurring basis in the Company's financial statements, the fair value of such assets and liabilities be measured based on the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company's assets measured at fair value on a recurring basis are categorized in the table below based upon their level within the fair value hierarchy.

| (In thousands) | Fair Value Measurements at Reporting Date Using | | | |
|----------------------------------|--|--|---------------------------------------|-----------|
| | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs | |
| Description | April 4, 2009 | (Level 1) | (Level 2) | (Level 3) |
| Assets: | | | | |
| Marketable securities | \$ 65,809 | \$ 65,809 | \$ | \$ |
| Pension assets not owned by plan | 8,469 | 8,469 | | |
| | \$ 74,278 | \$ 74,278 | \$ | \$ |

NOTE 4 SUPPLEMENTAL BALANCE SHEET INFORMATION*Inventories*

Inventories were as follows:

| (In thousands) | April 4, 2009 | January 3, 2009 |
|-----------------------------------|--------------------------|----------------------------|
| Raw materials and purchased parts | \$ 88,466 | \$ 84,472 |
| Work in process | 8,198 | 7,624 |

| | | |
|---|------------|-----------|
| Finished goods | 33,212 | 33,422 |
| | 129,876 | 125,518 |
| Allowance for excess and obsolete inventory | (27,285) | (26,685) |
| | \$ 102,591 | \$ 98,833 |

Accrued Warranty Obligations

Unless otherwise stated in the Company's product literature or in its agreements with customers, products sold by the Company's Photonics and Precision Technologies (PPT) Division generally carry a one-year warranty from the original invoice date on all product materials and workmanship, other than filters, gratings and crystals products, which generally carry a 90 day warranty. Products of this division sold to original equipment manufacturer (OEM)

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NEWPORT CORPORATION
Notes to Consolidated Financial Statements
April 4, 2009

customers generally carry longer warranties, typically 15 to 19 months. Products sold by the Company's Lasers Division carry warranties that vary by product and product component, but that generally range from 90 days to two years. In certain cases, such warranties for Lasers Division products are limited by either a set calendar period or a maximum amount of usage of the product, whichever occurs first. Defective products will be either repaired or replaced, generally at the Company's option, upon meeting certain criteria. The Company accrues a provision for the estimated costs that may be incurred for warranties relating to a product (based on historical experience) as a component of cost of sales at the time revenue for that product is recognized. Accrued warranty obligations are included in *accrued expenses and other current liabilities* in the accompanying consolidated balance sheets. The activity in accrued warranty obligations was as follows:

| (In thousands) | Three Months Ended | |
|------------------------------------|---------------------------|------------------|
| | April | March 29, |
| | 4, | 2008 |
| | 2009 | 2008 |
| Balance at beginning of year | \$ 5,978 | \$ 5,847 |
| Additions charged to cost of sales | 1,411 | 1,926 |
| Warranty claims | (1,951) | (1,265) |
| Balance at end of period | \$ 5,438 | \$ 6,508 |

Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities were as follows:

| (In thousands) | April 4, | January 3, |
|------------------------------|-----------------|-------------------|
| | 2009 | 2009 |
| Deferred revenue | \$ 11,443 | \$ 11,813 |
| Accrued warranty obligations | 5,438 | 5,978 |
| Other | 9,034 | 11,467 |
| | \$ 25,915 | \$ 29,258 |

Accumulated Other Comprehensive Income

Accumulated other comprehensive income consisted of the following:

| (In thousands) | April 4, | January 3, |
|--|-----------------|-------------------|
| | 2009 | 2009 |
| Cumulative foreign currency translation gains | \$ 4,536 | \$ 6,884 |
| Unrecognized net pension gains | 50 | 58 |
| Unrealized gains (losses) on marketable securities | 56 | (651) |
| | \$ 4,642 | \$ 6,291 |

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NEWPORT CORPORATION
Notes to Consolidated Financial Statements
April 4, 2009

NOTE 5 INTANGIBLE ASSETS

Intangible assets were as follows:

| (In thousands) | April 4, 2009 | January 3, 2009 |
|--|--------------------------|----------------------------|
| Intangible assets subject to amortization: | | |
| Developed technology, net of accumulated amortization of \$3,390 and \$3,210 as of April 4, 2009 and January 3, 2009, respectively | \$ 3,810 | \$ 3,990 |
| Customer relationships, net of accumulated amortization of \$9,181 and \$8,694 as of April 4, 2009 and January 3, 2009, respectively | 10,319 | 10,806 |
| | 14,129 | 14,796 |
| Intangible assets not subject to amortization: | | |
| Trademarks and trade names | 11,900 | 11,900 |
| Intangible assets, net | \$ 26,029 | \$ 26,696 |

Amortization expense related to intangible assets totaled \$0.7 million and \$1.0 million for the three months ended April 4, 2009 and March 29, 2008, respectively.

Estimated aggregate amortization expense for future fiscal years for both developed technology and customer relationships is as follows:

| (In thousands) | Estimated Aggregate Amortization Expense |
|-----------------------|---|
| 2009 (remaining) | \$ 2,003 |
| 2010 | 2,670 |
| 2011 | 2,670 |
| 2012 | 2,670 |
| 2013 | 2,670 |
| Thereafter | 1,446 |
| | \$ 14,129 |

NOTE 6 INTEREST AND OTHER EXPENSE, NET

Interest and other expense, net, was as follows:

| (In thousands) | Three Months Ended | |
|--|------------------------------|---------------------------|
| | April 4, 2009 | March 29, 2008 |
| Interest and dividend income | \$ 615 | \$ 1,081 |
| Interest expense | (2,356) | (2,723) |
| Bank and portfolio asset management fees | (147) | (141) |

| | | |
|-----------------------------|------------|------------|
| Other income (expense), net | (231) | 64 |
| | \$ (2,119) | \$ (1,719) |

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NEWPORT CORPORATION
Notes to Consolidated Financial Statements
April 4, 2009

NOTE 7 STOCK-BASED COMPENSATION

During the three months ended April 4, 2009, the Company granted 1.2 million restricted stock units and 1.0 million stock appreciation rights with a weighted average grant date fair value of \$4.18 and \$1.64, respectively.

