ELECTRO SCIENTIFIC INDUSTRIES INC
Form 10-Q
February 05, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 28, 2013
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: 0-12853

ELECTRO SCIENTIFIC INDUSTRIES, INC.

Oregon	93-0370304
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
13900 N.W. Science Park Drive, Portland, Oregon	97229
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: 503-641-4141
Registrant's web address: www.esi.com

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

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

Large accelerated filer	¨	Accelerated filer	ý
Non-accelerated filer	¨	Smaller reporting company	¨

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

The number of shares outstanding of the Registrant's Common Stock as of February 3, 2014 was 29,915,584 shares.

Table of Contents

ELECTRO SCIENTIFIC INDUSTRIES, INC.
2014 FORM 10-Q QUARTERLY REPORT
TABLE OF CONTENTS

Table of Contents

ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands)	Dec 28, 2013	Mar 30, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$77,174	$88,913
Short-term investments	46,299	56,144
Trade receivables, net of allowances of $464 and $442	27,479	31,779
Inventories	68,626	63,067
Shipped systems pending acceptance	1,179	1,007
Deferred income taxes, net	1,714	1,682
Other current assets	4,796	3,898
Total current assets	227,267	246,490
Non-current assets:		
Non-current investments	6,024	12,329
Property, plant and equipment, net of accumulated depreciation of $97,056 and $98,734	27,830	27,894
Non-current deferred income taxes, net	3,680	3,766
Goodwill	7,889	7,889
Acquired intangible assets, net of accumulated amortization of $17,524 and $15,393	7,696	9,088
Other assets	19,199	14,752
Total assets	$299,585	$322,208
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$14,191	$16,958
Accrued liabilities	20,944	24,930
Deferred revenue	6,694	10,196
Total current liabilities	41,829	52,084
Non-current liabilities:		
Income taxes payable	6,208	5,982
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, without par value; 1,000 shares authorized; no shares issued	—	—
Common stock, without par value; 100,000 shares authorized; 30,095 and 29,583 issued and outstanding	181,844	176,631
Retained earnings	69,368	87,228
Accumulated other comprehensive income, other	336	283
Total shareholders' equity	251,548	264,142
Total liabilities and shareholders' equity	$299,585	$322,208

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

Table of Contents

ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands, except per share amounts)	Dec 28, 2013	Dec 29, 2012	Dec 28, 2013	Dec 29, 2012
Net sales	$38,267	$37,930	$144,086	$177,051
Cost of sales	21,986	24,697	83,787	106,645
Gross profit	16,281	13,233	60,299	70,406
Operating expenses:				
Selling, service and administration	12,408	11,696	41,206	42,473
Research, development and engineering	9,768	8,730	27,912	28,791
Legal settlement proceeds, net	—	(15,365)	—	(15,365)
Gain on sale of property and equipment, net	(1,301)	(1,226)	(1,301)	(1,226)
Gain on acquisition of Semiconductor Systems business	—	—	(499)	—
Net operating expenses	20,875	3,835	67,318	54,673
Operating (loss) income	(4,594)	9,398	(7,019)	15,733
Non-operating income (expense):				
Other-than-temporary impairment of cost based investments	—	—	(3,588)	—
Interest and other income (expense), net	95	(5)	115	(64)
Total non-operating income (expense)	95	(5)	(3,473)	(64)
(Loss) income before income taxes	(4,499)	9,393	(10,492)	15,669
Provision for income taxes	141	2,625	209	4,634
Net (loss) income	$(4,640)	$6,768	$(10,701)	$11,035
Net (loss) income per share—basic	$(0.15)	$0.23	$(0.36)	$0.38
Net (loss) income per share—diluted	$(0.15)	$0.23	$(0.36)	$0.37
Weighted average number of shares—basic	30,054	29,434	29,922	29,296
Weighted average number of shares—diluted	30,054	30,043	29,922	29,954
Cash dividends paid per outstanding common share	$0.08	$2.08	$0.24	$2.24

ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS COMPREHENSIVE (LOSS) INCOME
(Unaudited)

