II-VI INC
Form 10-Q
May 08, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2009

¨ **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: 0-16195

II-VI INCORPORATED

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	**25-1214948**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

375 Saxonburg Boulevard

Saxonburg, PA	**16056**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: 724-352-4455

N/A

(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 x	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date:

At May 4, 2009, 29,525,931 shares of Common Stock, no par value, of the registrant were outstanding.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements
II-VI Incorporated and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

($000)

	March 31, 2009	June 30, 2008
Assets		
Current Assets		
Cash and cash equivalents	$ 83,513	$ 69,835
Marketable securities		3,000
Accounts receivable less allowance for doubtful accounts of $886 at March 31, 2009 and $1,170 at June 30, 2008	38,757	55,866
Inventories	80,444	69,642
Deferred income taxes	10,701	8,943
Prepaid and refundable income taxes	636	5,368
Prepaid and other current assets	4,523	5,386
Assets held-for-sale	7,126	8,229
Total Current Assets	225,700	226,269
Property, plant & equipment, net	87,031	86,331
Goodwill	25,945	26,531
Other intangible assets, net	12,529	13,268
Investments	9,491	3,665
Other assets	4,479	4,862
Total Assets	$ 365,175	$ 360,926
Liabilities and Shareholders Equity		
Current Liabilities		
Accounts payable	$ 10,614	$ 16,412
Accrued salaries and wages	5,635	5,962
Accrued bonuses	5,560	10,342
Accrued profit sharing contribution	2,270	3,393
Other accrued liabilities	7,349	8,439
Liabilities held-for-sale	2,304	1,977
Total Current Liabilities	33,732	46,525
Long-term debt	6,060	3,791
Deferred income taxes	4,377	5,210
Unrecognized tax benefits	2,695	8,842
Other liabilities	5,304	6,432
Total Liabilities	52,168	70,800
Commitments and Contingencies		
Shareholders Equity		
Preferred stock, no par value; authorized 5,000,000 shares; none issued		

Common stock, no par value; authorized 100,000,000 shares; issued 32,752,504 shares at March 31, 2009; 32,605,504 shares at June 30, 2008	88,361	81,585
Accumulated other comprehensive income	1,949	3,576
Retained earnings	250,989	220,325
	341,299	305,486
Treasury stock, at cost, 3,229,133 shares at March 31, 2009 and 2,727,910 shares at June 30, 2008	28,292	15,360
Total Shareholders Equity	313,007	290,126
Total Liabilities and Shareholders Equity	$ 365,175	$ 360,926

- See notes to condensed consolidated financial statements.

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Earnings (Unaudited)

($000 except per share data)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Revenues		
Net sales:		
Domestic	$ 35,506	$ 40,351
International	26,339	37,877
	61,845	78,228
Contract research and development	2,266	2,728
Total Revenues	64,111	80,956
Costs, Expenses and Other Expense (Income)		
Cost of goods sold	40,066	45,574
Contract research and development	1,358	2,085
Internal research and development	1,612	1,992
Selling, general and administrative	13,554	15,722
Interest expense	68	22
Other expense (income), net	(1,460)	(654)
Total Costs, Expenses, and Other Expense (Income)	55,198	64,741
Earnings from Continuing Operations Before Income Taxes	8,913	16,215
Income Taxes	2,177	2,862
Earnings from Continuing Operations	6,736	13,353
Loss from Discontinued Operation, Net of Income Taxes	(1,926)	(305)
Net Earnings	$ 4,810	$ 13,048
Basic Earnings (Loss) Per Share:		
Continuing operations	$ 0.23	$ 0.45
Discontinued operation	$ (0.07)	$ (0.01)
Total	$ 0.16	$ 0.44
Diluted Earnings (Loss) Per Share:		
Continuing operations	$ 0.23	$ 0.44
Discontinued operation	$ (0.06)	$ (0.01)
Total	$ 0.16	$ 0.43

- See notes to condensed consolidated financial statements.