The total stock-based compensation expense included in the Company's consolidated statements of operations was as follows:

| (In thousands) | Three Months Ended | |
|--|------------------------------|---------------------------|
| | April 4, 2009 | March 29, 2008 |
| Cost of sales | \$ 26 | \$ 45 |
| Selling, general and administrative expenses | 378 | 650 |
| Research and development expense | 45 | 62 |
| | \$ 449 | \$ 757 |

At April 4, 2009, the total compensation cost related to unvested stock-based awards granted to employees, officers and directors under the Company's stock-based benefit plans that had not yet been recognized was \$5.2 million (net of estimated forfeitures of \$1.5 million). Such amount excludes compensation expense associated with awards that are subject to performance conditions that the Company does not expect will vest. This future compensation expense will be amortized, using the straight-line method for time-based awards and the graded vesting method for performance-based awards, over a weighted-average period of 1.8 years. The actual compensation expense that the Company will recognize in the future related to stock-based awards will be adjusted for subsequent forfeitures and will be adjusted based on the Company's determination as to the extent to which performance conditions applicable to any stock-based awards will be achieved. At April 4, 2009, there were 1.4 million performance-based restricted stock units outstanding with a weighted-average grant date fair value of \$11.20 per share that were not expected to vest. At April 4, 2009, 2,664,430 stock options with a weighted average exercise price of \$20.45 per share, intrinsic value of \$0.2 million and remaining contractual term of 3.5 years were vested or expected to vest, and 2,661,786 stock options with a weighted average exercise price of \$20.45 per share, intrinsic value of \$0.2 million and remaining contractual term of 3.5 years were exercisable.

NOTE 8 DEBT AND LINES OF CREDIT

During February 2007, the Company issued \$175 million in convertible subordinated notes. The notes are subordinated to all of the Company's existing and future senior indebtedness, mature on February 15, 2012 and bear interest at a rate of 2.5% per year, payable in cash semiannually in arrears on February 15 and August 15 of each year. During the fourth quarter of 2008, the Company extinguished \$28 million of these notes.

Holder may convert their notes based on a conversion rate of 41.5861 shares of the Company's common stock per \$1,000 principal amount of notes (equal to an initial conversion price of approximately \$24.05 per share) under certain circumstances. Upon conversion, in lieu of shares of the common stock, for each \$1,000 principal amount of notes, a holder will receive an amount in cash equal to the lesser of (i) \$1,000 or (ii) the conversion value, determined in the manner set forth in the indenture. If the conversion value exceeds \$1,000, the Company will also deliver, at its election, cash or common stock or a combination of cash and common stock with respect to the remaining common stock deliverable upon conversion. As of April 4, 2009, the conversion value was less than the principal amount of the notes.

During the first quarter of 2009, the Company adopted FSP APB 14-1, which requires the liability and equity components of convertible debt instruments to be separately accounted for in a manner that reflects the non-convertible debt borrowing rate for interest expense recognition. In addition, direct issuance costs associated with

the convertible debt instruments are required to be allocated to the liability and equity components in proportion to the allocation of proceeds and accounted for as debt issuance costs and equity issuance costs, respectively. These

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Notes to Consolidated Financial Statements
April 4, 2009

provisions have been applied retrospectively upon adoption. In accordance with FSP APB 14-1, the Company has recorded a debt discount of \$27.5 million and a deferred tax liability of \$10.6 million and has allocated \$0.9 million of issuance costs to the equity component. Such amounts were calculated using an income approach and assumed a non-convertible debt borrowing rate of 6.25%, which is also the effective interest rate used to calculate interest expense. Due to the valuation allowance maintained by the Company against its deferred tax assets, the recording of the deferred tax liability resulted in a reduction to this valuation allowance rather than in a reduction in capital in excess of par value. Upon the adoption of FSP APB 14-1, the amortization of the debt discount resulted in an increase in non-cash interest expense of \$4.2 million and \$4.9 million for the Company's fiscal years 2008 and 2007, respectively. The cumulative effect of adopting FSP APB 14-1 was an increase in stockholders' equity of \$14.6 million as of January 3, 2009. The Company's consolidated statement of operations for the three months ended March 29, 2008 has been retrospectively adjusted compared with previously reported amounts as follows:

| (In thousands) | Three Months Ended March 29, 2008 | |
|--|--|--------|
| Additional non-cash interest expense | \$ | 1,299 |
| Reduction in amortization of debt issuance costs | | (63) |
| Retrospective change in net income | \$ | 1,236 |
| Change to basic earnings per share | \$ | (0.03) |
| Change to diluted earnings per share | \$ | (0.03) |

At April 4, 2009, the Company had \$147.0 million in convertible subordinated notes outstanding with a carrying value of \$133.3 million, net of \$13.7 million in unamortized debt discount, which is included in *long-term debt* in the accompanying consolidated balance sheets. At January 3, 2009, the Company had \$147.0 million in convertible subordinated notes outstanding with a carrying value of \$132.2 million, net of \$14.8 million in unamortized debt discount. At April 4, 2009 and January 3, 2009, the carrying value of the equity component was \$26.6 million, net of \$0.9 million of equity issuance costs. At April 4, 2009 and January 3, 2009, debt issuance costs of \$2.4 million and \$2.6 million, respectively, net of accumulated amortization, were included in other long-term assets in *investments and other assets*. The remaining debt issuance costs and unamortized debt discount are being amortized through February 15, 2012 using the effective interest method.

Interest costs on the convertible subordinated notes consisted of the following components:

| (In thousands) | Three Months Ended April 4, 2009 | | March 29, 2008 |
|---|---|-------|-----------------------|
| Contractual interest | \$ | 919 | \$ 1,094 |
| Amortization of debt discount | | 1,129 | 1,299 |
| Interest cost on convertible subordinated notes | \$ | 2,048 | \$ 2,393 |

During June 2008, the Company issued 300 million yen (\$3.0 million at April 4, 2009) in private placement bonds through a Japanese bank. These bonds bear interest at a rate of 1.55% per year, payable in cash semiannually in arrears on June 30 and December 31 of each year. The bonds mature on June 30, 2011. The bonds are included in *long-term debt* in the accompanying consolidated balance sheets.

