ELECTRO SCIENTIFIC INDUSTRIES INC
Form 10-Q
February 09, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended January 2, 2010

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

Registrant s telephone number: (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 x No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See 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	x
Non-accelerated filer	¨	Smaller Reporting Company	¨

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

The number of shares outstanding of the Registrant s Common Stock at February 5, 2010 was 27,567,828 shares.

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ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES

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ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands)	Jan 2, 2010	Mar 28, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 52,642	$ 153,538
Restricted cash	10,824	
Short-term investments	99,287	2,380
Total cash, restricted cash and investments	162,753	155,918
Trade receivables, net of allowances of $1,011 and $969	22,436	18,847
Inventories	78,610	84,882
Shipped systems pending acceptance	1,858	2,072
Deferred income taxes, net	8,746	6,298
Other current assets	12,947	10,594
Total current assets	287,350	278,611
Non-current assets:		
Auction rate securities	7,007	6,007
Property, plant and equipment, net of accumulated depreciation of $81,969 and $74,877	40,027	43,005
Non-current deferred income taxes, net	31,346	22,620
Acquired intangible assets, net of accumulated amortization of $6,504 and $4,885	8,785	9,972
Other assets	13,305	24,032
Total assets	$ 387,820	$ 384,247
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 11,388	$ 7,492
Accrued liabilities	21,046	12,958
Deferred revenue	7,327	11,251
Total current liabilities	39,761	31,701
Non-current liabilities:		
Income taxes payable	8,793	9,023
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; 27,565 and 27,184 issued and outstanding	140,274	133,808
Retained earnings	197,408	211,085
Accumulated other comprehensive income related to auction rate securities	1,940	
Accumulated other comprehensive loss, other	(356)	(1,370)
Total shareholders equity	339,266	343,523
Total liabilities and shareholders equity	$ 387,820	$ 384,247

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

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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)	**Jan 2, 2010**	**Dec 27, 2008**	**Jan 2, 2010**	**Dec 27, 2008**
Net sales	$ 39,048	$ 25,618	$ 89,289	$ 139,252
Cost of sales	24,231	18,200	59,085	85,471
Gross profit	14,817	7,418	30,204	53,781
Operating expenses:				
Selling, service and administration	11,910	12,062	35,236	40,908
Research, development and engineering	8,793	7,939	23,689	26,043
Restructuring costs		112		2,035
Merger termination proceeds, net			(4,516)	
Goodwill impairment charge		17,396		17,396
Net operating expenses	20,703	37,509	54,409	86,382
Operating loss	(5,886)	(30,091)	(24,205)	(32,601)
Non-operating income (expense):				
Other-than-temporary impairment of auction rate securities		(2,022)		(12,497)
Interest and other income, net	369	1,021	1,068	2,998
Total non-operating income (expense)	369	(1,001)	1,068	(9,499)
Loss before income taxes	(5,517)	(31,092)	(23,137)	(42,100)
Benefit from income taxes	(3,104)	(1,834)	(9,074)	(5,975)
Net loss	$ (2,413)	$ (29,258)	$ (14,063)	$ (36,125)
Net loss per share basic	$ (0.09)	$ (1.08)	$ (0.51)	$ (1.33)
Net loss per share diluted	$ (0.09)	$ (1.08)	$ (0.51)	$ (1.33)
Weighted average number of shares basic	27,517	27,040	27,394	27,061
Weighted average number of shares diluted	27,517	27,040	27,394	27,061

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

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ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three fiscal quarters ended	
(In thousands)	**Jan 2, 2010**	**Dec 27, 2008**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (14,063)	$ (36,125)
Adjustments to reconcile net loss to cash (used in) provided by operating activities:		
Depreciation and amortization	7,445	7,591
Amortization of acquired intangible assets	1,619	1,864
Share-based compensation expense	6,106	3,385
(Recovery of) provision for doubtful accounts	(31)	491
Loss on disposal of property, plant and equipment	10	92
Other-than-temporary impairment of auction rate securities		12,497
Deferred income taxes	(11,723)	(7,330)
Goodwill impairment charge		17,396
Changes in operating accounts:		
(Increase) decrease in trade receivables, net	(3,366)	34,285
Decrease in inventories	7,701	9,268
Decrease in shipped systems pending acceptance	214	607
Increase in other current assets	(2,285)	(1,802)
Increase (decrease) in accounts payable and accrued liabilities	11,132	(16,782)
Decrease in deferred revenue	(3,924)	(705)
Net cash (used in) provided by operating activities	(1,165)	24,732
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(205,780)	(805,141)
Proceeds from sales and maturities of investments	110,183	788,035
Purchase of property, plant and equipment	(1,883)	(2,975)
Proceeds from the sale of property, plant and equipment	2	4
Increase in restricted cash	(10,824)	
Acquisition transaction costs		(1,440)
Decrease in other assets	7,337	942
Minority equity investment	(193)	(876)
Net cash used in investing activities	(101,158)	(21,451)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from exercise of stock options and stock plans	872	2,367
Share repurchases	(555)	(4,724)
Net cash provided by (used in) financing activities	317	(2,357)
Effect of exchange rate changes on cash	1,110	(3,192)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(100,896)	(2,268)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	153,538	141,059
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 52,642	$ 138,791

SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for income taxes	$	(1,948)	$	(2,782)
Income tax refunds received	$	757	$	1,028

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

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ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES

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. 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 U.S. generally accepted accounting principles 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; allowances for doubtful accounts; share-based compensation; income taxes including the valuation of deferred tax assets; fair value measurements; valuation of cost method equity investments; and valuation of long-lived assets.

With the exception of the adoption of certain pronouncements as described in Note 2 Recent Accounting Pronouncements , 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 filed for its fiscal year ended March 28, 2009.

Certain reclassifications have been made in the accompanying condensed consolidated financial statements for prior periods to conform to the current presentation. All references to years or quarters relate to fiscal years or fiscal quarters unless otherwise noted. The Company s fiscal quarters consist of either thirteen weeks or fourteen weeks. The fiscal quarter ended January 2, 2010, which represents the third quarter of fiscal 2010, included fourteen weeks.

2. Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued FASB Accounting Standards Codification (ASC) Accounting Standards Update (ASU) 2010-06 Improving Disclosures about Fair Value Measurements (ASC ASU 2010-06). ASC ASU 2010-06 requires various additional disclosures regarding fair value measurements, including the amounts of significant transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for any transfers in or out of Level 3, and a gross basis of presentation for purchases, sales, issuances and settlements within the Level 3 activity rollforward. The ASC will be effective for the Company s fourth quarter of fiscal 2010, except for the disclosures about purchases, sales, issuances and settlements within the Level 3 activity rollforward, which will be effective for the Company s first quarter of fiscal 2012. The Company s adoption of the ASC will not have a material impact on its financial statements.

3. Restricted Cash

As of January 2, 2010, the Company had restricted cash of $10.8 million. This amount collateralizes $9.1 million in commercial letters of credit substituted for the cash bond previously held by the Kaohsiung District Court of Taiwan. See Note 16 Legal Proceedings for further discussion.

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4. Fair Value Measurements

Fair value is defined under ASC Topic 820 Fair Value Measurements and Disclosures (ASC Topic 820) as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. 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 other than quoted prices in active markets for similar assets or liabilities that are either directly or indirectly observable; and

Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

As of January 2, 2010, the Company held a total of $13.7 million invested in auction rate securities (ARS) at par value. Additionally, the Company held $4.0 million of par value ARS which were converted by the bond issuer to its preferred stock during the third quarter of fiscal 2009. The ARS are comprised predominately of securities issued by insurance companies to raise funds to meet regulatory capital reserve requirements and the ARS assume the credit ratings of the bond insurers who guarantee the timely payment of principal and interest on these insured securities. At the time of purchase in fiscal 2007, these ARS were rated AAA and AA. The contractual maturities of these securities range up to calendar year 2050, and several securities and the preferred stock do not have stated maturities. Prior to September 2007, these securities provided short-term liquidity through a Dutch auction process that reset the applicable interest rate at pre-determined calendar intervals, generally every 28 to 35 days. This mechanism previously allowed existing investors to either retain or liquidate their holdings by selling such securities at par. As a result of the liquidity issues experienced in the global credit and capital markets, during the second quarter of fiscal 2008, the Company s ARS began to experience failed auctions.

Since that time, none of the Company s securities have traded through the auction process and very few market transactions for these securities have been observed. Additionally, the bond insurers of the ARS and preferred stock experienced credit rating downgrades throughout fiscal 2009. Consequently, it was determined that the declines in fair value of these securities during fiscal 2009 represented other-than-temporary impairments in accordance with U.S. generally accepted accounting principles. Accordingly, at the end of each quarter of fiscal 2009, the cost bases of these securities were written down to their estimated fair values with other-than-temporary impairment charges totaling $13.6 million, of which $2.0 million was recorded during the quarter ended December 27, 2008 and $12.5 million was recorded during the three quarters ended December 27, 2008.

As of the beginning of the first quarter of fiscal 2010, in accordance with the adoption of ASC Topic 320 Investments Debt and Equity Securities (ASC Topic 320), the Company recorded a cumulative-effect adjustment to increase the opening balance of retained earnings by $0.4 million, which represented the non-credit portion of the ARS loss previously recorded as an other-than-temporary impairment in the statement of operations. The credit portion of the ARS loss was determined by direct estimation of the change in fair value attributable to market movements. The Company utilized market indices representing investments of constant credit quality over time and measured the index yield, which is considered attributable to non-credit related factors, at the beginning and end of the period. The effect of this change in yield on the value of the security was measured and subtracted from the total change in fair value to arrive at the estimated change in value attributable to changes in credit quality.

The Company also recorded fair value adjustments to accumulated other comprehensive income of $1.1 million, $1.4 million, and $0.1 million at the end of the first, second, and third quarters of fiscal 2010, respectively, to reflect the estimated increases in fair value of the ARS. As of January 2, 2010, total net unrealized gains on our remaining ARS were $1.9 million, which represents the fiscal 2010 fair value adjustments of $2.6 million, reduced by the cumulative-effect adjustment of $0.4 million and $0.3 million related to the sale of certain ARS in the third quarter of fiscal 2010. The $7.0 million estimated fair value of the Company s remaining ARS securities is classified as a non-current asset on the Condensed Consolidated Balance Sheet at January 2, 2010, consistent with the classification at December 27, 2008 and each subsequent reporting period.

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During the third quarter of fiscal 2010, the Company agreed to sell certain ARS with a par value of $1.9 million pursuant to a tender agreement with the parent company of the securities original issuer. The Company received approximately $1.4 million on the sale of the ARS, which had an estimated fair value of $1.6 million as of September 26, 2009. As a result of the sale, the Company reclassified $0.3 million of the previously recorded unrealized net gain out of accumulated other comprehensive income. The unrealized net gain represented the cumulative total of the fair value adjustments related to these ARS prior to the transaction.

The Company currently continues to receive all interest and preferred stock dividend payments when due. It cannot reasonably predict if or when its remaining ARS will become liquid.