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Earnings (Unaudited)

($000 except per share data)

	Nine Months Ended March 31, 2009	Nine Months Ended March 31, 2008
Revenues		
Net sales:		
Domestic	$ 116,676	$ 113,392
International	102,431	101,338
	219,107	214,730
Contract research and development	7,048	9,652
Total Revenues	226,155	224,382
Costs, Expenses and Other Expense (Income)		
Cost of goods sold	129,538	124,634
Contract research and development	5,199	7,391
Internal research and development	7,919	5,388
Selling, general and administrative	44,301	43,698
Interest expense	150	216
Other expense (income), net	1,215	(2,554)
Gain on sale of equity investment, pre-tax		(26,455)
Total Costs, Expenses, and Other Expense (Income)	188,322	152,318
Earnings from Continuing Operations Before Income Taxes	37,833	72,064
Income Taxes	5,240	21,722
Earnings from Continuing Operations	32,593	50,342
Loss from Discontinued Operation, Net of Income Taxes	(1,929)	(912)
Net Earnings	$ 30,664	$ 49,430
Basic Earnings (Loss) Per Share:		
Continuing operations	$ 1.10	$ 1.70
Discontinued operation	$ (0.06)	$ (0.03)
Total	$ 1.03	$ 1.67
Diluted Earnings (Loss) Per Share:		
Continuing operations	$ 1.08	$ 1.65
Discontinued operation	$ (0.06)	$ (0.03)
Total	$ 1.02	$ 1.62

- See notes to condensed consolidated financial statements.

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

($000)

	Nine Months Ended March 31, 2009	Nine Months Ended March 31, 2008
Cash Flows from Operating Activities		
Net earnings	$ 30,664	$ 49,430
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Loss from discontinued operation, net of income taxes	1,929	912
Depreciation	10,281	10,993
Amortization	954	1,041
Share-based compensation expense	3,799	2,922
Gain on sale of equity investment		(26,455)
Loss (gain) on foreign currency remeasurements and transactions	1,954	(998)
Income from unconsolidated businesses	(974)	
Deferred income taxes	(2,547)	(3,975)
Excess tax benefits from share-based compensation expense	(1,252)	(2,601)
Loss on disposal of property, plant and equipment	885	34
Increase (decrease) in cash from changes in:		
Accounts receivable	13,281	1,188
Inventories	(12,692)	(4,430)
Accounts payable	(5,627)	(681)
Income taxes	205	4,449
Accrued other current liabilities	(6,613)	(558)
Other operating net assets	792	1,532
Net cash provided by (used in):		
Continuing operations	35,039	32,803
Discontinued operation	(69)	(495)
Net cash provided by operating activities	34,970	32,308
Cash Flows from Investing Activities		
Redemption of marketable securities	3,000	
Proceeds from sale of equity investment		30,236
Dividend from equity investment		366
Proceeds from sale of property, plant and equipment	72	36
Additions to property, plant and equipment	(12,284)	(12,404)
Purchase of business, net of cash acquired		(3,806)
Investment in unconsolidated business	(4,853)	
Payments on deferred purchase price of businesses	(913)	(295)
Net cash (used in) provided by:		
Continuing operations	(14,978)	14,133
Discontinued operation	(229)	(1,504)
Net cash (used in) provided by investing activities	(15,207)	12,629

Cash Flows from Financing Activities

Proceeds from exercise of stock options	1,673	2,591
Excess tax benefits from share-based compensation expense	1,252	2,601
Proceeds from long-term borrowings	7,000	3,000
Payments on long-term borrowings	(5,009)	(14,694)
Payments on short-term borrowings		(55)
Purchase of treasury stock	(12,880)	(5,865)
Net cash used in financing activities	(7,964)	(12,422)
Effect of exchange rate changes on cash and cash equivalents	1,879	(3,001)
Net increase in cash and cash equivalents	13,678	29,514
Cash and Cash Equivalents at Beginning of Period	69,835	32,618
Cash and Cash Equivalents at End of Period	$ 83,513	$ 62,132
Cash paid for interest	$ 136	$ 269
Cash paid for income taxes, net of refunds	$ 7,546	$ 19,823

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Shareholders Equity (Unaudited)

(000)

	Common Stock		Accumulated Other Comprehensive	Retained	Treasury Stock		
	Shares	Amount	Income	Earnings	Shares	Amount	Total
BALANCE JUNE 30, 2008	32,606	$ 81,585	$ 3,576	$ 220,325	(2,728)	$ (15,360)	$ 290,126
Shares issued under stock option and performance share plans	147	1,673					1,673
Share-based compensation expense		3,799					3,799
Net earnings				30,664			30,664
Purchase of treasury stock					(500)	(12,880)	(12,880)
Treasury stock under deferred compensation arrangements		52			(1)	(52)	
Excess tax benefit under SFAS 123(R)		1,252					1,252
Other comprehensive loss, net of tax			(1,627)				(1,627)
BALANCE MARCH 31, 2009	32,753	$ 88,361	$ 1,949	$ 250,989	(3,229)	$ (28,292)	$ 313,007

- See notes to condensed consolidated financial statements.