At April 4, 2009, the Company had a total of three lines of credit, including one domestic revolving line of credit and two revolving lines of credit with Japanese banks. Additionally, the Company has agreements with two Japanese banks under which it sells trade notes receivable with recourse.

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The Company's domestic revolving line of credit has a total credit limit of \$5.0 million and expires December 1, 2009. Certain cash equivalents held at this lending institution collateralize this line of credit, which bears interest at either the prevailing London Interbank Offered Rate (LIBOR) (0.48% at April 4, 2009) plus 1.00% or the British Bankers Association LIBOR Daily Floating Rate (0.27% at April 4, 2009) plus 1.00%, at the Company's option, and carries an unused line fee of 0.25% per year. At April 4, 2009, there were no balances outstanding under this line of credit, with \$4.0 million available, after considering outstanding letters of credit totaling \$1.0 million.

The two revolving lines of credit with Japanese banks totaled 1.4 billion yen (\$14.0 million at April 4, 2009) and expire as follows: \$6.0 million on May 29, 2009 and \$8.0 million on May 31, 2009. These lines are not secured and bear interest at the prevailing bank rate. At April 4, 2009, the Company had \$6.9 million outstanding and \$7.1 million available for borrowing under these lines of credit. Amounts outstanding are included in *short-term obligations* in the accompanying consolidated balance sheets. The Company has agreements with two Japanese banks under which it sells trade notes receivable with recourse. These agreements allow the Company to sell receivables totaling up to 550 million yen (\$5.5 million at April 4, 2009), have no expiration dates and bear interest at the prevailing bank rate. At April 4, 2009, the Company had \$2.7 million outstanding and \$2.8 million available for the sale of notes receivable under these agreements. Amounts outstanding under these agreements are included in *short-term obligations* in the accompanying consolidated balance sheets, as the sale of these receivables has not met the criteria for sale treatment in accordance with SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a replacement of FASB Statement No. 125*. As of April 4, 2009, the weighted average effective interest rate on all of the Company's Japanese borrowings, including the private placement bonds, was 1.8%.

Total long-term debt was as follows:

| (In thousands) | April 4, 2009 | January 3, 2009 |
|---|--------------------------|----------------------------|
| Japanese private placement bonds due June 2011, interest at 1.55% semi-annually | \$ 2,990 | \$ 3,307 |
| Convertible notes due February 2012, interest at 2.5% semi-annually | 133,301 | 132,171 |
| Total long-term debt | \$ 136,291 | \$ 135,478 |

NOTE 9 NET INCOME (LOSS) PER SHARE

The following table sets forth the computation of basic and diluted net income (loss) per share:

| (In thousands) | Three Months Ended | |
|---|---------------------------|---------------------------|
| | April 4, 2009 | March 29, 2008 |
| Net income (loss) | \$ (4,818) | \$ 2,489 |
| Shares: | | |
| Weighted average shares outstanding - basic | 36,066 | 36,539 |
| Dilutive potential common shares, using treasury stock method | | 55 |
| Weighted average shares outstanding - diluted | 36,066 | 36,594 |

Net income (loss) per share:

| | | |
|---------|-----------|---------|
| Basic | \$ (0.13) | \$ 0.07 |
| Diluted | \$ (0.13) | \$ 0.07 |

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For the three months ended April 4, 2009, 36,066,000 shares have been used as the denominator for computing both basic and diluted net loss per share, as including dilutive potential common shares in the calculation of diluted net loss per share would have had an antidilutive effect due to the Company incurring a loss. For the three months ended March 29, 2008, 2.7 million stock options with a weighted average exercise price of \$21.03 were excluded from the computations of diluted net income per share, as their inclusion would be antidilutive. In addition, for the three months ended March 29, 2008, 2.2 million performance-based restricted stock units were excluded from the computation of diluted net income per share, as the performance criteria for their vesting had not been met.

For the three months ended April 4, 2009 and March 29, 2008, the Company's convertible subordinated notes had no impact on diluted net income (loss) per share as the average price of the Company's common stock during those periods was below \$24.05, and the convertible subordinated notes, if converted, would require only cash settlement.

NOTE 10 INCOME TAXES

The Company has maintained a valuation allowance against substantially all of its gross deferred tax assets pursuant to SFAS No. 109, *Accounting for Income Taxes*, due to the uncertainty as to the timing and ultimate realization of those assets. As a result, until such valuation allowance is reversed, the U.S. tax provision relating to future earnings will be offset substantially by a reduction in the valuation allowance. Accordingly, current and future tax expense will consist of taxes in certain foreign jurisdictions, required state income taxes, the federal alternative minimum tax and the impact of discrete items.

The Company will continue to monitor actual results, refine forecasted data and assess the need for retaining a valuation allowance against the gross deferred tax assets. In the event it is determined that a valuation allowance is no longer required, substantially all of the reversal will be recorded as a discrete item in the appropriate period. As of April 4, 2009, the Company's valuation allowance was \$52.6 million.

NOTE 11 COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss), net of related tax, were as follows:

| (In thousands) | Three Months Ended | |
|--|---------------------------|---------------------------|
| | April 4, 2009 | March 29, 2008 |
| Net income (loss) | \$ (4,818) | \$ 2,489 |
| Foreign currency translation gains (losses) | (2,348) | 6,816 |
| Unrecognized net pension gains (losses) | (8) | 27 |
| Unrealized gains (losses) on marketable securities | 707 | (501) |
| | \$ (6,467) | \$ 8,831 |

NOTE 12 STOCKHOLDERS' EQUITY TRANSACTIONS

In May 2008, the Board of Directors of the Company approved a share repurchase program, authorizing the purchase of up to 4.0 million shares of the Company's common stock. Purchases may be made under this program from time to time in the open market or in privately negotiated transactions, and the timing and amount of the purchases will be based on factors including the Company's share price, cash balances, expected cash requirements and general business and market conditions. No purchases were made under this program during the first quarter of 2009. As of April 4, 2009, 3.9 million shares remained available for purchase under the program.

