II-VI INC
Form 10-Q
May 09, 2008
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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, 2008

¨ **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 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. (Check one):

Large accelerated filer x 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 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 5, 2008, 29,736,404 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, 2008	June 30, 2007
Assets		
Current Assets		
Cash and cash equivalents	$ 62,132	$ 32,618
Accounts receivable less allowance for doubtful accounts of $1,142 at March 31, 2008 and $1,121 at June 30, 2007	48,766	44,964
Inventories	66,918	57,898
Assets held-for-sale	8,275	8,004
Deferred income taxes	9,177	9,172
Prepaid and other current assets	3,511	2,313
Total Current Assets	198,779	154,969
Property, plant & equipment, net	85,518	82,666
Goodwill	26,717	24,489
Other intangible assets, net	13,076	13,920
Investments	3,665	6,982
Other assets	5,081	4,898
Total Assets	$ 332,836	$ 287,924
Current Liabilities		
Accounts payable	$ 14,531	$ 13,812
Accrued salaries and wages	5,691	5,418
Accrued bonuses	7,493	7,922
Income taxes payable	1,364	5,494
Accrued profit sharing contribution	2,417	2,678
Other accrued liabilities	6,444	7,348
Liabilities held-for-sale	1,415	1,607
Current portion of long-term debt		55
Total Current Liabilities	39,355	44,334
Long-term debt, less current maturities	4,024	14,940
Deferred income taxes	1,603	5,502
Other liabilities	16,139	3,708
Total Liabilities	61,121	68,484
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 32,430,594 shares at March 31, 2008; 32,092,077 shares at June 30, 2007	77,823	68,670
Accumulated other comprehensive income	3,765	939
Retained earnings	205,487	158,287
	287,075	227,896
Treasury stock, at cost, 2,727,910 shares at March 31, 2008 and 2,508,807 shares at June 30, 2007	15,360	8,456

Total Shareholders Equity	271,715	219,440
Total Liabilities and Shareholders Equity	$ 332,836	$ 287,924

- 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, 2008	Three Months Ended March 31, 2007
Revenues		
Net sales:		
Domestic	$ 40,351	$ 33,127
International	37,877	28,486
	78,228	61,613
Contract research and development	2,728	3,223
Total Revenues	80,956	64,836
Costs, Expenses & Other (Income) Expense		
Cost of goods sold	45,574	34,799
Contract research and development	2,085	2,384
Internal research and development	1,992	1,447
Selling, general and administrative	15,722	13,964
Interest expense	22	204
Other (income), net	(654)	(507)
Total Costs, Expenses and Other (Income)	64,741	52,291
Earnings from Continuing Operations Before Income Taxes	16,215	12,545
Income Taxes	2,862	2,423
Earnings from Continuing Operations	13,353	10,122
Loss from Discontinued Operation, Net of Income Tax Benefit	(305)	(73)
Net Earnings	$ 13,048	$ 10,049
Diluted Earnings Per Share:		
Continuing operations	$ 0.44	$ 0.33
Discontinued operation	$ (0.01)	$ (0.00)
Consolidated	$ 0.43	$ 0.33

- 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, 2008	Nine Months Ended March 31, 2007
Revenues		
Net sales:		
Domestic	$ 113,392	$ 94,458
International	101,338	82,554
	214,730	177,012
Contract research and development	9,652	7,829
Total Revenues	224,382	184,841
Costs, Expenses & Other (Income) Expense		
Cost of goods sold	124,634	99,656
Contract research and development	7,391	5,854
Internal research and development	5,388	4,008
Selling, general and administrative	43,698	40,286
Interest expense	216	873
Other (income), net	(2,554)	(2,060)
Gain on sale of equity investment (See Note R)	(26,455)	
Total Costs, Expenses and Other (Income)	152,318	148,617
Earnings from Continuing Operations Before Income Taxes	72,064	36,224
Income Taxes	21,722	9,138
Earnings from Continuing Operations	50,342	27,086
Loss from Discontinued Operation, Net of Income Tax Benefit	(912)	(429)
Net Earnings	$ 49,430	$ 26,657
Diluted Earnings Per Share:		
Continuing operations	$ 1.65	$ 0.90
Discontinued operation	$ (0.03)	$ (0.01)
Consolidated	$ 1.62	$ 0.88