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II-VI Incorporated and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note A - Basis of Presentation

The condensed consolidated financial statements for the three and nine month periods ended March 31, 2009 and 2008 are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation for the periods presented have been included. All adjustments are of a normal recurring nature unless disclosed otherwise. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto in the Company s annual report on Form 10-K for the year ended June 30, 2008. The consolidated results of operations for the three and nine month periods ended March 31, 2009 are not necessarily indicative of the results to be expected for the full fiscal year. Certain amounts from the prior year periods have been reclassified to conform to the current period presentation. The June 30, 2008 Condensed Consolidated Balance Sheet information was derived from our audited financial statements.

Note B - Discontinued Operation

On April 4, 2008 the Company announced its intention to sell its x-ray and gamma-ray radiation sensor business, eV PRODUCTS, Inc. This business was previously reported in the Compound Semiconductor Group for segment reporting. Because the Company intends to sell the business, the assets and liabilities of the eV PRODUCTS business are now reported separately as held-for-sale on the Condensed Consolidated Balance Sheets. Prior periods have been previously restated to present this business on a discontinued operation basis. The revenues and loss before taxes for eV PRODUCTS included in the discontinued operation are as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Revenues	$ 2,175	$ 1,614	$ 7,117	$ 5,115
Loss before income taxes, including estimated pre-tax loss of $2,984 on disposal for the three and nine months ended March 31, 2009	$ (3,148)	$ (811)	$ (3,152)	$ (1,977)

Note C - New Accounting Standards

In September 2006, the Financial Accounting Standard Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements where the FASB previously concluded in those accounting pronouncements that fair value is the relevant measurement attributes.

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SFAS No. 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. The hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on assumptions used to measure assets and liabilities at fair value. A financial asset or liability s classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company s adoption of SFAS No. 157 on July 1, 2008 did not have a material impact on the Company s financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of SFAS No. 115 (SFAS 159). SFAS 159 permits entities to measure eligible financial assets, financial liabilities and firm commitments at fair value, on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting principles generally accepted in the United States. The adoption of SFAS 159 on July 1, 2008 did not have a material impact on the Company s financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51 . This statement amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest (minority interest) in a subsidiary and for the deconsolidation of a subsidiary. Upon its adoption, effective as of July 1, 2009, noncontrolling interests will be classified as equity in the Company s financial statements and income and comprehensive income attributed to the noncontrolling interest will be included in the Company s income and comprehensive income. The provisions of this standard must be applied retrospectively upon adoption. The Company is currently evaluating the impact of adopting this statement.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141(R)). SFAS No. 141 (R) established principles and requirements for how an acquirer in a business combination recognizes and measures the assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree. The provisions of SFAS No. 141(R) are effective for the Company s business combinations occurring on or after July 1, 2009.

In March 2008, FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an Amendment of FASB Statement No. 133, which required enhanced disclosures on the effect of derivatives on a company s financial statements. This Statement is effective for the Company s financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of this statement did not have a material effect on the Company s financial position or results of operations.

Note D - Acquisitions, Investments and Divestures

HIGHYAG Lasertechnologie GmbH

In January 2008, the Company acquired a 74.9% equity interest in HIGHYAG Lasertechnologie GmbH (HIGHYAG) for approximately $3.8 million net of cash acquired of $2.8 million and including transaction costs of approximately $0.4 million. HIGHYAG designs and manufactures automated equipment to deliver high-power one micron laser light for cutting, drilling and welding in automotive, semiconductor and other material processing applications. The financial results of HIGHYAG are included since January 2008 in the Condensed Consolidated Statements of Earnings.