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	Dec 28, 2013	Dec 29, 2012	Dec 28, 2013	Dec 29, 2012
Net (loss) income	$(4,640)	$6,768	$(10,701)	$11,035
Other comprehensive (loss) income:				
Foreign currency translation adjustment, net of taxes of $(86), ($134), $22 and $19	(153)	(239)	39	37
Accumulated other comprehensive income related to benefit plan obligation, net of taxes of $2, $1, $5 and $4	3	3	9	8
Net unrealized gain (loss) on available-for-sale securities, net of taxes of $(2), ($8), $3 and ($5)	(3)	(15)	5	(9)

Comprehensive (loss) income	$(4,793)	$6,517	$(10,648)	$11,071

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

Table of Contents

ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three fiscal quarters ended	
(In thousands)	Dec 28, 2013	Dec 29, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$(10,701)	$11,035
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	5,636	6,867
Amortization of acquired intangible assets	2,133	1,810
Share-based compensation expense	5,130	6,132
Gain on sale of property and equipment, net	(1,264)	(1,226)
Gain on acquisition of Semiconductor Systems business	(499)	—
Other-than-temporary impairment of cost based investments	3,588	—
(Increase) decrease in deferred income taxes	(317)	4,537
Changes in operating accounts, net of acquisitions:		
Decrease in trade receivables, net	8,047	14,315
Increase in inventories	(1,389)	(11,744)
(Increase) decrease in shipped systems pending acceptance	(172)	1,002
(Increase) decrease in other current assets	(924)	61
Decrease in accounts payable and accrued liabilities	(9,460)	(912)
Decrease in deferred revenue	(3,681)	(4,343)
Net cash (used in) provided by operating activities	(3,873)	27,534
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(237,113)	(857,435)
Proceeds from sales and maturities of investments	253,265	885,818
Purchase of property, plant and equipment	(5,344)	(5,127)
Proceeds from sale of property, plant and equipment	3,617	2,020
Cash paid for business acquisitions	(9,731)	(9,466)
Minority equity investment	(5,000)	—
Decrease in other assets	(408)	403
Net cash (used in) provided by investing activities	(714)	16,213
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash dividends paid to shareholders	(7,158)	(65,723)
Stock plan activity, net	83	73
Excess tax benefit of share-based compensation	—	71
Net cash used in financing activities	(7,075)	(65,579)
Effect of exchange rate changes on cash	(77)	(708)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(11,739)	(22,540)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	88,913	69,780
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$77,174	$47,240
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for income taxes	$(3,072)	$(1,174)
Income tax refunds received	$65	$651

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

Table of Contents

ELECTRO SCIENTIFIC INDUSTRIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
1. Basis of Presentation

These unaudited interim condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted in these interim statements. Accordingly, these condensed consolidated financial statements are to be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for its fiscal year ended March 30, 2013. These interim statements include all adjustments (consisting of only normal recurring adjustments and accruals) necessary for a fair presentation of results for the interim periods presented. The results for interim periods are not necessarily indicative of the results of operations for the entire year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from those estimates.

Management believes that the estimates used are reasonable. Significant estimates made by management include: revenue recognition; inventory valuation; product warranty reserves; allowance for doubtful accounts; accrued restructuring costs; share-based compensation; income taxes including the valuation of deferred tax assets; fair value measurements; valuation of cost method equity investments; valuation of long-lived assets; valuation of goodwill; and valuation of acquired technology.

There have been no significant changes to the Company's significant accounting policies from those presented in Note 2 “Summary of Significant Accounting Policies” to the consolidated financial statements included in the Company's Annual Report on Form 10-K for its fiscal year ended March 30, 2013. All references to years or quarters relate to fiscal years or fiscal quarters unless otherwise noted.
2. Recent Accounting Pronouncements

There have been no recent accounting pronouncements or changes in accounting pronouncements during the quarter ended December 28, 2013 that are of significance to the Company.
3. Share-Based Compensation

The Company recognizes expense related to the fair value of its share-based compensation awards using the Black-Scholes model to estimate the fair value of awards on the date of grant, except for unvested restricted stock unit awards which are valued at the fair value of the Company's stock on the date of award. The Company recognizes compensation expense for all share-based compensation awards on a straight-line basis over the requisite service period of the award.