- 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,	
	2008	**2007**
Cash Flows from Operating Activities		
Net earnings	$ 49,430	$ 26,657
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Loss from discontinued operation, net of taxes	912	429
Depreciation	10,993	10,412
Amortization	1,041	1,005
Share-based compensation expense	2,922	2,263
Gain on sale of equity investment	(26,455)	
Gain on foreign currency remeasurements and transactions	(998)	(350)
Net loss on disposal of property, plant and equipment	34	8
Deferred income taxes	(3,975)	(4,069)
Excess tax benefits from share-based compensation expense	(2,601)	(2,449)
Increase (decrease) in cash from changes in:		
Accounts receivable	1,188	(2,934)
Inventories	(4,430)	(5,421)
Accounts payable	(681)	2,347
Income taxes payable	4,449	475
Deferred revenue		(2,572)
Other operating net assets	974	(354)
Net cash provided by (used in):		
Continuing operations	32,803	25,447
Discontinued operation	(495)	188
Net cash provided by operating activities	32,308	25,635
Cash Flows from Investing Activities		
Proceeds from sale of equity investment	30,236	
Dividend from equity investment	366	23
Proceeds from sale of property, plant and equipment	36	88
Additions to property, plant and equipment	(12,404)	(13,130)
Purchases of businesses, net of cash acquired	(3,806)	(840)
Payment on deferred purchase price of business	(295)	
Purchase of intangibles		(100)
Net cash provided by (used in) investing activities:		
Continuing operations	14,133	(13,959)
Discontinued operation	(1,504)	(707)
Net cash provided by (used in) investing activities	12,629	(14,666)
Cash Flows from Financing Activities		
Proceeds on long-term borrowings	3,000	
Payments on long-term borrowings	(14,694)	(2,000)
Payments on short-term borrowings	(55)	(14,790)
Proceeds from exercise of stock options	2,591	2,936
Excess tax benefits from share-based compensation expense	2,601	2,449
Purchase of treasury stock	(5,865)	(502)
Net cash used in financing activities	(12,422)	(11,907)

Effect of exchange rate changes on cash and cash equivalents	(3,001)	101
Net increase (decrease) in cash and cash equivalents	29,514	(837)
Cash and Cash Equivalents at Beginning of Period	32,618	26,885
Cash and Cash Equivalents at End of Period	$ 62,132	$ 26,048
Non-cash transactions:		
Additions to property, plant and equipment included in accounts payable	$	$ 1,317
Cash paid for interest	$ 269	$ 1,186
Cash paid for income taxes	$ 19,823	$ 12,563

- *See notes to condensed consolidated financial statements.*

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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, 2007	32,092	$ 68,670	$ 939	$ 158,287	(2,509)	$ (8,456)	$ 219,440
Cumulative effect of adoption of FIN 48				(2,230)			(2,230)
Shares issued under stock option and performance share plans	339	2,591					2,591
Share-based compensation expense		2,922					2,922
Net earnings				49,430			49,430
Purchase of treasury stock					(187)	(5,865)	(5,865)
Treasury stock under deferred compensation arrangements		1,039			(32)	(1,039)	
Excess tax benefit under SFAS 123(R)		2,601					2,601
Other comprehensive income, net of tax			2,826				2,826
BALANCE MARCH 31, 2008	32,431	$ 77,823	$ 3,765	$ 205,487	(2,728)	$ (15,360)	$ 271,715

- 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, 2008 and 2007 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, 2007. The consolidated results of operations for the three and nine month periods ended March 31, 2008 are not necessarily indicative of the results to be expected for the full fiscal year. Certain amounts from the prior year period have been reclassified to conform to the current period presentation.