This acquisition was accounted for using the purchase method in accordance with SFAS No. 141, Business Combinations. Accordingly, the Company recorded the net assets at their estimated fair values. Fixed and contingent payments are due for the remaining purchase price and are estimated to be approximately $1.6 million and will be paid in Euros. The following table presents the allocation of the purchase price to the assets acquired and liabilities assumed at the date of acquisition. ($000)

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Assets	
Accounts receivable, net	$ 2,205
Inventories	2,259
Prepaid and other current assets	57
Property, plant and equipment	702
Intangible assets	493
Goodwill	1,580
Other assets	125
Total assets acquired	$ 7,421
Liabilities	
Accounts payable	$ 289
Other accrued liabilities	1,292
Other liabilities	1,416
Deferred income taxes	152
Minority interest	466
Total liabilities assumed	$ 3,615
Net assets acquired	$ 3,806

Fuxin Electronic Technology Company

In March 2007, the Company acquired for $3.6 million a 10% non-controlling minority interest in Guangdong Fuxin Electronic Technology Company (Fuxin) based in Guangdong Province, China. In July 2008, the Company completed an additional investment of 10.2% of the equity interests of Fuxin for approximately $4.8 million. The Company has a total equity investment in Fuxin of 20.2%. This investment is accounted for under the equity method of accounting commencing with the period beginning July 1, 2008. Prior to July 1, 2008, this investment was accounted for under the cost method of accounting. During the nine months ended March 31, 2009, the Company s pro-rata share of earnings from this investment was $1.0 million, and is recorded in Other expense (income), net in the Condensed Consolidated Statements of Earnings. The pro-rata share of earnings from this investment during the three months ended March 31, 2009 was insignificant.

Sale of Equity Investment

During the quarter ended December 31, 2007, the Company sold its entire 36% equity investment in a Canadian company and supplier to the Company for $30.2 million in cash on which it recorded an after-tax gain of $15.9 million. This investment was included within the Compound Semiconductor Group and was accounted for under the equity method of accounting. The following table summarizes the reconciliation of the pre-tax gain to the after-tax gain on the sale of this investment. ($000)

	Nine Months Ended March 31, 2008
Gain on sale of equity investment, pre-tax	$ 26,455
Income taxes on gain	(10,542)
Gain on sale of equity investment, after-tax	$ 15,913

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Note E - Contract Receivables

The components of contract receivables, which are a component of accounts receivable, net, were as follows ($000):

	March 31, 2009	June 30, 2008
Billed		
Completed Contracts	$ 73	$ 127
Contracts in Progress	1,383	549
	1,456	676
Unbilled	1,571	1,526
	$ 3,027	$ 2,202

Note F - Inventories

The components of inventories were as follows ($000):

	March 31, 2009	June 30, 2008
Raw materials	$ 32,892	$ 22,510
Work in progress	25,569	23,467
Finished goods	21,983	23,665
	$ 80,444	$ 69,642

Note G - Property, Plant and Equipment

Property, plant and equipment at cost or valuation consist of the following ($000):

	March 31, 2009	June 30, 2008
Land and land improvements	$ 1,997	$ 1,968
Buildings and improvements	52,772	50,914
Machinery and equipment	128,857	118,900
Construction in progress	7,222	8,612
	190,848	180,394
Less accumulated depreciation	(103,817)	(94,063)
	$ 87,031	$ 86,331

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Note H - Goodwill and Intangible Assets

Changes in the carrying amount of goodwill are as follows for the nine months ended March 31, 2009 ($000):

	Nine Months Ended March 31, 2009
Balance Beginning of Period	$ 26,531
Foreign currency translation	(586)
Balance End of Period	$ 25,945

In accordance with SFAS No. 142 Goodwill and Other Intangible Assets, the Company tests goodwill for impairment at least annually in the fourth quarter of the fiscal year, or when events of changes in circumstances indicate that goodwill might be impaired.

The gross carrying amount and accumulated amortization of the Company s intangible assets other than goodwill as of March 31, 2009 and June 30, 2008 were as follows ($000):

	March 31, 2009			June 30, 2008		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Patents	$ 6,205	$ (3,380)	$ 2,825	$ 6,284	$ (2,927)	$ 3,357
Trademarks	7,491	(646)	6,845	7,491	(590)	6,901
Customer Lists	6,380	(3,528)	2,852	6,338	(3,343)	2,995
Other	1,377	(1,370)	7	1,391	(1,376)	15
Total	$ 21,453	$ (8,924)	$ 12,529	$ 21,504	$ (8,236)	$ 13,268