Stock-settled stock appreciation rights (SARs) grant the right to receive shares of the Company's stock equivalent to the increase in stock value of a specified number of shares over a specified period of time, divided by the stock price at the time of exercise. The Company uses the Black-Scholes model to estimate the fair value of SARs. Similar to options, SARs are recorded at the fair value of the award at grant date and the expense is recognized on a straight-line basis over the requisite service period of the award.
The Company granted a total of 621,000 restricted stock unit awards during the first three quarters of 2014, but did not grant any stock options or SARs. The Company granted 552,500 restricted stock unit awards and 5,000 stock

options during the first three quarters of 2013, but did not grant any SARs.

Table of Contents

Share-based compensation expense was included in the Company's Condensed Consolidated Statements of Operations as follows:

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	Dec 28, 2013	Dec 29, 2012	Dec 28, 2013	Dec 29, 2012
Cost of sales	$184	$202	$558	$635
Selling, service and administration	728	867	3,488	4,145
Research, development and engineering	350	413	1,084	1,579
Total share-based compensation expense	$1,262	$1,482	$5,130	$6,359

No share-based compensation costs were capitalized in the first three quarters of 2014. As of December 28, 2013, the Company had $9.2 million of total unrecognized share-based compensation costs, net of estimated forfeitures, which are expected to be recognized over a weighted average period of 1.9 years.

4. Fair Value Measurements

Financial Assets Measured at Fair Value

ASC Topic 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include the following:

- Level 1, defined as observable inputs such as quoted prices in active markets for identical assets or liabilities;
- Level 2, defined as inputs that are observable either directly or indirectly such as quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active and other inputs that can be corroborated by observable market data; and
- Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Table of Contents

The Company's fair value hierarchy for its financial assets measured at fair value on a recurring basis as of December 28, 2013 and March 30, 2013 was as follows (in thousands):

December 28, 2013	Level 1	Level 2	Level 3	Total
Money market securities	$3,724	$—	$—	$3,724
Commercial paper	—	20,447	—	20,447
Corporate Bonds	—	18,550	—	18,550
Municipal bonds	—	14,461	—	14,461
Government agencies	—	8,034	—	8,034
Forward purchase or (sale) contracts:				
Japanese Yen	—	108	—	108
New Taiwan Dollar	—	(5)	—	(5)
Korean Won	—	33	—	33
Euro	—	(129)	—	(129)
British Pound	—	29	—	29
Chinese Renminbi	—	(18)	—	(18)
Singapore Dollar	—	(3)	—	(3)
March 30, 2013	Level 1	Level 2	Level 3	Total
Money market securities	$9,457	$—	$—	$9,457
Commercial paper	—	51,443	—	51,443
Government agencies	—	29,646	—	29,646
Corporate bonds	—	18,396	—	18,396
Municipal bonds	—	3,389	—	3,389
Forward purchase or (sale) contracts:				
Japanese Yen	—	176	—	176
New Taiwan Dollar	—	(10)	—	(10)
Korean Won	—	(46)	—	(46)
Euro	—	100	—	100
British Pound	—	38	—	38
Chinese Renminbi	—	(1)	—	(1)
Singapore Dollar	—	(12)	—	(12)

For Level 1 assets, the Company utilized quoted prices in active markets for identical assets.

For Level 2 assets, exclusive of forward contracts, the Company utilized quoted prices in active markets for similar assets. For forward contracts, spot prices at December 28, 2013 and March 30, 2013 were utilized to calculate fair values.

During the first three quarters of 2014, there were no transfers between Level 1 and Level 2 assets.

