

II-VI INC  
Form 10-Q  
February 08, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the quarterly period ended December 31, 2012**

.. **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**for the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**Commission File Number: 0-16195**

**II-VI INCORPORATED**

**(Exact name of registrant as specified in its charter)**

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**PENNSYLVANIA**  
(State or other jurisdiction of  
incorporation or organization)

**25-1214948**  
(I.R.S. Employer  
Identification No.)

**375 Saxonburg Boulevard**  
  
**Saxonburg, PA**  
(Address of principal executive offices)

**16056**  
(Zip Code)

**Registrant's telephone number, including area code: 724-352-4455**

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  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 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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

At February 1, 2013, 62,199,324 shares of Common Stock, no par value, of the registrant were outstanding.

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## Item 1. Financial Statements

## II-VI Incorporated and Subsidiaries

## Condensed Consolidated Balance Sheets (Unaudited)

(\$000)

	December 31, 2012	June 30, 2012
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 162,810	\$ 134,944
Accounts receivable less allowance for doubtful accounts of \$1,498 at December 31, 2012 and \$1,536 at June 30, 2012	93,758	104,761
Inventories	151,942	137,607
Deferred income taxes	10,861	10,796
Prepaid and refundable income taxes	4,936	8,488
Prepaid and other current assets	12,613	13,777
<b>Total Current Assets</b>	<b>436,920</b>	<b>410,373</b>
Property, plant & equipment, net	184,025	153,918
Goodwill	123,075	80,748
Other intangible assets, net	76,094	44,014
Investment	11,254	10,661
Deferred income taxes	6,519	145
Other assets	8,973	6,627
<b>Total Assets</b>	<b>\$ 846,860</b>	<b>\$ 706,486</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 29,930	\$ 29,420
Accrued compensation and benefits	26,919	27,234
Accrued income tax payable	6,504	8,761
Deferred income taxes	129	209
Other accrued liabilities	18,978	18,104
<b>Total Current Liabilities</b>	<b>82,460</b>	<b>83,728</b>
Long-term debt	124,482	12,769
Deferred income taxes	4,632	5,883
Other liabilities	17,827	12,720
<b>Total Liabilities</b>	<b>\$ 229,401</b>	<b>\$ 115,100</b>
<b>Shareholders' Equity</b>		
Preferred stock, no par value; authorized 5,000,000 shares; none issued		
Common stock, no par value; authorized 300,000,000 shares; issued 69,888,663 shares at December 31, 2012; 69,626,883 shares at June 30, 2012	186,136	176,295
Accumulated other comprehensive income	13,576	10,238
Retained earnings	463,589	438,671

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	\$ 663,301	\$ 625,204
Treasury stock, at cost, 7,487,965 shares at December 31, 2012 and 6,793,928 shares at June 30, 2012	47,519	35,247
Total II-VI Incorporated Shareholders' Equity	\$ 615,782	\$ 589,957
Noncontrolling Interests	1,677	1,429
Total Shareholders' Equity	\$ 617,459	\$ 591,386
Total Liabilities and Shareholders' Equity	\$ 846,860	\$ 706,486

*See notes to condensed consolidated financial statements.*

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Earnings (Unaudited)

(\$000 except per share data)

	Three Months Ended December 31,	
	2012	2011
<b>Revenues</b>		
Domestic	\$ 51,479	\$ 50,156
International	74,410	76,601
<b>Total Revenues</b>	<b>125,889</b>	<b>126,757</b>
<b>Costs, Expenses and Other Expense (Income)</b>		
Cost of goods sold	79,019	83,289
Internal research and development	5,626	5,016
Selling, general and administrative	26,309	24,214
Interest expense	223	77
Other expense (income), net	(4,551)	(1,506)
<b>Total Costs, Expenses, and Other Expense (Income)</b>	<b>106,626</b>	<b>111,090</b>
<b>Earnings Before Income Taxes</b>	<b>19,263</b>	<b>15,667</b>
<b>Income Taxes</b>	<b>6,796</b>	<b>2,147</b>
<b>Net Earnings</b>	<b>12,467</b>	<b>13,520</b>
Less: Net Earnings Attributable to Noncontrolling Interests	267	233
<b>Net Earnings Attributable to II-VI Incorporated</b>	<b>\$ 12,200</b>	<b>\$ 13,287</b>
<b>Net Earnings Attributable to II-VI Incorporated: Basic Earnings Per Share:</b>	<b>\$ 0.19</b>	<b>\$ 0.21</b>
<b>Net Earnings Attributable to II-VI Incorporated: Diluted Earnings Per Share:</b>	<b>\$ 0.19</b>	<b>\$ 0.21</b>

*See notes to condensed consolidated financial statements.*

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Earnings (Unaudited)

(\$000 except per share data)

	Six Months Ended December 31,	
	2012	2011
<b>Revenues</b>		
Domestic	\$ 103,762	\$ 105,725
International	154,419	159,405
<b>Total Revenues</b>	<b>258,181</b>	<b>265,130</b>
<b>Costs, Expenses and Other Expense (Income)</b>		
Cost of goods sold	162,476	166,652
Internal research and development	11,211	10,179
Selling, general and administrative	52,965	51,026
Interest expense	259	136
Other expense (income), net	(5,312)	(3,136)
<b>Total Costs, Expenses, and Other Expense (Income)</b>	<b>221,599</b>	<b>224,857</b>
<b>Earnings Before Income Taxes</b>	<b>36,582</b>	<b>40,273</b>
<b>Income Taxes</b>	<b>10,983</b>	<b>8,039</b>
<b>Net Earnings</b>	<b>25,599</b>	<b>32,234</b>
Less: Net Earnings Attributable to Noncontrolling Interests	681	368
<b>Net Earnings Attributable to II-VI Incorporated</b>	<b>\$ 24,918</b>	<b>\$ 31,866</b>
<b>Net Earnings Attributable to II-VI Incorporated: Basic Earnings Per Share:</b>	<b>\$ 0.40</b>	<b>\$ 0.51</b>
<b>Net Earnings Attributable to II-VI Incorporated: Diluted Earnings Per Share:</b>	<b>\$ 0.39</b>	<b>\$ 0.50</b>