Amortization expense recorded on these intangible assets was $0.4 million and $1.0 million, for the three and nine months ended March 31, 2009, respectively, and was $0.3 million and $1.0 million for the three and nine months ended March 31, 2008, respectively. During the three months ended March 31, 2009, in connection with the Company s recent formation of its sales and distribution office in Italy, the Company acquired an intangible asset, consisting of a customer list for approximately $0.4 million from its former distributor in Italy. The acquired customer list is being amortized over ten years. The gross carrying amount of Trademarks includes $6.0 million of an acquired trade name with an indefinite life not amortized but tested annually for impairment. Included in the gross carrying amount and accumulated amortization of the Company s customer lists, patents and other components of intangible assets and goodwill is the effect of the foreign currency translation of the portion relating to the Company s German subsidiaries. At March 31, 2009, the estimated amortization expense for existing intangible assets for each of the five succeeding fiscal years is as follows:

Year Ending June 30,	
($000)	
Remaining 2009	$ 334
2010	1,296
2011	1,243
2012	1,173
2013	925

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Note I - Debt

The components of debt were as follows ($000):

	March 31, 2009	June 30, 2008
Line of credit, interest at the LIBOR Rate, as defined, plus 0.50%	$ 2,500	$
Yen denominated term note, interest at the Japanese Yen Base Rate, as defined, plus 1.49%, principal payable in full in June 2012	3,560	3,791
Total debt	6,060	3,791
Current portion of long-term debt		
Long-term debt, less current portion	$ 6,060	$ 3,791

The Company s credit facility is a $60.0 million line of credit which, under certain conditions, may be expanded to $100.0 million. The credit facility has a five-year term through October 2011 and has interest rates ranging from LIBOR plus 0.50% to LIBOR plus 1.25%. Additionally, the facility is subject to certain covenants, including those relating to minimum interest coverage and maximum leverage ratios.

The weighted average interest rate of borrowings was 2.2% and 4.4% for the nine months ended March 31, 2009 and 2008, respectively. The Company had available $56.8 million and $59.3 million under its line of credit as of March 31, 2009 and June 30, 2008, respectively. The amounts available under the Company s line of credit are reduced by outstanding letters of credit. At March 31, 2009 and June 30, 2008, total outstanding letters of credit supported by the credit facilities were $0.7 million.

The Company has a Yen loan which allows for borrowings up to 600 million Yen. The Yen loan has a term through June 2012. At March 31, 2009 and June 30, 2008, the Company had 350 million Yen and 400 million Yen borrowed under the Yen loan, respectively. Interest is at a rate equal to the Japanese Yen Base Rate, as defined in the loan agreement, plus 1.49%. The Japanese Yen Base Rate was 0.78% at March 31, 2009 and 1.03% at June 30, 2008.

Note J - Income Taxes

On July 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. As a result of the adoption of FIN 48 and recognition of the cumulative effect of adoption of this new accounting principle, the Company increased the liability for net unrecognized tax benefits by $2.2 million, and accounted for the increase as a cumulative effect of a change in accounting principles that resulted in a decrease to retained earnings of $2.2 million.

In July 2008, the Internal Revenue Service completed its examination of the Company s federal income tax return for fiscal years 2005 and 2006. As a result, during the quarter ended September 30, 2008, the Company reversed certain unrecognized tax benefits from those fiscal years and recognized an income tax benefit of approximately $4.7 million. As of March 31, 2009, the gross unrecognized income tax benefits were $2.7 million. The Company has classified the uncertain tax positions as non-current income tax liabilities as the amounts are not expected to be paid within one year. If recognized, approximately $2.5 million of the gross unrecognized tax benefits would impact the effective tax rate. The Company does not expect the total amount of unrecognized tax benefits to significantly change in the next twelve months. The Company recognized interest and penalties related to uncertain tax positions in the income tax provision on the Condensed Consolidated Statement of Earnings. As of March 31, 2009, the Company had approximately $0.2 million of accrued interest and penalties related to uncertain tax positions included in the liability on its Condensed Consolidated Balance Sheet.

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Fiscal years 2007 to 2008 remain open to examination by the United States Internal Revenue Service, fiscal years 2004 to 2008 remain open to examination by certain state jurisdictions, and fiscal years 2003 to 2008 remain open to examination by certain foreign taxing jurisdictions.