Certain information regarding marketable securities at January 2, 2010 and March 28, 2009 was as follows (in thousands):

		Unrealized		Realized	
January 2, 2010	**Cost**	**Gain**	**Loss**	**Loss**	**Fair Value**
Available-for-sale debt securities (current):					
Government agencies	$ 72,094	$	$ (16)	$	$ 72,078
Commercial paper	29,989				29,989
U.S. treasuries	10,068				10,068
	$ 112,151	$	$ (16)	$	$ 112,135
Available-for-sale debt securities (non-current):					
Auction rate securities	$ 13,700	$ 1,940	$	$ (9,013)	$ 6,627
Preferred stock	4,000			(3,620)	380
	$ 17,700	$ 1,940	$	$ (12,633)	$ 7,007

		Unrealized		Realized	
March 28, 2009	**Cost**	**Gain**	**Loss**	**Loss**	**Fair Value**
Available-for-sale debt securities (current):					
Corporate notes and bonds	$ 2,072	$ 12	$	$	$ 2,084
Available-for-sale debt securities (non-current):					
Auction rate securities	$ 15,600	$	$	$ (9,973)	$ 5,627
Preferred stock	4,000			(3,620)	380
	$ 19,600	$	$	$ (13,593)	$ 6,007

Other than the sale of ARS discussed above, there were no sales of available-for-sale securities during the quarters ended January 2, 2010 and December 27, 2008. For purposes of determining gross realized gains and losses and reclassification out of accumulated other comprehensive 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 income were an immaterial loss and a $0.1 million gain as of January 2, 2010 and December 27, 2008, respectively. Gains reclassified out of accumulated other comprehensive income into earnings during the quarter ended January 2, 2010 were $0.3 million.

Underlying maturities of investments and ARS at January 2, 2010 were approximately $112.1 million within one year and $7.0 million beyond 10 years.

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As of January 2, 2010, the Company had $6.0 million invested in Series D Preferred Stock and $2.2 million invested in Series E Preferred Stock of OmniGuide, Inc., representing an 11% 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 as it is not practicable to do so. As of January 2, 2010 and March 28, 2009, management had not identified any events or circumstances that indicated the investments were impaired; therefore, as presented in Note 8 Other Assets , the full carrying values of $8.2 million and $8.0 million were included in Other assets on the Condensed Consolidated Balance Sheets at January 2, 2010 and March 28, 2009, respectively.

The following table represents the Company s fair value hierarchy for its financial assets measured at fair value on a recurring basis as of January 2, 2010:

(In thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Money market securities	$ 18,665	$	$	$ 18,665
Government agencies		72,078		72,078
Commercial paper		29,989		29,989
U.S. Treasuries		10,068		10,068
Forward purchase or (sale) contracts:				
Japanese Yen		29		29
Taiwan Dollar		(11)		(11)
Korean Won		(2)		(2)
Euro		(49)		(49)
British Pound		(54)		(54)
Auction rate securities			6,627	6,627
Preferred stock			380	380

The following table illustrates Level 3 activity during the third quarter of fiscal 2010:

(In thousands)	**Auction Rate Securities**	**Preferred Stock**	**Total**
Fair value, September 26, 2009	$ 8,175	$ 380	$ 8,555
Net unrealized gains:			
Included in earnings			
Included in other comprehensive income	95		95
Sales	(1,643)		(1,643)
Purchases, issuances and settlements			
Net transfers into (out of) Level 3			
Fair value, January 2, 2010	$ 6,627	$ 380	$ 7,007

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 the forward contracts, spot prices at December 31, 2009 were utilized to calculate the unrealized gain/loss on open forward contracts which were recorded in Accumulated other comprehensive income (loss) and Other assets on the Condensed Consolidated Balance Sheet as of January 2, 2010.

The Level 3 assets consisted of ARS and preferred stock acquired through the conversion of certain ARS during the third quarter of fiscal 2009. As none of the Company s securities have traded through the auction process and very few market transactions have been observed for these securities, estimated fair values were based primarily upon the income approach using a discounted cash flow model which took into account the following: (i) the underlying structure of each security; (ii) the present value of future principal and interest payments discounted at rates that reflect current market conditions; (iii) consideration of the probabilities of default, restructuring or redemption by the issuer (trigger events); (iv) estimates of the recovery rates in the event of default for each security; (v) the financial condition, results, ratings of and financial claims on the bond insurers and issuers; and (vi) the underlying trust assets of the securities.

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5. 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)	Jan 2, 2010	Mar 28, 2009
Raw materials and purchased parts	$ 51,884	$ 56,701
Work-in-process	13,332	7,741
Finished goods	13,394	20,440
	$ 78,610	$ 84,882

6. Other Current Assets

Other current assets consisted of the following:

(In thousands)	Jan 2, 2010	Mar 28, 2009
Prepaid expenses	$ 6,799	$ 2,055
Income tax refund receivable	3,191	4,828
Value added tax receivable	2,951	3,426
Other	6	285
	$ 12,947	$ 10,594

7. Acquired Intangible Assets

The following table presents the details of acquired intangible assets and accumulated amortization to date at January 2, 2010:

(In thousands, except years)	Useful Life (in years)	Estimated Fair Value at Acquisition Date	Accumulated Amortization	Recorded Value at Jan 2, 2010
Developed technology	7	$ 8,100	$ (2,825)	$ 5,275
Customer relationships	6	2,700	(1,641)	1,059
Customer backlog	1	700	(700)	
Trade name and trademarks	3	400	(326)	74
Change of control agreements	1	100	(100)	
Fair value of below-market lease (non-current portion)	3.8	311	(265)	46
Patents*	13.2	2,978	(647)	2,331
Subtotal long term		15,289	(6,504)	8,785
Fair value of below-market lease (current portion)		110		110
Total acquired intangible assets		$ 15,399	$ (6,504)	$ 8,895

* Useful life for Patents represents a weighted average of multiple patents with varying useful lives.

Amortization expense for intangible assets has been recorded in the Condensed Consolidated Statements of Operations as follows:

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	Jan 2, 2010	Dec 27, 2008	Jan 2, 2010	Dec 27, 2008
Cost of sales	$ 288	$ 289	$ 866	$ 867
Selling, service and administration	190	222	609	952
Research, development and engineering	52	15	144	45
Total	$ 530	$ 526	$ 1,619	$ 1,864

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The estimated amortization expense for intangible assets for the current year, including amounts amortized year to date, and in future years is as follows (in thousands):

Year	Amortization
2010	$ 2,149
2011	1,939
2012	1,671
2013	1,512
2014	1,383
Future years	1,860
	$ 10,514

8. Other Assets

Other assets consisted of the following:

(In thousands)	Jan 2, 2010	Mar 28, 2009
Minority equity investment	$ 8,184	$ 7,991
Consignment and demo equipment, net	4,187	6,447
All-Ring patent suit court bond		8,738
Other	934	856
	$ 13,305	$ 24,032

During fiscal 2010, the Company established letters of credit as substitution for the All-Ring patent suit court bond and received back $9.1 million in total proceeds from the court. The All-Ring patent suit court bond balance declined by $8.7 million due to the receipt of the $9.1 million proceeds, inclusive of a $0.4 million favorable impact from foreign currency rate fluctuation.

9. Accrued Liabilities

Accrued liabilities consisted of the following:

(In thousands)	Jan 2, 2010	Mar 28, 2009
Customer deposits	$ 7,716	$ 624
Payroll-related liabilities	3,879	3,971
Value added taxes payable	1,728	2,095
Product warranty accrual	1,692	2,057
Professional fees payable	1,411	1,143
Purchase order commitments and receipts	1,176	673
Restructuring costs payable	190	447
Other	3,254	1,948
	$ 21,046	$ 12,958

10. Product Warranty Accrual

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

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	**Jan 2, 2010**	**Dec 27, 2008**	**Jan 2, 2010**	**Dec 27, 2008**
Product warranty accrual, beginning	$ 1,120	$ 3,799	$ 2,057	$ 3,740
Warranty charges incurred, net	(546)	(2,946)	(3,207)	(6,923)
Provision for warranty charges	1,118	2,245	2,842	6,281
Product warranty accrual, ending	$ 1,692	$ 3,098	$ 1,692	$ 3,098

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Net warranty charges incurred include labor costs 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.

11. Deferred Revenue

Generally, revenue is recognized upon fulfillment of acceptance criteria at the Company s factory and title transfer which frequently occur 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 fair value 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)	**Jan 2, 2010**	**Dec 27, 2008**	**Jan 2, 2010**	**Dec 27, 2008**
Deferred revenue, beginning	$ 12,490	$ 11,219	$ 11,251	$ 12,583
Revenue deferred	4,275	6,414	16,992	19,105
Revenue recognized	(9,438)	(5,755)	(20,916)	(19,810)
Deferred revenue, ending	$ 7,327	$ 11,878	$ 7,327	$ 11,878

12. Earnings (Loss) Per Share

Basic earnings per share was calculated based on the weighted average number of common shares outstanding during each period. Diluted earnings per share was calculated based on these same weighted average shares outstanding plus the effect of potentially dilutive share-based awards as calculated using the treasury stock method. Share-based awards were excluded from the calculation to the extent their effect would be antidilutive.

Awards of options, stock-settled stock appreciation rights (SOSARs) and unvested restricted stock units (RSUs) representing an additional 4.6 million and 4.4 million shares of stock for the quarters ended January 2, 2010 and December 27, 2008, 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 January 2, 2010 and December 27, 2008, awards of options, SOSARs and unvested RSUs representing an additional 4.5 million shares were excluded from the calculation of diluted net earnings per share as their effect would have been antidilutive.

13. Comprehensive Loss

The components of comprehensive loss, net of tax, were as follows:

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	**Jan 2, 2010**	**Dec 27, 2008**	**Jan 2, 2010**	**Dec 27, 2008**
Net loss	$ (2,413)	$ (29,258)	$ (14,063)	$ (36,125)
Foreign currency translation adjustment	(26)	(925)	1,114	(2,204)
Reclassification of unrealized (gain) loss on auction rate securities to earnings	(317)		(317)	2,496
Unrealized gain on auction rate securities	95		2,643	
Net unrealized gain (loss) on securities classified as available-for-sale	(17)	88	(16)	(2)
Unrealized loss on cash flow hedge	(87)		(87)	
Other comprehensive income	1	2	3	6

Comprehensive loss	$ (2,764)	$ (30,093)	$ (10,723)	$ (35,829)

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14. Share Repurchase Program

On May 15, 2008, the Board of Directors authorized a share repurchase program totaling $20.0 million to acquire shares of the Company s outstanding common stock primarily to offset dilution from equity compensation programs. 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. There is no fixed completion date for the repurchase program.

The Company did not repurchase any shares under this program during the quarter ended January 2, 2010. During the three quarters ended January 2, 2010, the Company repurchased 64,960 shares for $0.6 million under this program at an average price per share of $8.55, calculated inclusive of commissions and fees.

As of January 2, 2010, a total of 372,825 shares have been repurchased for $5.3 million under this authorization at an average price of $14.16 per share, calculated inclusive of commissions and fees. Cash used to settle repurchase transactions is reflected as a component of cash used in financing activities in the Condensed Consolidated Statements of Cash Flows.

