NEWPORT CORP
Form 10-Q
August 12, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 3, 2004

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: 0-1649

NEWPORT CORPORATION

(Exact name of registrant as specified in its charter)

Nevada	**94-0849175**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*

1791 Deere Avenue, Irvine, California 92606

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: (949) 863-3144

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 an accelerated filer (as defined in Exchange Act Rule 12b-2).

Yes x No ¨

As of July 30, 2004, 42,670,189 shares of the registrant s sole class of common stock were outstanding.

NEWPORT CORPORATION

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

NEWPORT CORPORATION

Consolidated Statements of Operations

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 3, 2004	**June 30, 2003**	**July 3, 2004**	**June 30, 2003**
Net sales	**$ 47,500**	$ 33,781	**$ 89,899**	$ 67,085
Cost of sales	**30,703**	22,237	**58,854**	44,491
Gross profit	**16,797**	11,544	**31,045**	22,594
Selling, general and administrative expense	**11,209**	11,307	**22,199**	22,859
Research and development expense	**3,898**	4,724	**7,723**	9,712
Operating income (loss)	**1,690**	(4,487)	**1,123**	(9,977)
Interest and other income, net	**1,057**	2,375	**2,565**	3,948
Income (loss) from continuing operations before income taxes	**2,747**	(2,112)	**3,688**	(6,029)
Income tax provision (benefit)	**40**		**(160)**	
Income (loss) from continuing operations	**2,707**	(2,112)	**3,848**	(6,029)
Loss from discontinued operations, net of income tax		(240)		(2,192)
Net income (loss)	**$ 2,707**	$ (2,352)	**$ 3,848**	$ (8,221)
Basic net income (loss) per share:				
Income (loss) from continuing operations	**$ 0.07**	$ (0.05)	**$ 0.10**	$ (0.15)
Loss from discontinued operations		(0.01)		(0.06)
Net income (loss)	**$ 0.07**	$ (0.06)	**$ 0.10**	$ (0.21)
Diluted net income (loss) per share:				
Income (loss) from continuing operations	**$ 0.07**	$ (0.05)	**$ 0.09**	$ (0.15)
Loss from discontinued operations		(0.01)		(0.06)
Net income (loss)	**$ 0.07**	$ (0.06)	**$ 0.09**	$ (0.21)
Shares used in computation of net income (loss) per share:				
Basic	**39,308**	38,607	**39,234**	38,563

Diluted	**41,074**	38,607	**41,241**	38,563

See accompanying notes.

NEWPORT CORPORATION

Consolidated Balance Sheets

(In thousands, except share data)

	July 3, 2004	December 31, 2003
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 29,240**	$ 11,795
Marketable securities	**235,549**	255,507
Accounts receivable, net of allowance for doubtful accounts of $568 and $647	**32,862**	23,960
Inventories	**52,435**	54,854
Prepaid expenses and other current assets	**6,174**	6,000
Total current assets	**356,260**	352,116
Property and equipment, net	**30,289**	32,734
Goodwill	**57,606**	57,606
Deferred income taxes	**14,900**	14,900
Investments and other assets	**12,416**	10,863
	$ 471,471	$ 468,219
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	**$ 9,564**	$ 8,517
Accrued payroll and related expenses	**7,500**	7,811
Accrued expenses and other current liabilities	**8,986**	9,567
Accrued restructuring costs	**234**	1,124
Obligations under capital leases	**261**	272
Total current liabilities	**26,545**	27,291
Obligations under capital leases, less current portion	**1,425**	1,612
Accrued restructuring costs and other liabilities	**578**	907
Commitments and contingencies		
Stockholders equity:		
Common stock, par value $0.1167 per share, 200,000,000 shares authorized; 39,445,639 and 39,032,509 shares issued and outstanding	**4,603**	4,555
Capital in excess of par value	**443,041**	440,194
Deferred stock compensation	**(95)**	(139)
Accumulated other comprehensive income	**679**	2,952
Retained deficit	**(5,305)**	(9,153)
Total stockholders equity	**442,923**	438,409
	$ 471,471	$ 468,219

See accompanying notes.

NEWPORT CORPORATION

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended	
	July 3, 2004	**June 30, 2003**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	**$ 3,848**	$ (8,221)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	**4,549**	4,966
Provision for losses on inventories	**(587)**	(151)
Other non-cash items, net	**(131)**	(212)
Increase (decrease) in cash due to changes in:		
Accounts receivable	**(9,074)**	(3,247)
Inventories	**3,495**	1,709
Prepaid expenses and other current assets	**(155)**	2,192
Other assets and liabilities	**(1,436)**	(4)
Accounts payable	**1,171**	1,036
Accrued payroll and related expenses	**(234)**	(2,523)
Accrued expenses and other current liabilities	**(629)**	(4,315)
Accrued restructuring costs	**(1,174)**	(3,016)
Net cash used in operating activities	**(357)**	(11,786)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment, net	**(1,728)**	(1,397)
Proceeds from the sale of business and property and equipment	**11**	628
Purchase of marketable securities	**(161,295)**	(360,095)
Proceeds from the sale of marketable securities	**178,545**	346,924
Purchase of equity investments and intellectual property	**(410)**	(4,030)
Net cash provided by (used in) investing activities	**15,123**	(17,970)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long-term debt and obligations under capital leases	**(148)**	(3,131)
Repurchase of the Company s common stock		(2,484)
Proceeds from the issuance of common stock under employee plans	**2,895**	2,197
Net cash provided by (used in) financing activities	**2,747**	(3,418)
Impact of foreign exchange rate changes on cash balances	**(68)**	458
Net increase (decrease) in cash and cash equivalents	**17,445**	(32,716)
Cash and cash equivalents at beginning of period	**11,795**	44,059
Cash and cash equivalents at end of period	**$ 29,240**	$ 11,343
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	**$ 80**	$ 121

Income tax paid, net	**$ 253**	$ 109

See accompanying notes.

NEWPORT CORPORATION

Notes to Consolidated Financial Statements

July 3, 2004

1. Basis of Presentation

The accompanying consolidated financial statements include the financial statements of the Company and its wholly owned subsidiaries. These financial statements are unaudited and have been prepared in accordance with the instructions to Form 10-Q and Article 10 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.

The accompanying consolidated financial statements do not include certain footnotes and financial presentations normally required under generally accepted accounting principles 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 December 31, 2003. The results for the interim period are not necessarily indicative of results for the full year ending January 1, 2005. The December 31, 2003 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 December 31, 2003.

Effective beginning in the first quarter of 2004, the Company changed to a conventional 52/53-week accounting fiscal year. The Company s fiscal year will end on the Saturday closest to December 31, and its fiscal quarters will end on the Saturday closest to the end of each corresponding calendar quarter. As a result, for fiscal 2004, the Company s first and second quarters ended on April 3, 2004 and July 3, 2004, respectively. The Company s third quarter will end on October 2, 2004, and its fiscal year will end on January 1, 2005.

Certain prior period amounts have been reclassified to conform to the current period presentation.

2. Revenue Recognition

Revenue is recognized after all significant obligations have been met, collectibility is probable and title has passed, which typically occurs upon shipment or completion of services. Revenue for products that require installation for which the installation is essential to functionality or is not deemed inconsequential or perfunctory are recognized upon completion of installation. Revenues for products that require installation where installation is not essential to functionality and is deemed inconsequential or perfunctory are recognized upon shipment with estimated installation costs accrued. However, if a portion of the revenue is not payable until installation is complete, the Company defers revenue up to the amount that is not payable. Revenues for training are deferred until the service is completed. Revenues for extended service contracts are recognized over the related contract periods.

Customers generally have 30 days from the original invoice date (generally 60 days for international customers) to return a standard catalog product purchase for exchange or credit. The catalog product must be returned in its original condition and meet certain other criteria. Product returns of catalog items have historically been insignificant and are charged against revenue in the period returned. Custom, option-configured and certain other products as defined in the terms and conditions of sale cannot be returned.

3. Accounts Receivable

The Company estimates the collectibility of customer receivables on an ongoing basis by periodically reviewing invoices that have been outstanding for longer than a specified period of time. The Company has recorded reserves for specific receivables deemed to be at risk for collection, as well as a general reserve based on the Company s historical collections experience. A considerable amount of judgment is required in assessing the ultimate realization of these receivables, including the current credit-worthiness of each customer.

4. Derivative Instruments

The Company recognizes all derivative financial instruments in the consolidated financial statements at fair value regardless of the purpose or intent for holding the instrument. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. The Company does not engage in currency speculation; however, the Company uses forward exchange contracts to mitigate the risks associated with certain

NEWPORT CORPORATION

Notes to Consolidated Financial Statements

July 3, 2004

foreign currency transactions entered into in the ordinary course of business, primarily foreign currency denominated receivables and payables. Such contracts do not qualify for hedge accounting and, accordingly, changes in fair values are reported in the statements of operations. The forward exchange contracts generally require the Company 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 (AA or A+ rated banks) do not fulfill their obligations to deliver the contracted currencies, the Company could be at risk for any currency-related fluctuations. Transaction gains and losses are included in the statements of operations in *interest and other income, net*.