NOTE 13 DEFINED BENEFIT PENSION PLANS

Several of the Company's non-U.S. subsidiaries have defined benefit pension plans covering substantially all full-time employees at those subsidiaries. Some of the plans are unfunded, as permitted under the plans and applicable laws. For financial reporting purposes, the calculation of net periodic pension costs is based upon a number of actuarial assumptions, including a discount rate for plan obligations, an assumed rate of return on pension plan

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assets and an assumed rate of compensation increase for employees covered by the plan. All of these assumptions are based upon management's judgment, considering all known trends and uncertainties. Actual results that differ from these assumptions would impact future expense recognition and the cash funding requirements of the Company's pension plans.

Net periodic benefit costs for the plans in aggregate included the following components:

| (In thousands) | Three Months Ended | |
|--------------------------------------|---------------------------|------------------|
| | April | March 29, |
| | 4, | 2008 |
| | 2009 | 2008 |
| Service cost | \$ 145 | \$ 146 |
| Interest cost on benefit obligations | 149 | 173 |
| Expected return on plan assets | (29) | (42) |
| Amortization of actuarial net loss | (7) | |
| | \$ 258 | \$ 277 |

NOTE 14 BUSINESS SEGMENT INFORMATION

The operating segments reported below are the segments of the Company for which separate financial information is available and for which operating results are evaluated regularly by the Chief Executive Officer, which is the chief operating decision maker, in deciding how to allocate resources and in assessing performance. The Company develops, manufactures and markets its products within two distinct business segments, its Lasers Division and its PPT Division.

The Company measured operating income (loss) reported for each business segment, which included only those costs that were directly attributable to the operations of that segment, and excluded certain corporate expenses, interest and other expense, net, and income taxes.

| (In thousands) | Lasers | Photonics and Precision Technologies | Total |
|------------------------------------|---------------|---|--------------|
| Three months ended April 4, 2009: | | | |
| Sales to external customers | \$37,225 | \$ 52,311 | \$ 89,536 |
| Segment income (loss) | \$ (1,462) | \$ 6,977 | \$ 5,515 |
| Three months ended March 29, 2008: | | | |
| Sales to external customers | \$47,783 | \$ 67,460 | \$115,243 |
| Segment income (loss) | \$ (1,267) | \$ 12,375 | \$ 11,108 |

The following reconciles segment income to consolidated income (loss) before income taxes:

| (In thousands) | Three Months Ended | |
|-----------------------|---------------------------|------------------|
| | April | March 29, |
| | 4, | 2008 |
| | 2009 | 2008 |
| Segment income | \$ 5,515 | \$ 11,108 |

| | | |
|---------------------------------|------------|----------|
| Unallocated operating expenses | (8,050) | (6,232) |
| Interest and other expense, net | (2,119) | (1,719) |
| | \$ (4,654) | \$ 3,157 |

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our unaudited consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and in conjunction with our Annual Report on Form 10-K for the year ended January 3, 2009. This discussion contains descriptions of our expectations regarding future trends affecting our business. These forward-looking statements and other forward-looking statements made elsewhere in this report are made in reliance upon safe harbor provisions in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Words such as may, will, expect, believe, anticipate, intend, could, continue or the negative or other variations thereof or comparable terminology are intended to identify forward-looking statements. In addition, any statements that refer to projections of our future financial performance or condition, trends in our business, or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of several factors, including, but not limited to those factors set forth and discussed elsewhere in this Quarterly Report on Form 10-Q and in Item 1 (Business) and Item 1A (Risk Factors) of Part I, and Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations) of Part II, of our Annual Report on Form 10-K for the year ended January 3, 2009. In light of the significant uncertainties inherent in the forward-looking information included in this report, the inclusion of this information should not be regarded as a representation by us or any other person that our objectives or plans will be achieved and readers are cautioned not to place undue reliance on such forward-looking information. We undertake no obligation to update or revise these forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

We are a global supplier of advanced technology lasers, components, instruments, subsystems and systems to markets where high-precision, efficient manufacturing, test, measurement and assembly are critical. Our products are used worldwide in industries including scientific research, microelectronics, aerospace and defense/security, life and health sciences and industrial manufacturing. We operate within two distinct business segments, our Lasers Division and our Photonics and Precision Technologies (PPT) Division. Both of our divisions offer a broad array of advanced technology products and services to original equipment manufacturer and end-user customers across a wide range of applications and markets.

The following is a discussion and analysis of certain factors that have affected our results of operations and financial condition during the periods included in the accompanying consolidated financial statements.

Critical Accounting Policies and Estimates

The preparation of these financial statements requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and related disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We evaluate these estimates and assumptions on an ongoing basis. We base our estimates on our historical experience and on various other factors which we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the amounts of certain expenses that are not readily apparent from other sources. The accounting policies that involve the most significant judgments, assumptions and estimates used in the preparation of our financial statements are those related to revenue recognition, allowances for doubtful accounts, pension liabilities, inventory reserves, warranty obligations, asset impairment, income taxes and stock-based compensation expense. The judgments, assumptions and estimates used in these areas by their nature involve risks and uncertainties, and in the event that any of them prove to be inaccurate in any material respect, it could have a material adverse effect on our reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. A summary of these critical accounting policies is included in Item 7 (Management's Discussion and Analysis of Financial Condition and Results of Operations) of Part II, of our Annual Report on Form 10-K for the fiscal year ended January 3, 2009. There have been no material changes to the critical accounting policies disclosed in our Annual Report on Form 10-K.