*See notes to condensed consolidated financial statements.*

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

(\$000)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Net earnings	\$ 12,467	\$ 13,520	\$ 25,599	\$ 32,234
Other comprehensive income:				
Foreign currency translation adjustments	2,043	(343)	3,122	597
Comprehensive income	\$ 14,510	\$ 13,177	\$ 28,721	\$ 32,831
Net earnings attributable to noncontrolling interests:	\$ 267	\$ 233	\$ 681	\$ 368
Other comprehensive income attributable to noncontrolling interests:				
Foreign currency translation adjustments attributable to noncontrolling interests	57		(216)	
Comprehensive income attributable to noncontrolling interests	\$ 324	\$ 233	\$ 465	\$ 368
Comprehensive income attributable to II-VI Incorporated	\$ 14,186	\$ 12,944	\$ 28,256	\$ 32,463

*See notes to condensed consolidated financial statements.*



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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

(\$000)

	Six Months Ended December 31,	
	2012	2011
<b>Cash Flows from Operating Activities</b>		
Net earnings	\$ 25,599	\$ 32,234
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	16,860	14,784
Amortization	2,374	2,048
Share-based compensation expense	6,534	7,176
Impairment of property, plant and equipment		434
Loss (gain) on foreign currency remeasurements and transactions	810	(595)
Earnings from equity investments	(593)	(484)
Deferred income taxes	2,307	(433)
Excess tax benefits from share-based compensation expense	(387)	(122)
Increase (decrease) in cash from changes in:		
Accounts receivable	20,932	7,694
Inventories	(6,445)	(14,501)
Accounts payable	(4,640)	1,464
Income taxes	1,688	797
Other operating net assets	(4,062)	(7,583)
<b>Net cash provided by operating activities</b>	<b>60,977</b>	<b>42,913</b>
<b>Cash Flows from Investing Activities</b>		
Additions to property, plant & equipment	(13,177)	(23,068)
Purchase of businesses, net of cash acquired	(126,397)	(46,141)
Proceeds received on contractual settlement from Thailand flood	2,436	
Proceeds from the collection of note receivable	1,395	
Other investing activities	70	24
<b>Net cash used in investing activities</b>	<b>(135,673)</b>	<b>(69,185)</b>
<b>Cash Flows from Financing Activities</b>		
Proceeds from long-term borrowings	113,000	7,000
Payments on long-term borrowings	(1,000)	(6,295)
Payment of debt issuance costs	(560)	
Purchases of treasury stock	(10,840)	
Distribution of noncontrolling interests	(217)	
Minimum tax withholding requirements	(137)	
Proceeds from exercises of stock options	1,625	452
Excess tax benefits from share-based compensation expense	387	122
<b>Net cash provided by financing activities</b>	<b>102,258</b>	<b>1,279</b>
Effect of exchange rate changes on cash and cash equivalents	304	(634)
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>27,866</b>	<b>(25,627)</b>

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Cash and Cash Equivalents at Beginning of Period	134,944	149,460
Cash and Cash Equivalents at End of Period	\$ 162,810	\$ 123,833
Cash paid for interest	\$ 184	\$ 119
Cash paid for income taxes	\$ 6,379	\$ 7,602
Non-cash transactions:		
Purchase of business utilizing earnout arrangement recorded in other long-term liabilities	\$ 4,200	\$
Purchase of business utilizing deferred purchase price recorded in other current liabilities	\$ 700	\$

*See notes to condensed consolidated financial statements.*

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II-VI Incorporated and Subsidiaries

Condensed Consolidated Statement of Shareholders' Equity (Unaudited)

(000)

	Common Stock		Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock		Non- Controlling Interests	Total
	Shares	Amount			Shares	Amount		
Balance June 30, 2012	69,627	\$ 176,295	\$ 10,238	\$ 438,671	(6,794)	\$ (35,247)	\$ 1,429	\$ 591,386
Shares issued under share-based compensation plans	262	1,625						1,625
Minimum tax withholding requirements					(7)	(137)		(137)
Share-based compensation expense		6,534						6,534
Net earnings				24,918			681	25,599
Purchases of treasury stock					(617)	(10,840)		(10,840)
Treasury stock under deferred compensation arrangements		1,295			(70)	(1,295)		
Excess tax benefits from share-based compensation		387						387
Distributions of noncontrolling interests							(217)	(217)
Foreign currency translation adjustments			3,338				(216)	3,122
Balance December 31, 2012	69,889	\$ 186,136	\$ 13,576	\$ 463,589	(7,488)	\$ (47,519)	\$ 1,677	\$ 617,459

*See notes to condensed consolidated financial statements.*

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The condensed consolidated financial statements of II-VI Incorporated (sometimes referred to herein as "II-VI" or the "Company") for the three and six months ended December 31, 2012 and 2011 are unaudited. In the opinion of management, all adjustments considered necessary for a fair presentation for the periods presented have been included. All adjustments are of a normal recurring nature unless disclosed otherwise. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K ("Annual Report") for the year ended June 30, 2012. The consolidated results of operations for the three and six months ended December 31, 2012 are not necessarily indicative of the results to be expected for the full fiscal year. The consolidated results of operations for the three and six months ended December 31, 2012, include M Cubed Technologies, Inc. and the Oclaro thin film filter business and product line since their respective dates of acquisition. LightWorks Optics, Inc. was acquired near the end of the quarter ended December 31, 2012 and had no contribution to our operating results during the three and six months ended December 31, 2012. For further information, see Note 3. Acquisitions. The June 30, 2012 Condensed Consolidated Balance Sheet information was derived from the Company's audited financial statements.