Note B Discontinued Operation

On April 4, 2008 the Company announced its intention to sell its x-ray and gamma-ray radiation division, doing business as eV PRODUCTS, Inc.

eV PRODUCTS was previously reported in the Compound Semiconductor Group for segment reporting. Because the Company intends to sell the division, the assets and liabilities of the eV PRODUCTS business are now reported separately as held-for-sale on the Consolidated Balance Sheets. Prior periods have been restated to present this business on a discontinued operation basis. The sales and loss before taxes for eV PRODUCTS included in discontinued operations are as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Revenues	$ 1,614	$ 2,249	$ 5,115	$ 6,383
Loss before income taxes	$ (811)	$ (122)	$ (1,977)	$ (699)

Note C Newly Adopted Accounting Standards

The Company adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 as of July 1, 2007. As a result, the Company increased its liability for unrecognized tax benefits by $2.2 million, which was recorded as a direct decrease to retained earnings. See Note K, Income Taxes for additional information.

Note D Other New Accounting Standards

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This standard only applies when other standards require or permit the fair value measurement of assets and liabilities. It does not increase the use of fair value measurement. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting this Statement.

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In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting this Statement.

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 the beginning of the Company s fiscal year 2010, 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 financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact of adopting this statement.

Note E Acquisitions

HIGHYAG Lasertechnologie GmbH

On January 2, 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 for the quarter ended March 31, 2008 and in three of the nine months ended March 31, 2008, since the date of acquisition, 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, and included operating results in the consolidated financial statements since January 2008. The Company plans on finalizing its purchase price allocation of HIGHYAG, primarily related to the valuation of property, plant and equipment and other intangible assets by June 30, 2008. Fixed and contingent payments are due for the remaining purchase price and are estimated to be approximately 1.7 million Euros. The following table presents the preliminary allocation of the purchase price to the assets acquired and liabilities assumed at the date of acquisition ($000 s).

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Assets	
Accounts receivable, net	$ 2,205
Inventories	2,259
Prepaid and other current assets	57
Property, plant and equipment	702
Goodwill	1,921
Other assets	125
Total assets acquired	$ 7,269
Liabilities	
Accounts payable	$ 289
Other accrued liabilities	1,292
Other liabilities	1,416
Minority interest	466
Total liabilities assumed	$ 3,463
Net assets acquired	$ 3,806

II-VI Suisse S.a.r.l.

In January 2007, the Company exercised its call option and purchased the remaining 25% interest of II-VI Suisse S.a.r.l. for approximately $0.8 million. In connection with the purchase, the Company entered into two separate three-year non-compete agreements with the sellers. The purchase price was allocated to goodwill and these non-compete agreements.

Note F Contract Receivables

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

	March 31, 2008	June 30, 2007
Billed		
Completed Contracts	$ 179	$ 187
Contracts in Progress	1,002	832
	1,181	1,019
Unbilled	3,207	2,850
	$ 4,388	$ 3,869

Note G Inventories

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

	March 31, 2008	June 30, 2007
Raw materials	$ 21,308	$ 14,933
Work in progress	22,119	17,521
Finished goods	23,491	25,444

	$ 66,918	$ 57,898

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Note H Property, Plant and Equipment

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

	March 31, 2008	June 30, 2007
Land and land improvements	$ 1,942	$ 1,942
Buildings and improvements	49,973	48,202
Machinery and equipment	116,306	104,688
Construction in progress	9,846	9,578
	178,067	164,410
Less accumulated depreciation	(92,549)	(81,744)
	$ 85,518	$ 82,666

Note I Goodwill and Intangible Assets

Changes in the carrying amount of goodwill are as follows for the nine months ended March 31, 2008 ($000):

	Nine Months Ended March 31, 2008
Balance Beginning of Period	$ 24,489
Goodwill acquired	
HIGHYAG Lasertechnologie GmbH	1,921
Foreign currency translation	307
Balance End of Period	$ 26,717

In connection with the acquisition of HIGHYAG in January 2008, the Company recorded the excess purchase price over the net assets of the business acquired as goodwill in the accompanying Condensed Consolidated Balance Sheets based on the purchase price allocation. The Company plans on finalizing its purchase price allocation of HIGHYAG by June 30, 2008.