There were no foreign exchange contracts outstanding at December 31, 2003 or July 3, 2004.

5. Income Taxes

The Company provides for income taxes in interim periods based on the estimated effective income tax rate for the complete fiscal year. The income tax provision (benefit) is computed on the pretax income (loss) of the consolidated entities located within each taxing jurisdiction based on current tax law. Deferred taxes result from the future tax consequences associated with temporary differences between the amount of assets and liabilities recorded for tax and financial accounting purposes. A valuation allowance for deferred tax assets is recorded to the extent the Company cannot determine, in accordance with the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS No. 109), that the ultimate realization of net deferred tax assets is more likely than not.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers taxable income in carryback years, the scheduled reversal of deferred tax liabilities, tax planning strategies and projected future taxable income in making this assessment. As of July 3, 2004, due to uncertainties surrounding the realization of the cumulative federal and state net operating losses sustained during 2003 and 2002, the Company has recorded a valuation allowance against a portion of the gross deferred tax assets.

6. Discontinued Operations

In March 2003, the Company shut down its Plymouth, Minnesota operation and liquidated the majority of the remaining assets. Results for 2003 include the treatment of the Company s former metrology business and its Minnesota operation as discontinued operations, reflecting the completed divestitures of those operations.

7. Inventories

Inventories are stated at cost, determined on either a first in, first-out (FIFO) or average cost basis and do not exceed net realizable value. In assessing the ultimate realization of inventories, the Company makes judgments as to future demand requirements and compares those requirements with the current or committed inventory levels. Reserves are established for inventory levels that exceed expected future demand.

Inventories consist of the following:

(In thousands)	July 3, 2004	December 31, 2003
Raw materials and purchased parts	**$ 28,822**	$ 33,372
Work in process	**8,102**	7,463
Finished goods	**15,511**	14,019
Total inventories	**$ 52,435**	$ 54,854

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Notes to Consolidated Financial Statements

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8. Warranty

Unless otherwise stated in the Company s product literature or in its agreements with customers, the Company provides a one-year warranty from the original invoice date on all product material and workmanship. Products sold to original equipment manufacturer (OEM) customers generally carry longer warranties, typically 15 to 24 months. 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 product warranties relating to a product as a component of cost of sales at the time revenue for that product is recognized.

The activity in accrued warranty obligations is as follows:

	Six Months Ended	
(In thousands)	**July 3, 2004**	**June 30, 2003**
Balance at beginning of year	**$ 806**	$ 2,047
Additions charged to cost of sales	**868**	921
Warranty claims	**(808)**	(1,949)
Balance at end of period	**$ 866**	$ 1,019

Such amounts are included in accrued expenses and other current liabilities in the accompanying consolidated balance sheets.

9. Accrued Restructuring Costs

As of July 3, 2004, $0.5 million of facility-related accruals remained under the Company s 2002 restructuring plan. All severance actions were completed in 2003 and a total of 331 employees were terminated under this plan.

The following table summarizes the Company s accrued restructuring costs:

(In thousands)	**Facility Consolidation**

Balance at December 31, 2003	$	**1,687**
Cash payments		**(1,174)**
Balance at July 3, 2004	$	**513**

The facility consolidation reserves will be paid over the associated lease terms, which expire at various dates between 2005 and 2008. At July 3, 2004 and December 31, 2003, $0.2 million and $1.1 million, respectively, of accrued restructuring costs were expected to be paid within one year and are reflected in current liabilities; and $0.3 million and $0.6 million, respectively, of accrued restructuring costs are included in long-term *accrued restructuring costs and other liabilities* in the accompanying consolidated balance sheets.

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Notes to Consolidated Financial Statements

July 3, 2004

10. Interest and Other Income, Net

Interest and other income, net, consist of the following:

	Three Months Ended		Six Months Ended	
(In thousands)	**July 3, 2004**	**June 30, 2003**	**July 3, 2004**	**June 30, 2003**
Interest and dividend income	**$ 1,305**	$ 1,813	**$ 2,599**	$ 3,779
Gains (losses) on sales of marketable securities, net	**(52)**	1,067	**260**	1,284
Bank and portfolio asset management fees	**(138)**	(184)	**(270)**	(402)
Foreign exchange gains (losses), net	**(3)**	(180)	**54**	(298)
Interest expense	**(39)**	(117)	**(80)**	(192)
Other income (expense), net	**(16)**	(24)	**2**	(223)
Total interest and other income, net	**$ 1,057**	$ 2,375	**$ 2,565**	$ 3,948

11. Accumulated other comprehensive income and comprehensive income (loss)

Accumulated other comprehensive income consists of the following:

(In thousands)	**July 3, 2004**	**December 31, 2003**
Cumulative foreign currency translation gains	**$ 2,663**	$ 2,955
Unrealized losses on marketable securities	**(1,984)**	(3)
	$ 679	$ 2,952

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

	Three Months Ended	Six Months Ended

(In thousands)	July 3, 2004	June 30, 2003	July 3, 2004	June 30, 2003
Net income (loss)	**$ 2,707**	$ (2,352)	**$ 3,848**	$ (8,221)
Foreign currency translation gain (loss)	**152**	2,548	**(292)**	4,131
Unrealized holding period gains (losses) arising during period	**(2,432)**	602	**(1,721)**	856
Less: reclassification adjustments for (gain) loss included in net income (loss)	**52**	(1,067)	**(260)**	(1,284)
Comprehensive income (loss)	**$ 479**	$ (269)	**$ 1,575**	$ (4,518)

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Notes to Consolidated Financial Statements

July 3, 2004

12. Net Income (Loss) Per Share

Basic income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the periods, excluding restricted stock. *Diluted* income per share is computed using the weighted average number of shares of common stock outstanding during the periods, including restricted stock, and the dilutive effects of common stock equivalents (restricted stock and employee stock options) outstanding during the periods, determined using the treasury stock method. Diluted loss per share excludes the antidilutive effects of common stock equivalents outstanding during the periods.

The following table sets forth the numerator and denominator used in the computation of net income (loss) per share:

	Three Months Ended		Six Months Ended	
(In thousands)	**July 3, 2004**	**June 30, 2003**	**July 3, 2004**	**June 30, 2003**
Numerator for basic and diluted net income (loss) per share:				
Income (loss) from continuing operations	$ 2,707	$ (2,112)	$ 3,848	$ (6,029)
Loss from discontinued operations		(240)		(2,192)
Net income (loss)	$ 2,707	$ (2,352)	$ 3,848	$ (8,221)
Denominator for basic net income (loss) per share:				
Weighted average shares outstanding	39,372	38,672	39,298	38,628
Weighted unvested restricted stock outstanding	(64)	(65)	(64)	(65)
Denominator for basic net income (loss) per share:	**39,308**	38,607	**39,234**	38,563
Effect of dilutive securities:				
Employee stock options	1,702		1,943	
Restricted stock	64		64	
Denominator for diluted net income (loss) per share:	41,074	38,607	41,241	38,563

Common stock equivalents of 2,049 and 1,845, respectively, have been excluded from the denominator for purposes of calculating diluted loss per share for the three and six months ended June 30, 2003, as their inclusion would be antidilutive due to the net losses incurred.

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Notes to Consolidated Financial Statements

July 3, 2004

13. Stock Based Compensation

The Company applies the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and related Interpretations in accounting for its stock-based compensation and complies with the disclosure provisions of Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure* (SFAS No. 148) and Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). Accordingly, no compensation expense is recognized for employee stock options with exercise prices greater than or equal to the Company s stock price at date of grant. Costs related to restricted stock grants, representing the difference between the grant date fair value of the award and the purchase price, if any, of the related shares, are fixed at the date of grant and amortized over the vesting period. Pro forma amounts adjusted for the effect of recording compensation cost related to the Company s stock option and employee stock purchase plans determined based upon the fair value of awards under these plans as of the grant date, consistent with the methodology prescribed under SFAS No. 148 and SFAS No. 123, are presented below:

	Three Months Ended		Six Months Ended	
(In thousands, except per share data)	**July 3, 2004**	**June 30, 2003**	**July 3, 2004**	**June 30, 2003**
Net income (loss) reported	**$ 2,707**	$ (2,352)	**$ 3,848**	$ (8,221)
Employee compensation expense under fair value method	**(3,447)**	(4,345)	**(7,094)**	(8,741)
Net loss pro forma	**$ (740)**	$ (6,697)	**$ (3,246)**	$ (16,962)
Basic net income (loss) per share reported	**$ 0.07**	$ (0.06)	**$ 0.10**	$ (0.21)
Basic net loss per share pro forma	**$ (0.02)**	$ (0.17)	**$ (0.08)**	$ (0.44)
Diluted net income (loss) per share reported	**$ 0.07**	$ (0.06)	**$ 0.09**	$ (0.21)
Diluted net loss per share pro forma	**$ (0.02)**	$ (0.17)	**$ (0.08)**	$ (0.44)
Shares used in computation of net income (loss) per share:				
Basic	**39,308**	38,607	**39,234**	38,563
Diluted reported	**41,074**	38,607	**41,241**	38,563
Diluted pro forma	**39,308**	38,607	**39,234**	38,563

For purposes of reporting diluted net loss pro forma per share, for the three and six months ended July 3, 2004, common stock equivalents of 1,766 and 2,007, respectively, have been excluded from the denominator, as their inclusion would be antidilutive due to the pro forma net loss incurred. Common stock equivalents of 2,049 and 1,845, respectively, have been excluded from the denominator for purposes of calculating diluted net loss and diluted net loss pro forma per share for the three and six months ended June 30, 2003, as their inclusion would be antidilutive due to net losses incurred.