Table of Contents

Investments

Certain information regarding the Company's investments at December 28, 2013 and March 30, 2013 was as follows (in thousands):

December 28, 2013	Cost	Unrealized Gain	Loss	Fair Value
Available-for-sale securities (current):				
Commercial paper	$20,447	$—	$—	$20,447
Corporate Bonds	18,549	1	—	18,550
Municipal Bonds	10,428	7	—	10,435
Government agencies	6,035	1	—	6,036
	$55,459	$9	$—	$55,468
Available-for-sale securities (non-current):				
Municipal Bonds	$4,019	$7	$—	$4,026
Government agencies	1,998	—	—	1,998
	$6,017	$7	$—	$6,024

March 30, 2013	Cost	Unrealized Gain	Loss	Fair Value
Available-for-sale securities (current):				
Commercial paper	$51,443	$—	$—	$51,443
Government agencies	26,556	8	—	26,564
Corporate Bonds	10,473	7	—	10,480
Municipal Bonds	2,058	—	—	2,058
	$90,530	$15	$—	$90,545
Available-for-sale securities (non-current):				
Corporate Bonds	$7,923	$—	$(7)	$7,916
Government agencies	3,082	—	—	3,082
Municipal Bonds	1,330	1	—	1,331
	$12,335	$1	$(7)	$12,329

For purposes of determining gross realized gains and losses and reclassification out of accumulated other comprehensive (loss) income, the cost of securities sold is based on specific identification. Net unrealized holding gains and losses on current available-for-sale securities included in accumulated other comprehensive (loss) income were insignificant as of December 28, 2013 and March 30, 2013.

Underlying maturities of investments at December 28, 2013 were $55.5 million within one year and $6.0 million between one to five years.

5. Business Acquisitions

Fiscal 2014

On May 3, 2013, the Company completed the purchase of assets related to the Semiconductor Systems business of GSI Group Inc. for $8.0 million, subject to certain closing working capital adjustments. As of June 29, 2013 the working capital adjustments had not been finalized but were estimated and accrued at $1.6 million. On September 20, 2013, the Company finalized the closing working capital adjustment and paid $1.7 million of cash for a total purchase price of $9.7 million.

The acquisition provides the Company with direct access to industry-leading wafer marking, wafer trimming and circuit trimming laser systems. The purchase price was allocated to the underlying assets acquired and liabilities assumed based on their fair values and resulted in a net gain on bargain purchase of $0.5 million. The fair value of the acquired net assets of $10.5 million was in excess of the total purchase consideration of $9.7 million, primarily due to the recognition of certain intangible assets. The resulting gain of $0.8 million was partially offset by $0.3 million of deferred tax liabilities. Analysis supporting the purchase price allocation included a valuation of assets and liabilities as of the closing date, an analysis of intangible assets and a detailed review of the opening balance sheet to determine other significant adjustments required to recognize assets and liabilities at fair value. The acquisition was an asset purchase for tax purposes.

Table of Contents

As a result of the acquisition, the Company recorded approximately $8.2 million of inventory, $3.9 million of accounts receivable and other current assets, $0.7 million of identifiable intangible assets, $2.3 million of current liabilities, and a gain on bargain purchase of $0.8 million. The $0.7 million of identifiable intangible assets includes approximately $0.5 million of backlog and $0.2 million of developed technology. The acquired intangibles will be amortized over their estimated useful lives which range from one to three years.

In the first three quarters of 2014, the Company also incurred approximately $1.3 million in acquisition related costs which are included in Selling, service and administration expenses in the Condensed Consolidated Statements of Operations.

The operating results of this purchase are included in the Company's results of operations since the date of acquisition. Pro forma financial information has not been provided for the purchase as it was not material to the Company's overall financial position.

Fiscal 2013

On June 14, 2012, the Company acquired Eolite Systems (Eolite), a designer and manufacturer of unique fiber lasers, for $9.7 million in cash for all its outstanding shares. The purchase price of $9.5 million, net of cash acquired, was allocated to the underlying assets acquired and liabilities assumed based on their fair values. Analyses supporting the purchase price allocation included a valuation of assets and liabilities as of the closing date, an analysis of intangible assets and a detailed review of the opening balance sheet to determine other significant adjustments required to recognize assets and liabilities at fair value.

The acquisition provides the Company with direct access to differentiated, higher power laser technology which can be used in a broad set of microfabrication applications. The Company has allocated $3.9 million of the purchase price to goodwill. The premium paid over the fair value of the individual assets acquired and liabilities assumed reflects the Company's view that this acquisition will increase the Company's ability to customize lasers to specific customer applications with differentiated capability. None of the goodwill is deductible for tax purposes.