15. Product and Geographic Information

Net sales by product type were as follows:

	Fiscal quarter ended		Three fiscal quarters ended	
(In thousands)	**Jan 2, 2010**	**Dec 27, 2008**	**Jan 2, 2010**	**Dec 27, 2008**
Semiconductor Group (SG)	$ 9,906	$ 5,534	$ 22,880	$ 39,782
Passive Component Group (PCG)	10,344	4,557	21,592	24,551
Interconnect/Micro-machining Group (IMG)	18,798	15,527	44,817	74,919
	$ 39,048	$ 25,618	$ 89,289	$ 139,252

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)	**Jan 2, 2010**	**Dec 27, 2008**	**Jan 2, 2010**	**Dec 27, 2008**
Asia	$ 32,046	$ 16,810	$ 70,698	$ 99,732
Americas	3,992	5,508	11,196	26,593
Europe	3,010	3,300	7,395	12,927
	$ 39,048	$ 25,618	$ 89,289	$ 139,252

16. Legal Proceedings

All Ring Patent Infringement Prosecution

In August 2005, the Company commenced a proceeding in the Kaohsiung District Court of Taiwan (the Court) directed against All Ring Tech Co., Ltd. (All Ring) of Taiwan. The Company alleged that All Ring s Capacitor Tester Model RK-T6600 (the Capacitor Tester) infringes ESI s Taiwan Patent No. 207469, entitled Circuit Component Handler (the 207469 patent). As part of this proceeding, the Court issued a Provisional Attachment Order (PAO) in August 2005, restricting the use of some of All Ring s assets. All Ring then filed a bond with the Court to obtain relief from the attachment of its assets. In July 2007, the Court issued a second PAO and approximately $6.0 million was restricted in All Ring s accounts. The second PAO remains in effect and cannot be revoked.

In October 2005, the Company filed a formal patent infringement action against All Ring in the Court. The Court-appointed expert initially concluded that the Capacitor Tester and All Ring s RK-T2000 both infringe every claim of the 207469 patent and that All Ring s RK-L50 infringes a number of the claims as well. Because the Company had amended its claims in the cancellation action as described below, the Court asked the Court-appointed expert to respond to questions regarding the expert s initial opinion. The

Court-appointed expert conducted an additional inspection of each of these systems on September 21, 2009, and will re-evaluate whether the systems infringe after reviewing the briefs that the Company and All Ring have submitted. At the request of the Court, an audit of All Ring was conducted by an independent accounting firm in November and December of calendar 2009 to assist the Court in making any damages determinations. The firm has not yet issued its audit report.

Also in October 2005, the Court executed a Preliminary Injunction Order (PIO) that prohibits All Ring from manufacturing, selling, offering for sale or using the Capacitor Tester until final judgment is entered in the formal patent infringement action. The Court dismissed All Ring s application to revoke the PIO on January 18, 2008, and the PIO remains in place.

In November 2005, All Ring filed a cancellation action against ESI s 207469 patent in the Taiwan Intellectual Property Office (the IPO). On July 5, 2007, the IPO issued a notice requiring the Company to cancel two of the claims in the 207469 patent. The Company filed a response canceling the two claims and amending the remaining claims accordingly in August 2007. On August 12, 2008, the IPO decided the action in the Company s favor and dismissed the cancellation action. All Ring appealed the IPO s cancellation decision to the Board of Appeal of the Ministry of Economic Affairs (MOEA) on September 12, 2008. On March 23, 2009, the MOEA dismissed the IPO s cancellation decision solely on procedural grounds. The MOEA remanded the case to the IPO with a request that the IPO issue another decision within six months that rectifies the procedural defects of the IPO s earlier decision. On July 22, 2009, the IPO issued a decision dismissing All Ring s cancellation action. All Ring appealed the IPO s decision to the MOEA in August 2009.

Pursuant to the Court s PAO and PIO, the Company was required to post Taiwan dollar security bonds with the Court. In July 2009, the Company established a letter of credit as a partial substitution and received back $2.0 million of the security bonds from the Court. The letter of credit is collateralized by $2.4 million of restricted cash. In September 2009, the Company established an additional letter of credit and received back the remaining $7.1 million of the security bonds. This second letter of credit is collateralized by $8.4 million of restricted cash. The total restricted cash balance of $10.8 million is included in the Condensed Consolidated Balance Sheet at January 2, 2010 as a current asset.

In the ordinary course of business, the Company is involved in various other legal matters, either asserted or unasserted, and investigations. In the opinion of management, ultimate resolution of these matters will not have a material effect on the Company s consolidated financial position, results of operations or cash flows.

17. Subsequent Events

For the third quarter of fiscal 2010, the Company evaluated subsequent events, as defined under ASC Topic 855 Subsequent Events , through February 9, 2010, the date the financial statements were issued. No such events were identified.

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) provide high-technology manufacturing equipment to the global semiconductor and micro-electronics markets, including advanced laser systems that are used to micro-engineer electronic device features in high-volume production environments. Our customers are primarily manufacturers of semiconductors, passive components, electronic interconnect devices, and other components used in a wide variety of end products in the computer, consumer electronics, communications and other industries. Our equipment enables these manufacturers to achieve yield and productivity gains in their manufacturing processes that can be critical to their profitability. ESI was founded in 1944, is headquartered in Portland, Oregon, and has subsidiaries in the U.S., Europe and Asia.

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Our advanced laser microengineering and inspection systems allow semiconductor and micro-electronics manufacturers to physically alter select device features during high-volume production in order to heighten performance and boost production yields. Laser micro-engineering comprises a set of precise fine-tuning processes, including micro-machining, wafer scribing and dicing, semiconductor memory-link cutting, device trimming and via drilling, that requires application-specific laser systems able to meet our customers exacting performance and productivity requirements. Our laser-based systems improve production yields or enable improved performance for semiconductor devices, high-density interconnect (HDI) circuits, including flexible interconnect material and advanced semiconductor packaging, high-brightness light emitting diodes (LED), flat panel liquid crystal displays (LCD) and general micro-machining applications.

Additionally, we produce high-capacity test and optical inspection equipment that is critical to the quality control process during the production of multi-layer ceramic capacitors (MLCCs). Our equipment ensures that each MLCC meets both the electrical and physical tolerances required to perform properly.

Summary of Sequential Quarterly Results

Our fiscal quarters consist of either thirteen weeks or fourteen weeks. The fiscal quarter ended January 2, 2010, which represents the third quarter of fiscal 2010, included fourteen weeks.

The financial results of our third quarter of fiscal 2010 reflected continued improvement in the end markets for our products from the prior quarter. Total order volume for the third quarter was $61.2 million, compared to $29.3 million for the second quarter of fiscal 2010, which ended September 26, 2009. The sequential increase in orders was driven by increases in our Interconnect/Micro-machining Group (IMG) and Passive Components Group (PCG), which significantly offset slightly lower orders in our Semiconductor Group (SG).

Orders for our SG products declined slightly for the third quarter compared to the prior quarter. The decrease in orders for SG products reflected continued low demand for our memory repair systems as customers manage current business levels with existing system capacity. However, our LED and LCD markets were strong, reflecting increased demand for LED-backlit displays and consumer products.

Orders for our PCG products increased during the third quarter to almost three times the order level of the prior quarter. The increase was driven by multi-unit orders for our MLCC testing systems as the market for Passive Component products improved and capacity utilization rates increased.

Orders for our Interconnect/Micro-machining Group (IMG) products more than doubled during the third quarter compared to the second quarter, driven largely by the receipt of a large order for our new Model ML5900 micro-machining system.

Net sales increased $11.4 million for the third quarter to $39.0 million compared to $27.6 million for the prior quarter. This increase reflects improvements in each of our product groups.

Gross margin was 37.9% on net sales of $39.0 million for the third quarter compared to 34.1% on net sales of $27.6 million for the prior quarter. The increase in gross margin percentage reflects the benefit from higher sales volume and improved mix, partially offset by higher costs. Costs increased primarily due to the partial restoration of salaries that had been subject to a temporary salary reduction program and an extra week included in the third quarter.

Net operating expenses increased $1.9 million to $20.7 million in the third quarter compared to $18.8 million in the prior quarter. This increase was primarily attributable to the additional week included in the third quarter of fiscal 2010, the partial reinstatement of temporary pay reductions and increased project expenses for new products.

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Operating loss decreased to $5.9 million in the third quarter compared to $9.4 million in the prior quarter. The decrease was due to the increase in revenues and gross profit.

Net interest and other income of $0.4 million remained essentially flat in the third quarter compared to the prior quarter.

The effective tax rate was 56.3% for the third quarter, resulting in an income tax benefit of $3.1 million, compared to an effective rate of 32.1% for the prior quarter that resulted in an income tax benefit of $2.9 million. The change in the effective tax rate was primarily due to lower estimated annual losses and credits related to the completion of tax audits in the third quarter of fiscal 2010.

Net loss for the third quarter was $2.4 million or $0.09 per basic and diluted share, compared to a net loss of $6.1 million or $0.22 per basic and diluted share in the prior quarter.

Results of Operations

Our fiscal quarters consist of either thirteen weeks or fourteen weeks. The fiscal quarter ended January 2, 2010, which represents the third quarter of fiscal 2010, included fourteen weeks.

Quarter Ended January 2, 2010 Compared to Quarter Ended December 27, 2008

The following table presents results of operations data as a percentage of net sales for the quarters ended January 2, 2010 and December 27, 2008:

	Fiscal quarter ended	
	Jan 2, 2010	**Dec 27, 2008**
Net sales	100.0%	100.0%
Cost of sales	62.1	71.0
Gross margin	37.9	29.0
Selling, service and administration	30.4	47.1
Research, development and engineering	22.5	31.0
Restructuring costs		0.4
Goodwill impairment charge		67.9
Operating loss	(15.0)	(117.4)
Other-than-temporary impairment of auction rate securities		(7.9)
Interest and other income, net	0.9	4.0
Loss before income taxes	(14.1)	(121.3)
Benefit from income taxes	(7.9)	(7.2)
Net loss	(6.2)%	(114.1)%

Net Sales

Net sales were $39.0 million for the quarter ended January 2, 2010, an increase of $13.4 million or 52.4% compared to net sales of $25.6 million for the quarter ended December 27, 2008. Compared to the prior year, revenue increased in each of our product groups, reflecting general improvements as capacity utilization improved and customers began to recover from the global economic downturn.

Net sales by product group for the quarters ended January 2, 2010 and December 27, 2008 were as follows:

	Fiscal quarter ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	Net Sales	% of Net Sales	Net Sales	% of Net Sales
Semiconductor Group (SG)	$ 9,906	25.4%	$ 5,534	21.6%
Passive Components Group (PCG)	10,344	26.5%	4,557	17.8%
Interconnect/Micro-machining Group (IMG)	18,798	48.1%	15,527	60.6%
	$ 39,048	100.0%	$ 25,618	100.0%

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SG sales in the quarter ended January 2, 2010 increased $4.4 million or 79.0% compared to the quarter ended December 27, 2008. The overall increase in sales was due to a small number of system sales to non-memory customers combined with an increase in service revenues as customers increase utilization of existing systems.

PCG sales in the quarter ended January 2, 2010 increased $5.8 million or 127.0% compared to the quarter ended December 27, 2008. The increase was primarily due to demand for new systems for capacity expansion along with increased tooling sales resulting from increasing utilization levels of our MLCC customers existing systems.

IMG sales in the quarter ended January 2, 2010 increased $3.3 million or 21.1% compared to the quarter ended December 27, 2008. The increase was primarily driven by sales of our new Model 5900 for micromachining applications.