Table of Contents**Adoption of Financial Accounting Standards Board (FASB) Staff Position (FSP) APB 14-1**

During the first quarter of 2009, we adopted FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*, which requires the liability and equity components of convertible debt instruments to be separately accounted for in a manner that reflects the non-convertible debt borrowing rate for interest expense recognition. In addition, direct issuance costs associated with the convertible debt instruments are required to be allocated to the liability and equity components in proportion to the allocation of proceeds and accounted for as debt issuance costs and equity issuance costs, respectively. These provisions have been applied retrospectively upon adoption. In accordance with FSP APB 14-1, we have recorded a debt discount of \$27.5 million and a deferred tax liability of \$10.6 million and have allocated \$0.9 million of issuance costs to the equity component. Such amounts were calculated using an income approach and assumed a non-convertible debt borrowing rate of 6.25%, which is also the effective interest rate used to calculate interest expense. Due to the valuation allowance maintained against our deferred tax assets, the recording of the deferred tax liability resulted in a reduction to this valuation allowance rather than in a reduction in capital in excess of par value. Upon the adoption of FSP APB 14-1, the amortization of the debt discount resulted in an increase in non-cash interest expense of \$4.2 million and \$4.9 million for our fiscal years 2008 and 2007, respectively. The cumulative effect of adopting FSP APB 14-1 was an increase in stockholders' equity of \$14.6 million as of January 3, 2009. Our consolidated statement of operations for the three months ended March 29, 2008 has been retrospectively adjusted compared with previously reported amounts as follows:

| (In thousands) | Three Months Ended March 29, 2008 | |
|--|--|--------|
| Additional non-cash interest expense | \$ | 1,299 |
| Reduction in amortization of debt issuance costs | | (63) |
| Retrospective change in net income | \$ | 1,236 |
| Change to basic earnings per share | \$ | (0.03) |
| Change to diluted earnings per share | \$ | (0.03) |

Stock-Based Compensation

During the three months ended April 4, 2009, we granted 1.2 million restricted stock units and 1.0 million stock appreciation rights with a weighted average grant date fair value of \$4.18 and \$1.64, respectively.

The total stock-based compensation expense included in our consolidated statements of operations was as follows:

| (In thousands) | Three Months Ended | |
|--|---------------------------|-----------------------|
| | April 4, 2009 | March 29, 2008 |
| Cost of sales | \$ 26 | \$ 45 |
| Selling, general and administrative expenses | 378 | 650 |
| Research and development expense | 45 | 62 |
| | \$ 449 | \$ 757 |

Table of Contents**Results of Operations for the Three Months Ended April 4, 2009 and March 29, 2008**

The following table presents our results of operations for the periods indicated as a percentage of net sales:

| | Percentage of Net Sales Three Months Ended | |
|--|---|---------------------------|
| | April 4, 2009 | March 29, 2008 |
| Net sales | 100.0% | 100.0% |
| Cost of sales | 61.7 | 60.0 |
| Gross profit | 38.3 | 40.0 |
| Selling, general and administrative expenses | 30.7 | 25.9 |
| Research and development expense | 10.4 | 9.9 |
| Operating (loss) income | (2.8) | 4.2 |
| Interest and other expense, net | (2.4) | (1.5) |
| Income (loss) before income taxes | (5.2) | 2.7 |
| Income tax provision | 0.2 | 0.6 |
| Net income (loss) | (5.4)% | 2.1% |

In the following discussion regarding our net sales, certain prior period amounts have been reclassified between end markets to conform to the current period presentation.

Net Sales

Net sales for the three months ended April 4, 2009 decreased \$25.7 million, or 22.3%, compared with the corresponding period in 2008. Net sales by our Lasers Division decreased \$10.6 million, or 22.1%, and net sales by our PPT Division decreased \$15.1 million, or 22.5%, compared with the prior year period. We experienced decreases in net sales in the first quarter of 2009 compared with the first quarter of 2008 due primarily to decreased sales to our microelectronics market and industrial manufacturing and other end markets resulting from the continued cyclical downturn in the semiconductor equipment industry and the deterioration of worldwide macro-economic conditions over the past year.

Net sales to the scientific research, aerospace and defense/security markets for the three months ended April 4, 2009 decreased \$0.5 million, or 1.4%, compared with the same period in 2008. The decrease in sales to these markets in the first quarter of 2009 compared with the prior year period was due primarily to large shipments for major aerospace and defense/security programs in the 2008 period that did not recur in the 2009 period. Generally, our net sales to these markets by each of our divisions may fluctuate from period to period due to changes in overall research and defense spending levels and the timing of large sales relating to major research and aerospace/defense programs and, in some cases, these fluctuations may be offsetting between our divisions or between such periods.

Net sales to the microelectronics market for the three months ended April 4, 2009 decreased \$18.9 million, or 50.8%, compared with the same period in 2008. The decrease in sales to this market during the three months ended April 4, 2009 compared with the same period in 2008 was due primarily to a significant decline in sales to our semiconductor manufacturing equipment customers as a result of the severe cyclical downturn in that industry, as well as lower sales of laser-based disk texturing systems, offset in part by an increase in sales to solar cell manufacturing customers.

Net sales to the life and health sciences market for the three months ended April 4, 2009 decreased \$1.2 million, or 5.4%, compared with the same period in 2008, due primarily to decreased sales of products for bioinstrumentation

applications and for cosmetic and other elective treatment applications, offset in part by higher sales of products for bioimaging applications.

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Net sales to our industrial manufacturing and other end markets for the three months ended April 4, 2009 decreased \$5.1 million, or 26.2%, compared with the same period in 2008, due primarily to the current macro-economic climate. Geographically, net sales were as follows:

| (In thousands) | Three Months Ended | | Increase (Decrease) | Percentage Increase (Decrease) |
|----------------|--------------------|-------------------|------------------------|--------------------------------------|
| | April 4, 2009 | March 29, 2008 | | |
| United States | \$ 36,990 | \$ 52,469 | \$ (15,479) | (29.5)% |
| Europe | 23,433 | 28,090 | (4,657) | (16.6) |
| Pacific Rim | 23,035 | 29,373 | (6,338) | (21.6) |
| Other | 6,078 | 5,311 | 767 | 14.4 |
| | \$ 89,536 | \$ 115,243 | \$ (25,707) | (22.3)% |

The decrease in sales to customers in the United States in the first quarter of 2009 compared with the first quarter of 2008 was due primarily to lower sales to our semiconductor manufacturing equipment and industrial manufacturing customers. The decrease in sales to customers in Europe in the first quarter of 2009 compared with the prior year period was due primarily to large shipments for major aerospace and defense/security programs in the 2008 period that did not recur in the 2009 period and to lower sales to semiconductor manufacturing equipment customers in the 2009 period. Sales to customers in the Pacific Rim decreased in the first quarter of 2009 compared with the prior year period due primarily to lower sales of laser-based disk texturing systems and lower sales to semiconductor equipment manufacturing customers. The increase in sales to customers in other areas of the world in the first quarter of 2009 compared with the first quarter of 2008 was due primarily to increased sales to research customers.