The gross carrying amount and accumulated amortization of the Company s intangible assets other than goodwill as of March 31, 2008 and June 30, 2007 were as follows ($000):

	March 31, 2008			June 30, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Patents	$ 5,756	$ (2,765)	$ 2,991	$ 5,756	$ (2,332)	$ 3,424
Trademarks	7,491	(571)	6,920	7,491	(516)	6,975
Customer Lists	6,337	(3,195)	3,142	5,961	(2,561)	3,400
Other	1,391	(1,368)	23	1,378	(1,257)	121
Total	$ 20,975	$ (7,899)	$ 13,076	$ 20,586	$ (6,666)	$ 13,920

Amortization expense recorded on these intangible assets was $0.3 million and $1.0 million, for the three and nine months ended March 31, 2008, respectively, and was $0.3 million and $1.0 million for the three and nine months ended March 31, 2007, respectively. 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 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, 2008, the estimated amortization expense for existing intangible assets for each of the five succeeding fiscal years is as follows:

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Year Ending June 30, ($000)	
Remaining 2008	$ 308
2009	1,209
2010	1,207
2011	1,149
2012	1,011

Note J Debt

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

	March 31, 2008	June 30, 2007
Line of credit, interest at the LIBOR Rate, as defined, plus 0.50%	$	$ 11,500
Pennsylvania Industrial Development Authority (PIDA) term note, interest at 3.00%		250
Yen denominated term note, interest at the Japanese Yen Base Rate, as defined, plus 1.49%, principal payable in full in September 2011	4,024	3,245
Total debt	4,024	14,995
Current portion of long-term debt		(55)
Long-term debt, less current portion	$ 4,024	$ 14,940

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 4.4% and 6.0% for the nine months ended March 31, 2008 and 2007, respectively. The Company had available $59.3 million and $47.8 million under its line of credit as of March 31, 2008 and June 30, 2007, respectively. The amounts available under the Company s line of credit are reduced by outstanding letters of credit. At March 31, 2008 and June 30, 2007, 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 September 2011. At March 31, 2008 and June 30, 2007, the Company had 400 million Yen borrowed under the Yen loan. 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 1.03% at March 31, 2008 and 0.73% at June 30, 2007.

Note K 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. The total amount of gross unrecognized tax benefits as of the date of adoption was $7.6 million. In conjunction with the adoption of

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FIN 48, the Company has classified uncertain tax positions as non-current income tax liabilities unless the amount is expected to be paid within one year. Prior to the adoption of FIN 48 the Company had previously recorded its tax contingencies as current liabilities. As of March 31, 2008, the gross unrecognized income tax benefits were $8.7 million and the change from July 1, 2007 was the result of increases to tax positions taken in the current fiscal year. If recognized, approximately $6.6 million of the gross unrecognized income tax benefits would affect the effective tax rate. During the quarter ended March 31, 2008, the Company decreased its unrecognized income tax benefit by $0.7 million due to the expiration of the statute of limitation on certain income tax exposure items. 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 operations. As of March 31, 2008, the Company had approximately $0.9 million of accrued interest and penalties related to uncertain tax positions included in the liability on its condensed consolidated balance sheet.

During fiscal year 2007, the IRS commenced examination of the Company s U.S. federal income tax return for fiscal years 2005 and 2006. Upon completion of this examination, it is possible that the total amount of unrecognized benefits will change.

The fiscal years 2005 to 2007 remain open to examination by the United States Internal Revenue Service, fiscal years 2004 to 2007 remain open to examination by certain state jurisdictions, and fiscal years 2003 to 2007 remain open to examination by certain foreign taxing jurisdictions.