Net sales by geographic region for the quarters ended January 2, 2010 and December 27, 2008 were as follows:

	Fiscal quarter ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	Net Sales	% of Net Sales	Net Sales	% of Net Sales
Asia	$ 32,046	82.1%	$ 16,810	65.6%
Americas	3,992	10.2%	5,508	21.5%
Europe	3,010	7.7%	3,300	12.9%
	$ 39,048	100.0%	$ 25,618	100.0%

Compared to the quarter ended December 27, 2008, net sales for the quarter ended January 2, 2010 increased $15.2 million or 90.6% in Asia and decreased $1.5 million or 27.5% in the Americas and $0.3 million or 8.8% in Europe. The increase in Asia was driven by increases in sales across all three product groups as utilization and capacity requirements of our Asian manufacturing customers increased. The decreases in the Americas and Europe primarily reflect a reduction in sales in our IMG laser ablation markets compared to robust sales levels during the quarter ended December 27, 2008.

Gross Profit

Gross profit for the quarters ended January 2, 2010 and December 27, 2008 was as follows:

	Fiscal quarter ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	Gross Profit	% of Net Sales	Gross Profit	% of Net Sales
Gross profit	$ 14,817	37.9%	$ 7,418	29.0%

Gross profit for the quarter ended January 2, 2010 was $14.8 million, an increase of $7.4 million compared to gross profit of $7.4 million for the quarter ended December 27, 2008. Gross profit as a percentage of net sales increased to 37.9% for the quarter ended January 2, 2010 from 29.0% for the quarter ended December 27, 2008. These increases were primarily related to higher revenue levels along with an associated increase in production capacity utilization.

Operating Expenses

Operating expenses for the quarters ended January 2, 2010 and December 27, 2008 were as follows:

Fiscal quarter ended	
Jan 2, 2010	Dec 27, 2008

(In thousands, except percentages)	Expense	% of Net Sales	Expense	% of Net Sales
Selling, service and administration	$ 11,910	30.4%	$ 12,062	47.1%
Research, development and engineering	8,793	22.5	7,939	31.0
Restructuring costs			112	0.4
Goodwill impairment charge			17,396	67.9
	$ 20,703	52.9%	$ 37,509	146.4%

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Selling, Service and Administration

Selling, service and administration (SS&A) primarily consists of labor and other employee-related expenses including share-based compensation expense, travel expense, professional fees, sales commissions and facilities costs. SS&A expenses were $11.9 million for the quarter ended January 2, 2010, a decrease of $0.2 million compared to $12.1 million in the quarter ended December 27, 2008. The decrease in SS&A expenses was primarily attributable to restructuring and cost management activities completed in fiscal 2009. These actions included company-wide reductions in force and related decreases in compensation and labor-related costs. Additionally, we implemented several temporary cost reduction measures in calendar 2009 including salary reductions, furloughs, and elimination of the Company match of 401(k) contributions. The impact of these activities was partially offset by the additional week included in the third quarter of fiscal 2010 and an increase of $0.4 million in SS&A share-based compensation expense. Share-based compensation expense increased primarily due to the incremental charge for our annual stock grant.

Research, Development and Engineering

Research, development and engineering (RD&E) expenses are primarily comprised of labor and other employee-related expenses, professional fees, project materials, equipment costs and facilities costs. RD&E expenses totaled $8.8 million for the quarter ended January 2, 2010, an increase of $0.9 million compared to $7.9 million for the quarter ended December 27, 2008. This increase was primarily due to an increase of $0.4 million in R&D share-based compensation expense resulting from our annual stock grant, an additional week in the third quarter of 2010, and to lesser extents, increases in project expenses and depreciation. Engineering project expenses can fluctuate from quarter-to-quarter depending upon the various project timelines and content.

Restructuring Costs

No restructuring expenses were incurred during the quarter ended January 2, 2010. During the quarter ended December 27, 2008, $0.1 million of restructuring expenses were incurred as a result of reductions in workforce initiated in the second quarter of fiscal 2009 in response to lower customer demand.

Goodwill Impairment Charge

No goodwill impairment charges were incurred during the quarter ended January 2, 2010. During the quarter ended December 27, 2008, a $17.4 million charge was incurred due to declines in the Company s stock price and market capitalization during that quarter.

Non-operating Income and Expense

Other-than-temporary Impairment of Auction Rate Securities

No other-than-temporary impairment charges related to our auction rate securities (ARS) were recorded during the quarter ended January 2, 2010. During the quarter ended December 27, 2008, $2.0 million of impairment charges were incurred as instability in the global financial markets impacted the estimated fair values of our ARS. See Note 4 Fair Value Measurements for further discussion.

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Interest and Other Income, net

Interest and other income, net, consists of interest income and expense, market gains and losses on assets held in employees deferred compensation accounts, realized and unrealized foreign exchange gains and losses, bank charges, investment management fees, ARS valuation fees and other miscellaneous non-operating items. Net interest and other income for the quarters ended January 2, 2010 and December 27, 2008 were as follows:

	Fiscal quarter ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	Interest and Other Income, net	% of Net Sales	Interest and Other Income, net	% of Net Sales
Interest and other income, net	$ 369	0.9%	$ 1,021	4.0%

Interest and other income, net, for the quarter ended January 2, 2010 decreased $0.7 million compared to the quarter ended December 27, 2008. The decrease was primarily attributable to a $0.5 million decrease in interest income caused by declines in market interest rates during this period.

Income Taxes

The income tax benefit for the quarter ended January 2, 2010 was $3.1 million on pretax loss of $5.5 million, an effective tax rate of 56.3%. This improved rate was primarily due to lower estimated annual losses and credits related to the completion of tax audits in the third quarter of fiscal 2010, which resulted in a reduction in income taxes payable. Comparatively, the income tax benefit was $1.8 million on a pretax loss of $31.1 million for the quarter ended December 27, 2008, an effective tax rate of 5.9%. The low effective tax rate was primarily related to the goodwill impairment charge recorded in the third quarter of fiscal 2009 that is not deductible for U.S. tax purposes, as well as a valuation allowance on deferred tax assets that was established in that quarter. The valuation allowance was required due to unrealized capital losses arising from the write-down of our auction rate securities.

Our effective tax rate is subject to fluctuation based upon the occurrence and timing of numerous discrete events such as changes in tax laws or their interpretations, extensions or expirations of research and experimentation credits, closure of tax years subject to examination, finalization of income tax returns, the timing and fluctuations of quarterly results and also due to the relationship of fixed deductions to overall changes in estimated and actual pretax income or loss. For example, in accordance with ASC Topic 740 Income Taxes , the tax benefit associated with our loss through the third quarter of fiscal 2010 has been limited to our estimated tax benefit expected for the year. As a result, this remaining benefit will serve to lower overall tax expense in the fourth quarter of fiscal 2010. We anticipate no significant changes in unrecognized tax benefits in the next twelve months as the result of examinations or lapsed statutes of limitation.

Net Loss

Net losses for the quarters ended January 2, 2010 and December 27, 2008 were as follows:

	Fiscal quarter ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	Net Loss	% of Net Sales	Net Loss	% of Net Sales
Net loss	$ (2,413)	(6.2)%	$ (29,258)	(114.1)%

Net loss for the quarter ended January 2, 2010 was $2.4 million, or $0.09 per basic and diluted share, compared to net loss of $29.3 million, or $1.08 per basic and diluted share for the quarter ended December 27, 2008. The decrease in net loss was primarily the result of the $17.4 million goodwill impairment charge and the $2.0 million other-than-temporary impairment charge on our ARS recorded during the quarter ended December 27, 2008 and improved gross profit during the quarter ended January 2, 2010 on higher revenues.

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Three Quarters Ended January 2, 2010 Compared to Three Quarters Ended December 27, 2008

The following table presents results of operations data as a percentage of net sales for the three quarters ended January 2, 2010 and December 27, 2008:

	Three fiscal quarters ended	
	Jan 2, 2010	Dec 27, 2008
Net sales	100.0%	100.0%
Cost of sales	66.2	61.4
Gross margin	33.8	38.6
Selling, service and administration	39.5	29.4
Research, development and engineering	26.5	18.7
Restructuring costs		1.5
Merger termination proceeds, net	(5.1)	
Goodwill impairment		12.5
Operating loss	(27.1)	(23.5)
Other-than-temporary impairment of auction rate securities		(9.0)
Interest and other income, net	1.2	2.2
Loss before income taxes	(25.9)	(30.3)
Benefit from income taxes	(10.2)	(4.3)
Net loss	(15.7)%	(26.0)%

Net Sales

Net sales for the three quarters ended January 2, 2010 were $89.3 million, a decrease of $50.0 million or 35.9% compared to the three quarters ended December 27, 2008. Revenue decreased in each of our product groups, reflecting the impact on customer demand resulting from the global economic downturn. Our worldwide customers have been severely affected by depressed consumer demand for consumer electronics that started in calendar 2008 and has only begun to improve in the second half of calendar 2009.

Net sales by product group for the three quarters ended January 2, 2010 and December 27, 2008 were as follows:

	Three fiscal quarters ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	Net Sales	% of Net Sales	Net Sales	% of Net Sales
Semiconductor Group (SG)	$ 22,880	25.6%	$ 39,782	28.6%
Passive Components Group (PCG)	21,592	24.2%	24,551	17.6%
Interconnect/Micro-machining Group (IMG)	44,817	50.2%	74,919	53.8%
	$ 89,289	100.0%	$ 139,252	100.0%

SG sales in the three quarters ended January 2, 2010 decreased $16.9 million or 42.5% compared to the three quarters ended December 27, 2008. The decrease in sales was due to continued weakness in the memory markets, as customers continue to manage existing capacity levels through the utilization of existing systems and are slow to invest in new technologies.

PCG sales in the three quarters ended January 2, 2010 decreased $3.0 million or 12.1% compared to the three quarters ended December 27, 2008. The decrease in PCG sales was driven by higher sales volumes in the first quarter of fiscal 2009 resulting from capacity buys from key customers in that quarter. Following that point, we saw demand for our products decline as lower consumer demand and utilization rates impacted our customers in the second half of calendar 2008 and the first half of calendar 2009.

IMG sales in the three quarters ended January 2, 2010 decreased $30.1 million or 40.2% compared to the three quarters ended December 27, 2008. The decrease was primarily due to strong sales in the prior year of our micro-machining products due to initial demand for the Model 5800 released during the first quarter of fiscal 2009.

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Net sales by geographic region for the three quarters ended January 2, 2010 and December 27, 2008 were as follows:

	Three fiscal quarters ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	**Net Sales**	**% of Net Sales**	**Net Sales**	**% of Net Sales**
Asia	$ 70,698	79.2%	$ 99,732	71.6%
Americas	11,196	12.5%	26,593	19.1%
Europe	7,395	8.3%	12,927	9.3%
	$ 89,289	100.0%	$ 139,252	100.0%

Compared to the three quarters ended December 27, 2008, net sales for the three quarters ended January 2, 2010 decreased $29.0 million or 29.1% in Asia, $15.4 million or 57.9% in the Americas, and $5.5 million or 42.8% in Europe. The decreases in each of these regions reflect the impact of the global economic downturn.