Effective July 1, 2012, the Company changed its reportable segments in accordance with how the Company's chief operating decision maker receives and reviews financial information. Effective July 1, 2012, VLOC Incorporated ("VLOC") has been included in the Military & Materials operating segment for financial reporting purposes. Prior to July 1, 2012, the Company's VLOC business unit was included in the Near-Infrared Optics operating segment. The Company has revised the consolidated segment information for all periods presented in this Quarterly Report on Form 10-Q to reflect this reclassification.

**Note 2. Recent Accounting Pronouncements**

In July 2012, the Financial Accounting Standards Board ("FASB") issued an accounting standard update related to impairment testing of indefinite-lived intangible assets. The update simplifies the guidance of testing for potential impairment of indefinite-lived intangible assets other than goodwill. The amendment provides entities the option to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. An entity electing to perform a qualitative assessment is no longer required to calculate the fair value of an indefinite-lived intangible asset unless the organization determines, based on a qualitative assessment, that it is more likely than not (that is, a likelihood of more than 50 percent) that the asset is impaired. The amendments in this update are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The adoption of this standard is not expected to have a significant impact on the Company's consolidated financial statements and indefinite-lived intangible asset impairment testing.

In September 2011, the FASB issued an accounting standard update related to goodwill impairment testing. The objective of the accounting standard update is to simplify how entities test goodwill for impairment by permitting an assessment of qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. This update also allows entities an unconditional option to bypass this qualitative assessment and proceed directly to performing the first step of the goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. This accounting standard update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning on or after December 15, 2011, with early adoption permitted. The adoption of this standard is not expected to have a significant impact on the Company's consolidated financial statements and goodwill impairment testing.

In June 2011, the FASB issued changes to the presentation of comprehensive income that require entities to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The option to present components of other comprehensive income as part of the statement of changes in stockholders' equity is no longer permitted. This guidance, with retrospective application, was adopted by the Company in the first quarter of fiscal year 2013. Other than the change in presentation, these changes have had no impact on the consolidated financial statements and the calculation and presentation of earnings per share.

**Note 3. Acquisitions**

***M Cubed Technologies, Inc.***

On November 1, 2012, the Company acquired all of the outstanding shares of M Cubed Technologies, Inc. ( M Cubed ), a privately-held company based in Connecticut with manufacturing locations in Monroe and Newtown, Connecticut, and Newark, Delaware. The total consideration consisted of cash of \$68.2 million, net of cash acquired of \$5.7 million. M Cubed develops advanced ceramic materials and precision motion control products addressing the semiconductor, display, industrial and defense markets. As a result of the acquisition, the Company will diversify its engineered materials product portfolio in the reaction bonded silicon carbide ceramics and metal matrix composite markets while realizing synergies in engineered materials growth and processes. Due to the timing of the

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acquisition, the Company is still in the process of completing its fair market valuation, including the valuation of certain tangible, and intangible assets as well as deferred income taxes. The following table presents the preliminary allocation of the purchase price of the assets acquired and liabilities assumed at the date of acquisition, as the Company intends to finalize its accounting for the acquisition of M Cubed during fiscal year 2013 (\$000):

<b>Assets</b>	
Accounts receivable, net	\$ 7,424
Inventories	4,811
Prepaid and other assets	518
Deferred income taxes	21,089
Property, plant & equipment	19,884
Intangible assets	11,078
Goodwill	18,132
<b>Total assets acquired</b>	<b>\$ 82,936</b>
<b>Liabilities</b>	
Accounts payable	\$ 2,807
Deferred income taxes	11,100
Other accrued liabilities	864
<b>Total liabilities assumed</b>	<b>\$ 14,771</b>
<b>Net assets acquired</b>	<b>\$ 68,165</b>

The goodwill of M Cubed of \$18.1 million is included in the Advanced Products Group segment and is attributed to the expected synergies and the assembled workforce of M Cubed. None of the goodwill is deductible for income tax purposes. The fair value of accounts receivable acquired was \$7.4 million with the gross contractual amount being \$7.5 million. At the time of acquisition, the Company expected \$0.1 million of accounts receivable to be uncollectible. The majority of the deferred tax assets of M Cubed are related to net operating loss carryforwards. The Company has considered any carryforward limitations and expirations and expects to fully utilize these carryforwards to offset future income taxes.

The amount of revenues of M Cubed included in the Company's Condensed Consolidated Statement of Earnings for the three and six months ended December 31, 2012 was \$7.3 million. The amount of earnings of M Cubed included in the Company's Condensed Consolidated Statements of Earnings for the three and six months ended December 31, 2012 were not material.

***Thin Film Filter Business and Interleaver Product Line***

On December 3, 2012, the Company purchased the thin film filter and interleaver product line of Oclaro, Inc. ( Oclaro ) for \$27.4 million in cash. These businesses design and manufacture thin film filter optical chips and products for optical communications, life sciences, and industrial applications and will report within the Company's Photop Technologies, Inc. ( Photop ) business unit as part of the Company's Near-Infrared Optics operating segment for financial reporting purposes. Due to the timing of the acquisition, the Company is still in the process of completing its fair market valuation, including the valuation of certain tangible and intangible assets. The following table presents the preliminary allocation of the purchase price of the assets acquired at the date of acquisition, as the Company intends to finalize its accounting for this acquisition during fiscal year 2013 (\$000):

<b>Assets</b>	
Inventories	\$ 1,085

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Prepaid and other assets	129
Property, plant & equipment	10,400
Intangible assets	7,882
Goodwill	7,951
<b>Total assets acquired</b>	<b>\$ 27,447</b>

The goodwill of \$8.0 million is included in the Near-Infrared Optics segment and is attributed to the expected synergies and the assembled workforce of the business and is fully deductible for income tax purposes.

The amount of revenues and earnings of these businesses included in the Company's Condensed Consolidated Statement of Earnings for the three and six months ended December 31, 2012 were not material.