As a result of the acquisition, the Company recorded $5.5 million of identifiable intangible assets including approximately $5.0 million of developed technology, $0.4 million in customer relationships, and $0.1 million in trademarks and backlog. The acquired intangibles will be amortized over their estimated useful lives which range from one to nine years.

In the first three quarters of 2013, the Company also incurred approximately $0.9 million in acquisition-related costs which are included in Selling, service and administration expenses in the Condensed Consolidated Statements of Operations.

The operating results of this acquisition are included in the Company's results of operations since the date of acquisition. Pro forma financial information has not been provided for the acquisition of Eolite as it was not material to the Company's overall financial position.

6. Inventories

Inventories are principally valued at standard costs, which approximate the lower of cost (first-in, first-out) or market. Components of inventories were as follows:

(In thousands)	Dec 28, 2013	Mar 30, 2013
Raw materials and purchased parts	$49,298	$44,332
Work-in-process	13,353	8,985
Finished goods	5,975	9,750
	$68,626	$63,067

7. Other Current Assets

Other current assets consisted of the following:

(In thousands)	Dec 28, 2013	Mar 30, 2013
Prepaid expenses	$2,931	$2,240
Value added tax receivable	672	763
Other	1,193	895
	$4,796	$3,898

Table of Contents

8. Other Assets

Other assets consisted of the following:

(In thousands)	Dec 28, 2013	Mar 30, 2013
Minority equity investment	$10,378	$8,966
Consignment and demo equipment, net	6,830	4,263
Long term deposits and other	1,991	1,523
	$19,199	$14,752

Minority equity investment represents the Company's investment in OmniGuide, Inc. During the second quarter of 2014, the Company invested $5 million in Series F Preferred Stock of OmniGuide, Inc. As of December 28, 2013, the Company had $6.0 million invested in Series D Preferred Stock, $3.0 million invested in Series E Preferred Stock, and $5.0 million invested in Series F Preferred Stock of OmniGuide, Inc., representing a 15% interest. At each reporting period end, the Company determines whether events or circumstances have occurred that are likely to have a significant adverse effect on the fair value of these investments. If there are no events or circumstances identified that would adversely affect the fair value of the investments, the fair values of the investments are not calculated. In the second quarter of 2014, OmniGuide, Inc. engaged in a Series F Preferred Stock round of equity financing at pricing below previous rounds which was considered a triggering event. As a result, the Company performed a valuation of the investment which resulted in a $3.6 million impairment charge of our Series D and Series E investments.

9. Accrued Liabilities

Accrued liabilities consisted of the following:

(In thousands)	Dec 28, 2013	Mar 30, 2013
Payroll-related liabilities	$7,805	$7,918
Product warranty accrual	4,623	5,411
Professional fees payable	1,762	1,322
Pension benefit liabilities	1,667	1,501
Purchase order commitments and receipts	1,257	2,533
Customer deposits	685	225
Freight accrual	536	646
Income taxes payable	429	2,884
Restructuring costs payable	327	485
Value added taxes payable	272	258
Other	1,581	1,747
	$20,944	$24,930

10. Product Warranty

The following is a reconciliation of the changes in the aggregate product warranty accrual:

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	Dec 28, 2013	Dec 29, 2012	Dec 28, 2013	Dec 29, 2012
Product warranty accrual, beginning	$5,563	$6,096	$5,411	$4,187
Warranty charges incurred, net	(1,755)	(1,603)	(5,298)	(5,513)
Provision for warranty charges	815	1,297	4,510	7,116
Product warranty accrual, ending	$4,623	$5,790	$4,623	$5,790

Net warranty charges incurred include labor charges and costs of replacement parts for system repairs under warranty. These costs are recorded net of any estimated cost recoveries resulting from either successful repair of damaged parts or from warranties offered by the Company’s suppliers for defective components. The provision for warranty charges reflects the estimate of future anticipated net warranty costs to be incurred for all products under warranty at quarter end and is recorded to cost of sales.