Gross Profit

Gross profit for the three quarters ended January 2, 2010 and December 27, 2008 was as follows:

	Three fiscal quarters ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	**Gross Profit**	**% of Net Sales**	**Gross Profit**	**% of Net Sales**
Gross profit	$ 30,204	33.8%	$ 53,781	38.6%

Gross profit for the three quarters ended January 2, 2010 was $30.2 million, a decrease of $23.6 million compared to gross profit of $53.8 million for the three quarters ended December 27, 2008. Gross profit as a percentage of net sales decreased to 33.8% for the three quarters ended January 2, 2010 from 38.6% for the three quarters ended December 27, 2008. These decreases were primarily related to decreased revenue levels along with an associated reduction in production capacity utilization. In response to the reductions in business, management implemented cost reduction efforts throughout fiscal 2009, including reductions in manufacturing labor and overhead, which partially mitigated the impact of lower production volumes.

Operating Expenses

Operating expenses for the three quarters ended January 2, 2010 and December 27, 2008 were as follows:

	Three fiscal quarters ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	**Expense**	**% of Net Sales**	**Expense**	**% of Net Sales**
Selling, service and administration	$ 35,236	39.5%	$ 40,908	29.4%
Research, development and engineering	23,689	26.5	26,043	18.7
Restructuring costs			2,035	1.5
Merger termination proceeds, net	(4,516)	(5.1)		
Goodwill impairment			17,396	12.5
	$ 54,409	60.9%	$ 86,382	62.1%

Selling, Service and Administration

Selling, service and administration (SS&A) expenses primarily consist of labor and other employee-related expenses including share-based compensation expense, travel expenses, professional fees, sales commissions and facilities costs. SS&A expenses were $35.2 million for the three quarters ended January 2, 2010, a decrease of $5.7 million compared to $40.9 million for the three quarters ended December 27, 2008. The decrease in SS&A expenses was primarily attributable to restructuring and cost management activities implemented in fiscal 2009. These activities included company-wide reductions in force and related

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decreases in compensation, labor, and travel-related costs. Additionally, we implemented several temporary cost reduction measures, including salary reductions, furloughs, and elimination of the Company match of 401(k) contributions. The impact of these reductions was partially offset by an increase of $2.1 million in SS&A share-based compensation expense and the impact of an additional week included in the three fiscal quarters ended January 2, 2010. Share-based compensation expense increased primarily due to vesting of annual grants for the board of directors in May of 2009 and the incremental cost of our annual stock grant.

Research, Development and Engineering

Research, development and engineering (RD&E) expenses are primarily comprised of labor and other employee-related expenses, professional fees, project materials, equipment costs and facilities costs. RD&E expenses totaled $23.7 million for the three quarters ended January 2, 2010 compared to $26.0 million for the three quarters ended December 27, 2008. This decrease was primarily due to reductions in employee-related expense resulting from our cost containment actions, and lower project materials expenses in the first two quarters of fiscal 2010. Partially offsetting these impacts were increases of $0.5 million in depreciation expense, $0.4 million in RD&E share-based compensation, and the impact of an additional week included in the three fiscal quarters ended January 2, 2010. RD&E share-based compensation expense increased due to the incremental cost of our annual stock grant. Engineering project expenses can fluctuate from quarter-to-quarter depending upon the various project timelines and content.

Restructuring Costs

No restructuring expenses were incurred during the three quarters ended January 2, 2010. During the three quarters ended December 27, 2008, $2.0 million of restructuring expenses were incurred as a result of reductions in workforce taken in response to lower customer demand.

Merger Termination Proceeds, net

In the first quarter of fiscal 2010, we recorded a net benefit of $4.5 million in operating expenses related to a merger termination fee. This amount represented the receipt of a $5.4 million merger termination fee offset by an additional $0.9 million of merger transaction costs.

Goodwill Impairment Charge

No goodwill impairment charges were incurred during the three quarters ended January 2, 2010. During the three quarters ended December 27, 2008, a $17.4 million charge was incurred due to declines in the Company s stock price and market capitalization during the third quarter of fiscal 2009.

Non-operating Income and Expense

Other-than-temporary Impairment of Auction Rate Securities

No other-than-temporary impairment charges related to our auction rate securities (ARS) were recorded during the three quarters ended January 2, 2010. During the three quarters ended December 27, 2008, we recorded $12.5 million of other-than-temporary impairment charges as instability in the global financial markets impacted the estimated fair values of our ARS. Given the continued challenges in the financial markets and the prolonged credit crisis, we cannot reasonably predict when or if our remaining ARS will become liquid. See Note 4 Fair Value Measurements for further discussion.

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Interest and Other Income, net

Interest and other income, net, consists of interest income and expense, market gains and losses on assets held in employees deferred compensation accounts, realized and unrealized foreign exchange gains and losses, bank charges, investment management fees, ARS valuation fees and other miscellaneous non-operating items. Net interest and other income for the three quarters ended January 2, 2010 and December 27, 2008 was as follows:

	Three fiscal quarters ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	Interest and Other Income, net	% of Net Sales	Interest and Other Income, net	% of Net Sales
Interest and other income, net	$ 1,068	1.2%	$ 2,998	2.2%

Interest and other income, net, for the three quarters ended January 2, 2010 decreased $1.9 million compared to the three quarters ended December 27, 2008. The decrease was primarily attributable to a $2.1 million decrease in interest income due to declines in market interest rates over this period.

Income Taxes

The income tax benefit recorded for the three quarters ended January 2, 2010 was $9.1 million on pretax loss of $23.1 million, an effective rate of 39.2%. This rate improved due to a higher effective rate in the third quarter of 2010, primarily due to lower estimated annual losses and credits related to the completion of tax audits in the third quarter of fiscal 2010, which resulted in a reduction in income taxes payable. Comparatively, the income tax benefit was $6.0 million on a pretax loss of $42.1 million for the three quarters ended December 27, 2008, an effective tax rate of 14.2%. The low effective tax rate was primarily due to the goodwill impairment charge recorded in the third quarter of fiscal 2009 that is not deductible for U.S. tax purposes as well as a valuation allowance on deferred tax assets that was established in the third quarter of fiscal 2009. The valuation allowance was required due to unrealized capital losses arising from the write-down of our auction rate securities.

Our effective tax rate is subject to fluctuation based upon the occurrence and timing of numerous discrete events such as changes in tax laws or their interpretations, extensions or expirations of research and experimentation credits, closure of tax years subject to examination, finalization of income tax returns, the timing and fluctuations of quarterly results and also due to the relationship of fixed deductions to overall changes in estimated and actual pretax income or loss. For example, in accordance with ASC Topic 740 Income Taxes , the tax benefit associated with our loss through the third quarter of fiscal 2010 has been limited to our estimated tax benefit expected for the year. As a result, this remaining benefit will serve to lower overall tax expense in the fourth quarter of fiscal 2010. We anticipate no significant changes in unrecognized tax benefits in the next twelve months as the result of examinations or lapsed statutes of limitation.

Net Loss

Net loss for the three quarters ended January 2, 2010 and the three quarters ended December 27, 2008 was as follows:

	Three fiscal quarters ended			
	Jan 2, 2010		Dec 27, 2008	
(In thousands, except percentages)	Net Loss	% of Net Sales	Net Loss	% of Net Sales
Net loss	$ (14,063)	(15.7)%	$ (36,125)	(26.0)%

Net loss for the three quarters ended January 2, 2010 was $14.1 million, or $0.51 per basic and diluted share, compared to net loss for the three quarters ended December 27, 2008 of $36.1 million, or $1.33 per basic and diluted share. The decrease in net loss was primarily due to several charges incurred during the three quarters ended December 27, 2008 which did not repeat during the three quarters ended January 2, 2010, including a $17.4 million goodwill impairment charge, $12.5 million of other-than-temporary impairment charges related to ARS and $2.0 million in restructuring charges. Additionally, the three quarters ended January 2, 2010 included $4.5 million of merger termination proceeds received in the first quarter of fiscal 2010. The combination of these factors offset the impact of lower revenues.

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Financial Condition and Liquidity

At January 2, 2010, our principal sources of liquidity were cash and cash equivalents of $52.6 million, current marketable investments of $99.3 million and accounts receivable of $22.4 million. We also held $10.8 million of restricted cash which represented collateral for commercial letters of credit. At January 2, 2010, we had a current ratio of 7.2 and held no long-term debt. Working capital of $247.6 million was up slightly compared to the March 28, 2009 balance of $246.9 million.

On May 15, 2008, the Board of Directors authorized a share repurchase program totaling $20.0 million to acquire shares of the Company s outstanding common stock primarily to offset dilution from equity compensation programs. Repurchases under the program 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. We did not repurchase any shares under this program during the quarter ended January 2, 2010. During the three quarters ended January 2, 2010, we repurchased 64,960 shares for $0.6 million under this program at an average price per share of $8.55, calculated inclusive of commissions and fees. As of January 2, 2010, a total of 372,825 shares have been repurchased for $5.3 million under this authorization at an average price of $14.16 per share, calculated inclusive of commissions and fees. Cash used to settle repurchase transactions is reflected as a component of cash used in financing activities in the Condensed Consolidated Statements of Cash Flows. There is no fixed completion date for the repurchase program.

As of January 2, 2010, we held a total of $13.7 million invested in auction rate securities (ARS) at par value. Additionally, we held $4.0 million of par value ARS which were converted by the bond issuer to its preferred stock during the third quarter of fiscal 2009. The ARS are comprised predominately of securities issued by insurance companies to raise funds to meet regulatory capital reserve requirements and the ARS assume the credit ratings of the bond insurers who guarantee the timely payment of principal and interest on these insured securities. At the time of purchase in fiscal 2007, these ARS were rated AAA and AA. The contractual maturities of these securities range up to calendar year 2050, and several securities and the preferred stock do not have stated maturities. Prior to September 2007, these securities provided short-term liquidity through a Dutch auction process that reset the applicable interest rate at pre-determined calendar intervals, generally every 28 to 35 days. This mechanism previously allowed existing investors to either retain or liquidate their holdings by selling such securities at par. As a result of the liquidity issues experienced in the global credit and capital markets, during the second quarter of fiscal 2008, our ARS began to experience failed auctions.

Since that time, none of these securities have traded through the auction process and very few market transactions for these securities have been observed. Additionally, the bond insurers of the ARS and preferred stock experienced credit rating downgrades throughout fiscal 2009. Consequently, it was determined that the declines in fair value of these securities during fiscal 2009 represented other-than-temporary impairments in accordance with U.S. generally accepted accounting principles. Accordingly, at the end of each quarter of fiscal 2009, the cost bases of these securities were written down to their estimated fair values with other-than-temporary impairment charges totaling $13.6 million, of which $2.0 million was recorded during the third quarter of fiscal 2009 and $12.5 million was recorded during the three quarters ended December 27, 2008.

As of the beginning of the first quarter of fiscal 2010, in accordance with the adoption of the Accounting Standards Codification (ASC) Topic 320 Investments - Debt and Equity Securities (ASC Topic 320), we recorded a cumulative-effect adjustment to increase the opening balance of retained earnings by $0.4 million, which represented the non-credit portion of the ARS loss previously recorded as an other-than-temporary impairment in the statement of operations. The credit portion of the ARS loss was determined by direct estimation of the change in fair value attributable to market movements. We utilized market indices representing investments of constant credit quality over time and measured the index yield, which is considered attributable to non-credit related factors, at the beginning and end of the period. The effect of this change in yield on the value of the security was measured and subtracted from the total change in fair value to arrive at the estimated change in value attributable to changes in credit quality.