**Table of Contents*****LightWorks Optics, Inc.***

On December 21, 2012, the Company purchased all of the outstanding shares of LightWorks Optics, Inc. ( *LightWorks* ), a privately held company based in Tustin, California with manufacturing locations in both Tustin and Vista, California. Under the terms of the merger agreement, the initial consideration consisted of cash paid at acquisition date of \$30.8 million and other closing adjustments of \$0.7 million, which are expected to be paid by March 31, 2013. In addition, the agreement provided up to a maximum of \$4.2 million of additional cash earnout arrangement based upon LightWorks achieving certain agreed upon financial targets for revenues and customer orders in calendar year 2013, which if earned, would be payable in March 2014. The final purchase price is subject to customary closing adjustments, including working capital adjustments. LightWorks manufactures precision optical systems and components, including visible, infrared, and laser-based systems and subassemblies addressing the defense, aerospace, industrial and life science markets. LightWorks will work cooperatively with the Company's Exotic Electro-Optics ( *EEO* ) business unit to broaden and expand current product offerings in the defense and aerospace markets while strengthening customer relationships through complementary technology and product development. Due to the timing of the acquisition, the Company is still in the process of completing its fair market valuation, including the valuation of certain tangible and intangible assets, as well as the earnout arrangement. The following table presents the preliminary allocation of the purchase price of the assets acquired and liabilities assumed at the date of acquisition, as the Company intends to finalize its accounting for the acquisition of LightWorks during fiscal year 2013 (\$000):

<b>Assets</b>	
Accounts receivable, net	\$ 2,412
Inventories	463
Prepaid and other assets	270
Property, plant & equipment	3,453
Intangible assets	15,351
Goodwill	15,894
Total assets acquired	\$ 37,843
<b>Liabilities</b>	
Accounts payable	\$ 692
Other accrued liabilities	1,451
Total liabilities assumed	\$ 2,143
Net assets acquired	\$ 35,700

The goodwill of LightWorks of \$15.9 million is included in the Military & Materials segment and is attributed to the expected synergies and the assembled workforce of LightWorks. All goodwill acquired is deductible for income tax purposes. The gross contractual amount and fair value of accounts receivable acquired was \$2.4 million as the Company believes the entire amount to be fully collectible.

In conjunction with the acquisitions of M Cubed, the Oclaro business and interleaver product line and LightWorks, the Company expensed transaction costs of approximately \$0.9 million and \$1.2 million, respectively, during the three and six months ended December 31, 2012, which are recorded in selling, general and administrative expenses in the Condensed Consolidated Statements of Earnings.

***Pro Forma Information***

The following unaudited pro forma consolidated results of operations for fiscal year 2013 have been prepared as if the acquisitions of M Cubed, the Oclaro business and interleaver product line and LightWorks had occurred on July 1, 2011, the beginning of the Company's fiscal year 2012, which is the fiscal year prior to acquisition (\$000 except per share data).



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	Three Months Ended December 31,		Six Months Ended December 31,	
	2012	2011	2012	2011
Net revenues	\$ 139,172	\$ 145,191	\$ 296,746	\$ 301,897
Net earnings attributable to II-VI Incorporated	13,009	13,845	30,179	31,439
Basic earnings per share	0.21	0.22	0.48	0.50
Diluted earnings per share	0.20	0.22	0.47	0.49

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The pro forma results are not necessarily indicative of what actually would have occurred if the transactions had occurred on July 1, 2011, and are not intended to be a projection of future results and do not reflect any cost savings that might be achieved from the combined operations.

**Note 4. Investment**

The Company has an equity investment in Guangdong Fuxin Electronic Technology ( Fuxin ) based in Guangdong Province, China of 20.2%, which is accounted for under the equity method of accounting. The total carrying value of this investment recorded at December 31, 2012 and June 30, 2012 was \$11.3 million and \$10.7 million, respectively. During the three and six months ended December 31, 2012, the Company's pro-rata share of earnings from this investment was \$0.2 million and \$0.6 million, respectively, and was \$0.3 million and \$0.7 million, respectively, for the three and six months ended December 31, 2011 and were recorded in other expense (income), net in the Condensed Consolidated Statements of Earnings for all periods.

**Note 5. Inventories**

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

	December 31, 2012	June 30, 2012
Raw materials	\$ 62,551	\$ 59,105
Work in progress	46,469	39,292
Finished goods	42,922	39,210
	\$ 151,942	\$ 137,607

**Note 6. Property, Plant & Equipment**

Property, plant & equipment consists of the following (\$000):

	December 31, 2012	June 30, 2012
Land and land improvements	\$ 2,236	\$ 2,236
Buildings and improvements	80,894	78,149
Machinery and equipment	273,078	228,564
Construction in progress	16,156	17,614
	372,364	326,563
Less accumulated depreciation	(188,339)	(172,645)
	\$ 184,025	\$ 153,918

**Note 7. Goodwill and Other Intangible Assets**

Changes in the carrying amount of goodwill are as follows (\$000):

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	Six Months Ended December 31, 2012				Total
	Infrared Optics	Near-Infrared Optics	Military & Materials	Advanced Products Group	
Balance beginning of period	\$ 9,612	\$ 48,496	\$ 12,326	\$ 10,314	\$ 80,748
Goodwill acquired		7,951	15,894	18,132	41,977
Foreign currency translation	147	203			350
Balance end of period	\$ 9,759	\$ 56,650	\$ 28,220	\$ 28,446	\$ 123,075

The Company reviews the recoverability of goodwill at least annually and any time business conditions indicate a potential change in recoverability. The measurement of a potential impairment begins with comparing the current fair value of the Company's reporting units to the recorded value (including goodwill). The Company uses a discounted cash flow model ( DCF model ) and a market analysis to determine the current fair value of its reporting units. A number of significant assumptions and estimates are involved in estimating the forecasted cash flows used in the DCF model, including markets and market shares, sales volume and pricing, costs to produce, working capital changes and income tax rates. Management considers historical experience and all available information at

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the time the fair values of the reporting units are estimated. However, actual fair values that could be realized could differ from those used to evaluate the impairment of goodwill.