Table of Contents

11. Deferred Revenue

Generally, revenue is recognized upon fulfillment of acceptance criteria at the Company's factory and title transfer which frequently occurs at the time of delivery to a common carrier. Revenue is deferred whenever title transfer is pending and/or acceptance criteria have not yet been fulfilled. Deferred revenue occurrences include sales to Japanese customers, shipments of substantially new products and shipments with custom specifications and acceptance criteria. In sales involving multiple element arrangements, the relative selling price of any undelivered elements, including installation services, is deferred until the elements are delivered and acceptance criteria are met. Revenue related to maintenance and service contracts is deferred and recognized ratably over the duration of the contracts.
The following is a reconciliation of the changes in deferred revenue:

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	Dec 28, 2013	Dec 29, 2012	Dec 28, 2013	Dec 29, 2012
Deferred revenue, beginning	$7,855	$9,456	$10,196	$10,751
Revenue deferred	5,294	5,394	18,892	43,340
Revenue recognized	(6,455)	(8,330)	(22,394)	(47,571)
Deferred revenue, ending	$6,694	$6,520	$6,694	$6,520

12. Earnings (Loss) Per Share
The following is a reconciliation of weighted average shares outstanding used in the calculation of basic and diluted earnings per share:

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands, except per share data)	Dec 28, 2013	Dec 29, 2012	Dec 28, 2013	Dec 29, 2012
Net (loss) income	$(4,640)	$6,768	$(10,701)	$11,035
Weighted average shares used for basic earnings per share	30,054	29,434	29,922	29,296
Incremental diluted shares	—	609	—	658
Weighted average shares used for diluted earnings per share	30,054	30,043	29,922	29,954
Net (loss) income per share:				
Net (loss) income — basic	$(0.15)	$0.23	$(0.36)	$0.38
Net (loss) income — diluted	$(0.15)	$0.23	$(0.36)	$0.37

Awards of options, stock appreciation rights (SARs) and unvested restricted stock units (RSUs) representing an additional 3.8 million and 2.5 million shares of stock for the third quarter of 2014 and 2013, respectively, were not included in the calculation of diluted net earnings per share because their effect would have been antidilutive.
For the three quarters ended December 28, 2013 and December 29, 2012, awards of options, SARs, and unvested RSUs representing an additional 4.0 million and 2.3 million shares, respectively, were not included in the calculation of diluted net earnings per share because their effect would have been antidilutive.
13. Product and Geographic Information
Net sales by product type were as follows:

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	Dec 28, 2013	Dec 29, 2012	Dec 28, 2013	Dec 29, 2012
Interconnect & Microfabrication Group (IMG)	$25,378	$30,537	$98,096	$147,506
Semiconductor Group (SG)	8,535	3,322	25,083	9,938
Components Group (CG)	4,354	4,071	20,907	19,607
	$38,267	$37,930	$144,086	$177,051

Table of Contents

Net sales by geographic area, based on the location of the end user, were as follows:

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	Dec 28, 2013	Dec 29, 2012	Dec 28, 2013	Dec 29, 2012
Asia	$29,087	$28,928	$117,361	$154,962
Americas	4,761	6,990	15,470	15,696
Europe	4,419	2,012	11,255	6,393
	$38,267	$37,930	$144,086	$177,051

14. Restructuring and Cost Management Plans

In 2013, the Company initiated a restructuring plan to improve efficiency, transition from memory repair and other legacy products, and focus on laser microfabrication for consumer electronics, emerging technologies related to semiconductor 3D packaging, and proprietary laser technology. The planned completion date for remaining actions to be taken under this plan is April 30, 2014. See the Company's Form 10-K for the year ended March 30, 2013 for additional information related to restructuring and cost management plans.

In the first three quarters of 2014, net restructuring credits of $31 thousand were recognized due to changes in estimates. At December 28, 2013 and March 30, 2013, the amount of unpaid restructuring costs included in accrued liabilities was $0.3 million and $0.5 million, respectively.