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We also recorded fair value adjustments to accumulated other comprehensive income of $1.1 million, $1.4 million, and $0.1 million at the end of the first, second, and third quarters of fiscal 2010, respectively, to reflect the estimated increases in fair value of the ARS. As of January 2, 2010, total net unrealized gains on our remaining ARS were $1.9 million, which represents the fiscal 2010 fair value adjustments of $2.6 million reduced by the cumulative-effect adjustment of $0.4 million and $0.3 million related to the sale of certain ARS in the third quarter of fiscal 2010. The $7.0 million estimated fair value of our remaining ARS securities is classified as a non-current asset on the Condensed Consolidated Balance Sheet at January 2, 2010, consistent with the classification at December 27, 2008 and each subsequent reporting period.

During the third quarter of fiscal 2010, we agreed to sell certain ARS with a par value of $1.9 million pursuant to a tender agreement with the parent company of the securities original issuer. We received approximately $1.4 million on the sale of the ARS, which had an estimated fair value of $1.6 million as of September 26, 2009. As a result of the sale, we reclassified $0.3 million of the previously recorded unrealized net gain out of accumulated other comprehensive income. The unrealized net gain represented the cumulative total of the fair value adjustments related to these ARS prior to the transaction.

We currently continue to receive all interest and preferred stock dividend payments when due. We cannot reasonably predict if or when our remaining ARS will become liquid.

Sources and Uses of Cash for the Three Quarters Ended January 2, 2010

Net cash flows used in operating activities totaled $1.2 million for the three quarters ended January 2, 2010. Significant impacts to cash flows for the period were the year-to-date net loss of $14.1 million, adjusted for non-cash items totaling $3.4 million, offset by net improvements within working capital. Net increases in accounts payable and accrued liabilities provided operating cash of $11.1 million and net decreases in inventories provided $7.7 million, while decreases in deferred revenue consumed $3.9 million, net increases in trade receivables consumed $3.4 million and other working capital increases consumed $2.1 million.

For the three quarters ended January 2, 2010, net cash used in investing activities of $101.2 million was primarily due to the purchase of securities of $205.8 million and increases in restricted cash of $10.8 million, offset by $110.2 million in proceeds from sales and maturities of securities and $7.3 million provided by decreases in other assets, which primarily reflected the substitution of letters of credit for the cash bond previously held by the Kaohsiung District Court of Taiwan. Net cash provided by financing activities of $0.3 million was attributable to $0.9 million of proceeds from the exercise of stock options and stock plans offset by $0.6 million used for share repurchases.

We believe that our existing cash, cash equivalents and marketable securities are adequate to fund our operations, share repurchase program and contractual obligations for at least the next twelve months.

Critical Accounting Policies and Estimates

Except as discussed below, we reaffirm the Critical Accounting Policies and Estimates in Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations reported in our Form 10-K for the year ended March 28, 2009.

Fair Value Measurements

Effective March 29, 2009, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157 pertaining to nonfinancial assets and liabilities. The Company had adopted the provisions of SFAS No. 157 pertaining to financial assets and liabilities as of March 30, 2008. The adoption of SFAS No. 157 did not have a material impact on the Company s financial statements. SFAS No. 157 was incorporated into the Accounting Standards Codification (ASC) within ASC Topic 820 Fair Value Measurements and Disclosures (ASC Topic 820).

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS No. 157-4; FSP FAS No. 115-2 and FAS No. 124-2; and FSP No. 107 and APB No. 28-1. FSP FAS No. 157-4 provides guidance on how to determine the fair value of assets and liabilities under SFAS No. 157

when there is no active market, and reaffirms the SFAS No. 157 objective to reflect an asset s sale price in an orderly transaction at the date of the financial statements. FSP FAS No. 157-4 was incorporated into the ASC within ASC Topic 820. FSP FAS No. 115-2 and FAS No. 124-2 modifies the requirements for recognizing other-than-temporarily-impaired debt securities and revises the existing impairment model for such securities, by distinguishing between credit and non-credit components of impaired debt securities that are not expected to be sold. FASP FAS No. 115-2 and FAS No. 124-2 was incorporated into the ASC within ASC Topic 320. FSP FAS No. 107-1 and APB No. 28-1 enhances disclosures about fair value for instruments under the scope of SFAS No. 157 for both interim and annual periods. FASP FAS No. 107-1 and APB No. 28-1 was incorporated into the ASC within ASC Topic 825 Financial Instruments . The Company adopted these Staff Positions as of the first quarter of fiscal 2010.

Business Combinations

The Company adopted SFAS No. 141R beginning in the first quarter of fiscal 2010. SFAS No. 141R was incorporated into the ASC within ASC Topic 805 Business Combinations. The Company will apply the provisions of this statement prospectively to future business combinations.

Contractual Obligations

There have been no significant changes in our contractual obligations subsequent to those reported in our 2009 Annual Report on Form 10-K for the year ended on March 28, 2009.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the market risk disclosure contained in our 2009 Annual Report on Form 10-K for the year ended on March 28, 2009. The information regarding liquidity of auction rate securities under the heading Financial Condition and Liquidity in Item 2 of Part I of this report is incorporated herein by reference.

Item 4. Controls and Procedures

Attached to this quarterly report as exhibits 31.1 and 31.2 are the certifications of our President and Chief Executive Officer (CEO) and our Chief Financial Officer (CFO) required by Section 302 of the Sarbanes-Oxley Act of 2002 (the Section 302 Certifications). This portion of our quarterly report on Form 10-Q is our disclosure of the conclusions of our management regarding the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report based on management s evaluation of those disclosure controls and procedures. This disclosure should be read in conjunction with the Section 302 Certifications for a complete understanding of the topics presented.

Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our CEO and CFO, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (Exchange Act). Based on that evaluation, our CEO and CFO have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective in ensuring that information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter ended January 2, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

All Ring Patent Infringement Prosecution

In August 2005, we commenced a proceeding in the Kaohsiung District Court of Taiwan (the Court) directed against All Ring Tech Co., Ltd. (All Ring) of Taiwan. We alleged that All Ring s Capacitor Tester Model RK-T6600 (the Capacitor Tester) infringes ESI s Taiwan Patent No. 207469, entitled Circuit Component Handler (the 207469 patent). As part of this proceeding, the Court issued a Provisional Attachment Order (PAO) in August 2005, restricting the use of some of All Ring s assets. All Ring then filed a bond with the Court to obtain relief from the attachment of its assets. In July 2007, the Court issued a second PAO and approximately $6.0 million was restricted in All Ring s accounts. The second PAO remains in effect and cannot be revoked.

In October 2005, we filed a formal patent infringement action against All Ring in the Court. The Court-appointed expert initially concluded that the Capacitor Tester and All Ring s RK-T2000 both infringe every claim of the 207469 patent and that All Ring s RK-L50 infringes a number of the claims as well. Because we had amended our claims in the cancellation action as described below, the Court asked the Court-appointed expert to respond to questions regarding the expert s initial opinion. The Court-appointed expert conducted an additional inspection of each of these systems on September 21, 2009, and will re-evaluate whether the systems infringe after reviewing the briefs that the Company and All Ring have submitted. At the request of the Court, an audit of All Ring was conducted by an independent accounting firm in November and December of calendar 2009 to assist the Court in making any damages determinations. The firm has not yet issued its audit report.

Also in October 2005, the Court executed a Preliminary Injunction Order (PIO) that prohibits All Ring from manufacturing, selling, offering for sale or using the Capacitor Tester until final judgment is entered in the formal patent infringement action. The Court dismissed All Ring s application to revoke the PIO on January 18, 2008, and the PIO remains in place.

In November 2005, All Ring filed a cancellation action against ESI s 207469 patent in the Taiwan Intellectual Property Office (the IPO). On July 5, 2007, the IPO issued a notice requiring us to cancel two of the claims in the 207469 patent. We filed a response canceling the two claims and amending the remaining claims accordingly in August 2007. On August 12, 2008, the IPO decided the action in our favor and dismissed the cancellation action. All Ring appealed the IPO s cancellation decision to the Board of Appeal of the Ministry of Economic Affairs (MOEA) on September 12, 2008. On March 23, 2009, the MOEA dismissed the IPO s cancellation decision solely on procedural grounds. The MOEA remanded the case to the IPO with a request that the IPO issue another decision within six months that rectifies the procedural defects of the IPO s earlier decision. On July 22, 2009, the IPO issued a decision dismissing All Ring s cancellation action. All Ring appealed the IPO s decision to the MOEA in August 2009.

Pursuant to the Court s PAO and PIO, we were required to post Taiwan dollar security bonds with the Court. In July 2009, we substituted a letter of credit as a partial substitution and received back $2.0 million of the security bonds from the Court. The letter of credit is collateralized by $2.4 million of restricted cash. In September 2009, we established an additional letter of credit and received back $7.1 million of the security bonds. This second letter of credit is collateralized by $8.4 million of restricted cash. The total restricted cash balance of $10.8 million is included in the Condensed Consolidated Balance Sheet at January 2, 2010 as a current asset.

In the ordinary course of business, we are involved in various other legal matters, either asserted or unasserted, and investigations. In our opinion, ultimate resolution of these matters will not have a material effect on our consolidated financial position, results of operations or cash flows.

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Item 1A. Risk Factors

Factors That May Affect Future Results

The statements contained in this report that are not statements of historical fact, including without limitation statements containing the words believes, expects 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 differ materially. The following information highlights some of the factors that could cause actual results to differ materially from the results expressed or implied by our forward-looking statements. Forward-looking statements should be considered in light of these factors. Factors that may result in such variances include, but are not limited to, the following:

The industries that comprise our primary markets are volatile and unpredictable and we have experienced weakness in our markets and may experience weakness in the future.

Our business depends upon the capital expenditures of manufacturers of components and circuitry used in wireless communications, computers and other electronic products. The markets for electronic devices have experienced sharp downturns in the past, are currently experiencing such a downturn, and may experience further downturns in the future. In fiscal 2008, we began to see the impact of weakness in the memory market and lower capital spending, particularly in the fourth quarter. This weakening increased significantly and expanded to general microelectronics and other markets during 2009 driven by disruption in the financial and credit markets and the subsequent global economic downturn, resulting in a decrease in orders for all of our product groups in the second, third and fourth quarters of 2009, with virtually no SG systems orders in the third and fourth quarters of 2009 and a low level of system orders during the first three quarters of fiscal 2010. There could be further declines in these markets and others. Our customers may even declare bankruptcy or discontinue operations as a result of a downturn. During such downturns, semiconductor and micro-electronics manufacturers, including our customers, can be expected to delay or cancel capital expenditures, which would have a negative impact on our financial results. During a downturn, we are not able to project when or if demand for our products will increase or that demand will not decrease further. Even if demand for our products does increase, there may be significant fluctuations in our profitability and net sales.