The gross carrying amount and accumulated amortization of the Company's intangible assets other than goodwill as of December 31, 2012 and June 30, 2012 were as follows (\$000):

	December 31, 2012			June 30, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Patents	\$ 38,202	\$ (8,631)	\$ 29,571	\$ 21,856	\$ (7,640)	\$ 14,216
Trademarks	15,005	(926)	14,079	13,166	(888)	12,278
Customer Lists	42,187	(9,743)	32,444	25,816	(8,296)	17,520
Other	1,380	(1,380)		1,375	(1,375)	
<b>Total</b>	<b>\$ 96,774</b>	<b>\$ (20,680)</b>	<b>\$ 76,094</b>	<b>\$ 62,213</b>	<b>\$ (18,199)</b>	<b>\$ 44,014</b>

As a result of the preliminary valuations, the Company recorded approximately \$34.3 million of identifiable intangible assets in connection with the acquisitions of M Cubed, the Oclaro business and interleaver product line and LightWorks. These identifiable intangible assets included patents, customer lists and trademarks of \$16.3 million, \$16.2 million and \$1.8 million, respectively. The Company intends to finalize its identifiable intangible asset valuations for these acquisitions during fiscal year 2013.

Amortization expense recorded on all intangible assets was \$1.3 million and \$2.4 million, respectively, for the three and six months ended December 31, 2012 and was \$1.0 million and \$2.0 million for the three and six months ended December 31, 2011, respectively. Patents are being amortized over a range of 60 to 240 months with a weighted average remaining life of approximately 142 months. Customer lists are being amortized over approximately 120 months with a weighted average remaining life of approximately 103 months. The gross carrying amount of trademarks includes \$13.2 million of all acquired trade names. These trade names have indefinite lives and are not amortized but tested annually for impairment or more frequently if a triggering event occurs. Included in the gross carrying amount and accumulated amortization of the Company's intangible assets is the effect of foreign currency translation on that portion of the intangible assets relating to the Company's German subsidiaries, Photop and Photop AOFR Pty. Ltd. ( Photop AOFR ).

At December 31, 2012, the estimated amortization expense for existing intangible assets for each of the five succeeding fiscal years is as follows (\$000):

Year Ending June 30,	
Remaining 2013	\$ 3,704
2014	6,985
2015	6,703
2016	6,636
2017	6,627

**Note 8. Debt**

In October 2012, the Company exercised the accordion feature of its \$50 million unsecured credit facility to increase the size of its credit facility from \$50 million to \$80 million. Except for the increase in size, the credit facility continued pursuant to its existing terms and conditions. The Company used a portion of its increased available credit facility to finance the acquisition of M Cubed. See Note 3. Acquisitions.

In November 2012, the Company entered into a new credit agreement. The Company's new credit facility is a \$140 million unsecured line of credit which under certain conditions may be expanded by an additional \$35 million. The revolving credit facility has an expiration date of November 2017 and has interest rates of LIBOR, as defined in the agreement, plus 0.75% to LIBOR plus 1.75% based on the Company's ratio of

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consolidated indebtedness to consolidated EBITDA; however until the date when the Company submits its compliance certificate for the period ending June 30, 2013, interest accrues at LIBOR plus 1.25%. The December 31, 2012 interest rate was 1.46% on the outstanding borrowings. Additionally, the facility is subject to certain covenants, including those relating to minimum interest coverage and maximum leverage ratios. As of December 31, 2012, the Company was in compliance with all covenants.

The Company's Yen denominated line of credit is a 500 million Yen facility that has a five-year term through June 2016 and has an interest rate equal to LIBOR, as defined in the loan agreement, plus 0.625% to 1.50%. Additionally, the facility is subject to certain covenants, including those relating to minimum interest coverage and maximum leverage ratios. As of December 31, 2012, the Company was in compliance with all covenants.

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The components of debt for the periods indicated were as follows (\$000):

	December 31, 2012	June 30, 2012
Line of credit, interest at LIBOR, as defined, plus 1.25% and 0.625%, respectively	\$ 121,000	\$ 9,000
Yen denominated line of credit, interest at LIBOR, as defined, plus 0.625%	3,482	3,769
<b>Total debt</b>	<b>124,482</b>	<b>12,769</b>
Current portion of long-term debt		
<b>Long-term debt, less current portion</b>	<b>\$ 124,482</b>	<b>\$ 12,769</b>

The Company had aggregate availability of \$20.2 million and \$42.3 million under its lines of credit as of December 31, 2012 and June 30, 2012, respectively. The amounts available under the Company's lines of credit are reduced by outstanding letters of credit. As of December 31, 2012 and June 30, 2012, total outstanding letters of credit supported by the credit facilities were \$1.1 million and \$0.9 million, respectively.

The weighted average interest rate of total borrowings was 1.2% for the three and six months ended December 31, 2012 and was 1.0% for the three and six months ended December 31, 2011.

**Note 9. Income Taxes**

The Company's year-to-date effective income tax rate at December 31, 2012 and 2011 was 30.0% and 20.0%, respectively. The variations between the Company's effective tax rates and the U.S. statutory rate of 35.0% were primarily due to the consolidation of the Company's foreign operations, which are subject to income taxes at lower statutory rates. A change in the mix of pretax income from these various tax jurisdictions could have a material impact on the Company's effective tax rate. During the six months ended December 31, 2012, the Company recorded certain interim tax adjustments in accordance with current accounting standards. As a result, the Company recorded additional income tax expense of \$1.2 million during the three months ended December 31, 2012. In addition, the Company experienced a shift in earnings to higher tax jurisdictions resulting in a higher effective tax rate for the period.