Note K - Earnings Per Share

The following table sets forth the computation of earnings per share for the periods indicated. Weighted average shares issuable upon the exercise of stock options that were not included in the calculation were approximately 840,000 and 252,000 for the three and nine months ended March 31, 2009, respectively, because they were antidilutive. Weighted average shares issuable upon the exercise of stock options that were not included in the calculation because they were antidilutive, were immaterial for the three and nine months ended March 31, 2008 (000 except per share data):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2009	2008	2009	2008
Earnings from continuing operations	$ 6,736	$ 13,353	$ 32,593	$ 50,342
Loss from discontinued operation	(1,926)	(305)	(1,929)	(912)
Net earnings	4,810	13,048	30,664	49,430
Divided by:				
Weighted average shares	29,520	29,692	29,714	29,661
Basic earnings from continuing operations per common share	$ 0.23	$ 0.45	$ 1.10	$ 1.70
Basic loss from discontinued operation per common share	$ (0.07)	$ (0.01)	$ (0.06)	$ (0.03)
Basic earnings per common share	$ 0.16	$ 0.44	$ 1.03	$ 1.67
Earnings from continuing operations	$ 6,736	$ 13,353	$ 32,593	$ 50,342
Loss from discontinued operation	(1,926)	(305)	(1,929)	(912)
Net earnings	4,810	13,048	30,664	49,430
Divided by:				
Weighted average shares	29,520	29,692	29,714	29,661
Dilutive effect of common stock equivalents	180	896	433	775
Diluted weighted average common shares	29,700	30,588	30,147	30,436
Diluted earnings from continuing operations per common share	$ 0.23	$ 0.44	$ 1.08	$ 1.65
Diluted loss from discontinued operation per common share	$ (0.06)	$ (0.01)	$ (0.06)	$ (0.03)
Diluted earnings per common share	$ 0.16	$ 0.43	$ 1.02	$ 1.62

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Note L - Comprehensive Income

The components of comprehensive income were as follows for the periods indicated ($000):

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008	Nine Months Ended March 31, 2009	Nine Months Ended March 31, 2008
Net earnings	$ 4,810	$ 13,048	$ 30,664	$ 49,430
Other comprehensive income (loss):				
Foreign currency translation adjustments net of income taxes of $(441) and $(213), respectively, for the three and nine months ended March 31, 2009, and $278 and $1,182, respectively, for the three and nine months ended March 31, 2008.	(2,220)	1,538	(1,627)	2,826
Comprehensive income	$ 2,590	$ 14,586	$ 29,037	$ 52,256

Note M - Segment Reporting

The Company reports its business segments using the management approach model for segment reporting. The Company determines its reportable business segments based on the way the chief operating decision maker organizes business segments within the Company for making operating decisions and assessing performance. To aggregate operating segments, the Company considers if the operating segments have similar economic characteristics, and if the operating segments are similar in each of the following areas:

a. The nature of the products and services

b. The nature of the production processes

c. The type of class of customer for their products and services

d. The methods used to distribute their products or provide their services

The Company has four reportable segments. The Company s chief operating decision maker receives and reviews financial information in this format. The Company evaluates business segment performance based upon reported business segment earnings, which is defined as earnings from continuing operations before income taxes, interest and other income or expense. The segments are managed separately due to the production requirements and facilities that are unique to each segment. The Company has the following reportable segments: (i) Infrared Optics, which is the Company s infrared optics and material products businesses, HIGHYAG a manufacturer of fiber-delivered beam transmission systems and processing tools for industrial lasers, and remaining corporate activities, primarily corporate assets and capital expenditures; (ii) Near-Infrared Optics, which is the Company s VLOC Incorporated subsidiary, and the China and Vietnam near-infrared operations; (iii) Military & Materials, which is the Company s Exotic Electro-Optics, Inc. (EEO) subsidiary and Pacific Rare Specialty Metals & Chemicals, Inc. subsidiary (PRM); and (iv) the Compound Semiconductor Group, which is the aggregation of the Company s Marlow Industries, Inc. (Marlow) subsidiary, the Wide Bandgap Materials (WBG) group and the Worldwide Materials Group (WMG) which is responsible for the corporate research and development activities.

The Company intends to sell its x-ray and gamma-ray radiation sensor business, eV PRODUCTS. eV PRODUCTS was previously reported in the Compound Semiconductor Group. Segment information for all periods presented have been restated to exclude eV PRODUCTS as this is accounted for as a discontinued operation.