During this and any downturn, it is difficult for us to maintain our sales levels. As a consequence, to maintain profitability or minimize losses we need to reduce our operating expenses. Our ability to quickly reduce operating expenses is dependent upon the nature of the actions we take to reduce expense and our subsequent ability to implement those actions and realize expected cost savings. Additionally, we may be unable to defer capital expenditures and we need to continue to invest in certain areas such as research and development. These factors could cause us to use greater amounts of cash in our operating and investing activities, thereby reducing our existing cash and investment balances. This and any economic downturn may also cause us to incur charges related to impairment of assets, inventory write-offs, and reductions in force, and we may experience delays in payments from our customers, which would have a negative effect on our financial results.

In the current environment, we also implemented several temporary cost reduction measures, including salary reductions, furloughs and elimination of our match of 401(k) contributions. These reductions are temporary in nature and will not be sustained over a long period of time. For example, on October 1, 2009, salaries that had been subject to a temporary salary reduction program were partially restored and on January 1, 2010, salaries were fully restored as the temporary salary reduction program was discontinued. Accordingly, our current level of employee-related expenses increased during the third quarter of fiscal 2010 and is expected to further increase in the fourth quarter of fiscal 2010.

In addition, because we derive a substantial portion of our revenue from the sale of a relatively small number of products, the timing of, or changes to, orders by our customers may also cause our order levels and results of operations to fluctuate between periods, perhaps significantly. Accordingly, order levels or results of operations for a given period may not be indicative of order levels or results of operations for following periods.

Our business is highly competitive, and if we fail to compete effectively, our business will be harmed.

The industries in which we operate are highly competitive. We face substantial competition from established competitors, some of which have greater financial, engineering, manufacturing and marketing resources than we do. If we are unable to compete effectively with these companies, our market share may decline and our business could be harmed. Our competitors can be expected to continue to improve the design and performance of their products and to introduce new products. New companies may enter

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the markets in which we compete, or industry consolidation may occur, further increasing competition in those markets. Additionally, in the current environment, existing competitors may price opportunistically to reduce inventory or maintain business levels. Furthermore, our technological advantages may be reduced or lost as a result of technological advances by our competitors.

Those competitors with greater resources in the areas described above may enable them to:

- Better withstand periodic downturns;
- Compete more effectively on the basis of price and technology; and
- More quickly develop enhancements to and new generations of products.

We believe that our ability to compete successfully depends on a number of factors, including:

- Performance of our products;
- Quality of our products;
- Reliability of our products;
- Cost of using our products;
- The ability to upgrade our products;
- Consistent availability of critical components;
- Our ability to ship products on schedules required;
- Quality of the technical service we provide;
- Timeliness of the services we provide;
- Our success in developing new products and enhancements, including those that are able to compete with new technological advancements;
- Our understanding of the needs of our customers;

Existing market and economic conditions; and

Price of our products as compared to our competitors products.

We may not be able to compete successfully in the future and increased competition may result in price reductions, reduced profit margins and loss of market share.

We depend on a few significant customers and we do not have long-term contracts with any of our customers.

We depend on a few significant customers for a large portion of our revenue. For example, our top ten customers for 2009 accounted for approximately 50% of total net sales in 2009, with one customer accounting for approximately 21% of total net sales. None of our customers have any long-term obligation to continue to buy our products or services, and any customer could delay, reduce or cease ordering our products or services at any time. Further, reduced revenue resulting from cyclicality or market downturns may result in a few customers accounting for a higher percentage of our revenue, as evidenced by one customer accounting for approximately 21% of net sales in 2009. As a result, any delay, reduction or cessation in purchases by such customers during a period of reduced sales could have a significant negative impact on our financial results. In addition, the semiconductor industry, and particularly the memory market, is very cyclical, which could result in consolidation among customers, changes in various partnership and technology arrangements among customers, bankruptcy of customers or departures of customers from the industry. For example, in January 2009, Qimonda AG, historically one of our top customers, filed a petition to open insolvency proceedings in Germany. These changes could negatively affect demand for our products or negatively impact the value of our technology strategies.

Our markets are subject to rapid technological change, and to compete effectively, we must continually introduce new products that achieve market acceptance.

The markets for our products are characterized by rapid technological change and innovation, frequent new product introductions, changes in customer requirements and evolving industry standards. Our future performance will depend on the successful development, introduction and market acceptance of new and enhanced products that address technological changes as well as current and potential customer requirements.

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We and our competitors are continuously working to develop new or enhanced products and new technologies. For example, for many years, the semiconductor memory industry has employed alternative redundancy technologies. The adoption by our customers of non-laser based redundancy technology could have a material adverse effect on demand for our SG products. The introduction by us or by our competitors of new or enhanced products, or alternative technologies, may cause our customers to defer, change or cancel orders for our existing products or cease purchasing our products altogether, which may harm our operating results.

In the past we have also experienced delays in new product development. Similar delays may occur in the future. We also may not be able to develop the underlying core technologies necessary to create new products and enhancements or, where necessary, to license these technologies from others.

Product development delays may result from numerous factors, including:

- Changing product specifications and customer requirements;
- Difficulties in hiring and retaining necessary technical personnel;
- Difficulties in reallocating engineering resources and overcoming resource limitations;
- Difficulties with contract manufacturers;
- Changing market or competitive product requirements; and
- Unanticipated engineering complexities.

The development of new, technologically advanced products is a complex and uncertain process, requiring high levels of innovation and highly skilled engineering and development personnel, as well as the accurate anticipation of technological and market trends. We cannot assure that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully, if at all, or on a timely basis. Further, we cannot assure that our new products will gain market acceptance or that we will be able to respond effectively to product announcements by competitors, technology changes or emerging industry standards. Any failure to respond to product or technology changes or new industry standards that may render our current products or technologies obsolete could significantly harm our business.

Failure of critical suppliers of parts, components and manufacturing equipment to deliver sufficient quantities to us in a timely and cost-effective manner could negatively affect our business.

We use a wide range of materials from numerous suppliers in the production of our products, including custom electronic and mechanical components. We generally do not have guaranteed supply arrangements with our suppliers. We seek to reduce the risk of production and service interruptions and shortages of key parts by selecting and qualifying alternative suppliers for key parts, monitoring the financial stability of key suppliers and maintaining appropriate inventories of key parts. Although we make reasonable efforts to ensure that parts are available from multiple suppliers, some key parts are available only from a single supplier or a limited group of suppliers in the short term. In addition, some of the lasers we use in our products are difficult to manufacture, and as a result we may not receive an adequate supply of lasers in a timely fashion to fill orders. Operations at our suppliers facilities are subject to disruption for a variety of reasons, including changes in business relationships, competitive factors, financial difficulties, work stoppages, fire, natural disasters or other causes. Such disruption could interrupt our manufacturing. Our business may be harmed if we do not receive sufficient parts to meet our production requirements in a timely and cost-effective manner.

Delays in manufacturing, shipment or customer acceptance of our products could substantially decrease our sales for a period.

We depend on manufacturing flexibility to meet the changing demands of our customers. Any significant delay or interruption in receiving raw materials or components or in our manufacturing operations as a result of software deficiencies, natural disasters, or other causes could result in reduced manufacturing capabilities or delayed product deliveries, any or all of which could materially and adversely affect our results of operations.

We also have an arrangement with a contract manufacturer in Singapore to complete the manufacture of certain of our products. Any significant interruption in this contract manufacturer s ability to provide manufacturing services to us as a result of contractual disputes with us or another party, labor disruptions, financial difficulties, natural disasters, delay or interruption in the receipt of inventory or other causes could result in reduced manufacturing capabilities or delayed deliveries for certain of our products, any or all of which could materially and adversely affect our results of operations.

In addition, we derive a substantial portion of our revenue from the sale of a relatively small number of products. Consequently, shipment and/or customer acceptance delays, including acceptance delays related to new product introductions or customizations, could significantly impact recognition of revenue and could be further magnified by announcements from us or our competitors of new products and technologies. Such announcements could cause our customers to defer purchases of our systems, change existing orders or purchase products from our competitors. Any of these delays could result in a material adverse change in our results of operations for any particular period.

We acquire inventory based upon projected demand and our technology roadmap. If these projections are incorrect, or our technology strategy changes, we may carry inventory that cannot be used, which may result in significant charges for excess and obsolete inventory.

Our business is highly competitive and one factor on which we compete is the ability to ship products on schedules required by customers. In order to facilitate timely shipping, management forecasts demand, both in type and amount of products, and these forecasts are used to determine inventory to be purchased. We also order materials based on our technology roadmap which we expect to be utilized in new products. Certain types of inventory, including lasers and optical equipment, are particularly expensive and can only be used in the production of a single type of product. If actual demand is lower than forecast with respect to the type or amount of products actually ordered, or both, our inventory levels may increase. For example, at January 2, 2010, we had $78.6 million of inventory reflected on our Condensed Consolidated Balance Sheet, much of which we purchased or committed to purchase prior to the time the severity of the current economic downturn became apparent. As a result, there is a risk that we may have to incur material accounting charges for excess and obsolete inventory if inventory cannot be used, which would negatively affect our financial results. Also, if we alter our technology or product development strategy, we may have inventory which may not be usable under the new strategy, which may result in material accounting charges. For example, during 2009, we wrote-off $4.1 million of material from a research, development, and engineering program due to a change in our product development strategy.

We are exposed to the risks that others may violate our proprietary rights, and our intellectual property rights may not be well protected in foreign countries.

Our success is dependent upon the protection of our proprietary rights. In the high technology industry, intellectual property is an important asset that is always at risk of infringement. We incur substantial costs to obtain and maintain patents and defend our intellectual property. For example, we have initiated litigation alleging that certain parties have violated various patents of ours, such as the action we initiated in Taiwan against All Ring Tech Co., Ltd. in August 2005. We rely upon the laws of the United States and of foreign countries in which we develop, manufacture or sell our products to protect our proprietary rights. However, these proprietary rights may not provide the competitive advantages that we expect or other parties may challenge, invalidate or circumvent these rights.

Further, our efforts to protect our intellectual property may be less effective in some foreign countries where intellectual property rights are not as well protected as in the United States. Many U.S. companies have encountered substantial problems in protecting their proprietary rights against infringement in foreign countries. If we fail to adequately protect our intellectual property in these countries, it could be easier for our competitors to sell competing products in foreign countries, which could result in reduced sales and gross margins.

We may be subject to claims of intellectual property infringement.

Several of our competitors hold patents covering a variety of technologies, applications and methods of use similar to some of those used in our products. While we attempt in our designs to avoid patent infringement, from time to time we and our customers have received correspondence from our competitors claiming that some of our products, as used by our customers, may be infringing one or more of these patents. Competitors or others have in the past and may in the future assert infringement claims against our customers or us with respect to current or future products or uses, and these assertions may result in costly litigation or require us to obtain a license to use intellectual property rights of others. If claims of infringement are asserted against our customers, those customers may seek indemnification from us for damages or expenses they incur.

If we become subject to infringement claims, we will evaluate our position and consider the available alternatives, which may include seeking licenses to use the technology in question or defending our position. These licenses, however, may not be available on satisfactory terms or at all. If we are not able to negotiate the necessary licenses on commercially reasonable terms or successfully defend our position, our financial condition and results of operations could be materially and adversely affected.

Our ability to reduce costs is limited by our need to invest in research and development.