Gross Margin

Gross margin was 38.3% and 40.0% for the three months ended April 4, 2009 and March 29, 2008, respectively. The decrease in gross margin in the 2009 period was due primarily to lower gross margins in our Lasers Division, which experienced reduced absorption of overhead costs due to lower manufacturing volume and a higher proportion of sales of products with lower gross margins. Gross margins in our PPT Division in the first quarter of 2009 were approximately the same as the prior year period. Such margins were negatively impacted by our lower sales volume, but were positively impacted by the recognition of revenue that had been deferred previously but for which the total cost of the related products had been recognized previously.

Selling, General and Administrative (SG&A) Expenses

SG&A expenses totaled \$27.5 million, or 30.7% of net sales, and \$29.8 million, or 25.9% of net sales, for the three months ended April 4, 2009 and March 29, 2008, respectively. The decrease in SG&A expenses in absolute dollars in the current year period was due primarily to decreases in personnel costs, travel expenses, consulting expenses and shipping costs.

In general, we expect that SG&A expense will vary as a percentage of sales in the future based on our sales level in any given period. Because the majority of our SG&A expense is fixed in the short term, changes in SG&A expense will likely not be in proportion to the changes in net sales.

Research and Development (R&D) Expense

R&D expense totaled \$9.4 million, or 10.4% of net sales, and \$11.4 million, or 9.9% of net sales, for the three months ended April 4, 2009 and March 29, 2008, respectively. The decrease in R&D expense in absolute dollars in the current year period was due primarily to decreased personnel costs and project supplies expense.

We believe that the continued development and advancement of our key products and technologies is critical to our success, and we intend to continue to invest in key R&D initiatives, while working to ensure that the efforts are focused and the funds are deployed efficiently. In general, we expect that R&D expense as a percentage of net sales

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will vary in the future based on our sales level in any given period. Because of our commitment to continued product development, and because the majority of our R&D expense is fixed in the short term, changes in R&D expense will likely not be in proportion to the changes in net sales.

Interest and Other Expense, Net

Interest and other expense, net totaled \$2.1 million and \$1.7 million for the three months ended April 4, 2009 and March 29, 2008, respectively. In the current year period, interest income was negatively impacted by lower average cash balances, due to our use of cash for repurchases of our common stock and extinguishment of our convertible subordinated notes during 2008, and by lower interest rates. This lower interest income was offset in part by reduced interest expense due to the extinguishment of \$28 million of our convertible subordinated notes in the fourth quarter of 2008.

Income Taxes

Our effective tax rate for the three months ended April 4, 2009 and March 29, 2008 was (3.5%) and 15.2%, respectively. The effective tax rate for the three months ended April 4, 2009 reflects taxes applicable to certain foreign jurisdictions and required state taxes, offset in part by an allocation of tax to other comprehensive income.

Under Accounting Principles Board (APB) Opinion No. 28, *Interim Financial Reporting*, we are required to adjust our effective tax rate each quarter to be consistent with the estimated annual effective tax rate. We are also required to record the tax impact of certain discrete items, unusual or infrequently occurring, including changes in judgment about valuation allowances and effects of changes in tax laws or rates, in the interim period in which they occur. In addition, jurisdictions with a projected loss for the year or a year-to-date loss where no tax benefit can be recognized are excluded from the estimated annual effective tax rate. The impact of such an exclusion could result in a higher or lower effective tax rate during a particular quarter, based upon the mix and timing of actual earnings compared with annual projections.

We have maintained a valuation allowance against substantially all of our gross deferred tax assets pursuant to Statement of Financial Accounting Standard (SFAS) No. 109, *Accounting for Income Taxes*, due to the uncertainty as to the timing and ultimate realization of those assets. As a result, until such valuation allowance is reversed, the U.S. tax provision relating to future earnings will be offset substantially by a reduction in the valuation allowance.

Accordingly, current and future tax expense will consist of taxes in certain foreign jurisdictions, required state income taxes, the federal alternative minimum tax and the impact of discrete items.

As of April 4, 2009, our valuation allowance was \$52.6 million. We will continue to monitor actual results, refine forecasted data and assess the need for retaining a valuation allowance against a portion of our gross deferred tax assets. In the event it is determined that a valuation allowance is no longer required, substantially all of the reversal will be recorded as a discrete item in the appropriate period.

Liquidity and Capital Resources

Our cash and cash equivalents and marketable securities balances decreased to a total of \$141.7 million as of April 4, 2009 from \$148.4 million as of January 3, 2009. The decrease was primarily attributable to cash used in operations and the repayment of short-term borrowings.

Net cash used in our operating activities of \$1.9 million for the three months ended April 4, 2009 was attributable primarily to cash used in our operations, an increase of \$7.5 million in inventory, a decrease of \$5.8 million in accrued payroll and related expenses due to the timing of payments and the payout of annual bonuses, a decrease of \$3.1 million in accrued expenses and other liabilities due to the timing of payments including the semi-annual interest payment on our convertible notes and a decrease of \$1.1 million in accounts payable due to the timing of payments, offset in part by a decrease of \$11.8 million in accounts receivable due to decreased sales, improved collection efforts and customer prepayments.

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Net cash provided by investing activities of \$6.5 million for the three months ended April 4, 2009 was attributable to net sales of marketable securities of \$7.7 million, offset in part by purchases of property and equipment of \$1.2 million.