U.S. GAAP clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. As of December 31, 2012 and June 30, 2012, the gross unrecognized income tax benefit was \$3.1 million and \$2.9 million, respectively. The Company has classified the uncertain tax positions as non-current income tax liabilities, as the amounts are not expected to be paid within one year. If recognized, substantially all of the gross unrecognized tax benefits at December 31, 2012 would impact the effective tax rate. The Company recognizes interest and penalties related to uncertain tax positions in the income tax provision on the Condensed Consolidated Statements of Earnings. The amount of accrued interest and penalties included in the \$3.1 million and \$2.9 million of gross unrecognized income tax benefit at December 31, 2012 and June 30, 2012 was immaterial. Fiscal years 2010 to 2012 remain open to examination by the United States Internal Revenue Service, fiscal years 2008 to 2012 remain open to examination by certain state jurisdictions, and fiscal years 2005 to 2012 remain open to examination by certain foreign taxing jurisdictions.

**Note 10. Earnings Per Share**

The following table sets forth the computation of earnings per share attributable to II-VI Incorporated for the periods indicated. Weighted average shares issuable upon the exercise of stock options and the release of performance and restricted shares that were not included in the calculation were approximately 450,000 and 433,000, respectively, for the three and six months ended December 31, 2012 and 147,000 and 209,000, respectively, for the three and six months ended December 31, 2011, because they were anti-dilutive (\$000 except per share data):

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	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2012	2011	2012	2011
Net earnings attributable to II-VI Incorporated	\$ 12,200	\$ 13,287	\$ 24,918	\$ 31,866
Divided by:				
Weighted average shares	62,580	62,720	62,683	62,709
Basic earnings attributable to II-VI Incorporated per common share	\$ 0.19	\$ 0.21	\$ 0.40	\$ 0.51
Net earnings attributable to II-VI Incorporated	\$ 12,200	\$ 13,287	\$ 24,918	\$ 31,866
Divided by:				
Weighted average shares	62,580	62,720	62,683	62,709
Dilutive effect of common stock equivalents	1,442	1,474	1,427	1,457
Diluted weighted average common shares	64,022	64,194	64,110	64,166
Diluted earnings attributable to II-VI Incorporated per common share	\$ 0.19	\$ 0.21	\$ 0.39	\$ 0.50

**Note 11. Segment Reporting**

The Company reports its business segments using the management approach model for segment reporting. The Company determines its reportable business segments based on the way the chief operating decision maker organizes business segments within the Company for making operating decisions and assessing performance.

Effective July 1, 2012, the Company's VLOC business unit has been included in the Military & Materials operating segment for financial reporting purposes in accordance with how the Company's chief operating decision maker receives and reviews financial information. Prior to July 1, 2012, VLOC was included in the Near-Infrared Optics operating segment. The Company has revised the consolidated segment information for all periods presented in this Quarterly Report on Form 10-Q to reflect this reclassification.

The Company has four reportable segments. The Company's chief operating decision maker receives and reviews financial information in this format. The Company evaluates business segment performance based upon reported business segment earnings, which is defined as earnings before income taxes, interest and other income or expense. The segments are managed separately due to the production requirements and facilities that are unique to each segment. The Company had the following reportable segments at December 31, 2012: (i) Infrared Optics, which consists of the Company's infrared optics and material products businesses, HIGHYAG Lasertechnologie GmbH (HIGHYAG) and certain remaining corporate activities, primarily corporate assets and capital expenditures; (ii) Near-Infrared Optics, which consists of Photop, Photop Aegis, Inc. (Photop Aegis) and Photop AOFR; (iii) Military & Materials, which consists of the Company's EEO business unit, VLOC, Max Levy Autograph (MLA), LightWorks and Pacific Rare Speciality Metals & Chemicals, Inc. (PRM); and (iv) Advanced Products Group, which consists of Marlow Industries, Inc. (Marlow), M Cubed, the Wide Bandgap Materials Group (WBG) and the Worldwide Materials Group (WMG); which is responsible for the corporate research and development activities.

The Infrared Optics segment is divided into geographic locations in the U.S., Singapore, China, Germany, Switzerland, Japan, Belgium, the U.K. and Italy. The Infrared Optics segment is directed by a general manager, while each geographic location is also directed by a general manager, and is further divided into production and administrative units that are directed by managers. The Infrared Optics segment designs, manufactures and markets optical and electro-optical components and materials sold under the II-VI brand name and used primarily in high-power CO<sub>2</sub> lasers. The Infrared Optics segment also manufactures fiber-delivered beam delivery systems and processing tools for industrial lasers sold under the HIGHYAG brand name.

The Near-Infrared Optics segment is located in the U.S., China, Vietnam, Australia, Germany, Japan, the U.K., Italy and Hong Kong. The Near-Infrared Optics segment is directed by a Corporate Executive Vice President and is further divided into production and administrative units that are directed by managers. The Near-Infrared Optics segment manufactures crystal materials, optics, microchip lasers and opto-electronic modules for use in optical communication networks and other diverse consumer and commercial applications sold under the Photop brand name, and manufactures tunable optical devices and couplers and combiners required for high speed optical networks sold under the Photop Aegis and Photop AOFR brand names, respectively.

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The Military & Materials segment is located in the U.S. and the Philippines. The Military & Materials segment is directed by a Corporate Vice President, while each geographic location is directed by a general manager. The Military & Materials segment is further divided into production and administrative units that are directed by managers. The Military & Materials segment designs, manufactures and markets infrared, near infrared and UV Filter products, as well as micro-fine conductive mesh patterns for military applications under the EEO, LightWorks, MLA and VLOC brand names. This segment also refines specialty metals and rare earth elements, primarily selenium and tellurium, under the PRM brand name.



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The Advanced Products Group is located in the U.S., Vietnam, Japan, China and Germany and is directed by a Corporate Executive Vice President. In the Advanced Products Group segment, Marlow designs and manufactures thermoelectric cooling and power generation solutions for use in defense and space, optical communications, medical, consumer and industrial markets. M Cubed develops advanced ceramic materials and precision motion control products addressing the semiconductor, display, industrial and defense markets. WBG manufactures and markets single crystal silicon carbide substrates for use in solid-state lighting, wireless infrastructure, radio frequency ( RF ) electronics and power switching industries. WMG directs the corporate research and development initiatives.