Our industry is characterized by the need for continued investment in research and development. Because of intense competition in the industries in which we compete, if we were to fail to invest sufficiently in research and development, our products could become less attractive to potential customers, and our business and financial condition could be materially and adversely affected. As a result of our need to maintain our spending levels in this area, our operating results could be materially harmed if our net sales decline. In addition, as a result of our emphasis on research and development and technological innovation, our operating costs may increase in the future, and research and development expenses may increase as a percentage of total operating expenses and as a percentage of net sales.

Our worldwide direct sales and service operations and our overseas research and development facilities expose us to employer-related risks in foreign countries.

We have established direct sales and service organizations throughout the world. We have also established research and development facilities in China and Taiwan. Having overseas employees involves certain risks. We are subject to compliance with the labor laws and other laws governing employers in the countries where our operations are located and as a result, we may incur additional costs to comply with these local regulations. Additionally, we may encounter labor shortages or disputes that could inhibit our ability to effectively sell, market and service our products. If we cannot effectively manage the risks related to employing persons in foreign countries, our operating results could be adversely affected.

We may make acquisitions in the future, and these acquisitions may subject us to risks associated with integrating these businesses into our current business.

We may make acquisitions of, or significant investments in, other businesses with complementary products, services or technologies. Acquisitions involve numerous risks, many of which are unpredictable and beyond our control, including:

- Difficulties and increased costs in connection with integration of the personnel, operations, technologies and products of the merged businesses;

- Implementation of our enterprise resource planning (ERP) system into the acquired company s operations;

- Diversion of management s attention from other operational matters;

- The potential loss of key employees of the acquired company;

Lack of synergy or inability to realize expected synergies resulting from the acquisition;

Acquired assets becoming impaired as a result of technological advancements or worse-than-expected performance by the acquired company;

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Difficulties establishing satisfactory internal controls at the acquired company;

Risks and uncertainties relating to the performance of the combined company following the transaction; and

Incurring unanticipated liabilities for which we will not be indemnified.

Our inability to effectively manage these risks could materially and adversely affect our business, financial condition and results of operations and could cause us not to realize the anticipated benefits of an acquisition on a timely basis or at all. In addition, if we issue common stock to pay for an acquisition, the ownership percentage of our existing shareholders will be reduced and the value of the shares held by our existing shareholders could be diluted. If we use cash to pay for an acquisition, the payment could significantly reduce the cash that would be available to fund our operations or to use for other purposes. If we need to borrow funds in connection with an acquisition, we would be required to use cash to service the debt and to comply with financial and other covenants. In addition, the accounting for an acquisition could result in significant charges resulting from amortization of intangible assets we acquire, and in the future, all acquisition transaction costs must be expensed as incurred rather than capitalized.

We may also make strategic investments in development stage companies and such investments are subject to a high degree of risk, and therefore it is possible that we could lose our entire investment.

We are exposed to the risks of operating a global business, including risks associated with exchange rate fluctuations, legal and regulatory changes and the impact of regional and global economic disruptions.

International shipments accounted for 81% of net sales in 2009, with 70% of our net sales to customers in Asia. We expect that international shipments will continue to represent a significant percentage of net sales in the future. We also have an arrangement with a contract manufacturer in Singapore to complete the manufacture of certain of our products. Our non-U.S. sales, purchases and operations, including contract manufacturing, are subject to risks inherent in conducting business abroad, many of which are outside our control, including the following:

Periodic local or geographic economic downturns and unstable political conditions;

Price and currency exchange controls;

Fluctuation in the relative values of currencies;

Difficulties protecting intellectual property;

Local labor disputes;

Shipping delays and disruptions;

Increases in shipping costs, caused by increased fuel costs or otherwise, which we may not be able to pass on to our customers;

Unexpected changes in trading policies, regulatory requirements, tariffs and other barriers; and

- Difficulties in managing a global enterprise, including staffing, collecting accounts receivable, managing suppliers, distributors and representatives, and repatriation of earnings.

Our business and operating results are subject to uncertainties arising out of the possibility of regional or global economic disruptions (including those resulting from natural disasters, or outbreaks of infectious disease), the economic consequences of military action or terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. In particular, due to these uncertainties, we are subject to:

- The risk that future tightening of immigration controls may adversely affect the residence status of non-U.S. engineers and other key technical employees in our U.S. facilities or our ability to hire new non-U.S. employees in such facilities;
- The risk of more frequent instances of shipping delays;
- The risk that demand for our products may not increase or may decrease; and
- The risk that our customers or suppliers may experience financial difficulties or cease operations.

Our tax rates are subject to fluctuation, which could impact our financial position, and our estimates of tax liabilities may be subject to audit, which could result in additional assessments.

Our effective tax rates are subject to fluctuation because the income tax rates for each year are a function of: (a) taxable income levels and the effects of a mix of profits (losses) earned by ESI and our subsidiaries in numerous tax jurisdictions with a broad range of income tax rates, (b) our ability to utilize deferred tax assets, (c) taxes, refunds, interest or penalties resulting from tax audits, (d) the magnitude of various credits and deductions as a percentage of total taxable income and (e) changes in tax laws or the interpretation of such tax laws. Changes in the mix of these items may cause our effective tax rates to fluctuate between periods, which could have a material adverse effect on our financial position and results of operations.

We are subject to income taxes in both the United States and numerous foreign jurisdictions. During the ordinary course of business, there are transactions and calculations for which the ultimate tax determination is uncertain. Significant judgment is exercised in determining our worldwide provisions for income taxes. Furthermore, we are occasionally under audit by tax authorities and are currently under audit by the United States Internal Revenue Service. Although we believe our tax estimates are reasonable, the final outcome of tax audits and the impact of changes in tax laws or the interpretation of tax laws could result in material differences from what is reflected in historical income tax accruals. If additional taxes are assessed as a result of an examination, a material effect on our financial results, tax positions or cash flows could occur in the period or periods in which the determination is made.

No market currently exists for the auction rate securities (ARS) we hold and as a result we may not be able to liquidate them at the current valuation, if at all. As a result, we have written down the cost bases of these securities to their estimated fair value with other-than-temporary impairment charges to earnings and we may have to write them down further in the future.

As of January 2, 2010, we held a total of $13.7 million invested in ARS at par value. Additionally, we held $4.0 million of par value ARS which were converted by the bond issuer to its preferred stock during the third quarter of fiscal 2009. The ARS are comprised predominately of securities issued by insurance companies to raise funds to meet regulatory capital reserve requirements and the ARS assume the credit ratings of the bond insurers who guarantee the timely payment of principal and interest on these securities. At the time of purchase in 2007, these ARS were rated AAA and AA. The contractual maturities of these securities range up to calendar year 2050, and several securities and the preferred stock do not have stated maturities. Prior to September 2007, these securities provided short-term liquidity through a Dutch auction process that reset the applicable interest rate at pre-determined calendar intervals, generally every 28 to 35 days. This mechanism previously allowed existing investors to either retain or liquidate their holdings by selling such securities at par. As a result of the liquidity issues experienced in the global credit and capital markets, during the second quarter of 2008 our ARS began to experience failed auctions.

Since that time, none of these securities have traded through the auction process and very few market transactions for these securities have been observed. Additionally, the bond insurers of the ARS and preferred stock experienced credit rating downgrades throughout 2009. Consequently, it was determined that the declines in fair value of these securities during 2009 represented other-than-temporary impairments in accordance with U.S. generally accepted accounting principles. Accordingly, at the end of each quarter of fiscal 2009, the cost bases of these securities were written down to their estimated fair values with other-than-temporary impairment charges totaling $13.6 million, of which $2.0 million was recorded during the third quarter of fiscal 2009 and $12.5 million was recorded during the three quarters ended December 27, 2008. We also recorded fair value adjustments to accumulated other comprehensive income of $1.1 million, $1.4 million, and $0.1 million at the end of the first, second, and third quarters of fiscal 2010, respectively, to reflect the estimated increase in fair value of the ARS. The $7.0 million estimated fair value of these securities is classified as a non-current asset on the Condensed Consolidated Balance Sheet at January 2, 2010, consistent with the classification at December 27, 2008 and each subsequent reporting period.

During the third quarter of fiscal 2010, we agreed to sell certain ARS with a par value of $1.9 million pursuant to a tender agreement with the parent company of the securities original issuer. We received approximately $1.4 million on the sale of the ARS, which had an estimated fair value of $1.6 million as of September 26, 2009. As a result of the sale, we reclassified $0.3 million of the previously recorded unrealized net gain out of accumulated comprehensive income. The unrealized net gain represented the cumulative total of the fair value adjustments related to these ARS prior to the transaction.

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We cannot reasonably predict if or when our remaining ARS will become liquid, and it is not possible to ascertain when or whether market conditions will change resulting in the recovery of fair value on these auction rate securities. It is possible that a secondary market for auction rate securities may emerge in which securities similar to our own would trade at prices below our currently recorded fair values. Under such a scenario, or if other events arise that impact the fair value of the securities, we may have to recognize further other-than-temporary impairment charges, which would adversely impact our financial position and results of operations.

It is also possible that continued uncertainty in the credit markets could also impact the liquidity of our other investments and cash equivalents, which could impair our liquidity or require us to recognize other-than-temporary impairment on the value of those investments, which would negatively impact our financial position and results of operations.

The loss of key personnel or our inability to attract, retain and assimilate sufficient numbers of managerial, financial, engineering and other technical personnel could have a material effect upon our results of operations.

Our continued success depends, in part, upon key managerial, financial, engineering and technical personnel as well as our ability to continue to attract, retain and assimilate additional personnel. The loss of key personnel could have a material adverse effect on our business or results of operations. We may not be able to retain our key managerial, financial, engineering and technical employees. Attracting qualified personnel may be difficult and our efforts to attract and retain these personnel may not be successful. In addition, we may not be able to assimilate qualified personnel, including any new members of senior management, which could disrupt our operations.

Item 6. Exhibits

This list is intended to constitute the exhibit index.

3.1	Restated Articles of Incorporation. Incorporated by reference to Exhibit 3-A of the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 1991.
3.2	Articles of Amendment of Third Restated Articles of Incorporation. Incorporated by reference to Exhibit 3-B of the Company s Annual Report on Form 10-K for the fiscal year ended May 31, 1999.
3.3	Articles of Amendment of Third Restated Articles of Incorporation. Incorporated by reference to Exhibit 3 of the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended December 2, 2000.
3.4	Articles of Amendment to Third Restated Articles of Incorporation. Incorporated by reference to Exhibit 3.1 of the Company s Current Report on form 8-K filed on May 19, 2009 (the May 19 8-K).
3.5	2009 Amended and Restated Bylaws. Incorporated by reference to Exhibit 3.2 of the May 19 8-K.
4.1	Rights Agreement, dated as of May 18, 2009, between Electro Scientific Industries, Inc. and Mellon Investor Services LLC. Incorporated by reference to Exhibit 4.1 of the May 19 8-K.
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

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

Dated: February 9, 2010

ELECTRO SCIENTIFIC INDUSTRIES, INC.

By: /s/ Nicholas Konidaris
Nicholas Konidaris
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Paul Oldham
Paul Oldham
Vice President of Administration,
Chief Financial Officer and Corporate Secretary
(Principal Financial Officer)

By: /s/ Kerry Mustoe
Kerry Mustoe
Vice President, Corporate Controller and

Chief Accounting Officer
(Principal Accounting Officer)