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The Infrared Optics segment is divided into geographic locations in the U.S., Singapore, China, Germany, Switzerland, Japan, Belgium, the U.K and Italy. The Infrared Optics segment is directed by the segment s president, while each geographic location is directed by a general manager, and is further divided into production and administrative units that are directed by managers. The Infrared Optics segment designs, manufactures and markets optical and electro-optical components and materials sold under the II-VI brand name and used primarily in high-power CO_2 lasers. The Infrared Optics segment also manufactures fiber-delivered beam delivery systems and processing tools for industrial lasers sold under the HIGHYAG brand name.

The Near-Infrared Optics segment is located in the U.S., China, Vietnam, Germany, Japan, the U.K and Italy. The Near-Infrared Optics segment is directed by a general manager. The Near-Infrared Optics segment is further divided into production and administrative units that are directed by managers. The Near-Infrared Optics segment designs, manufactures and markets near-infrared and visible-light products for industrial, scientific, military and medical instruments and laser gain material and products for solid-state YAG lasers, YLF lasers and UV Filter components.

The Military & Materials segment is located in the U.S. and the Philippines. The Military & Materials segment is directed by a Corporate Vice President while each geographic location is directed by a general manager. The Military & Materials segment is further divided into production and administrative units that are directed by managers. The Military & Materials segment designs, manufactures and markets infrared products for military applications under the EEO brand name and refines specialty metals, primarily selenium and tellurium under the PRM brand name.

The Compound Semiconductor Group is located in the U.S., Japan, China, Vietnam and Germany. The Compound Semiconductor Group segment is directed by a Corporate Vice President. In the Compound Semiconductor Group segment, Marlow designs and manufacturers thermo-electric cooling and power generation solutions for use in defense and space, telecommunications, medical, consumer and industrial markets. The WBG group manufactures and markets single crystal silicon carbide substrates for use in solid-state lighting, wireless infrastructure, radio frequency (RF) electronics and power switching industries. The WMG group directs the corporate research and development initiatives.

The accounting policies of the segments are the same as those of the Company. Substantially all of the Company s corporate expenses are allocated to the segments. The Company evaluates segment performance based upon reported segment earnings, which is defined as earnings from continuing operations before income taxes, interest and other income or expense. Inter-segment sales and transfers have been eliminated.

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The following table summarizes selected financial information of the Company s operations by segment ($000):

	Three Months Ended March 31, 2009					
	Infrared Optics	Near-Infrared Optics	Military & Materials	Compound Semiconductor Group	Eliminations	Total
Revenues	$ 27,785	$ 9,602	$ 14,068	$ 12,656	$	$ 64,111
Inter-segment revenues	258	47	591	1,093	(1,989)	
Segment earnings	4,369	647	1,224	1,281		7,521
Interest expense						(68)
Other income, net						1,460
Earnings from continuing operations before income taxes						8,913
Depreciation and amortization	1,845	676	375	637		3,533
Segment assets	213,040	37,385	44,233	63,391		358,049
Expenditures for property, plant and equipment	1,516	203	1,074	236		3,029
Equity investment	9,455					9,455
Goodwill	$ 9,790	$ 1,927	$ 3,914	$ 10,314	$	$ 25,945

	Three Months Ended March 31, 2008					
	Infrared Optics	Near-Infrared Optics	Military & Materials	Compound Semiconductor Group	Eliminations	Total
Revenues	$ 41,004	$ 14,769	$ 11,975	$ 13,208	$	$ 80,956
Inter-segment revenues	295	90	57	1,917	(2,359)	
Segment earnings	10,200	2,705	1,415	1,263		15,583
Interest expense						(22)
Other income, net						654
Earnings from continuing operations before income taxes						16,215
Depreciation and amortization	1,723	659	341	1,117		3,840
Segment assets	186,980	41,412	35,058	61,111		324,561
Expenditures for property, plant and equipment	2,335	549	429	460		3,773
Equity investment	3,615					3,615
Goodwill	$ 10,562	$ 1,927	$ 3,914	$ 10,314	$	$ 26,717

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	Nine Months Ended March 31, 2009					
	Infrared Optics	Near-Infrared Optics	Military & Materials	Compound Semiconductor Group	Eliminations	Total
Revenues	$ 105,069	$ 35,505	$ 43,068	$ 42,513	$	$ 226,155
Inter-segment revenues	1,039	199	2,073	3,665	(6,976)	
Segment earnings	24,459	5,803	5,111	3,825		39,198
Interest expense						(150)
Other expense, net						(1,215)
Earnings from continuing operations before income taxes						37,833
Depreciation and amortization	5,718	2,185	1,151	2,181		11,235
Expenditures for property, plant and equipment	5,773	1,400	2,664	2,447		12,284