The following table presents the amounts related to restructuring costs payable (in thousands):

Restructuring costs payable balance as of March 30, 2013	$485	
Employee severance and related benefits:		
Cash payments	(153	)
Other adjustments	(5	)
Restructuring costs payable balance as of December 28, 2013	$327	

15. Shareholders' Equity

Share Repurchase Program

On December 9, 2011, the Board of Directors authorized a share repurchase program totaling $20.0 million to acquire shares of the Company's outstanding common stock. The repurchases are to be made at management's discretion in the open market or in privately negotiated transactions in compliance with applicable securities laws and other legal requirements and are subject to market conditions, share price and other factors. The Company did not repurchase any shares under this program in either the first three quarters of 2013 or 2014. There is no fixed completion date for the repurchase program.

Dividends

In December 2011, the Board of Directors adopted a dividend policy under which the Company intends to pay quarterly cash dividends. The following table summarizes the quarterly dividend declared and paid by the Company since the third quarter of 2013:

Date Declared	Record Date	Payable Date	Amount per Share
November 7, 2013	November 19, 2013	December 4, 2013	$0.08
August 8, 2013	August 19, 2013	September 3, 2013	$0.08
May 14, 2013	June 5, 2013	June 19, 2013	$0.08
February 7, 2013	February 28, 2013	March 14, 2013	$0.08
November 8, 2012	November 21, 2012	December 5, 2012	$0.08

A special dividend of $2.00 per share was declared by the Board of Directors on December 3, 2012 after the successful settlement of a patent dispute. The special dividend should not be considered a recurring event.

The Company paid aggregate dividends of $7.2 million and $65.7 million in the first three quarters of 2014 and 2013, respectively.

Table of Contents

The Company currently anticipates that it will continue to pay cash dividends on a quarterly basis in the future, although the declaration, timing and amount of any future cash dividends are at the discretion of the Board of Directors and will depend on the Company's financial condition, results of operations, capital requirements, business conditions and other factors, as well as a determination that cash dividends are in the best interest of the shareholders.

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

The statements contained in this report that are not statements of historical fact, including without limitation, statements containing the words "believes," "expects," "anticipates" and similar words, constitute forward-looking statements that are subject to a number of risks and uncertainties. From time to time we may make other forward-looking statements. Investors are cautioned that such forward-looking statements are subject to an inherent risk that actual results may materially differ as a result of many factors, including the risks described in Part II, Item 1A "Risk Factors."

Overview of Business

Electro Scientific Industries, Inc. and its subsidiaries (ESI) is a leading supplier of innovative laser-based manufacturing solutions for the microtechnology industry. Our advanced laser systems enable precise structuring of micron to submicron features in components and devices which are used in a wide variety of end products in the consumer electronics, computer, semiconductor, communications and other markets. These features enable our customers to achieve functionality, or improve yield and productivity in their manufacturing processes that can be critical to their profitability. Founded in 1944, ESI is headquartered in Portland, Oregon, with global operations and subsidiaries in Asia, Canada, Europe and the United States.

Our advanced laser microfabrication systems allow microelectronics, semiconductor, and other microtechnology manufacturers to physically alter select device features during high-volume production in order to increase performance and improve production yields. Laser microfabrication comprises a set of precise micron-level processes, including drilling, scribing, dicing, singulation, cutting, ablating, trimming, and precision marking on multiple types of materials. These processes require application-specific laser systems that are able to meet our customers' exacting performance and productivity requirements. Our laser-based systems improve production yields or enable improved performance for flexible and rigid high density interconnect printed circuit boards, semiconductor devices, light emitting diodes (LEDs), advanced semiconductor packaging, touch-panel glass, flat panel liquid crystal displays (LCDs) and other high value components.

Additionally, we produce high-capacity test and inspection equipment that is critical to the quality control process during the production of multilayer ceramic capacitors (MLCCs). Our equipment ensures that each component meets the electrical and physical tolerances required to perform properly. Lastly, we produce systems that use photonic technology to perform precision inspection for quality control and defect identification.