Net cash used in financing activities of \$3.0 million for the three months ended April 4, 2009 was attributable primarily to the repayment of short-term borrowings of \$3.2 million.

During June 2008, we issued 300 million yen (\$3.0 million at April 4, 2009) in private placement bonds through a Japanese bank. These bonds bear interest at a rate of 1.55% per year, payable in cash semiannually in arrears on June 30 and December 31 of each year. The bonds mature on June 30, 2011. The bonds are included in *long-term debt* in the accompanying consolidated balance sheets.

At April 4, 2009, we had a total of three lines of credit, including one domestic revolving line of credit and two revolving lines of credit with Japanese banks. In addition, we had two other agreements with Japanese banks under which we sell trade notes receivable with recourse.

Our domestic revolving line of credit has a total credit limit of \$5.0 million and expires on December 1, 2009. Certain cash equivalents held at this lending institution collateralize this line of credit, which bears interest at either the prevailing London Interbank Offered Rate (LIBOR) (0.48% at April 4, 2009) plus 1.00% or the British Bankers Association LIBOR Daily Floating Rate (0.27% at April 4, 2009) plus 1.00%, at our option, and carries an unused line fee of 0.25% per year. At April 4, 2009, there were no balances outstanding under this line of credit, with \$4.0 million available, after considering outstanding letters of credit totaling \$1.0 million.

Our two revolving lines of credit with Japanese banks totaled 1.4 billion yen (\$14.0 million at April 4, 2009) and expire as follows: \$6.0 million on May 29, 2009 and \$8.0 million on May 31, 2009. These lines are not secured and bear interest at the prevailing bank rate. At April 4, 2009, we had \$6.9 million outstanding and \$7.1 million available for borrowing under these lines of credit. Amounts outstanding under these revolving lines of credit are included in *short-term obligations* in the accompanying consolidated balance sheets. Our two other agreements with Japanese banks, under which we sell trade notes receivable with recourse, totaled 550 million yen (\$5.5 million at April 4, 2009), have no expiration dates and bear interest at the bank's prevailing rate. At April 4, 2009, we had \$2.7 million outstanding and \$2.8 million available for the sale of notes receivable under these agreements. Amounts outstanding under these agreements are included in *short-term obligations* in the accompanying consolidated balance sheets. As of April 4, 2009, the weighted average effective interest rate on all of our Japanese borrowings, including the private placement bonds, was 1.8%.

In May 2008, our Board of Directors approved a share repurchase program, authorizing the purchase of up to 4.0 million shares of our common stock. Purchases may be made under this program from time to time in the open market or in privately negotiated transactions, and the timing and amount of the purchases will be based on factors including our share price, cash balances, expected cash requirements and general business and market conditions. No purchases were made under this program during the first quarter of 2009. As of April 4, 2009, 3.9 million shares remained available for purchase under the program.

During the remainder of 2009, we expect to use \$7 million to \$10 million of cash for capital expenditures.

We believe our current working capital position, together with our expected future cash flows from operations, will be adequate to fund our operations in the ordinary course of business, anticipated capital expenditures, debt payment requirements and other contractual obligations for at least the next twelve months. However, this belief is based upon many assumptions and is subject to numerous risks including those discussed in Item 1A (Risk Factors) of Part I of our Annual Report on Form 10-K for the year ended January 3, 2009, and there can be no assurance that we will not require additional funding in the future.

Except for the aforementioned capital expenditures, we have no present agreements or commitments with respect to any material acquisitions of other businesses, products, product rights or technologies or any other material capital expenditures. However, we will continue to evaluate acquisitions of and/or investments in products, technologies, capital equipment or improvements or companies that complement our business and may make such acquisitions and/or investments in the future. Accordingly, we may need to obtain additional sources of capital in the future to

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finance any such acquisitions and/or investments. We may not be able to obtain such financing on commercially reasonable terms, if at all. Due to the ongoing global economic crisis, we believe it may be difficult to obtain additional financing if needed. Even if we are able to obtain additional financing, it may contain undue restrictions on our operations, in the case of debt financing, or cause substantial dilution for our stockholders, in the case of equity financing.

Recent Accounting Pronouncements

In April 2009, the FASB issued a series of Staff Positions related to the application of fair value measurements, disclosing fair value measurements and recognizing other than temporary impairments. FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, provides guidance for estimating the fair value of an asset or liability when the volume or level of trading activity has significantly decreased. In addition, FSP FAS 157-4 requires companies to disclose inputs and valuation techniques used in interim and annual periods and any changes in valuation techniques and related inputs. FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, requires public companies to include the disclosures required by Statement of Financial Accounting Standards (SFAS) No. 107, *Disclosures about Fair Value of Financial Instruments*, to be included in interim filings. FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, amends the guidance for recognizing an other-than-temporary impairment on debt securities. If a company intends to sell a debt security or if it is more likely than not that a company will be required to sell a debt security prior to its anticipated recovery, an other-than-temporary impairment is considered to have occurred. If a company determines it does not intend to sell a debt security and it is not more likely than not that the company will be required to sell the debt security before its anticipated recovery, then only credit losses, if any, would be recorded as an other-than-temporary impairment through earnings and all other impairments would be recorded through other comprehensive income. Companies are also required to disclose the methodology and significant inputs used to calculate credit losses and provide a rollforward of credit losses. In addition, FSP FAS 115-2 and FAS 124-2 requires the disclosures required by SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* and FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, be made on a quarterly basis. All of the FSPs issued in April 2009 must be applied prospectively and will be effective for interim and annual periods ending after June 15, 2009, and early adoption for periods ending after March 15, 2009 is permitted if all three FSPs are adopted early. We will adopt these FSPs in our second fiscal quarter of 2009, and we do not expect that such adoption will have a material impact on our financial position or results of operations.