The accounting policies of the segments are the same as those of the Company. All of the Company's corporate expenses are allocated to the segments. The Company evaluates segment performance based upon reported segment earnings, which is defined as earnings before income taxes, interest and other income or expense. Inter-segment sales and transfers have been eliminated.

On November 1, 2012, the Company completed its acquisition of M Cubed. On December 3, 2012 the Company completed its acquisition of the Oclaro business and interleaver product line. On December 21, 2012, the Company completed its acquisition of LightWorks. See Note 3. Acquisitions. The operating results of these acquisitions have been reflected in the selected segment financial information of the Company's operating segments since the respective dates of acquisition.

The following tables summarize selected financial information of the Company's operations by segment:

	Three Months Ended December 31, 2012					Total
	Infrared Optics	Near-Infrared Optics	Military & Materials	Advanced Products Group	Eliminations	
Revenues	\$ 45,410	\$ 36,996	\$ 21,360	\$ 22,123	\$	\$ 125,889
Inter-segment revenues	651	636	798	1,376	(3,461)	
Segment earnings (loss)	10,532	5,141	(1,075)	337		14,935
Interest expense						223
Other income, net						(4,551)
Income taxes						6,796
Net earnings						12,467
Depreciation and amortization	2,168	4,385	1,587	2,022		10,162
Segment assets	207,715	309,342	143,319	186,484		846,860
Expenditures for property, plant and equipment	1,448	2,558	676	2,566		7,248
Investment				11,254		11,254
Goodwill	9,759	56,650	28,220	28,446		123,075

	Three Months Ended December 31, 2011					Total
	Infrared Optics	Near-Infrared Optics	Military & Materials	Advanced Products Group	Eliminations	
Revenues	\$ 46,762	\$ 32,525	\$ 30,646	\$ 16,824	\$	\$ 126,757
Inter-segment revenues	1,046	653	2,976	1,133	(5,808)	
Segment earnings (loss)	11,470	2,386	(1,088)	1,470		14,238
Interest expense						77
Other income, net						(1,506)
Income taxes						2,147
Net earnings						13,520
Depreciation and amortization	2,139	4,349	991	1,043		8,522
Segment assets	206,543	244,958	123,490	103,506		678,497
Expenditures for property, plant and equipment	2,127	1,997	3,118	3,114		10,356
Investments				15,938		15,938
Goodwill	9,696	52,449	12,326	10,314		84,785

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	Six Months Ended December 31, 2012					Total
	Infrared Optics	Near-Infrared Optics	Military & Materials	Advanced Products Group	Eliminations	
Revenues	\$ 96,966	\$ 77,642	\$ 45,295	\$ 38,278	\$	\$ 258,181
Inter-segment revenues	1,151	968	2,338	2,560	(7,017)	
Segment earnings (loss)	22,374	12,863	(3,223)	(485)		31,529
Interest expense						259
Other income, net						(5,312)
Income taxes						10,983
Net earnings						25,599
Depreciation and amortization	4,232	8,672	3,074	3,256		19,234
Expenditures for property, plant and equipment	2,588	4,203	2,006	4,380		13,177

	Six Months Ended December 31, 2011					Total
	Infrared Optics	Near-Infrared Optics	Military & Materials	Advanced Products Group	Eliminations	
Revenues	\$ 97,558	\$ 63,514	\$ 61,426	\$ 42,632	\$	\$ 265,130
Inter-segment revenues	1,704	1,195	4,911	1,917	(9,727)	
Segment earnings	23,827	4,946	1,022	7,478		37,273
Interest expense						136
Other income, net						(3,316)
Income taxes						8,039
Net earnings						32,234
Depreciation and amortization	4,334	7,412	3,106	1,980		16,832
Expenditures for property, plant and equipment	3,827	6,213	6,630	6,398		23,068

**Note 12. Share-Based Compensation**

The Board of Directors adopted the II-VI Incorporated 2012 Omnibus Incentive Plan (the "Plan") which was approved by the shareholders of the Company at the Company's Annual Meeting in November 2012. The Plan provides for the grant of non-qualified stock options, stock appreciation rights, restricted shares, restricted share units, deferred shares, performance shares and performance share units to employees, officers, directors and consultants of the Company. The Company records share-based compensation expense for these awards in accordance with U.S. GAAP, which requires the recognition of the fair value of share-based compensation in net earnings. The Company recognizes the share-based compensation expense over the requisite service period of the individual grantees, which generally equals the vesting period.

Share-based compensation expense for the three and six months ended December 31, 2012 and 2011 is as follows (\$000):

	Three Months Ended	Three Months Ended	Six Months Ended	Six Months Ended
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
Stock Options and Stock Appreciation Rights	\$ 1,175	\$ 1,092	\$ 2,764	\$ 4,028
Restricted Share Awards and Restricted Share Unit Awards	1,035	717	2,096	1,486
Performance Share Awards and Performance Share Unit Awards	1,051	806	2,027	1,658
	\$ 3,261	\$ 2,615	\$ 6,887	\$ 7,172

The share-based compensation expense is allocated approximately 20% to cost of goods sold and 80% to selling, general and administrative expense in the Condensed Consolidated Statements of Earnings, based on the employee classification of the grantees.