	Nine Months Ended March 31, 2008					
	Infrared Optics	Near-Infrared Optics	Military & Materials	Compound Semiconductor Group	Eliminations	Total
Revenues	$ 108,539	$ 43,420	$ 36,191	$ 36,232	$	$ 224,382
Inter-segment revenues	853	364	117	6,111	(7,445)	
Segment earnings	25,388	8,444	5,183	4,256		43,271
Interest expense						(216)
Other income, net						29,009
Earnings from continuing operations before income taxes						72,064
Depreciation and amortization	5,153	2,138	1,193	3,550		12,034
Expenditures for property, plant and equipment	7,715	1,475	1,263	1,951		12,404

Note N - Share-Based Compensation

The Company records share-based compensation expense pursuant to SFAS No. 123 (revised 2004), (SFAS 123R) Share-Based Payment. SFAS 123(R) requires the recognition of the fair value of share-based compensation in net earnings. The Company recognizes the share-based compensation expense over the requisite service period of the individual grantees, which generally equals the vesting period.

Under the provisions of SFAS 123(R), the Company recorded $1.2 million and $3.8 million in share-based compensation expense in its Condensed Consolidated Statements of Earnings for the three and nine months ended March 31, 2009, respectively, and $0.8 million and $2.9 million for the three and nine months ended March 31, 2008, respectively. The share-based compensation expense is allocated approximately 25% to cost of goods sold and 75% to selling, general and administrative expense in the Condensed Consolidated Statements of Earnings. The Company utilized the Black-Scholes valuation model for estimating the fair value of the share-based compensation expense. During the three and nine months ended March 31, 2009, the weighted-average fair values of options granted under the stock option plan were $8.80 and $17.86, respectively, and $12.66 and $13.03 for the three and nine months ended March 31, 2008, respectively, per option using the following assumptions:

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008	Nine Months Ended March 31, 2009	Nine Months Ended March 31, 2008
Risk free interest rate	1.97%	2.69%	2.91%	3.87%
Expected volatility	44%	39%	41%	40%
Expected life of options	5.82 years	5.86 years	5.82 years	5.86 years
Dividend yield	None	None	None	None

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The risk-free interest rate is derived from the average U.S. Treasury Note rate during the period, which approximates the rate in effect at the time of grant related to the expected life of the options. The risk-free interest rate shown above is the weighted-average rate for all options granted during the periods. Expected volatility is based on the historical volatility of the Company s Common Stock over the period commensurate with the expected life of the options. The expected life calculation is based on the observed and expected time to post-vesting exercise and forfeitures of options by our employees. The dividend yield of zero is based on the fact the Company has never paid cash dividends and has no intention to pay cash dividends in the future. The estimated annualized forfeitures are based on the Company s historical experience of option pre-vesting cancellations and are estimated at a rate of 22%. Under the provisions of SFAS 123(R), the Company will record additional expense in future periods if the actual forfeiture rate is lower than estimated, and will record a recovery of prior expense if the actual forfeiture is higher than estimated.

The Compensation Committee of the Board of Directors of the Company granted certain named executive officers performance share awards under the Company s 2005 Omnibus Incentive Plan. At March 31, 2009, the Company had two separate performance share grants covering the periods from July 2007 to June 2009 and July 2008 to June 2010. The awards are intended to provide continuing emphasis on specified financial performance goals that the Company considers important contributors to long-term shareholder value. The awards are only payable if the Company achieves specified levels of revenue and cash flows from operations for the performance periods. Included in the $1.2 million and $3.8 million share-based compensation expense for the three and nine months ended March 31, 2009 was $0.2 million and $0.3 million, respectively, of expense attributable to performance shares. Included in the $0.8 million and $2.9 million share-based compensation expense for the three and nine months ended March 31, 2008 was $0.1 million and $0.5 million, respectively, of expense attributed to the performance share awards. The performance shares compensation expense was calculated based on the estimated number of shares expected to be earned multiplied by the stock price at the date of grant.

Note O - Derivative Instruments

The Company from time to time purchases foreign currency forward exchange contracts, primarily in Japanese Yen, that permit it to sell specified amounts of foreign currencies expected to be received fro