In April 2009, the Securities and Exchange Commission (SEC) issued SEC Staff Accounting Bulletin (SAB) 111. SAB 111 amends and replaces SAB Topic 5M, *Miscellaneous Accounting – Other Than Temporary Impairment of Certain Investments in Equity Securities*, to reflect the changes set forth in FSP FAS 115-2 and FAS 124-2, as described above. SAB 111 is effective upon the adoption of FSP FAS 115-2 and FAS 124-2. The adoption of SAB 111 is not expected to have a material impact on our financial position or results of operations.

In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies*. FSP FAS 141(R)-1 amends the guidance in SFAS No. 141 (Revised 2007), *Business Combinations*, to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value if fair value can be reasonably estimated. If fair value of such an asset or liability cannot be reasonably estimated, the asset or liability would generally be recognized in accordance with SFAS No. 5, *Accounting for Contingencies*, and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, and the requirement to disclose an estimate of the range of outcomes of recognized contingencies at the acquisition date would not be required. For unrecognized contingencies, entities would only be required to include the disclosures required by SFAS No. 5. Further, FSP FAS 141(R)-1 provides that contingent consideration arrangements of an acquiree assumed by the acquirer in a business combination should be treated as contingent consideration of the acquirer and should be initially and subsequently measured at fair value in accordance with Statement No. 141R. This FSP is effective for annual reporting periods beginning on or after December 15, 2008. The adoption of this FSP will not have an impact on our financial position or results of operations.

other than in accounting for any contingencies arising from a business combination that may occur after the effective date.

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The principal market risks (i.e., the risk of loss arising from adverse changes in market rates and prices) to which we are exposed are foreign currency exchange rates, which may generate translation and transaction gains and losses, and changes in interest rates.

Foreign Currency Risk

Operating in international markets sometimes involves exposure to volatile movements in currency exchange rates. The economic impact of currency exchange rate movements on our operating results is complex because such changes are often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. These changes, if material, may cause us to adjust our financing and operating strategies. Consequently, isolating the effect of changes in currency does not incorporate these other important economic factors.

From time to time we use forward exchange contracts to mitigate the risks associated with certain foreign currency transactions entered into in the ordinary course of business, primarily foreign currency denominated receivables and payables. We do not engage in currency speculation. The forward exchange contracts generally require us to exchange U.S. dollars for foreign currencies at maturity, at rates agreed to at the inception of the contracts. If the counterparties to the exchange contracts (typically highly rated banks) do not fulfill their obligations to deliver the contracted currencies, we could be at risk for any currency related fluctuations. Transaction gains and losses are included in our current net income (loss) in our statements of operations. Net foreign exchange gains and losses were not material to our reported results of operations for the three months ended April 4, 2009. There were no forward exchange contracts outstanding at April 4, 2009.

As currency exchange rates change, translation of the statements of operations of international operations into U.S. dollars affects the year-over-year comparability of operating results. We do not generally hedge translation risks because cash flows from international operations are generally reinvested locally. We do not enter into hedges to minimize volatility of reported earnings because we do not believe it is justified by the exposure or the cost.

Changes in currency exchange rates that would have the largest impact on translating our future international operating income include the euro and Japanese yen. We estimate that a 10% change in foreign exchange rates would not have had a material effect on our reported net loss for the three months ended April 4, 2009. We believe that this quantitative measure has inherent limitations because, as discussed in the first paragraph of this section, it does not take into account any governmental actions or changes in either customer purchasing patterns or our financing and operating strategies.

Interest Rate Risk

The interest rates we pay on certain of our debt instruments are subject to interest rate risk. Our collateralized line of credit bears interest at either the prevailing London Interbank Offered Rate (LIBOR) plus 1.00% or the British Bankers Association LIBOR Daily Floating Rate plus 1.00%, at our option. Our revolving lines of credit and other credit agreements with Japanese banks bear interest at the lending bank's prevailing rate. Our convertible subordinated notes and private placement bonds bear interest at a fixed rate of 2.5% and 1.55% per year, respectively, and are not impacted by changes in interest rates. Our cash and marketable securities, which totaled \$141.7 million at April 4, 2009, are sensitive to changes in the general level of U.S. interest rates. In addition, certain assets related to our pension plans that are not owned by such plans, which totaled \$8.5 million at April 4, 2009, are sensitive to interest rates and economic conditions in Europe. We estimate that a 10% change in the interest rate earned on our cash and marketable securities or a 10% change in interest rates payable on our lines of credit would not have had a material effect on our net loss for the three months ended April 4, 2009.

Table of Contents**Item 4. Controls and Procedures****(a) Evaluation of Disclosure Controls and Procedures**

Our Chief Executive Officer and our Chief Financial Officer, after evaluating our disclosure controls and procedures (as defined in Securities Exchange Act of 1934 (the Exchange Act) Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q (the Evaluation Date), have concluded that as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our chief executive officer and chief financial officer where appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. We continue to enhance our internal control over financial reporting, primarily by evaluating and enhancing our process and control documentation, in connection with our ongoing efforts to meet the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. We discuss with and disclose these matters to the Audit Committee of our Board of Directors and our independent registered public accounting firm.

PART II OTHER INFORMATION**Item 1A. Risk Factors**

Our Annual Report on Form 10-K for the year ended January 3, 2009 contains a full discussion of the risks associated with our business. There have been no material changes to the risks described in our Annual Report on Form 10-K.

Item 6. Exhibits

| Exhibit Number | Description of Exhibit |
|-----------------------|--|
| 10.1 | Form of Restricted Stock Unit Award Agreement (as revised March 2009) to be used under the Registrant's 2006 Performance-Based Stock Incentive Plan. |
| 10.2 | Form of Stock Appreciation Right Award Agreement to be used under the Registrant's 2006 Performance-Based Stock Incentive Plan. |
| 31.1 | Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 (the Exchange Act). |
| 31.2 | Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act. |
| 32.1 | Certification pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and 18 U.S.C. Section 1350. |
| 32.2 | Certification pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and 18 U.S.C. Section 1350. |

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SIGNATURES

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

Dated: May 14, 2009

NEWPORT CORPORATION

By: */s/ Charles F. Cargile*
Charles F. Cargile,
Senior Vice President, Chief Financial
Officer and Treasurer (Principal
Financial Officer and Duly Authorized
Officer)

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