**Table of Contents*****Stock Options and Stock Appreciation Rights:***

The Company utilizes the Black-Scholes valuation model for estimating the fair value of these awards. The weighted-average fair values of awards granted under the Plan were \$8.19 and \$8.45 per award, respectively, during the three and six months ended December 31, 2012, and \$8.33 and \$9.33 per award, respectively, during the three and six months ended December 31, 2011, using the following assumptions:

	Three Months Ended December 31, 2012	Three Months Ended December 31, 2011	Six Months Ended December 31, 2012	Six Months Ended December 31, 2011
Risk free interest rate	0.95%	0.78%	0.94%	1.06%
Expected volatility	48%	49%	49%	59%
Expected life of options	6.0 years	4.5 years	5.7 years	5.5 years
Dividend yield	None	None	None	None

The risk-free interest rate is derived from the average U.S. Treasury Note rate during the period, which approximates the rate in effect at the time of grant related to the expected life of the awards. The risk free interest rate shown above is the weighted average rate for all awards granted during the fiscal year. Expected volatility is based on the historical volatility of the Company's Common Stock over the period commensurate with the expected life of the awards. The expected life calculation is based on the observed time to post-vesting exercise and/or forfeitures of awards by our employees. The dividend yield of zero is based on the fact that the Company has never paid cash dividends and currently has no intention to pay cash dividends in the future. The estimated annualized forfeitures are based on the Company's historical experience of award cancellations pre-vesting and are estimated at a rate of 16%. The Company will record additional expense in future periods if the actual forfeiture rate is lower than estimated, and will adjust expense in future periods if the actual forfeitures are higher than estimated.

***Restricted Share Awards and Restricted Share Unit Awards:***

The restricted share awards and restricted share unit awards compensation expense was calculated based on the number of shares or units expected to be earned by the grantee multiplied by the stock price at the date of grant and is being recognized over the vesting period. Generally, the restricted share awards and restricted share unit awards have a three year cliff-vesting provision and an estimated forfeiture rate of 7.5%.

***Performance Share Awards and Performance Share Unit Awards:***

The Compensation Committee of the Board of Directors of the Company has granted certain named executive officers and employees performance share awards and performance share unit awards under the Plan. As of December 31, 2012, the Company had outstanding grants covering performance periods ranging from 24 to 48 months. These awards are intended to provide continuing emphasis on specified financial performance goals that the Company considers important contributors to long-term shareholder value. These awards are payable only if the Company achieves specified levels of financial performance during the performance periods.

The performance share awards and performance share unit awards compensation expense is calculated based on the estimated number of shares or units expected to be earned multiplied by the stock price at the date of grant.

**Note 13. Fair Value of Financial Instruments**

The FASB defines fair value 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 markets for the asset and liability in an orderly transaction between market participants at the measurement date. The Company estimates fair value of its financial instruments utilizing an established three-level hierarchy in accordance with U.S. GAAP. The hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date as follows:

Level 1 Valuation is based upon unadjusted quoted prices for identical assets or liabilities in active markets.

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Level 2 Valuation is based upon quoted prices for similar assets and liabilities in active markets, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments.

Level 3 Valuation is based upon other unobservable inputs that are significant to the fair value measurements.

The classification of fair value measurements within the hierarchy is based upon the lowest level of input that is significant to the measurement. At December 31, 2012, the Company had foreign currency forward contracts recorded at fair value. The fair values of these instruments were measured using valuations based upon quoted prices for similar assets and liabilities in active markets (Level 2) and are valued by reference to similar financial instruments, adjusted for credit risk and restrictions and other terms specific to the contracts. At December 31, 2012, the Company had a contingent earnout arrangement related to the December 2012 acquisition of LightWorks recorded at a preliminary fair value. Due to the timing of the acquisition, the Company is still in the process of completing its fair market valuation, including the valuation of certain tangible and intangible assets, as well as the earnout

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arrangement. The Company intends to finalize its accounting for the acquisition of LightWorks during fiscal year 2013. The fair value of the earnout arrangement was based on significant inputs not observable in the market and represents a Level 3 measurement as defined in ASC 820. The Company uses the income approach in measuring the fair value of the earnout arrangement, which assumed 100% probability and no discount as the earnout period ends on December 31, 2013. There were no fair value remeasurements recorded on the earnout arrangement for the three and six months ended December 31, 2012 and 2011. The following table provides a summary by level of the fair value of financial instruments that are measured on a recurring basis as of December 31, 2012 (\$000):

	Fair Value Measurements at December 31, 2012 Using:			
	December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Foreign currency forward contracts	\$ 240	\$	\$ 240	\$
<b>Liabilities:</b>				
Contingent earnout arrangement	\$ 4,200	\$	\$	\$ 4,200

	Fair Value Measurements at June 30, 2012 Using:			
	June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Liabilities:</b>				
Foreign currency forward contracts	\$ 174	\$	\$ 174	\$

The Company's policy is to report transfers into and out of Levels 1 and 2 of the fair value hierarchy at fair values as of the beginning of the period in which the transfers occur. There were no transfers in and out of Levels 1 and 2 of the fair value hierarchy during the three and six months ended December 31, 2012.

The following table presents a reconciliation of the beginning and ending fair value measurements of the Company's Level 3 contingent earnout arrangement related to the acquisition of LightWorks:

Balance beginning of period	\$
Earnout arrangement	4,200
Changes in fair value	
Balance end of period	\$ 4,200

**Table of Contents****Note 14. Commitments and Contingencies**

The Company records a warranty reserve as a charge against earnings based on a percentage of sales utilizing actual returns over the last twelve months. The following table summarizes the change in the carrying value of the Company's warranty reserve, which is a component of Other accrued liabilities in the Company's Condensed Consolidated Balance Sheets, as of December 31, 2012 (\$000):

	Six Months Ended December 31, 2012
Balance beginning of period	\$ 1,247
Payments made during the period	(562)
Additional warranty liability recorded during the period	541
Balance end of period	\$ 1,226

**Note 15. Share Repurchase Program**

In May 2012, the Board of Directors authorized the Company to purchase up to \$25 million of its Common Stock. The repurchase program called for shares to be purchased in the open market or in private transactions from time to time. Shares purchased by the Company are retained as treasury stock and available for general corporate purposes. During the six months ended December 31, 2012, the Company purchased 617,000 shares of its common stock pursuant to the share repurchase program for approximately \$10.8 million. As of December 31, 2012, the Company had purchased a total of 919,000 shares of its common stock for approximately \$15.9 million under this share repurchase program.

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**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**  
***Forward-Looking Statements***

This Management's Discussion and Analysis contains forward-looking statements as defined by Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding projected growth rates, markets, product development, financial position, capital expenditures and foreign currency exposure. