ELECTRO SCIENTIFIC INDUSTRIES INC
Form 10-Q
August 12, 2010
Table of Contents

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 July 3, 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 August 7, 2010 was 27,971,360 shares.

Table of Contents

ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

Table of Contents

ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands)	Jul 3, 2010	Apr 3, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 54,225	$ 39,335
Restricted cash	10,824	10,824
Short-term investments	114,894	116,140
Total cash, restricted cash and investments	179,943	166,299
Trade receivables, net of allowances of $552 and $697	33,482	38,061
Inventories	69,936	72,090
Shipped systems pending acceptance	3,412	4,106
Deferred income taxes, net	7,216	7,232
Other current assets	8,441	8,677
Total current assets	302,430	296,465
Non-current assets:		
Auction rate securities	4,630	5,021
Property, plant and equipment, net of accumulated depreciation of $86,808 and $84,422	39,732	40,590
Non-current deferred income taxes, net	33,984	31,079
Acquired intangible assets, net	7,734	8,255
Other assets	11,200	13,008
Total assets	$ 399,710	$ 394,418
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 15,829	$ 14,607
Accrued liabilities	18,554	14,937
Deferred revenue	10,591	13,193
Total current liabilities	44,974	42,737
Non-current liabilities:		
Income taxes payable	9,195	9,019
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; 27,901 and 27,665 issued and outstanding	145,312	142,369
Retained earnings	199,687	199,486
Accumulated other comprehensive income related to auction rate securities	910	1,301
Accumulated other comprehensive loss, other	(368)	(494)
Total shareholders equity	345,541	342,662
Total liabilities and shareholders equity	$ 399,710	$ 394,418

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

Table of Contents

ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)	Fiscal quarter ended Jul 3, 2010	Jun 27, 2009
Net sales	$ 58,471	$ 22,603
Cost of sales	36,998	16,642
Gross profit	21,473	5,961
Operating expenses:		
Selling, service and administration	12,845	11,971
Research, development and engineering	10,211	7,455
Merger termination proceeds, net		(4,516)
Net operating expenses	23,056	14,910
Operating loss	(1,583)	(8,949)
Non-operating income:		
Interest and other income, net	58	342
Total non-operating income	58	342
Loss before income taxes	(1,525)	(8,607)
Benefit from income taxes	(1,726)	(3,077)
Net income (loss)	$ 201	$ (5,530)
Net income (loss) per share basic	$ 0.01	$ (0.20)
Net income (loss) per share diluted	$ 0.01	$ (0.20)
Weighted average number of shares basic	27,791	27,234
Weighted average number of shares diluted	28,212	27,234

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

Table of Contents

ELECTRO SCIENTIFIC INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Fiscal quarter ended	
(In thousands)	**Jul 3, 2010**	**Jun 27, 2009**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ 201	$ (5,530)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:		
Depreciation and amortization	2,559	2,497
Amortization of acquired intangible assets	531	552
Share-based compensation expense	2,874	2,307
Recovery of doubtful accounts	(150)	
Loss on disposal of property, plant and equipment	55	
Deferred income taxes	(2,809)	(3,496)
Changes in operating accounts:		
Decrease (increase) in trade receivables, net	5,477	(681)
Decrease in inventories	3,857	6,279
Decrease (increase) in shipped systems pending acceptance	694	(867)
Increase in other current assets	377	403
Increase (decrease) in accounts payable and accrued liabilities	3,791	(2,900)
(Decrease) increase in deferred revenue	(2,688)	525
Net cash provided by (used in) operating activities	14,769	(911)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(81,348)	(46,312)
Proceeds from sales and maturities of investments	82,612	18,000
Purchase of property, plant and equipment	(1,277)	(398)
(Increase) decrease in other assets	(185)	186
Minority equity investment		(193)
Net cash used in investing activities	(198)	(28,717)
CASH FLOWS FROM FINANCING ACTIVITIES		
Stock plan activity, net	(74)	342
Excess tax benefit of share-based compensation	143	
Share repurchases		(555)
Net cash provided by (used in) financing activities	69	(213)
Effect of exchange rate changes on cash	250	777
NET CHANGE IN CASH AND CASH EQUIVALENTS	14,890	(29,064)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	39,335	153,538
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 54,225	$ 124,474
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for income taxes	$ (663)	$ (343)
Income tax refunds received	$ 263	$ 27

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

Table of Contents

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 accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from those estimates. Management believes that the estimates used are reasonable. Significant estimates made by management include: revenue recognition; inventory valuation; product warranty reserves; allowance for doubtful accounts; 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.

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 April 3, 2010.

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.

2. Recent Accounting Pronouncements

There have been no recent accounting pronouncements or changes in accounting pronouncements during the quarter ended July 3, 2010 that are of significance to the Company.

3. Restricted Cash

As of July 3, 2010, the Company had restricted cash of $10.8 million, which collateralizes commercial letters of credit substituted for the cash bond previously held by the Kaohsiung District Court of Taiwan. See Note 17 Legal Proceedings for further discussion.

4. Share-Based Compensation

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

The Company granted stock-settled stock appreciation rights (SARs) starting in the first quarter of 2010. SARs grant the right to receive shares of the Company s stock equivalent to the increase in stock value of a specified number of shares over a specified period of time, divided by the stock price at the time of exercise. The Company uses the Black-Scholes model to estimate the fair value of SARs. Similar to options, SARs are recorded at the fair value of the award at grant date and the expense is recognized on a straight-line basis over the requisite service period of the award. The Company did not grant any stock options during the first quarter of 2011 or during fiscal 2010. All stock plan awards are settled with newly issued shares.

4

Table of Contents

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

	Fiscal quarter ended	
(In thousands)	**Jul 3, 2010**	**Jun 27, 2009**
Cost of sales	$ 282	$ 215
Selling, service and administration	2,224	1,778
Research, development and engineering	377	314
Total share-based compensation expense	$ 2,883	$ 2,307

For the quarter ended July 3, 2010, the Company received $0.5 million from Employee Stock Purchase Plan (ESPP) purchases and used $0.6 million for tax payments primarily related to vesting restricted stock units. The tax benefit realized from ESPP purchases during the quarter ended July 3, 2010 was $0.1 million.

As of July 3, 2010, no share-based compensation expenses were capitalized. The Company had $15.1 million of total unrecognized share-based compensation costs, net of estimated forfeitures, which are expected to be recognized over a weighted-average period of 2.38 years.

Valuation Assumptions

The Black-Scholes option pricing model is utilized to determine the fair value of options and SARs granted. The following assumptions were used in calculating the weighted-average fair value during the periods presented:

	Fiscal quarter ended	
(In thousands)	**Jul 3, 2010**	**Jun 27, 2009**
Expected life in years	5.5	5.6
Risk-free interest rate	2.06%	2.63%
Expected volatility	48%	48%
Expected dividend rate	0%	0%

The risk-free rates used are based on the U.S. Treasury yields over the expected terms. The expected term and forfeiture estimates for stock options and SARs are based on an analysis of actual exercise behavior. The Company uses its historical volatility over the estimated expected term as the expected volatility.

Share-Based Payment Award Activity

The weighted-average fair value of share-based compensation awards during the period were:

	Fiscal quarter ended	
(In thousands, except per share data)	**Jul 3, 2010**	**Jun 27, 2009**
SAR Awards:		
Grant date fair value per share	$ 6.31	$ 3.88
Total fair value of SARs granted	$ 1,149	$ 3,412
Total fair value of SARs vested	$ 1,005	$ 171
Total intrinsic value of SARs exercised	$ 251	$
Unvested Restricted Stock Unit Awards:		
Grant date fair value per share	$ 14.57	$ 8.26
Total fair value of awards granted	$ 6,643	$ 3,858
Employee Stock Purchase Plan:		
Grant date fair value per share	$ 2.74	$ 1.71
Total fair value of awards granted	$ 271	$ 141

5

Table of Contents

Information with respect to stock option and SAR activity is as follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at April 3, 2010	3,747,740	$ 20.86		
Granted	182,000	13.90		
Exercised	(42,237)	8.26		
Expired or forfeited	(137,425)	50.84		
Outstanding at July 3, 2010	3,750,078	$ 19.56	5.36	$ 3,839
Vested and expected to vest at July 3, 2010	3,625,269	$ 19.89	5.23	$ 3,411
Exercisable at July 3, 2010	2,798,871	$ 22.57	4.16	$ 810

Information with respect to unvested restricted stock unit awards activity was as follows:

	Shares	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding at April 3, 2010	928,437	$ 14.70		
Awarded	456,022	14.57		
Vested	(163,964)	13.82		
Forfeited	(2,824)	16.92		
Outstanding at July 3, 2010	1,217,671	$ 14.77	2.00	$ 15,684

5. Fair Value Measurements

Financial Assets Measured at Fair Value

Fair value is defined under Financial Accounting Standards Board (FASB) Accounting Standards Codification (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.

Table of Contents

The Company s fair value hierarchy for its financial assets measured at fair value on a recurring basis as of July 3, 2010 and April 3, 2010 was as follows (in thousands):

July 3, 2010	**Level 1**	**Level 2**	**Level 3**	**Total**
Money market securities	$ 2,233	$	$	$ 2,233
Government agencies		93,944		93,944
Commercial paper		38,939		38,939
U.S. treasuries		12,097		12,097
Forward purchase or (sale) contracts:				
Japanese Yen		(455)		(455)
Taiwan Dollar		(7)		(7)
Korean Won		(10)		(10)
Euro		(43)		(43)
British Pound		127		127
Auction rate securities			4,630	4,630
Preferred stock				

April 3, 2010	**Level 1**	**Level 2**	**Level 3**	**Total**
Money market securities	$ 4,244	$	$	$ 4,244
Government agencies		73,130		73,130
Commercial paper		41,992		41,992
U.S. treasuries		17,089		17,089
Forward purchase or (sale) contracts:				
Japanese Yen		165		165
Taiwan Dollar		(10)		(10)
Korean Won		15		15
Euro		6		6
British Pound		5		5
Auction rate securities			5,021	5,021
Preferred stock				

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

For Level 2 assets, exclusive of forward contracts, the Company utilized quoted prices in active markets for similar assets. For forward contracts, spot prices at July 2, 2010 were utilized to calculate unrealized gain/loss.

The Level 3 assets consisted of ARS and preferred stock acquired through the conversion of certain ARS during the third quarter of 2009. As none of the Company s securities have traded through the auction process and 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.

As of July 3, 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 2009. The contractual maturities of these securities range up to calendar year 2050, and several securities and the preferred stock do not have stated maturities. These securities previously 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. As a result of the liquidity issues experienced in the global credit and capital markets, the Company s ARS began to experience failed auctions during fiscal 2008. Since that time, none of the Company s ARS have traded through the auction process, few market transactions for these securities have been observed, and the credit quality of the counterparties has deteriorated.

As of July 3, 2010, total net unrealized gains on the Company s remaining ARS were $0.9 million. The $4.6 million estimated fair value of the Company s remaining ARS is classified as a non-current asset on the Condensed Consolidated Balance Sheet at July 3, 2010, consistent with the classification at April 3, 2010.

Table of Contents

The Company currently continues to receive all interest payments on its ARS when due, but has not received dividend payments on its preferred stock since the third quarter of 2010. The Company cannot predict if or when its remaining ARS will become liquid or dividend payments on its preferred stock will resume. See the Company s 2010 Annual Report on Form 10-K for the year ended April 3, 2010 for further information related to these investments.

The following table illustrates Level 3 activity from April 3, 2010 to July 3, 2010 (in thousands):

	Auction Rate Securities	Preferred Stock	Total
Fair Value, April 3, 2010	$ 5,021	$	$ 5,021
Adjustment to accumulated other comprehensive income (loss):			
Unrealized losses	(391)		(391)
Purchases, issuances and settlements			
Transfers into (out of) Level 3			
Fair Value, July 3, 2010	$ 4,630	$	$ 4,630

As of July 3, 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 July 3, 2010 and April 3, 2010, management had not identified any events or circumstances that indicated the investments were impaired; therefore, as presented in Note 9 Other Assets , the full carrying value of $8.2 million was included in Other assets on the Condensed Consolidated Balance Sheets at July 3, 2010 and April 3, 2010, respectively.

Investments

Certain information regarding the Company s investments at July 3, 2010 and April 3, 2010 was as follows (in thousands):

		Unrealized		
July 3, 2010	**Cost**	**Gain**	**Loss**	**Fair Value**
Available-for-sale securities (current):				
Government agencies	$ 93,915	$ 29	$	$ 93,944
Commercial paper	38,948		(9)	38,939
U.S. treasuries	12,098		(1)	12,097
	$ 144,961	$ 29	$ (10)	$ 144,980
Available-for-sale securities (non-current):				
Auction rate securities	$ 13,700	$ 910	$ (9,980)	$ 4,630
Preferred stock	4,000		(4,000)	
	$ 17,700	$ 910	$ (13,980)	$ 4,630

Table of Contents

		Unrealized		
April 3, 2010	**Cost**	**Gain**	**Loss**	**Fair Value**
Available-for-sale securities (current):				
Government agencies	$ 73,141	$	$ (11)	$ 73,130
Commercial paper	41,992			41,992
U.S. treasuries	17,088	1		17,089
	$ 132,221	$ 1	$ (11)	$ 132,211
Available-for-sale securities (non-current):				
Auction rate securities	$ 13,700	$ 1,301	$ (9,980)	$ 5,021
Preferred stock	4,000		(4,000)	
	$ 17,700	$ 1,301	$ (13,980)	$ 5,021

The Company had no sales of available for sale securities in the first quarter of 2011 or the first quarter of 2010. 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 insignificant as of July 3, 2010 and April 3, 2010. Gains reclassified out of accumulated other comprehensive income into earnings during the first quarter of 2011 were insignificant.

Underlying maturities of investments at July 3, 2010 were $145.0 million within one year and $4.6 million beyond ten years.

6. Inventories

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

(In thousands)	**Jul 3, 2010**	**Apr 3, 2010**
Raw materials and purchased parts	$ 47,702	$ 47,636
Work-in-process	12,803	10,731
Finished goods	9,431	13,723
	$ 69,936	$ 72,090

7. Other Current Assets

Other current assets consisted of the following:

(In thousands)	**Jul 3, 2010**	**Apr 3, 2010**
Prepaid expenses	$ 4,345	$ 4,286
Income tax refund receivable	2,931	3,017
Value added tax receivable	1,126	1,179
Other	39	195
	$ 8,441	$ 8,677

Table of Contents

8. Acquired Intangible Assets

Acquired intangible assets as of July 3, 2010 and April 3, 2010 consisted of the following:

(In thousands, except years)	Weighted-Average Useful Life (In years)	Jul 3, 2010	Apr 3, 2010
Developed technology	7	$ 8,100	$ 8,100
Customer relationships	6	2,700	2,700
Customer backlog	1	700	700
Trade name and trademarks	3	400	400
Change of control agreements	1	100	100
Fair value of below-market lease (non-current portion)	3.8	311	311
Patents	13.2	2,978	2,978
		15,289	15,289
Less accumulated amortization		(7,555)	(7,034)
Total non-current acquired intangible assets		7,734	8,255
Fair value of below-market lease (current portion)		110	110
Less accumulated amortization		(10)	
Total acquired intangible assets		$ 7,834	$ 8,365

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

	Fiscal quarter ended	
(In thousands)	Jul 3, 2010	Jun 27, 2009
Cost of sales	$ 289	$ 289
Selling, service and administration	189	222
Research, development and engineering	53	41
Total	$ 531	$ 552

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
2011	$ 1,939
2012	1,671
2013	1,512
2014	1,383
2015	543
Thereafter	1,317
	$ 8,365

9. Other Assets

Other assets consisted of the following:

(In thousands)	Jul 3, 2010	Apr 3, 2010
Minority equity investment	$ 8,184	$ 8,184
Consignment and demo equipment, net	2,148	3,957
Other	868	867
	$ 11,200	$ 13,008

Table of Contents

10. Accrued Liabilities

Accrued liabilities consisted of the following:

(In thousands)	Jul 3, 2010	Apr 3, 2010
Payroll-related liabilities	$ 4,532	$ 5,727
Product warranty accrual	3,709	2,576
Customer deposits	3,256	1,020
Professional fees payable	1,676	1,327
Pension benefit liabilities	1,577	1,415
Purchase order commitments and receipts	1,241	1,352
Other	2,563	1,520
	$ 18,554	$ 14,937

11. Product Warranty Accrual

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

	Fiscal quarter ended	
(In thousands)	Jul 3, 2010	Jun 27, 2009
Product warranty accrual, beginning	$ 2,576	$ 2,057
Warranty charges incurred, net	(1,199)	(1,690)
Provision for warranty charges	2,332	917
Product warranty accrual, ending	$ 3,709	$ 1,284

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

12. 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	
(In thousands)	Jul 3, 2010	Jun 27, 2009
Deferred revenue, beginning	$ 13,193	$ 11,251
Revenue deferred	7,614	5,660
Revenue recognized	(10,216)	(5,135)

Deferred revenue, ending	$ 10,591	$ 11,776

Table of Contents

13. Earnings (Loss) Per Share

Following is a reconciliation of weighted average shares outstanding used in the calculation of basic and diluted earnings per share:

(In thousands, except per share data)	Fiscal quarter ended Jul 3, 2010	Jun 27, 2009
Net income (loss)	$ 201	$ (5,530)
Weighted average shares used for basic earnings per share	27,791	27,234
Incremental diluted shares	421	
Weighted average shares used for diluted earnings per share	28,212	27,234
Net income (loss) per share:		
Net income (loss) basic	$ 0.01	$ (0.20)
Net income (loss) diluted	$ 0.01	$ (0.20)

Awards of options, stock-settled stock appreciation rights (SARs) and unvested restricted stock units (RSUs) representing an additional 3.0 million and 4.4 million shares for the quarters ended July 3, 2010 and June 27, 2009, respectively, were not included in the calculation of diluted net earnings per share because their effect would have been antidilutive.

14. Comprehensive Income (Loss)

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

(In thousands)	Fiscal quarter ended Jul 3, 2010	Jun 27, 2009
Net income (loss)	$ 201	$ (5,530)
Foreign currency translation adjustment	105	791
Net unrealized (loss) gain on auction rate securities	(391)	1,127
Net unrealized gain (loss) on current available for sale securities	19	(5)
Other comprehensive income	2	1
Other comprehensive loss	$ (64)	$ (3,616)

15. 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 July 3, 2010. As of July 3, 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.

Table of Contents

16. Product and Geographic Information

Net sales by product type were as follows:

	Fiscal quarter ended	
(In thousands)	**Jul 3, 2010**	**Jun 27, 2009**
Semiconductor Group (SG)	$ 19,057	$ 5,260
Passive Component Group (PCG)	18,803	5,150
Interconnect/Micro-machining Group (IMG)	20,611	12,193
	$ 58,471	$ 22,603

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

	Fiscal quarter ended	
(In thousands)	**Jul 3, 2010**	**Jun 27, 2009**
Asia	$ 50,785	$ 16,087
Americas	4,101	4,287
Europe	3,585	2,229
	$ 58,471	$ 22,603

17. Legal Proceedings

All Ring Patent Infringement Prosecution

The Company s proceedings against All Ring Tech Co., Ltd. (All Ring) in Taiwan for alleged patent infringement are ongoing. As part of these proceedings, the Court issued orders restricting the use of some of All Ring s assets. Pursuant to these orders, the Company was required to post security bonds with the Court. In July 2009 and September of 2009, the Company established letters of credit as a substitution for the security bonds and received back a total of $9.1 million from the Court. The letters of credit are collateralized by a total of $10.8 million of restricted cash, which is included on the Condensed Consolidated Balance Sheet at July 3, 2010 as a current asset. See the Company s 2010 Annual Report on Form 10-K for the year ended April 3, 2010 for further background related to these proceedings.

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.

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, electronic interconnect devices, passive components, light-emitting diodes (LEDs), or 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 implement device features or achieve yield and productivity gains in their manufacturing processes that can be critical to their profitability. ESI was founded in 1944 and is headquartered in Portland, Oregon, with subsidiaries in the United States, Europe and Asia.

Our advanced laser micro-engineering 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 micron-level processes, including advanced micro-machining, wafer scribing and dicing, semiconductor memory-link cutting, semiconductor device trimming, material ablation and via drilling as well as nano-level structuring to alter material characteristics. These processes require 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, flexible interconnect material, advanced semiconductor packaging, LEDs, flat panel liquid crystal displays (LCDs) and other components.

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

The financial results of the fiscal quarter ended July 3, 2010, which represents the first quarter of 2011, reflected continued strength in the core markets for our products. Total order volume for the first quarter of 2011 was $64.1 million, compared to $54.2 million for the fourth quarter of 2010, which ended April 3, 2010. The sequential increase in orders was driven by the receipt of the first significant orders from memory repair customers since the beginning of the economic downturn, and continued strong orders in our Interconnect/Micro-machining Group (IMG).

Orders for our Semiconductor Group (SG) products increased significantly in the first quarter of 2011 compared to the prior quarter as our memory repair customers began adding capacity of memory repair tools. We also had strong orders in our LED and LCD markets, reflecting continued demand for LED-backlit displays and consumer products and driven by a large competitive win in China.

Orders for our Passive Component Group (PCG) products decreased approximately 30% compared to the orders in the prior quarter. The decrease was primarily due to a drop in orders from our MLCC manufacturing customers as they absorb the systems ordered in prior quarters. We continue to see high utilization of our test systems by most PCG customers.

Orders for our IMG products decreased approximately 10% compared to the prior quarter, driven largely by timing of service contracts for ongoing support, as renewals were concentrated at the beginning of the calendar year. System orders continue to be strong in both our micro-machining and flex circuit markets, as demand for small, portable electronic devices remains high.

Net sales of $58.5 million for the first quarter of 2011 decreased $1.1 million compared to $59.6 million for the prior quarter. The sequential decrease in net sales reflects lower IMG sales, following shipment of the large order received in the third quarter of 2010, largely offset by increased sales in many of our other key markets in the first quarter of 2011. Sales for our SG products increased $13.4 million as we were able to meet the near term capacity requirements of our memory repair customers. PCG sales increased $8.7 million due to significant prior quarter backlog as MLCC customers expand capacity. IMG sales decreased $23.2 million due to the shipment of a large order in the prior quarter.

Gross margin was 36.7% on net sales of $58.5 million for the first quarter of 2011 compared to 43.1% on net sales of $59.6 million for the prior quarter. The decrease in gross margin percentage was primarily due to an unfavorable shift in product mix towards lower-margin systems, and to a lesser extent, lower absorption of manufacturing costs due to increased sales of existing finished goods and demo inventory, especially in memory repair.

Net operating expenses of $23.1 million in the first quarter of 2011 decreased $0.2 million compared to the prior quarter. This decrease was primarily due to acquisition settlement proceeds of $0.9 million received in the first quarter of 2011 and a decrease of $0.4 million in depreciation expense, partially offset by a $1.2 million increase in share-based compensation expense. Share-based compensation expense increased primarily due to immediate vesting of annual board of director share grants and annual employee grants.

Table of Contents

Operating loss was $1.6 million in the first quarter of 2011, a decrease of $4.0 million compared to operating income of $2.4 million in the prior quarter. The decrease was primarily due to lower gross profit.

The effective tax rate was 113.2% for the first quarter of 2011, resulting from an income tax benefit of $1.7 million, compared to an effective rate of 51.2% for the prior quarter that resulted from an income tax benefit of $0.7 million. The increase in the effective tax rate was primarily due to the tax effect resulting from the mix of U.S. and foreign earnings expected for fiscal 2011.

Net income for the first quarter of 2011 was $0.2 million compared to $2.1 million in the prior quarter due to the impact of the items discussed above.

Quarter Ended July 3, 2010 Compared to Quarter Ended June 27, 2009

Results of Operations

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

	Fiscal quarter ended	
	Jul 3, 2010	**Jun 27, 2009**
Net sales	100.0%	100.0%
Cost of sales	63.3	73.6
Gross margin	36.7	26.4
Selling, service and administration	22.0	53.0
Research, development and engineering	17.5	33.0
Merger termination proceeds, net		(20.0)
Operating loss	(2.8)	(39.6)
Interest and other income, net	0.1	1.5
Loss before income taxes	(2.7)	(38.1)
Benefit from income taxes	3.0	13.6
Net income (loss)	0.3%	(24.5)%

Net Sales

Net sales were $58.5 million for the first quarter of 2011, an increase of $35.9 million or 159% compared to net sales of $22.6 million for the first quarter of 2010. Revenue increased in each of our product groups, reflecting improved capacity utilization as customers recover from the global economic downturn.

The following table presents net sales information by product group:

	Fiscal quarter ended			
(In thousands, except percentages)	**Jul 3, 2010**		**Jun 27, 2009**	
	Net Sales	**% of Net Sales**	**Net Sales**	**% of Net Sales**
Semiconductor Group (SG)	$ 19,057	32.6%	$ 5,260	23.3%
Passive Component Group (PCG)	18,803	32.2	5,150	22.8
Interconnect/Micro-machining Group (IMG)	20,611	35.2	12,193	53.9

	$ 58,471	100.0%	$ 22,603	100.0%

SG sales in the quarter ended July 3, 2010 increased $13.8 million or 262% compared to the quarter ended June 27, 2009. The overall increase in sales was due to a rebound in memory markets and rapid growth in LED and LCD markets. Our memory repair customers placed orders in the first quarter of 2011 as they began to add capacity of memory repair tools.

PCG sales in the quarter ended July 3, 2010 increased $13.7 million or 265% compared to the quarter ended June 27, 2009. The increase was primarily due to customer capacity expansion along with increased tooling sales, a result of increased utilization levels of our MLCC customers existing systems.

IMG sales in the quarter ended July 3, 2010 increased $8.4 million or 69% compared to the quarter ended June 27, 2009. The increase was primarily driven by strong orders from flex-circuit customers, a result of increasing consumer demand for portable consumer electronics, and repeat orders from micro-machining customers due to increased consumer demand.

The following table presents net sales information by geographic region:

	Fiscal quarter ended			
(In thousands, except percentages)	**Jul 3, 2010**		**Jun 27, 2009**	
	Net Sales	**% of Net Sales**	**Net Sales**	**% of Net Sales**
Asia	$ 50,785	86.9%	$ 16,087	71.1%
Americas	4,101	7.0	4,287	19.0
Europe	3,585	6.1	2,229	9.9
	$ 58,471	100.0%	$ 22,603	100.0%

Compared to the quarter ended June 27, 2009, net sales for the quarter ended July 3, 2010 increased $34.7 million or 216% in Asia, decreased $0.2 million or 4% in the Americas and increased $1.4 million or 61% 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 decrease in the Americas was primarily driven by low levels of investment in manufacturing facilities in the Americas as many of our customers expand their capabilities in Asia. The increase in Europe primarily reflected an increase in sales in our IMG laser ablation markets compared to modest sales levels during the quarter ended June 27, 2009.

Gross Profit

The following table presents gross profit information:

	Fiscal quarter ended			
(In thousands, except percentages)	**Jul 3, 2010**		**Jun 27, 2009**	
	Gross Profit	**% of Net Sales**	**Gross Profit**	**% of Net Sales**
Gross Profit	$ 21,473	36.7%	$ 5,961	26.4%

Gross profit for the quarter ended July 3, 2010 was $21.5 million, an increase of $15.5 million compared to gross profit of $6.0 million for the quarter ended June 27, 2009. Gross profit as a percentage of net sales increased to 36.7% for the quarter ended July 3, 2010 from 26.4% for the quarter ended June 27, 2009. These increases were primarily related to higher revenue levels and increased production capacity utilization, partially offset by increased warranty costs associated with higher sales volumes.

Operating Expenses

The following table presents operating expense information:

	Fiscal quarter ended			
(In thousands, except percentages)	**Jul 3, 2010**		**Jun 27, 2009**	
	Expense	**% of Net Sales**	**Expense**	**% of Net Sales**
Selling, service and administration	$ 12,845	22.0%	$ 11,971	53.0%
Research, development and engineering	10,211	17.5	7,455	33.0
Merger termination proceeds, net			(4,516)	(20.0)
	$ 23,056	39.5%	$ 14,910	66.0%

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 $12.8 million for the first quarter ended July 3, 2010, an increase of $0.9 million compared to the quarter ended June 27, 2009. Excluding the impact of $0.9 million of acquisition settlement

Table of Contents

proceeds received during the first quarter of 2011, the increase was $1.8 million. This increase was primarily attributable to overall increases in business activity and improved operating results, resulting in higher compensation costs, including variable-pay and share-based compensation. In addition, we had initiated several temporary cost reduction measures in fiscal years 2009 and 2010, including salary reductions which have since been restored.

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 $10.2 million for the quarter ended July 3, 2010, an increase of $2.8 million compared to the quarter ended June 27, 2009. This increase was primarily due to increased project expenses, selective increases in headcount, and compensation expense as a result of temporary pay reductions and other temporary cost actions enacted in fiscal years 2009 and 2010 which have since been restored.

Merger Termination Proceeds, net

Net merger termination proceeds for the quarter ended June 27, 2009 were $4.5 million, which represented the receipt of a $5.4 million merger termination fee offset by $0.9 million of merger transaction costs.

Non-operating Income and Expense

Interest and Other Income, net

Interest and other income, net, consists of interest income and expense, market gains and losses on assets held for our deferred compensation plan, 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 was $0.1 million during the quarter ended July 3, 2010 compared to $0.3 million for the quarter ended June 27, 2009. The reduction was primarily due to unrealized market losses on assets held for our deferred compensation plan, and to a lesser extent, lower interest yields on our investments.

Income Taxes

The following table presents income tax information:

	Fiscal quarter ended			
(In thousands, except percentages)	**Jul 3, 2010**		**Jun 27, 2009**	
	Income Tax Benefit	**Effective Tax Rate**	**Income Tax Benefit**	**Effective Tax Rate**
Income tax benefit	$ (1,726)	113.2%	$ (3,077)	35.7%

The income tax benefit for the quarter ended July 3, 2010 was $1.7 million on pretax loss of $1.5 million, an effective tax rate of 113.2%. For the quarter ended June 27, 2009, the income tax benefit was $3.1 million on pretax loss of $8.6 million, an effective tax rate of 35.7%. The increase in the effective tax rate was primarily due to the tax effect resulting from the mix of U.S. and foreign earnings expected for fiscal 2011.

Our effective tax rate is subject to fluctuation based upon the mix of income and relative tax rates between jurisdictions, and 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 relationship of fixed deductions to overall changes in estimated and actual pretax income or loss and the tax jurisdictions where income or loss is generated. Based on currently available information, we are not aware of any further discrete events which are likely to occur that would have a material effect on our financial position, expected cash flows or results of operations. We anticipate no significant changes in unrecognized tax benefits in the next twelve months as the result of examinations or lapsed statutes of limitation.

Table of Contents

Net Income (Loss)

The following table presents net income (loss) information:

(In thousands, except percentages)	Fiscal quarter ended			
	Jul 3, 2010		Jun 27, 2009	
	Net Income	% of Net Sales	Net Loss	% of Net Sales
Net income (loss)	$ 201	0.3%	$ (5,530)	(24.5)%

Net income for the quarter ended July 3, 2010 was $0.2 million, or $0.01 per basic and diluted share, compared to a net loss of $5.5 million, or $0.20 per basic and diluted share for the quarter ended June 27, 2009. The improvement was primarily due to improved gross profit on higher revenues in the first quarter of 2011 offsetting the impact of higher net operating expenses.

Financial Condition and Liquidity

At July 3, 2010, our principal sources of liquidity were cash and cash equivalents of $54.2 million, short-term investments of $114.9 million and accounts receivable of $33.5 million. We also held $10.8 million in restricted cash as collateral for commercial letters of credit. Our current ratio was 6.7 and we held no long-term debt. Working capital of $257.5 million was up slightly compared to the April 3, 2010 balance of $253.7 million.

On May 15, 2008, the Board of Directors authorized a share repurchase program totaling $20.0 million to acquire shares of our 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. During the quarter ended July 3, 2010, we did not repurchase any shares under this program. As of July 3, 2010, a total of 372,825 shares have been repurchased under this authorization for $5.3 million and 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 July 3, 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 2009. These securities were recorded at an estimated fair value of $4.6 million as of July 3, 2010. The contractual maturities of these securities range up to calendar year 2050, and several securities and the preferred stock do not have stated maturities.

We currently continue to receive all interest payments on our ARS when due, but have not received dividend payments on our preferred stock since the third quarter of 2010. We cannot predict if or when our remaining ARS will become liquid or dividend payments on our preferred stock will resume.

Sources and Uses of Cash

Net cash flows provided by operating activities totaled $14.8 million for the quarter ended July 3, 2010 due to net income of $0.2 million, non-cash items totaling $3.1 million and $11.5 million from net reductions within working capital. The primary sources of cash from working capital reductions consisted of $5.5 million from decreases in trade receivables, $3.9 million from net decreases in inventories, and $3.8 million from increases in accounts payable and accrued liabilities, partially offset by decreases in deferred revenue of $2.7 million.

For the quarter ended July 3, 2010, net cash used in investing activities of $0.2 million was due to the purchase of securities of $81.3 million, purchases of property, plant and equipment of $1.3 million, and increases in other assets of $0.2 million, partially offset by $82.6 million in proceeds from maturities of securities. Net cash provided by financing activities of $0.1 million was primarily due to excess tax benefit on share-based compensation, partially offset by net cash used in stock plan activity.

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

18

Table of Contents

Critical Accounting Policies and Estimates

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 April 3, 2010.

Contractual Obligations

There have been no significant changes in our contractual obligations subsequent to those reported in our 2010 Annual Report on Form 10-K for the year ended on April 3, 2010.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the market risk disclosure contained in our 2010 Annual Report on Form 10-K for the year ended April 3, 2010. 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 July 3, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

All Ring Patent Infringement Prosecution

Our proceedings against All Ring Tech Co., Ltd. (All Ring) in Taiwan for alleged patent infringement are ongoing. As part of these proceedings, the Court issued orders restricting the use of some of All Ring s assets. Pursuant to these orders, we were required to post security bonds with the Court. In July 2009 and September of 2009, we established letters of credit as a substitution for the security bonds and received back a total of $9.1 million from the Court. The letters of credit are collateralized by a total of $10.8 million of restricted cash, which is included on the Condensed Consolidated Balance Sheet at July 3, 2010 as a current asset. See our 2010 Annual Report on Form 10-K for the year ended April 3, 2010 for further background related to these proceedings.

Table of Contents

In the ordinary course of business, we are 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 our consolidated financial position, results of operations or cash flows.

Item 1A. Risk Factors

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 we serve are volatile and unpredictable.

Our business is dependent upon the capital expenditures of manufacturers of semiconductors and micro-electronics used in wireless communications, computers and other electronic products. The capital equipment market for semiconductor and micro-electronics manufacturers has historically been characterized by sudden and severe cyclical variations in product supply and demand due to a number of factors including capacity utilization, demand for customers products, inventory levels relative to demand, and access to affordable capital. The timing, severity and duration of these market cycles are difficult or impossible to predict. Significant downturns in the market for semiconductor and micro-electronics used in electronic devices reduce demand for our products and may materially and adversely affect our business, financial condition and operating results.

For example, the recent economic slowdown resulted in a decrease in orders for all of our product groups for each quarter throughout 2009, with virtually no orders for our memory repair systems throughout 2010. Additionally, some of our customers ability to access credit was adversely affected, limiting their ability to purchase our products. The degree of the impact on our business of the current economic environment will continue to depend on a number of factors, including the strength and continuity of the recovery in the US economy, the global economy in general, access to capital and stability of the financial system, and overall health of the semiconductor and micro-electronics industries. This impact may cause potential material adverse changes to our financial and operational results.

To meet rapidly changing demand in the industries we serve, we must effectively manage our resources and production capacity. During periods of decreasing demand for our products, we must be able to appropriately align our cost structure with prevailing market conditions and effectively manage our supply chain. Our ability to rapidly and effectively reduce our cost structure in response to such downturns is limited by the fixed nature of many of our expenses in the near term and by our need to continue our investment in next-generation product technology and to support and service our products. Conversely, when upturns in this market occur, we may have difficulty rapidly and effectively increasing our manufacturing capacity or procuring sufficient materials to meet sudden increases in customer demand, which could result in the loss of business to our competitors and harm to our relationships with our customers. If we are not able to timely and appropriately adapt to changes in our business environment, our business, financial condition or results of operations may be materially and adversely affected.

The markets in which we operate are highly competitive.

We face substantial competition from established competitors throughout the world, some of which have greater financial, engineering, manufacturing and marketing resources than we do. Those competitors with greater resources may, in addition to other things, be able to better withstand periodic downturns, compete more effectively on the basis of price and technology, or more quickly develop enhancements to, and new generations of, products that compete with the products we manufacture and market. New companies may enter the markets in which we compete, or industry consolidation may occur, further increasing competition in those markets. Furthermore, our technological advantages may be reduced or lost as a result of technological advances by our competitors.

Table of Contents

Moreover, our business, financial condition or results of operations may be materially and adversely affected by competitive pressure and intense price-based competition. We have experienced and continue to experience significant price competition in the sale of our products. In addition, pricing pressures typically have become more intense during cyclical downturns when competitors seek to maintain or increase market share, reduce inventory or introduce more technologically advanced products. We believe that to be competitive we must continue to expend significant financial resources in order to, among other things, invest in new product development and enhancements. 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.

Our operating results may fluctuate significantly from period to period, which could negatively impact our business.

Our revenues, operating margins and other operating results could fluctuate significantly from quarter to quarter depending upon a variety of factors, including:

- demand for our products as a result of the cyclical nature of the semiconductor and micro-electronics manufacturing industries and the markets upon which they depend or otherwise;
- changes in the timing and terms of product orders by our customers as a result of our customer concentration or otherwise;
- changes in the mix of products and services that we offer;
- timing and market acceptance of our new product introductions;
- delays or problems in the planned introduction of new products, or in the performance of any such products following delivery to customers;
- our competitors announcements of new products, services or technological innovations, which can, among other things, render our products less competitive due to the rapid technological change in our industry;
- the timing and related costs of any acquisitions, divestitures or other strategic transactions;
- our ability to reduce our costs in response to decreased demand for our products and services;
- disruptions in our manufacturing process or in the supply of components to us;
- write-offs for excess or obsolete inventory; and
- competitive pricing pressures.

These risks may be exacerbated by the fact that we derive a substantial portion of our revenue from the sale of a relatively small numbers of products. As a result of these risks, we believe that quarter to quarter comparisons of our revenue and operating results may not be meaningful, and that these comparisons may not be an accurate indicator of our future performance.

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 and the requirements of current and potential customers. 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 you 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. 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. For example, for many years the semi-conductor memory industry has employed alternative redundancy technologies. The adoption by our customers of electrical redundancy technology could have a material adverse effect on demand for our SG products. 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. If we are unable to develop new or enhanced products to address product or technology changes or new industry standards on a timely basis or at all, or if our new or enhanced products are not accepted by the market, our business, results of operations and financial condition may be adversely affected.

We depend on a few significant customers, none of which are bound by long-term contracts, for a large portion of our revenues.

We depend on a few significant customers for a large portion of our revenues. In fiscal 2010, our top ten customers accounted for approximately 56% of total net sales, with one customer accounting for approximately 30% of total net sales. We anticipate that sales of our products to a relatively small number of customers will continue to account for a significant portion of our revenues. Consolidation between customers, changes in various partnership and technology arrangements between customers, customer bankruptcies or customer departures from their respective industries all may result in even fewer customers accounting for a high percentage of our revenue. For example, in early calendar 2009 Qimonda AG, historically one of our top European customers, went bankrupt.

None of our customers have any long-term obligation to continue to buy our products or services. As a result, our customers may delay, reduce or cease ordering our products or services at any time. Cancellations, reductions or deferrals could result from a number of factors, including a prolonged or additional downturn in the semiconductor or micro-electronics industries, manufacturing delays, completion of new product manufacturing ramp-up by customers, quality or reliability issues with our products, the development and introduction of new products and technologies by our competitors, or interruptions to our customers operations due to fire, natural disasters or other events. In particular, the markets we serve are subject to significant and unpredictable volatility, and downturns in those markets reduce demand for our products. In the future, the cancellation, reduction or deferral of purchases of our products by even a single customer could significantly reduce our revenues in any particular quarter. If we were to lose any of our significant customers or suffer a material reduction in their purchase orders, revenue could decline and our business, financial condition and results of operations could be materially and adversely affected.

The failure of critical suppliers to deliver sufficient product quantities in a timely and cost-effective manner could negatively affect our business.

We use a wide range of materials from numerous suppliers in the manufacture of our products, including custom electronic, laser 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 or discontinuation for a variety of reasons, including changes in business relationships, competitive factors, financial difficulties, work stoppages, fire, natural disasters or other causes. Any such disruption or discontinuation to our suppliers operations could interrupt or reduce our manufacturing activities and delay delivery of our products, any or all of which could materially and adversely affect our results of operations. In addition, as markets recover, there is a heightened risk that one or more of our suppliers may not be able to meet increased demand requirements, adversely impacting our ability to fulfill orders and win business with our customers.

The failure of our contract manufacturers to timely perform could negatively affect our business.

We have arrangements with contract manufacturers to complete the manufacture of certain of our products or product subcomponents. Any significant interruption in our contract manufacturers 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.

We may recognize charges for excess or obsolete inventory if our demand projections are incorrect or our technology strategy changes.

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 represents management s assessment of technology that will be utilized in new products that we develop. Certain types of inventory, including lasers and optical equipment, are particularly expensive and may 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 July 3, 2010, we had $69.9 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 recent 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 also result in material accounting charges. For example, during fiscal 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.

Table of Contents

We may not be able to protect the proprietary rights upon which our business depends.

Our success depends significantly upon the protection of our proprietary rights. We attempt to protect our proprietary rights through patents, copyrights, trademarks, maintenance of trade secrets and other measures, including entering into confidentiality agreements. We incur substantial costs to obtain and maintain patents and to defend our intellectual property rights. For example, we initiated litigation against All Ring Tech Co., Ltd. in Taiwan in August 2005 alleging that certain of our patent rights had been violated. We rely upon the laws of the United States and foreign countries where we develop, manufacture or sell our products to protect our proprietary rights. We may not be successful in protecting these proprietary rights, these 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 United States 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 our current and potential customers or obsolete, 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.

We may make acquisitions in the future, which may be difficult to integrate, disrupt our business, dilute shareholder value or divert management attention.

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;

Table of Contents

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

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.

Furthermore, the accounting for an acquisition could result in significant charges resulting from amortization of intangible assets we acquire. Our inability to effectively manage these risks could result in our inability to realize the anticipated benefits of an acquisition on a timely basis, or at all, and materially and adversely affect our business, financial condition and results of operations. In addition, all acquisition transaction costs must be expensed as incurred rather than capitalized, which may have a material adverse effect on our results of operations.

The means by which we finance an acquisition may also significantly affect our business or the value of the shares of our common stock. 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 on hand 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 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.

We may from time to time also make strategic investments in development stage companies. Investments in development stage companies are subject to a high degree of risk. We cannot assure you that we will not lose all or a portion of our investment in any such company.

We are implementing our globalization strategy, and if we do not effectively implement a globalization plan or if we decide to change our strategy, our operating results could be negatively impacted.

We are implementing our globalization strategy in which we are moving certain operational resources and capabilities to different countries in Asia to reduce costs and to be closer to our customers. We believe this implementation will reduce our manufacturing costs for certain products, enhance customer relationships and improve our responsiveness. We are currently implementing the first major phase of this strategy, having opened a larger manufacturing facility in Singapore in the fourth quarter of 2010 for certain IMG and PCG products.

Our globalization strategy is subject to a variety of complexities and risks, many of which we have little experience managing, and which may divert a substantial amount of management s time. These risks include:

challenges in designing new facilities that can be scaled for future expansion, replicating current processes and bringing new facilities up to full operation;

unpredictable costs, redundancy costs and cost overruns for developing new facilities and acquiring equipment;

building local management teams, technical personnel and other staff for functions that we have not previously conducted outside of the United States;

technical obstacles such as poor production or process yield and loss of quality control during the ramp of a new facility;

requalifications and other procedures that may be required by our customers;

- our ability to bring up local suppliers to meet our quality and cycle-time needs;
- rapidly changing business conditions that may require plans to be changed or abandoned before they are fully implemented; and
- challenges posed by distance and by differences in language and culture.

These and other factors could delay the development and implementation of our strategy, as well as impair our gross margins, delay shipments and deliveries, cause us to lose sales, require us to write off investments already made, damage our reputation and harm our business, financial condition and operating results. If we decide to change our current global regionalization strategy, we may incur charges for certain costs incurred.

Table of Contents

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 90% of net sales in 2010, with 83% 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 significant foreign operations, including a Singapore manufacturing facility, research and development facilities in Taiwan and China, and sales and service offices in various countries. Under our globalization strategy, we intend to increase our foreign operations in the future. Our non-U.S. sales, purchases and operations 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;
- difficulty in repatriating money, whether as a result of tax laws or otherwise;
- difficulties protecting intellectual property;
- compliance with labor laws and other laws governing employees;
- 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 repatriating earnings.

Our business and operating results could also be impacted, directly or indirectly, by natural disasters, outbreaks of infectious disease, military action, international conflicts, terrorist activities, civil unrest and associated political instability. Any such events or circumstances may result in heightened security concerns with respect to domestic and international travel and commerce, which may further affect our business and operating results. In particular, due to these uncertainties, we are subject to the following additional risks:

- 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;

- more frequent instances of shipping delays;
- demand for our products may not increase or may decrease; and
- our customers or suppliers may experience financial difficulties or cease operations.

Unfavorable currency exchange rate fluctuations may lead to lower operating margins or may cause us to raise prices.

Currency exchange rate fluctuations could have an adverse effect on our sales and results of operations and we could experience losses with respect to forward exchange contracts into which we may enter. Unfavorable currency fluctuations could require us to increase prices to foreign customers, which could result in lower net sales by us to such customers. Alternatively, if we do not adjust the prices for our products in response to unfavorable currency fluctuations, our results of operations could be materially and adversely affected. In addition, many of our foreign sales are denominated in the currency of the country in which these products are sold and the currency we receive in payment for such sales could be less valuable at the time of receipt as a result of exchange rate fluctuations. From time to time, we enter into forward exchange contracts to hedge the value of accounts receivable primarily denominated in Japanese yen and other currencies. However, we cannot be certain that our efforts will be adequate to protect us against significant currency fluctuations or that such efforts will not expose us to additional exchange rate risks, which could adversely affect our results of operations.

Our effective tax rate is subject to fluctuation and we may have exposure to additional tax liabilities.

As a global company, we are subject to taxation in the United States and numerous foreign jurisdictions. Our effective tax rate is subject to fluctuation from one period to the next because the income tax rates for each year are a function of many factors, including: (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

Table of Contents

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 rate to fluctuate between periods, which could have a material adverse effect on our financial position and results of operations.

Furthermore, we are periodically under audits by United States and foreign tax authorities. We may have exposure to additional tax liabilities as a result of these audits. Significant judgment is required in determining our provision for income and other tax liabilities. 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 significant market currently exists for the auction rate securities we hold and we may not be able to liquidate them at the current valuation, if at all, and we may recognize impairment charges if their estimated fair values decline.

As of July 3, 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 2009. These securities were recorded at an estimated fair value of $4.6 million as of July 3, 2010. The contractual maturities of these securities range up to calendar year 2050, and several securities and the preferred stock do not have stated maturities. As a result of disruptions experienced in the global credit and capital markets, the auctions that previously provided liquidity for the ARS began to fail during the second fiscal quarter of 2008.

Since that time, none of these securities have traded through the auction process and few market transactions for these securities have been observed. Additionally, the bond insurers that guarantee the ARS experienced credit rating downgrades and the issuer of the preferred stock suspended dividend payments. Consequently, we recognized significant write downs of the ARS as a result of the declines in fair value and the ARS are categorized as non-current assets.

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 the underlying securities will develop in which trading prices fall 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 losses, which would adversely impact our financial position and results of operations.

It is 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 impairment charges on the value of those investments, which would negatively impact our financial position and results of operations.

Our intangible assets may become impaired.

We held $7.8 million in definite-lived acquired intangible assets at July 3, 2010. We review these intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If such an adverse event occurred and had the effect of changing one of the critical assumptions or estimates related to the fair value of our intangible assets, an impairment charge could result. For example, during fiscal 2009, as a result of a decrease in our market capitalization, we recorded a goodwill impairment charge of $17.4 million to write off all existing goodwill. Any such impairment charges may have a material negative impact on our financial condition and operating results.

We may be unable to retain, attract and assimilate key managerial, financial, engineering and other technical personnel.

Our continued success depends in part upon the services of our key managerial, financial and technical personnel. The loss of key personnel, or our inability to attract, assimilate and retain qualified personnel, could result in the loss of customers, inhibit our ability to operate and grow our business, and otherwise have a material adverse effect on our business and results of operations. We have previously had to, and may in the future have to, impose salary reductions on senior employees during economic downturns in an effort to maintain our financial position. These actions may have an adverse effect on employee loyalty and may make it more difficult for us to attract and retain key personnel. Competition for qualified personnel in the industries in which we compete is intense, and we may not be successful in attracting and retaining qualified personnel. We may incur significant costs in our efforts to recruit and retain key personnel, which could affect our financial position and results of operations.

We are exposed to lawsuits in the normal course of business.

We have been and may in the future be subject to various legal proceedings, including claims that involve possible infringement of patent or other intellectual property rights of third parties. It is inherently difficult to assess the outcome of litigation matters, and there can be no assurance that we will prevail in any litigation. Any such litigation could result in substantial cost and diversion of management s attention, which by itself could have a material adverse effect on our financial condition and operating results. Further, adverse determinations in such litigation could result in loss of our property rights, subject us to significant liabilities to third parties, require us to seek licenses from third parties or prevent us from manufacturing or selling our products, any of which could materially adversely affect our business, financial condition or results of operations.

Many of our products are highly complex and may contain defects or errors.

Our products are highly complex, and our extensive product development, manufacturing and testing processes may not be adequate to detect all defects, errors, failures and quality issues that could impact customer satisfaction or result in claims against us. As a result, we may have to replace certain components or provide remediation in response to the discovery of defects in products after they are shipped. The occurrence of any defects, errors, failures or quality issues could result in cancellation of orders, product returns, diversion of our resources, legal actions by our customers and other losses to us or to our customers. These occurrences could also result in the loss of, or delay in, market acceptance of our products and loss of sales, which would harm our business and adversely affect our revenues and profitability.

We are subject to numerous governmental regulations.

We are subject to federal, state, local and foreign regulations, including environmental regulations and regulations relating to the design and operation of our products. We may incur significant costs as we seek to ensure that our products meet safety standards, many of which vary across the states and countries in which our products are used. Compliance with future regulations, directives and standards could require us to modify or redesign some products, make capital expenditures or incur substantial costs. If we do not comply with current or future regulations, directives and standards, we could be subject to fines, our production or shipments could be suspended, and we could be prohibited from offering particular products in specified markets. If we are unable to comply with current or future regulations, directives and standards, our financial condition and results of operations could be materially and adversely affected.

Compliance with changing regulations and standards for accounting, corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including new Securities and Exchange Commission (SEC) regulations, new NASDAQ Stock Market rules and new accounting requirements have the potential to create uncertainty and result in additional governance and disclosure complexities for companies such as ours. To maintain high standards of corporate governance and public disclosure, we intend to invest all reasonably necessary resources to comply with all other current and future standards. These investments may result in increased general and administrative expenses and a diversion of management time and attention from strategic revenue generating and cost management activities.

We may be unable to maintain effective internal controls over financial reporting.

The SEC, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules that require us to include in our annual reports on Form 10-K a report by management assessing the effectiveness of our internal control over financial reporting. In addition, our independent registered public accounting firm must attest to, and report on the effectiveness of, our internal control over financial reporting. Although we regularly review our internal control over financial reporting in order to ensure compliance with the Section 404 requirements, there is no guarantee that we will be successful in complying with the requirements of Section 404. Our failure to maintain adequate internal controls over financial reporting could cause (a) investors to lose confidence in the reliability of our financial statements or (b) a delay in our ability to timely file our periodic reports with the SEC, each of which could, in addition to a number of other adverse consequences, negatively impact our stock price.

Table of Contents

Our stock price is volatile.

The market price of our common stock has fluctuated widely. During fiscal 2010, our stock price fluctuated between a high of $14.36 per share and a low of $5.92 per share. Consequently, the current market price of our common stock may not be indicative of future market prices, and we may be unable to sustain or increase the value of an investment in our common stock. Factors affecting our stock price, many of which our outside of our control, may include:

- variations in operating results from quarter to quarter;
- changes in earnings estimates by analysts or our failure to meet analysts expectations;
- changes in the market price per share of our public company customers;
- market conditions in the semiconductor and other industries into which we sell products;
- general economic conditions;
- political changes, hostilities or natural disasters;
- low trading volume of our common stock; and
- the number of firms making a market in our common stock.

In addition, the stock market has recently experienced significant price and volume fluctuations. These fluctuations have particularly affected the market prices of the securities of high-technology companies like ours. These market fluctuations could adversely affect the market price of our common stock.

Provisions of our charter documents, our shareholder rights plan and Oregon law could make it more difficult for a third party to acquire us.

Our articles of incorporation and bylaws contain provisions that could make it harder for a third party to acquire us without the consent of our Board of Directors. Our Board of Directors has also adopted a shareholder rights plan, or poison pill, which would significantly dilute the ownership of a hostile acquirer. In addition, the Oregon Control Share Act and the Oregon Business Combination Act limit the ability of parties who acquire a significant amount of voting stock to exercise control over us. These provisions may have the effect of lengthening the time required for a person to acquire control of us through a proxy contest or the election of a majority of our Board of Directors, may deter efforts to obtain control of us and may make it more difficult for a third party to acquire us without negotiation. These provisions may apply even if the offer may be considered beneficial by our shareholders.

Item 6. Exhibits

This list is intended to constitute the exhibit index.

3.1

	Third Restated Articles of Incorporation, as amended. Incorporated by reference to Exhibit 3.1 of the Company s Annual Report on Form 10-K filed on June 15, 2010.
3.2	2009 Amended and Restated Bylaws. Incorporated by reference to Exhibit 3.2 of the Company s Current Report on Form 8-K filed on May 19, 2009 (the May 19 8-K).
4.1	Rights Agreement, dated as of May 18, 2009, between Electro Scientific Industries, Inc. and Mellon Investor Services. 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 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Section 302 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.

Table of Contents

SIGNATURES

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

Dated: August 12, 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)