Note L 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 because they were antidilutive were immaterial for all periods presented (000 except per share data):

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Earnings from continuing operations	$ 13,353	$ 10,122	$ 50,342	$ 27,086
Loss from discontinued operation	(305)	(73)	(912)	(429)
Net earnings	13,048	10,049	49,430	26,657
Divided by:				
Weighted average shares	29,692	29,411	29,661	29,306
Basic earnings from continuing operations per common share	$ 0.45	$ 0.34	$ 1.70	$ 0.92
Basic loss from discontinued operation per common share	$ (0.01)	$ (0.00)	$ (0.03)	$ (0.01)
Basic earnings per common share	$ 0.44	$ 0.34	$ 1.67	$ 0.91
Earnings from continuing operations	$ 13,353	$ 10,122	$ 50,342	$ 27,086
Loss from discontinued operation	(305)	(73)	(912)	(429)
Net earnings	13,048	10,049	49,430	26,657
Divided by:				
Weighted average shares	29,692	29,411	29,661	29,306
Dilutive effect of common stock equivalents	896	925	775	853
Diluted weighted average common shares	30,588	30,336	30,436	30,159
Diluted earnings from continuing operations per common share	$ 0.44	$ 0.33	$ 1.65	$ 0.90
Diluted loss from discontinued operation per common share	$ (0.01)	$ (0.00)	$ (0.03)	$ (0.01)
Diluted earnings per common share	$ 0.43	$ 0.33	$ 1.62	$ 0.88

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Note M Comprehensive Income

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2008	2007	2008	2007
Net earnings	$ 13,048	$ 10,049	$ 49,430	$ 26,657
Other comprehensive income:				
Foreign currency translation adjustments net of income taxes of $278 and $1,182, respectively, for the three and nine months ended March 31, 2008, and $34 and $100, respectively, for the three and nine months ended March 31, 2007.	1,538	142	2,826	301
Comprehensive income	$ 14,586	$ 10,191	$ 52,256	$ 26,958

Note N Segment and Geographic 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 business segments are managed separately due to the production requirements and facilities that are unique to each business segment. The Company evaluates business segment performance based upon reported business segment earnings or loss, which is defined as earnings from continuing operations before income taxes, interest and other income or expense.

The Company has four reportable segments that offer similar products. The Company s chief operating decision maker receives and reviews financial information in this format. 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 Lasertechnologie GmbH, 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. 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 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 announced its intention to sell its x-ray and gamma-ray radiation sensor division doing business as eV PRODUCTS, Inc. and operating as a business within 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 and the U.K. 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 Lasertechnologie GmbH brand name. The Infrared Optics segment includes the operating results for the quarter ended March 31, 2008 and in three of the nine months ended March 31, 2008 for HIGHYAG as this acquisition occurred January 2, 2008.

The Near-Infrared Optics segment is located in the U.S., China, Vietnam, Germany, Japan and the U.K. 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, 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. In the Military & Materials segment, Exotic Electro-Optics, Inc. designs, manufactures and markets infrared products for military applications and PRM produces and refines selenium and tellurium materials. The Military & Materials segment includes the operating results for the three and nine months ended March 31, 2008 for PRM, as this acquisition occurred June 26, 2007.

The Compound Semiconductor Group is located in the U.S., the U.K., Japan, China and Vietnam. 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 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 s):

	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
Goodwill	10,562	1,927	3,914	10,314		26,717

	Three Months Ended March 31, 2007					
	Infrared Optics	Near-Infrared Optics	Military & Materials	Compound Semiconductor Group	Eliminations	Total
Revenues	$ 34,000	$ 12,866	$ 7,065	$ 10,905	$	$ 64,836
Inter-segment revenues	169	346	89	1,810	(2,414)	
Segment earnings	8,817	1,512	966	947		12,242
Interest expense						(204)
Other income, net						507
Earnings from continuing operations before income taxes						12,545
Depreciation and amortization	1,491	634	410	1,085		3,620
Segment assets	141,771	39,133	20,363	58,356		259,623
Expenditures for property, plant and equipment	3,182	877	429	1,627		6,115
Equity investment				3,042		3,042
Goodwill	8,316	1,927	3,914	10,644		24,801