The fair value of each option granted in 2004 was estimated as of the date of the grant using the Black-Scholes option pricing model with the following weighted-average assumptions: no annualized dividend yield; expected annual volatility of 70.60%; risk-free interest rate of 3.18%; expected life of 5 years; and expected turnover rate of 12.90%.

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Notes to Consolidated Financial Statements

July 3, 2004

14. Segment Reporting

The Company has two reportable business segments: Industrial and Scientific Technologies (ISTD) and Advanced Packaging and Automation Systems (APAS). Selected segment financial information follows:

(In thousands)	Industrial and Scientific Technologies	Advanced Packaging and Automation Systems	Total
Three Months Ended July 3, 2004:			
Sales to external customers	**$ 37,832**	**$ 9,668**	**$ 47,500**
Segment income (loss)	**4,839**	**(654)**	**4,185**
Three Months Ended June 30, 2003:			
Sales to external customers	$ 26,827	$ 6,954	$ 33,781
Segment income (loss)	2,402	(3,628)	(1,226)
Six Months Ended July 3, 2004:			
Sales to external customers	**$ 72,226**	**$ 17,673**	**$ 89,899**
Segment income (loss)	**7,914**	**(1,753)**	**6,161**
Six Months Ended June 30, 2003:			
Sales to external customers	$ 54,582	$ 12,503	$ 67,085
Segment income (loss)	3,372	(7,118)	(3,746)

In the first quarter of 2004, the Company reclassified certain fiber optic communications product lines from its APAS Division to its ISTD Division. All prior periods have been restated to reflect this change in business segment.

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

	Three Months Ended		Six Months Ended	
(In thousands)	July 3, 2004	June 30, 2003	July 3, 2004	June 30, 2003
Segment income (loss)	**$ 4,185**	$ (1,226)	**$ 6,161**	$ (3,746)
Unallocated operating expenses	**(2,495)**	(3,261)	**(5,038)**	(6,231)
Interest and other income, net	**1,057**	2,375	**2,565**	3,948

Income (loss) from continuing operations before income taxes	**$ 2,747**	$ (2,112)	**$ 3,688**	$ (6,029)

15. Subsequent Event

On July 16, 2004, the Company completed its acquisition of Spectra-Physics, Inc. and certain related entities for consideration of approximately $300 million. The purchase price was comprised of $200 million in cash, a $50 million promissory note bearing 5% interest and payable in 2009, and 3.2 million shares of Newport Corporation common stock.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations for the Three and Six Months Ended July 3, 2004 and June 30, 2003

INTRODUCTORY NOTE

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and we intend that such forward-looking statements be subject to the safe harbors created thereby. Words such as may, will, expect, believe, anticipate, intend, could, estimate, or continue or the negative or other thereof or comparable terminology are intended to identify forward-looking statements. In addition, any statements that refer to projections of our future financial performance, trends in our businesses, or other characterizations of future events or circumstances are forward-looking statements.

The forward-looking statements included herein are based on current expectations and involve a number of risks and uncertainties, all of which are difficult or impossible to predict accurately and many of which are beyond our control. As such, our actual results may differ significantly from those expressed in any forward-looking statements. Factors that may cause or contribute to such differences include, but are not limited to, those discussed in more detail under the subheading RISKS RELATING TO OUR BUSINESS on pages 22 through 29 of this Quarterly Report on Form 10-Q, and in Item 1 (Business) and Item 7 (Management s Discussion and Analysis of Financial Condition and Results of Operations) in our Annual Report on Form 10-K for the year ended December 31, 2003. Readers should carefully review these risks, as well as the additional risks described in other documents we file from time to time with the Securities and Exchange Commission. In light of the significant risks and uncertainties inherent in the forward-looking information included herein, the inclusion of such information should not be regarded as a representation by us or any other person that such results will be achieved, and readers are cautioned not to place undue reliance on such forward-looking information. We undertake no obligation to revise the forward-looking statements contained herein to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following is our discussion and analysis of certain significant factors that have affected our earnings and financial position during the periods included in the accompanying financial statements. This discussion compares the three- and six- month periods ended July 3, 2004 and June 30, 2003. This discussion should be read in conjunction with the financial statements and associated notes.

SUBSEQUENT EVENT

On July 16, 2004, we completed the acquisition of Spectra-Physics, Inc. and certain related entities for consideration of approximately $300 million. The purchase price was comprised of $200 million in cash, a $50 million promissory note bearing 5% interest and payable in 2009, and 3.2 million shares of our common stock.

DISCONTINUED OPERATIONS

In March 2003, we shut down our Plymouth, Minnesota operation and liquidated the majority of the remaining assets. Results for the 2003 periods include the treatment of our former metrology business and our Minnesota operation as discontinued operations, reflecting the completed divestitures of those operations.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management s Discussion and Analysis of Financial Condition and Results of Operations is based on our consolidated financial statements included in this Quarterly Report on Form 10-Q, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires 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. On an ongoing basis, we evaluate these estimates and assumptions, including those related to allowance for doubtful accounts, inventory reserves, warranty obligations, restructuring reserves, asset impairment valuations and income tax valuations. We base these estimates on 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 that are not readily apparent from other sources. These estimates and assumptions by their nature involve risks and uncertainties, and may prove to be inaccurate. In the event that any of our estimates or assumptions are 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.

The following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

We record revenue after all significant obligations have been met, collectibility is probable and title has passed, which typically occurs upon shipment or completion of services. For products that require installation for which the installation is essential to functionality or is not deemed inconsequential or perfunctory, we recognize revenue upon completion of installation. For products that require installation where installation is not essential to functionality and is deemed inconsequential or perfunctory we recognize revenue upon shipment with estimated installation costs accrued. However, if a portion of the revenue is not payable until installation is complete, we defer revenue equal to the amount that is not payable. We defer revenues for training until the service is completed. We recognize revenue for extended service contracts over the related contract periods.

Our customers generally have 30 days from the original invoice date (generally 60 days for international customers) to return a standard catalog product purchase for exchange or credit. The catalog product must be returned in its original condition and meet certain other criteria. Product returns of catalog items have historically been insignificant and are charged against revenue in the period returned. Custom, option-configured and certain other products as defined in our terms and conditions of sale cannot be returned.

Accounts Receivable

We estimate the collectibility of customer receivables on an ongoing basis by periodically reviewing invoices that have been outstanding for longer than a specified period of time. We have recorded reserves for specific receivables deemed to be at risk for collection, as well as a general reserve based on our historical collections experience. A considerable amount of judgment is required in assessing the ultimate realization of these receivables, including the current credit-worthiness of each customer. If the financial conditions of our customers in the markets we serve were to deteriorate, resulting in an impairment of their ability to make required payments, additional allowances could be required which could adversely affect our operating results.

Inventory

We state our inventories at the lower of cost (determined on either a first-in, first-out (FIFO) or average cost basis) or market and provide reserves for potentially excess and obsolete inventory. In assessing the ultimate realization of inventories, we make judgments as to future demand requirements and compare those requirements with the current or committed inventory levels. Reserves are established for inventory levels that exceed expected future demand. It is possible that additional changes in required inventory reserves may occur in the future due to changes in market conditions, which could adversely affect our operating results.

Warranty

Unless otherwise stated in our product literature, we provide a one-year warranty from the original invoice date on all product material and workmanship. Products sold to original equipment manufacturer (OEM) customers generally carry longer warranties, typically 15 to 24 months. Defective products will be either repaired or replaced, generally at our option, upon meeting certain criteria. We accrue a provision for the estimated costs that may be incurred for product warranties relating to a product as a component of cost of sales at the time revenue for that product is recognized. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers, our warranty obligation is affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage and/or service delivery costs differ from our estimates, revisions to the estimated warranty obligation would be required which could adversely affect our operating results.

Impairment of Assets

We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that their carrying value may not be recoverable. The determination of related estimated useful lives and whether or not these assets are impaired involves significant judgments, related primarily to the future profitability and/or future value of the assets. Changes in our strategic plan and/or market conditions could significantly impact these judgments and could require adjustments to recorded asset balances. We hold minority interests in companies having operations or technologies in areas within or adjacent to our strategic focus, all of which are privately held and whose values are difficult to determine. We record an investment impairment charge in any reporting period where we believe an investment has experienced a decline in value that is other than temporary. Future changes in our strategic direction, adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment s current carrying value, thereby possibly requiring an impairment charge in the future.

We perform annual impairment tests of our goodwill and other intangibles in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142). Under SFAS No. 142, goodwill is no longer amortized but is subject to impairment tests based upon a comparison of the fair value of each of our reporting units, as defined, and the carrying value of the reporting units net assets, including goodwill. SFAS No. 142 requires a review for impairment at least annually or when circumstances exist that would indicate an impairment of such goodwill. We perform the annual impairment review as of October 1st each year. The 2003 and 2002 annual reviews resulted in no additional impairment of the carrying value of goodwill. At July 3, 2004, we had goodwill of approximately $57.6 million.

Restructuring Reserves

As of July 3, 2004, $0.5 million of facility-related accruals remained under our 2002 restructuring plan. We completed all severance actions in 2003 and we terminated a total of 331 employees under this plan.

The following table summarizes our accrued restructuring costs:

(In thousands)	Facility Consolidation
Balance at December 31, 2003	$ 1,687
Cash payments	(1,174)
Balance at July 3, 2004	$ 513

The facility consolidation reserves will be paid over the associated lease terms, which expire at various dates between 2005 and 2008. At July 3, 2004 and December 31, 2003, $0.2 million and $1.1 million, respectively, of accrued restructuring costs were expected to be paid within one year and are reflected in current liabilities; and $0.3 million and $0.6 million, respectively, of accrued restructuring costs are included in long-term *accrued restructuring costs and other liabilities* in the accompanying consolidated balance sheets.

Income Taxes

We provide for income taxes in interim periods based on the estimated effective income tax rate for the complete fiscal year. The income tax provision (benefit) is computed on the pretax income (loss) of the consolidated entities located within each taxing jurisdiction based on current tax law. Deferred taxes result from the future tax consequences associated with temporary differences between the recorded amounts of the assets and liabilities for tax and financial accounting purposes. A valuation allowance for deferred tax assets is recorded to the extent we cannot determine, in accordance with the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*, (SFAS No. 109), that the ultimate realization of the net deferred tax assets is more likely than not.

We currently have significant deferred tax assets, which are subject to periodic recoverability assessments. We recorded a valuation reserve in the third quarter of 2002 against our deferred tax assets pursuant to SFAS No. 109, due to the uncertainty as to the timing and ultimate realization of those assets. As such, we did not recognize any tax benefit on the losses recorded in 2003 and recorded a valuation allowance against deferred tax assets for the current period. For the foreseeable future, the Federal tax provision related to future earnings will be substantially offset by a reduction in the valuation reserve, and any future pretax losses will not be offset by a tax benefit due to the uncertainty of the recoverability of the deferred tax assets. Accordingly, future tax expense will consist primarily of certain required minimum state income taxes and taxes in certain foreign jurisdictions.

Realization of our deferred tax assets is principally dependent upon our achievement of future taxable income and/or tax planning strategies, the estimation of which requires significant management judgment. Our judgments regarding future profitability may change due to many factors, including future market conditions and our ability to successfully execute our business plans and/or tax planning strategies. These changes, if any, may require material adjustments to these deferred tax asset balances.

Fiscal Year End

Effective beginning in the first quarter of 2004, we changed to a conventional 52/53-week accounting fiscal year. Our fiscal year will end on the Saturday closest to December 31, and our fiscal quarters will end on the Saturday closest to the end of each corresponding calendar quarter. As a result, for fiscal 2004, our first and second quarters ended on April 3, 2004 and July 3, 2004, respectively. Our third quarter will end on October 2, 2004, and our fiscal year will end on January 1, 2005.

RESULTS OF OPERATIONS

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

	Percentage of Net Sales		Percentage of Net Sales	
	Three Months Ended		Six Months Ended	
	July 3, 2004	June 30, 2003	July 3, 2004	June 30, 2003
Net sales	**100.0%**	100.0%	**100.0%**	100.0%
Cost of sales	**64.6**	65.8	**65.5**	66.3
Gross profit	**35.4**	34.2	**34.5**	33.7
Selling, general and administrative expenses	**23.6**	33.5	**24.7**	34.1
Research and development expense	**8.2**	14.0	**8.6**	14.5
Operating income (loss)	**3.6**	(13.3)	**1.2**	(14.9)
Interest and other income, net	**2.2**	7.0	**2.9**	5.9

Income (loss) from continuing operations before income taxes	**5.8**	(6.3)	**4.1**	(9.0)
Income tax provision (benefit)	**0.1**		**(0.2)**	
Income (loss) from continuing operations	**5.7**	(6.3)	**4.3**	(9.0)
Loss from discontinued operations		(0.7)		(3.3)
Net income (loss)	**5.7%**	(7.0)%	**4.3%**	(12.3)%

Net Sales

Net sales for the quarter ended July 3, 2004 were $47.5 million, an increase of 40.5% compared with $33.8 million for the quarter ended June 30, 2003. Net sales for the first half of 2004 were $89.9 million, and increase of 34.0% compared with $67.1 million in the first half of 2003. The sales increase was due to increases in demand across all of our end markets, together with a transition services agreement with our largest customer in the life and health sciences market. As part of the agreement, the customer made a payment of $1.1 million for product development services rendered in previous quarters and agreed on a financial arrangement for the provision of additional products and services in the future.

Sales to customers in the semiconductor equipment market for the quarter ended July 3, 2004 were $17.3 million, reflecting an increase of $4.3 million, or 33.1%, compared with the corresponding prior-year period. Sales to this market in the first half of 2004 were $33.8 million, an increase of $9.5 million, or 39.1%, compared with the first half of 2003. The increase reflected increases in demand by semiconductor manufacturers for capital equipment, which led to higher demand for the components, subsystems and robots we sell to this market, offset in part by a reduction in sales of the turnkey systems we sell to customers in this market.

Sales to the life and health sciences market for the quarter ended July 3, 2004 totaled $4.7 million, reflecting an increase of $2.0 million, or 74.1%, compared with the corresponding prior-year period. Sales to this market in the first half of 2004 were $7.7 million, an increase of $2.7 million, or 54.0%, compared with the first half of 2003. The increase was attributable primarily to higher sales of products to our largest customer in this market in the 2004 periods, as well as to a payment of approximately $1.1 million from this customer under the previously discussed transition services agreement.

Sales for the quarter ended July 3, 2004 to our other markets, comprised primarily of research, aerospace and defense, fiber optic communications and the other end markets we serve, were $25.5 million, an increase of $7.4 million, or 40.9%, compared with the corresponding prior-year period. Sales to these markets in the first half of 2004 were $48.4 million, an increase of $10.6 million, or 28.0%, compared with the first half of 2003. The increases were attributable primarily to the overall strength of the economy, our further penetration of the research market, sales of the new products we released during 2003, and greater governmental spending on research, defense and homeland security.

Domestic and international sales by end market were as follows:

(In thousands)	Three Months Ended July 3, 2004	Three Months Ended June 30, 2003	Increase	Percentage Increase
Domestic Sales:				
Semiconductor equipment	**$ 16,602**	$ 10,963	$ 5,639	51.4%
Life and health sciences	**4,002**	2,312	1,690	73.1
Other markets	**14,472**	9,644	4,827	50.0
Total domestic sales	**$ 35,076**	$ 22,920	$ 12,156	53.0%

	Three Months Ended		Increase (Decrease)	Percentage Increase (Decrease)

(In thousands)	July 3, 2004	June 30, 2003		
International Sales:				
Semiconductor equipment	**$ 747**	$ 2,044	$ (1,297)	(63.5)%
Life and health sciences	**692**	345	347	100.6
Other markets	**10,985**	8,472	2,513	29.7
Total international sales	**$ 12,424**	$ 10,861	$ 1,563	14.4%

(In thousands)	Six Months Ended July 3, 2004	Six Months Ended June 30, 2003	Increase	Percentage Increase
Domestic Sales:				
Semiconductor equipment	**$ 31,838**	$ 21,038	$ 10,800	51.3%
Life and health sciences	**6,646**	4,400	2,246	51.0
Other markets	**26,241**	20,227	6,014	29.7
Total domestic sales	**$ 64,725**	$ 45,665	$ 19,060	41.7%

(In thousands)	Six Months Ended July 3, 2004	Six Months Ended June 30, 2003	Increase (Decrease)	Percentage Increase (Decrease)
International Sales:				
Semiconductor equipment	**$ 1,978**	$ 3,220	$ (1,242)	(38.6)%
Life and health sciences	**1,076**	596	480	80.5
Other markets	**22,120**	17,604	4,516	25.7
Total international sales	**$ 25,174**	$ 21,420	$ 3,754	17.5%

Geographically, sales to European customers in the second quarter of 2004 were $7.0 million, an increase of $0.7 million, or 11.1%, and sales in the first half of 2004 were $13.9 million, an increase of $1.3 million, or 10.3%, compared with the corresponding prior-year periods. Sales to Pacific Rim customers in the second quarter of 2004 were $3.9 million, a decrease of $0.1 million, or 2.5%, and sales in the first half of 2004 were $8.5 million, an increase of $1.5 million, or 21.4%, compared with the corresponding prior-year periods. Second quarter sales to Canadian customers were $0.9 million, an increase of $0.5 million, and first half sales were $1.6 million, an increase of $0.6 million, or 60.0%, compared with the corresponding prior-year periods. Sales to other international customers in the quarter ended July 3, 2004 were $0.6 million, an increase of $0.4 million, or 200%, and first half sales to these customers were $1.2 million, an increase of $0.3 million, or 33.3%, compared with the respective prior-year periods. The increases in sales to international customers in the first half of 2004 were due primarily to the increases in sales to our research, aerospace and defense, fiber optic communications and other markets, as well as to favorable exchange rate fluctuations, offset in part by a decrease in sales to semiconductor customers, although the impact of such factors on sales to each geographic market varies based on the composition of our sales to that geographic market.

The results of our international operations are subject to currency fluctuations. As the value of the U.S. dollar weakens relative to other currencies, sales in those currencies convert to more U.S. dollars; conversely, when the value of the U.S. dollar strengthens relative to other currencies, sales in those countries convert to fewer U.S. dollars. Approximately $1.4 million of the increase in net sales in the first half of 2004 was attributable to reductions in the average value of the U.S. dollar relative to foreign currencies compared with the corresponding prior-year period.

We expect net sales for the third quarter of 2004 to more than double over the second quarter level due to the addition of the sales of Spectra-Physics, which we acquired on July 16, 2004. However, our business is subject to risks arising from market conditions in the semiconductor equipment market, as well as from general economic conditions. We have experienced significant increases in orders from and sales to the semiconductor equipment market in recent quarters, reflecting the higher levels of capital spending by semiconductor manufacturers. In addition, we expect net sales to this market for the third quarter of 2004 to more than double over the second quarter level due to our acquisition of Spectra-Physics. However, the duration and extent of the current upturn in this

market is difficult to predict and represents a significant uncertainty with respect to our future operating results. We likewise expect our sales to the life and health sciences market for the third quarter to more than double over the second quarter level due to our acquisition of Spectra-Physics. In general, we expect our sales to this market to fluctuate on a quarter to quarter basis in the short term due to our relatively small number of significant OEM customers in this market, but to increase over time as we increase our penetration of this market. The fiber optic communications market has remained depressed in 2003 and 2004, and we expect our orders from and sales to this market to remain depressed until at least the end of 2005. The precise timing and extent of any recovery in the fiber optic communications market is also difficult to predict and also represents a significant uncertainty with respect to our future operating results. We expect that our sales to the research, aerospace and defense markets will fluctuate from period to period in line with changes in overall research and defense spending levels, but will increase over time as we increase our penetration of these markets.

Gross Margin

Gross margin for the quarter ended July 3, 2004 was 35.4%, compared with a gross margin of 34.2% in the corresponding period in 2003. Gross margin for the first half of 2004 was 34.5%, compared with a gross margin of 33.7% in the first half of 2003. Gross margin in the second quarter and first half of 2004 benefited by approximately $1.1 million from the previously discussed transition services agreement. Excluding this impact, the improvement in gross margin in 2004 was due to the higher sales volume, which led to improved absorption of overhead, and was offset by a higher mix of sales to OEM customers, which generally carry lower gross margins. Gross margins for all periods presented were negatively impacted by previously capitalized underabsorbed overhead costs. Products sold in the current quarter were produced during periods in which unabsorbed overhead costs were allocated to inventory. In accordance with generally accepted accounting principles, these variances were capitalized when the inventory was produced and are charged to cost of sales when the related products are sold. We expect this negative impact on our gross margin to be lessened in the second half of 2004, when we add the results of Spectra-Physics, but we expect that it will continue to some degree for the next few quarters.

Gross margin for the third quarter is expected to be impacted significantly by the addition of Spectra-Physics, as well as to adjustments to cost of sales for acquisition, integration and other non-recurring items. Excluding such adjustments, we expect our gross margin to improve in the third quarter of 2004 compared with the second quarter level due to better absorption of overhead costs. In general, we expect that our gross margin will fluctuate in future periods due to factors including absorption of fixed overhead due to sales volumes and production activity, product mix and the proportion of sales to OEM customers, material costs, changes in the carrying value of inventory and manufacturing efficiencies. In particular, because a significant portion of our manufacturing overhead is fixed in the short term, the impact of increases or decreases in sales on our gross margin will likely not be in proportion to the changes in net sales.

Selling, General and Administrative (SG&A) Expense

SG&A expense for the quarter ended July 3, 2004 totaled $11.2 million, or 23.6% of net sales, compared with $11.3 million, or 33.5% of net sales, for the second quarter of 2003. SG&A expense for the first half of 2004 totaled $22.2 million, or 24.7% of net sales, compared with $22.9 million, or 34.1% of net sales, for the first half of 2003. The decrease in SG&A expenses in absolute dollars in the first half of 2004 was attributable primarily to the effects of our cost reduction efforts over the last 18 months and to higher expenses incurred in the first half of 2003 for legal fees related to protecting our intellectual property, offset in part by an increase in variable selling expenses in the first half of 2004 associated with the higher sales volume.

We expect that SG&A expense for the third quarter will slightly more than double compared with the second quarter level due to the addition of the SG&A expenses of Spectra-Physics, and will be increased further by charges for acquisition, integration and other non-recurring items. In addition, we expect to incur increased SG&A expense relating to compliance with Section 404 of the Sarbanes-Oxley Act of 2002, but the precise amount of this increase has not yet been determined. In general, we expect that SG&A expense will fluctuate as a percentage of sales in the future based on our sales level in any given period. Because a significant portion of our SG&A expense is fixed in the short term, these fluctuations will likely not be in proportion to the changes in net sales.

Research and Development (R&D) Expense

R&D expense for the quarter ended July 3, 2004 totaled $3.9 million, or 8.2% of net sales, compared with $4.7 million, or 14.0% of net sales, for the corresponding period in 2003. R&D expense for the first half of 2004 totaled $7.7 million, or 8.6% of net sales, compared with $9.7 million, or 14.5% of net sales, for the corresponding period in 2003. The lower R&D expense in the current year periods resulted primarily from reductions in R&D spending in the fiber optic communications area, as well as from our overall efforts to maximize the focus and efficiency of our R&D activities.

We expect that R&D expense will slightly more than double in the third quarter of 2004 compared with the second quarter level due to the addition of the R&D expenses of Spectra-Physics, and may be increased further by charges for acquisition, integration and other non-recurring items. In addition, we believe that the continued development and advancement of our key products and technologies is critical to our future success. Accordingly, 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 will fluctuate in the future based on our sales level in any given period. Because of our commitment to continued product development, and because a significant portion of our R&D expense is fixed in the short term, these fluctuations will likely not be in proportion to the changes in net sales.

Interest and Other Income, Net

Interest and other income, net, totaled $1.1 million for the second quarter of 2004, compared with $2.4 million in the second quarter of 2003, and totaled $2.6 million for the first half of 2004, compared with $3.9 million in the first half of 2003. The decrease in the second quarter was due primarily to lower yields on cash and marketable securities and to losses realized on sales of certain marketable securities. We expect to incur interest and other expense, net, in the third quarter of 2004 due to lower interest income earned due to the use of $200 million in cash to purchase Spectra-Physics, as well as due to the 5% annual interest payable on the $50 million note issued in connection with the Spectra-Physics acquisition. In addition, we will realize a loss on the sale of marketable securities in the third quarter of approximately $1.7 million resulting from the liquidation of such securities to fund the cash portion of the purchase price for Spectra-Physics.

Income Taxes

The effective tax rate from continuing operations for the quarter ended July 3, 2004 was an expense of 1.5%, versus 0.0% in the corresponding prior-year period, and was a net benefit of 4.3% in the first half of 2004, compared with 0.0% in the corresponding prior-year period. We have recorded a valuation reserve against our deferred tax assets pursuant to SFAS No. 109, due to the uncertainty as to the timing and ultimate realization of those assets. As such, for the foreseeable future, the Federal tax provision related to future earnings will be substantially offset by a reduction in the valuation reserve, and any future pretax losses will not be offset by a tax benefit due to the uncertainty of the recoverability of the deferred tax assets. Accordingly, future tax expense will consist primarily of certain required minimum state income taxes and taxes in certain foreign jurisdictions.

The income tax benefit recorded in the first half of 2004 was due primarily to a net income tax benefit of $0.2 million from the favorable settlement of a state income tax examination for less than amounts originally estimated.

Overall, we expect our tax rate to increase compared with the second quarter 2004 level due to increased state income taxes, as well as additional taxes payable in foreign jurisdictions, resulting primarily from our acquisition of Spectra-Physics.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in our operating activities of $0.4 million for the first half of 2004 was attributable primarily to an increase in accounts receivable as a result of an increase in sales at the end of the quarter, to a decrease in accrued expenses and to cash expenditures incurred in connection with the Spectra-Physics acquisition, offset in part by a decrease in inventories, an increase in accounts payable and the cash portion of our net income.

Net cash provided by investing activities of $15.1 million for the first half of 2004 was attributable to net proceeds from the sale of marketable securities of $17.2 million, offset in part by purchases of equity investments of $0.4 million and net purchases of property, plant and equipment of $1.7 million.

Net cash provided by financing activities of $2.7 million for the first half of 2004 was attributable to proceeds of $2.9 million received from the issuance of common stock in connection with stock option and purchase plans, offset in part by payments of capital lease obligations.

At July 3, 2004, we had cash and cash equivalents of $29.2 million and marketable securities of $235.5 million. These securities have been divided into two portfolios, each managed by a professional investment management firm, under the oversight of our senior financial management team and the Investment Committee of our Board of Directors. Such portfolio managers invest the funds allocated to them in accordance with our Investment Policy, which is reviewed regularly by our senior financial management and the Investment Committee. Our cash portfolio balances has declined by $200 million in the third quarter of 2004 due to the cash paid to acquire Spectra-Physics, and we expect to use additional cash in the third quarter for acquisition, integration and other non-recurring items. In addition, our cash balances will fluctuate in the future based on factors such as cash used in or provided by ongoing operations, acquisitions or divestitures, investments in other companies, share repurchases, capital expenditures and contractual obligations, as well as changes in interest rates.

At July 3, 2004, we had in place a $5.0 million revolving line of credit expiring December 31, 2004. Certain of the marketable securities that are being managed by the lending institution collateralize the line of credit. The line bears interest at the prevailing prime rate, or the prevailing London Interbank Offered Rate (2.34% at July 3, 2004) plus 1.5%, at our option, and an unused line fee of 0.25% per year. At July 3, 2004, there were no balances outstanding under the line of credit, with $4.5 million available under the line, after considering outstanding letters of credit totaling $0.5 million.

In 2003, we announced that our board of directors had approved a share repurchase program. The Board authorized us to purchase up to 3.9 million shares, or 10% of our then outstanding stock. The purchases may be made 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. During 2003, we repurchased 285,529 shares under this program at a cost of $4.5 million. We have not made any purchases under this program in 2004, and any future purchases will depend on the aforementioned factors.

On July 16, 2004, we completed the acquisition of Spectra-Physics and certain related entities for consideration of approximately $300 million. The purchase price was comprised of $200 million in cash, a $50 million promissory note bearing 5% interest and payable in 2009, and 3.2 million shares of our common stock. We will realize a loss on the sale of marketable securities in the third quarter of approximately $1.7 million to fund the cash portion of the purchase price for Spectra-Physics.

We believe our current working capital position, together with our expected future cash flows from operations and our existing credit availability, will be adequate to fund our operations in the ordinary course of business, anticipated capital expenditures, debt payment requirements and other contractual obligations for the foreseeable future. However, this belief is based upon many assumptions and is subject to numerous risks (see Risks Relating To Our Business, on pages 22-29), and there can be no assurance that we will not require additional funding in the future. In particular, in 2009 we will become obligated to pay the principal balance on the $50 million promissory note issued to Thermo Electron in connection with the acquisition of Spectra-Physics.

We have no present agreements or commitments with respect to any material acquisitions of other businesses, products, product rights or technologies or any 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, there can be no assurance that we will not need to obtain additional sources of capital in the future to finance any such acquisitions and/or investments.

RISKS RELATING TO OUR BUSINESS

The following is a summary of certain risks we face in our business. They are not the only risks we face. Additional risks of which we are not presently aware or that we currently believe are immaterial may also harm our business and results of operations. The trading price of our common stock could decline due to the occurrence of any of these risks, and investors could lose all or part of their investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in our other filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended December 31, 2003 and our Quarterly Report on Form 10-Q for the quarter ended April 3, 2004, including our consolidated financial statements and related notes included therein.

We may not be able to effectively or completely integrate the business and operations of Spectra-Physics, which may cause the market price of our common stock to decline significantly.

In connection with our acquisition of Spectra-Physics, we face several significant challenges in integrating the business and operations of Spectra-Physics with our own. There is no guarantee that we will be able to achieve the integration in an effective, complete, timely or cost-efficient manner. The acquisition of Spectra-Physics approximately doubled our size, including with respect to number of employees and facilities. The integration of Spectra-Physics with our operations involves substantial risks, including:

- our overall ability to integrate and manage Spectra-Physics operations, products and personnel;
- our ability to integrate the products of Spectra-Physics so that they complement our own;
- our ability to continue the production and development of the Spectra-Physics products and underlying technology;
- our ability to manufacture and sell the Spectra-Physics products;
- a decline in the demand for the Spectra-Physics products in the marketplace;
- our ability to retain and expand the customer base of Spectra-Physics;
- customer dissatisfaction or performance problems with the Spectra-Physics products;
- our ability to integrate the international operations of Spectra-Physics, particularly in those countries in which we have not had prior operations;
- our ability to retain key personnel who remained employed with Spectra-Physics following the acquisition, and our ability to replace key personnel who did not remain employed with Spectra-Physics following the acquisition;
- our ability to expand our financial and management controls and reporting systems and procedures to integrate and manage Spectra-Physics;

our ability to realize expected synergies resulting from the acquisition;

diversion of management s time and attention;

administrative integration and elimination of redundancies;

assumption of unknown or contingent liabilities, or other unanticipated events or circumstances;

- our ability to maintain the competitiveness of Spectra-Physics and its products and technology in the marketplace;

We cannot guarantee that the business and operations of Spectra-Physics will achieve the anticipated revenues and operating results. We may in the future choose to close or divest certain sectors or divisions of Spectra-Physics, which could require us to record losses relating to such closures or divestitures. Any of the foregoing risks could materially harm our business, financial conditions and results of operations.

In addition, we expect to continue to pursue acquisitions of other companies, technologies and complimentary product lines in the future to expand our product offerings and technology base to further our strategic goals. We expect that we would face the same and other similar risks as referenced above in connection with any such future acquisitions.

Our operating results are difficult to predict, and if we fail to meet the expectations of investors and/or securities analysts, the market price of our common stock will likely decline significantly.

Our operating results in any given quarter have fluctuated and will likely continue to fluctuate. These fluctuations are typically unpredictable and can result from numerous factors including:

- fluctuations in our customers capital spending, industry cyclicality and other economic conditions within the markets we serve;
- demand for our products and the products sold by our customers;
- the level of orders within a given quarter and preceding quarters;
- the timing and level of cancellations and delays of orders for our products;
- the timing of product shipments within a given quarter;
- our timing in introducing new products;
- variations in the mix of products we sell in each of the markets in which we do business;
- changes in our pricing policies or in the pricing policies of our competitors or suppliers;
- market acceptance of any new or enhanced versions of our products;
- the availability and cost of key components and raw materials we use to manufacture our products;
- our ability to manufacture a sufficient quantity of our products to meet customer demand;

fluctuations in foreign currency exchange rates;

timing of new product introductions by our competitors; and

our levels of expenses.

We may in the future choose to change prices, increase spending, or add or eliminate products in response to actions by competitors or in an effort to pursue new market opportunities. These actions may also adversely affect our business and operating results and may cause our quarterly results to be lower than the results of previous quarters. We believe that quarter-to-quarter comparisons of results from operations, or any other similar period-to-period comparisons, should not be construed as reliable indicators of our future performance. In any period, our results may be below the expectations of market analysts and investors, which would likely cause the trading price of our common stock to drop.

We are highly dependent on the semiconductor equipment industry, which is volatile and unpredictable.

A substantial portion of our current and expected future business comes from sales of subsystem products to manufacturers of semiconductor fabrication and metrology equipment and sales of capital equipment to integrated semiconductor device manufacturers. The semiconductor market has historically been characterized by sudden and severe cyclical variations in product supply and demand. The timing, severity and duration of these market cycles are difficult to predict, and we may not be able to respond effectively to these cycles. The continuing uncertainty in this market severely limits our ability to predict our business prospects or financial results in this market.

During industry downturns, our revenues from this market will decline suddenly and significantly. Our ability to rapidly and effectively reduce our cost structure in response to such downturns is limited by the fixed nature of many of our expenses in the near term and by our need to continue our investment in next-generation product technology and to support and service our products. In addition, due to the relatively long manufacturing lead times for some of the systems and subsystems we sell to this market, we may incur expenditures or purchase raw materials or components for products we cannot sell. Accordingly, downturns in the semiconductor capital equipment market may materially harm our operating results. Conversely, when upturns in this market occur, we must be able to rapidly and effectively increase our manufacturing capacity to meet increases in customer demand that may be extremely rapid, and if we fail to do so we may lose business to our competitors and our relationships with our customers may be harmed.

A limited number of customers account for a significant portion of our sales to the semiconductor market, and we are highly dependent on the success of their products.

We rely on a limited number of customers for a significant portion of our sales to the semiconductor capital equipment market. Our top five customers in this market comprised approximately 72.9%, 72.5%, 75.2% and 61.1% of our sales to this market for the first half of 2004, and for the fiscal years ended December 31, 2003, 2002 and 2001, respectively, and our top two customers accounted for approximately 51.6%, 51.6%, 54.3% and 38.5%, respectively, of our sales to this market in these periods. One customer in this market, KLA-Tencor Corporation, comprised 10.2% of our consolidated net sales in 2003, and comprised 12.1% of our consolidated net sales for the first half of 2004. In the back-end packaging portion of this market, two customers constituted substantially all of our sales to this portion during 2003, and these customers have significantly decreased their capital spending in the first half of 2004. If any of our principal customers discontinues its relationship with us, replaces us as a vendor for certain products or suffers downturns in its business, our business and results of operations could be harmed significantly. In addition, because a relatively small number of companies dominate the front-end equipment and back-end packaging portions of this market, and because those companies rarely change vendors in the middle of a product s life cycle, it may be particularly difficult for us to replace these customers if we lose their business.

The semiconductor capital equipment market is characterized by rapid technological change, frequent product introductions, changing customer requirements and evolving industry standards. Because our customers face uncertainties with regard to the growth and requirements of these markets, their products and components may not achieve, or continue to achieve, anticipated levels of market acceptance. If our customers are unable to deliver products that gain market acceptance, it is likely that these customers will not purchase our products or will purchase smaller quantities of our products. We often invest substantial resources in developing our systems and subsystems in advance of significant sales of these systems and/or subsystems to such customers. A failure on the part of our subsystem customers products to gain market acceptance, or a failure of the semiconductor capital equipment market to grow would have a significant negative effect on our business and results of operations.

A significant portion of our future growth is dependent on the growth of 300mm semiconductor wafer processes and flip chip packaging.

A significant portion of our expected future subsystem business in the semiconductor capital equipment market is comprised of products for the fabrication of 300mm semiconductor wafers. Wafer fabrication equipment for 300mm wafers is in an early stage of its adoption, and is expected to be driven by the need for the ability to manufacture more semiconductor chips at lower cost. The deployment of such equipment requires a significant capital investment by semiconductor manufacturers, and many semiconductor manufacturers have delayed plans to deploy such equipment until market conditions improve. In addition, recently certain industry analysts have forecasted more conservative capital equipment spending and slower adoption of new technologies by semiconductor manufacturers in future periods. If the demand for capital equipment for 300mm wafers does not increase, or increases more slowly than expected, demand for our subsystem products will likewise be adversely affected, and our business and results of operations could be harmed significantly.

In addition, a significant portion of our expected future capital equipment sales to the integrated semiconductor device manufacturing market is comprised of systems for flip chip bonding and other advanced die bonding techniques. Demand for these systems is expected to be driven in significant part by increases in demand for new technologies in industries such as communications and consumer electronics that require the use of such manufacturing techniques. Our customers in this market have significantly decreased their capital spending in the first half of 2004. If the demand for electronic devices requiring flip chip bonding and/or other advanced die bonding techniques does not increase, or increases more slowly than expected, demand for our capital equipment will likewise be adversely affected, and our business and results of operations could be harmed significantly.

Many of the markets and industries that we serve are subject to rapid technological change, and if we do not introduce new and innovative products or improve our existing products, our business and results of operations will be negatively affected.

Many of our markets are characterized by rapid technological advances, evolving industry standards, shifting customer needs and new product introductions and enhancements. Products in our markets often become outdated quickly and without warning. We depend to a significant extent upon our ability to enhance our existing products, to anticipate and address the demands of the marketplace for new and improved technology, either through internal development or by acquisitions, and to be price competitive. If we or our competitors introduce new or enhanced products, it may cause our customers to defer or cancel orders for our existing products. In addition, because certain of our markets experience severe cyclicality in capital spending, if we fail to introduce new products in a timely manner we may miss market upturns, and may fail to have our subsystem products designed into our customers products. We may not be successful in acquiring, developing, manufacturing or marketing new products on a timely or cost-effective basis. If we fail to adequately introduce new, competitive products on a timely basis, our business and results of operations would be harmed.

We offer products for multiple industries and must face the challenges of supporting the distinct needs of each of the markets we serve.

We offer products for a number of markets, including semiconductor capital equipment, scientific research, aerospace and defense, life and health sciences and fiber optic communications. Because we operate in multiple markets, we must work constantly to understand the needs, standards and technical requirements of several different industries and must devote significant resources to developing different products for these industries. Product development is costly and time consuming. Many of our products are used by our customers to develop, manufacture and test their own products. As a result, we must anticipate trends in our customers industries and develop products before our customers products are commercialized. If we do not accurately predict our customers needs and future activities, we may invest substantial resources in developing products that do not achieve broad market acceptance. Our decision to continue to offer products to a given market or to penetrate new markets is based in part on our judgment of the size, growth rate and other factors that contribute to the attractiveness of a particular market. If our product offerings in any particular market are not competitive or our analyses of a market are incorrect, our business and results of operations would be harmed.

Because the sales cycle for some of our products is long and difficult to predict, and certain of our orders are subject to rescheduling or cancellation, we may experience fluctuations in our operating results.

Many of our capital equipment and subsystem products are complex, and customers for these products require substantial time to make purchase decisions. These customers often perform, or require us to perform extensive configuration, testing and evaluation of our products before committing to purchasing them. The sales cycle for our capital equipment and subsystem products from initial contact through shipment typically varies, is difficult to predict and can last as long as one year. The orders comprising our backlog are often subject to cancellation and changes in delivery schedules by our customers without significant penalty. We have from time to time experienced order rescheduling and cancellations that have caused our revenues in a given period to be materially less than would have been expected based on our backlog at the beginning of the period. If we experience such rescheduling and/or cancellations in the future, our operating results will fluctuate from period to period. These fluctuations could harm our results of operations and cause our stock price to drop.

We face significant risks from doing business in foreign countries.

Our business is subject to risks inherent in conducting business internationally. For the first half of 2004, and for the years ended December 31, 2003, 2002 and 2001, our international revenues accounted for approximately 28.0%, 31.5%, 29.1% and 30.4%, respectively, of total net sales, with a substantial portion of international sales originating in Europe. We expect that international revenues will continue to account for a significant percentage of total net sales for the foreseeable future, and that, in particular, our proportion of sales to Asian customers will increase as a result of the addition of Spectra-Physics. As a result of our international operations, we face various risks, which include:

- adverse changes in the political or economic conditions in countries or regions where we manufacture or sell our products;
- challenges of administering our business globally;
- compliance with multiple and potentially conflicting regulatory requirements including export requirements, tariffs and other trade barriers;
- longer accounts receivable collection periods;
- overlapping, differing or more burdensome tax structures;
- adverse currency fluctuations;
- differing protection of intellectual property;
- difficulties in staffing and managing each of our individual foreign operations;
- increased risk of exposure to terrorist activities; and
- trade restrictions and licensing requirements.

As a result of our international operations, fluctuations in foreign exchange rates could affect the sales price in local currencies of our products in foreign markets, potentially making our products less competitive. In addition, exchange rate fluctuations could increase the costs and expenses of our foreign operations or require us to modify our current business practices. If we experience any of the risks associated with international business, our business and results of operations could be significantly harmed.

We face substantial competition, and if we fail to compete effectively, our operating results will suffer.

The markets for our products are intensely competitive, and we believe that competition from both new and existing competitors will increase in the future. We compete in several specialized markets, against a limited number of companies in each market. We also face competition in some of our markets from our existing and potential customers who have developed or may develop products that are competitive to ours, or who engage subcontract manufacturers to manufacture OEM subassembly products on their behalf. Many of our existing and potential competitors are more established, enjoy greater name recognition and possess greater financial, technological and marketing resources than we do. Other competitors are small and highly specialized firms that are able to focus on only one aspect of a market. We compete on the basis of product features, quality, reliability and price and on our ability to manufacture and deliver our products on a timely basis. We may not be able to compete successfully in the future against existing or new competitors. In addition, competitive pressures may force us to reduce our prices, which could negatively affect our operating results. If we do not respond adequately to competitive challenges, our business and results of operations would be harmed.

Acquisitions of additional businesses, products or technologies we may make could negatively affect our business.

We have in the past, and expect in the future, to achieve growth through a combination of internally developed new products and acquisitions. In recent years we have acquired several companies and technologies, and we expect to continue to pursue acquisitions of other companies, technologies and complementary product lines in the future to expand our product offerings and technology base to further our strategic goals. Each of our recent acquisitions involves, and any future acquisition would involve risks, including:

- a decline in demand by our customers for the products of the acquired business;
- our ability to integrate and manage the acquired business operations, products and personnel;
- our ability to retain key personnel of the acquired businesses;
- our ability to manufacture and sell the products of the acquired businesses;
- our ability to expand our financial and management controls and reporting systems and procedures to integrate and manage the acquired businesses;
- our ability to realize expected synergies resulting from the acquisition;
- diversion of management s time and attention;
- customer dissatisfaction or performance problems with the products or services of an acquired firm;
- assumption of unknown or contingent liabilities, or other unanticipated events or circumstances; and
- the need to record significant charges or write down the carrying value of intangible assets, which could lower our earnings.

We cannot guarantee that any business that we may acquire will achieve the anticipated revenues and operating results. We have in the past and may in the future choose to close or divest certain acquired companies, which could require us to record losses relating to such closures or divestitures. Any of these risks could materially harm our business, financial condition and results of operations.

If we are delayed in introducing our new products into the marketplace, or if our new products contain defects, our operating results will suffer.

Because certain of our products are sophisticated and complex, we may experience delays in introducing new products or enhancements to our existing products. If we do not introduce our new products or enhancements into the marketplace in a timely fashion, our customers may choose to use competitors   products. In addition, because certain of our markets, such as the semiconductor equipment market, are highly cyclical in nature, if we fail to timely introduce new products in advance of an upturn in the market s cycle, we may be foreclosed from selling products to many customers until the next cycle. As such, our inability to introduce new or enhanced products in a timely manner could cause our business and results of operations to suffer. In addition, our products may contain defects or undetected errors. As a result, we could incur substantial expenses in fixing any defects or undetected errors, which could result in damage to our competitive position and harm our business and results of operations.

If we fail to protect our intellectual property and proprietary technology, we may lose our competitive advantage.

Our success and ability to compete depend in large part upon protecting our proprietary technology. We rely on a combination of patent, trademark and trade secret protection and nondisclosure agreements to protect our proprietary rights. The steps we have taken may not be sufficient to prevent the misappropriation of our intellectual property, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. The patent and trademark law and trade secret protection may not be adequate to deter third party infringement or misappropriation of our patents, trademarks and similar proprietary rights. In addition, patents issued to us may be challenged, invalidated or circumvented. Our rights granted under those patents may not provide competitive advantages to us, and the claims under our patent applications may not be allowed. We have in the past and may in the future be subject to or may initiate interference proceedings in the United States Patent and Trademark Office, which can demand significant financial and management resources. The process of seeking patent protection can be time consuming and expensive and patents may not be issued from currently pending or future applications. Moreover, our existing patents or any new patents that may be issued may not be sufficient in scope or strength to provide meaningful protection or any commercial advantage to us. We may in the future initiate claims or litigation against third parties for infringement of our proprietary rights in order to determine the scope and validity of our proprietary rights or the proprietary rights of our competitors, which claims could result in costly litigation and the diversion of our technical and management personnel. For example, we have notified several manufacturers of semiconductor wafer handling robots and load ports that we believe that they are infringing upon certain of our U.S. patents, and may institute litigation against one or more of such companies in the future. We will take such actions where we believe that they are of sufficient strategic or economic importance to us to justify the cost.

We have experienced, and may in the future experience, intellectual property infringement claims.

We have from time to time received communications from third parties alleging that we are infringing certain trademarks, patents or other intellectual property rights held by them. Whenever such claims arise, we evaluate their merits. Any claims of infringement brought by third parties could result in protracted and costly litigation, and we could become subject to damages for infringement, or to an injunction preventing us from selling one or more of our products or using one or more of our trademarks. Such claims could also result in the necessity of obtaining a license relating to one or more of our products or current or future technologies, which may not be available on commercially reasonable terms or at all. Any intellectual property litigation and the failure to obtain necessary licenses or other rights could have a material adverse effect on our business, financial condition and results of operations. In addition, the terms of our customer contracts typically require us to indemnify the customer in the event of any claim of infringement brought by a third party based on our products. Any such claims of this kind may have a material adverse effect on our business, financial condition or results of operations.

If we are unable to attract new employees and retain and motivate existing employees, our business and results of operations will suffer.

Our ability to maintain and grow our business is directly related to the service of our employees in each area of our operations. Our future performance will be directly tied to our ability to hire, train, motivate and retain qualified personnel. Competition for personnel in the technology marketplace is intense, and if we are unable to hire sufficient numbers of employees with the experience and skills we need or to retain our employees, our business and results of operations would be harmed.

We rely on several sole-source and limited source suppliers.

We obtain some of the materials used to build our systems and subsystems, such as the sheet steel used in some of our vibration isolation tables, from single or limited sources due to unique component designs as well as specialized quality and performance requirements needed to manufacture our products. If our components or raw materials are unavailable in adequate amounts or are unavailable on satisfactory terms, we may be required to purchase them from alternative sources, if available, which could increase our costs and cause delays in the production and distribution of our products. If we do not obtain comparable replacement components from other sources in a timely manner, our business and results of operations will be harmed. Many of our suppliers require long lead-times to deliver the quantities of components that we need. If we fail to accurately forecast our needs, or if we fail to obtain sufficient quantities of components that we use to manufacture our products, then delays or reductions in production and shipment could occur, which would harm our business and results of operations.

Terrorism and acts of war and the associated economic uncertainties may negatively impact our business.

Terrorist attacks and military activities have created economic and political uncertainties, contributing to the recent global economic downturn. Future acts of terrorism or military action may create additional uncertainties and worsen or delay recovery of the global economy, which could negatively impact our business, financial condition or results of operations.

Natural disasters or power outages could disrupt or shut down our operations.

Our operations are susceptible to damages from earthquakes, floods, fire, loss of power or water supplies, or other similar contingencies. We have significant facilities in areas with above-average seismic activity. If any of our facilities were to experience a catastrophic loss or significant power outages, it could disrupt our operations, delay production, shipments and revenue, and result in large expenses to repair or replace the facility, any of which would harm our business. We are predominantly uninsured for losses and interruptions caused by earthquakes.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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 exchange rates which may generate translation and transaction gains and losses and interest rate risk.

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 inception of the contracts. If the counterparties to the exchange contracts (AA or A+ 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 loss in our statement of operations. Net foreign exchange gains and losses were not material to our reported results of operations for the last three years.

Our operating income from international operations totaled $1.2 million for the first half of 2004. As currency exchange rates change, translation of the income statements of international operations into U.S. dollars affects 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 future international operating profit include the euro, British pound, Canadian dollar and Taiwan dollar. We estimate that a 10% change in foreign exchange rates would not have had a material effect on reported net income for the quarter ended July 3, 2004 or the first half of 2004. 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 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 unsecured line of credit bears interest at either the prevailing prime rate, or the prevailing London Interbank Offered Rate plus 1.5%, at our option. Our investments in marketable securities, which totaled $235.5 million at July 3, 2004, are sensitive to changes in the general level of U.S. interest rates. We estimate that a 10% change in the interest rate earned on our investment portfolio or a 10% change in interest rates on our line of credit would not have had a material effect on our net income for the quarter ended July 3, 2004, nor would it have had a material effect on our net income for the first half of 2004.

The sensitivity analyses described in the interest rate and foreign exchange discussions above disregard the possibility that rates can move in opposite directions and that gains from one category may or may not be offset by losses from another category and vice versa.

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 15-d-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.

(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.

PART II OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

Our annual meeting of stockholders was held on May 19, 2004. Of the 39,331,443 shares of common stock issued and outstanding and entitled to vote at the meeting, there were present at the meeting, in person or by proxy, the holders of 35,015,749 common shares, representing 89.03% of the total number of shares entitled to vote at the meeting. This percentage represented a quorum. The following two proposals were presented and voted on at the meeting:

Proposal 1

To elect two nominees, R. Jack Aplin and Richard E. Schmidt, as Class IV members of our Board of Directors. The two nominees were elected by a plurality of the shares represented and entitled to vote at the meeting. The voting results were:

Nominee	For	Withheld
R. Jack Aplin	34,233,695	782,054
Richard E. Schmidt	22,636,003	12,379,746

Proposal 2

To approve the appointment of Ernst & Young LLP as our independent auditors for the fiscal year ended January 1, 2005. Such appointment was approved by more than a majority of the shares represented and entitled to vote at the meeting. The voting results were:

For	Against	Abstain	Broker Non-Vote
31,389,930	3,593,782	32,037	0

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

Exhibit Number	Description of Exhibit
2.1	Stock Purchase Agreement dated May 28, 2004 by and among the Registrant, Thermo Electron Corporation and other related parties (incorporated by reference to Exhibit 2.1 to the Registrant s Current Report on Form 8-K filed on June 17, 2004).
10.1	Subordinated Promissory Note dated July 16, 2004 payable by the Registrant to Thermo Electron Corporation (incorporated by reference to Exhibit 10.1 to the Registrant s Current Report on Form 8-K filed on July 20, 2004).
10.2	Stockholder Agreement dated July 16, 2004 by and between the Registrant and Thermo Electron Corporation (incorporated by reference to Exhibit 10.2 to the Registrant s Current Report on Form 8-K filed on July 20, 2004).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 (the Exchange Act).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act.
32.1	Certification of Chief Executive Officer 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 of Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and 18 U.S.C. Section 1350.

(b) Reports on Form 8-K.

On April 29, 2004, we filed a Current Report on Form 8-K, Item 12, disclosing our financial results for the quarter ended April 3, 2004, and our business outlook for the second quarter of 2004.

On June 1, 2004, we filed a Current Report on Form 8-K, Item 5, announcing that we had entered into a definitive agreement with Thermo Electron Corporation to purchase Spectra-Physics, Inc. and certain related entities.

On June 17, 2004, we filed a Current Report on Form 8-K, Item 5, relating to the Stock Purchase Agreement dated May 28, 2004 entered into with Thermo Electron Corporation for the purchase of Spectra-Physics, Inc. and certain related entities. A copy of the Stock Purchase Agreement was filed as Exhibit 2.1 to such Form 8-K.

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: August 11, 2004	NEWPORT CORPORATION
	By: */s/ Charles F. Cargile*
	Charles F. Cargile,
	Senior Vice President and Chief Financial Officer
	(Principal Financial Officer and Duly Authorized Officer)

EXHIBIT INDEX

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