Summary of Sequential Quarterly Results

The financial results of the quarter ended December 28, 2013, which represented the third quarter of 2014 , reflected a sequential decline in sales and earnings as a result of timing of design wins in our advanced micromachining business and absorption of capacity in some of our markets. Revenue decreased to $38.3 million from $59.6 million in the third quarter of 2014 which ended December 28, 2013. Total order volume for the third quarter of 2014 declined from $46.2 million to $35.6 million, primarily driven by timing of orders for advanced microfabrication equipment, and timing of service contract bookings.

Total shipments were $37.4 million in the third quarter of 2014 compared to $56.9 million in the second quarter of 2014. By product group, Semiconductor Group (SG) shipments increased by approximately 21%, Interconnect & Microfabrication Group (IMG) shipments decreased by approximately 39%, and Components Group (CG) shipments decreased by approximately 58%.

Net sales were $38.3 million in the third quarter of 2014 compared to $59.6 million in the second quarter of 2014. All three business groups showed a sequential decline in sales and orders. IMG decreased due to lower flex, microfabrication and service sales. CG decreased due to MLCC customers absorbing capacity following strong shipments in the second quarter. Finally, SG sales decreased due to shipment push-outs and acceptance delays.

Gross profit was $16.3 million in the third quarter of 2014 compared to a gross profit of $24.6 million in the second quarter of 2014. Gross margin was 42.5% on net sales of $38.3 million in the third quarter of 2014 compared to a gross profit of 41.3% on net sales of $59.6 million in the second quarter of 2014. The increase in gross margin was primarily driven by favorable product mix, partially offset by lower sales volume.

Table of Contents

Net operating expenses of $20.9 million in the third quarter of 2014 decreased $3.1 million from $23.9 million in the second quarter of 2014. This decrease is due to a $1.8 million decrease in selling, service and administration (SS&A) and a $1.3 million gain on sale of property. RD&E expense remained fairly flat compared to the prior quarter. SS&A expense decreased primarily due to reduced compensation and other variable expenses based on lower business volume and less amortization of acquired intangible assets.

Operating loss was $4.6 million in the third quarter of 2014 compared to an operating income of $0.7 million in the second quarter of 2014, a change of $5.3 million. The operating loss was primarily due to lower sales volumes in the third quarter partially offset by a decreased operating expenses and the gain on sale of property.

Non-operating income was $0.1 million in the third quarter of 2014 compared to expense of $3.5 million in the second quarter of 2014. The change is primarily due to the $3.6 million impairment against our minority equity investment in OmniGuide, Inc recorded in the second quarter of 2014.

Provision for income taxes was $141 thousand in the third quarter of 2014 compared to a benefit of $33 thousand in the second quarter of 2014.

Net loss was $4.6 million in the third quarter of 2014 compared to a net loss of $2.8 million in the second quarter of 2014.

Quarter Ended December 28, 2013 Compared to Quarter Ended December 29, 2012

Results of Operations

The following table presents results of operations data as a percentage of net sales:

	Fiscal quarter ended			
	Dec 28, 2013		Dec 29, 2012	
Net sales	100.0	%	100.0	%
Cost of sales	57.5		65.1	
Gross profit	42.5		34.9	
Selling, service and administration	32.4		30.8	
Research, development and engineering	25.5		23.0	
Legal settlement proceeds, net	—		(40.5	)
Gain on sale of property and equipment, net	(3.4	)	(3.2	)
Operating (loss) income	(12.0	)	24.8	
Interest and other income, net	0.2		—	
(Loss) income before income taxes	(11.8	)	24.8	
Provision for income taxes	0.3		7.0	
Net (loss) income	(12.1	)%	17.8	%

Net Sales

The following table presents net sales information by product group:

	Fiscal quarter ended					
	Dec 28, 2013			Dec 29, 2012		
(In thousands, except percentages)	Net Sales	% of Net Sales		Net Sales	% of Net Sales	
Interconnect & Microfabrication Group (IMG)	$25,378	66.3	%	$30,537	80.5	%
Semiconductor Group (SG)	8,535	22.3		3,322	8.8	
Components Group (CG)	4,354	11.4		4,071	10.7	
	$38,267	100.0	%	$37,930	100.0	%

Net sales for the third quarter of 2014