	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

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	Nine Months Ended March 31, 2007					
	Infrared Optics	Near-Infrared Optics	Military & Materials	Compound Semiconductor Group	Eliminations	Total
Revenues	$ 97,652	$ 35,105	$ 19,714	$ 32,370	$	$ 184,841
Inter-segment revenues	420	885	201	3,851	(5,357)	
Segment earnings	26,414	4,346	1,810	2,467		35,037
Interest expense						(873)
Other income, net						2,060
Earnings from continuing operations before income taxes						36,224
Depreciation and amortization	4,662	2,113	1,293	3,349		11,417
Expenditures for property, plant and equipment	7,448	2,421	646	3,652		14,167

Note O Share-Based Compensation

The Company records share-based compensation expense pursuant to Statement of Financial Accounting Standards No. 123 (revised 2004), (SFAS 123R) Share-Based Payment. SFAS 123R 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 123R, the Company recorded $0.8 million and $2.9 million in share-based compensation expense in its Condensed Consolidated Statements of Earnings for the three and nine months ended March 31, 2008, respectively and $0.7 million and $2.3 million for the three and nine months ended March 31, 2007, 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, 2008, the weighted-average fair value of options granted under the stock option plan was $12.66 and $13.03, respectively, and $18.82 and $14.60 for the three and nine months ended March 31, 2007, respectively, per option using the following assumptions:

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007	Nine Months Ended March 31, 2008	Nine Months Ended March 31, 2007
Risk free interest rate	2.69%	4.74%	3.87%	5.15%
Expected volatility	39%	58%	40%	59%
Expected life of options	5.86 years	6.92 years	5.86 years	6.92 years
Dividend yield	none	none	none	none

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 123R, 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.

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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, 2008, the Company had an outstanding performance share grant covering the period July 2007 to June 2009. 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 $0.8 million and $2.9 million share-based compensation expense for the three and nine months ended March 31, 2008, respectively, was $0.1 million and $0.5 million, respectively, of expense attributable to performance shares. Included in the $0.7 million and $2.3 million share-based compensation expense for the three and nine months ended March 31, 2007, respectively, was $0.1 million and $0.3 million, respectively, of expense attributed to 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 P 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 these foreign currencies expected to be received from its export sales for pre-established U.S. dollar amounts at specified dates. These contracts are entered into to limit transactional exposure to changes in currency exchange rates of export sales transactions in which settlement will occur in future periods and which otherwise would expose the Company, on the basis of its aggregate net cash flows in respective currencies, to foreign currency risk.

The Company has recorded the difference in the fair market value and the contract value of these contracts on the statement of financial position. These contracts have a contract value of $8.7 million at March 31, 2008. The Company does not account for these contracts as hedges as defined by SFAS No. 133 and records the change in the fair value of these contracts in the results of operations as they occur. The change in the fair value of these contracts decreased net earnings by $0.5 million and $0.2 million for the three months ended March 31, 2008 and 2007, respectively. The change in the fair value of these contracts decreased net earnings by $0.5 million and increased net earnings by $0.1 million for the nine months ended March 31, 2008 and 2007, respectfully.

Note Q Warranty Reserve

The Company records a warranty reserve as a charge against earnings based on a percentage of sales utilizing actual returns over the last twelve months. The following table summarizes the change in the carrying value of the Company s warranty reserve which is a component of other accrued liabilities as of and for the nine months ended March 31, 2008 ($000).

		Nine Months Ended March 31, 2008
Balance Beginning of Period	$	926
Expense and writeoffs, net		(145)
Balance End of Period	$	781

Note R Investments

During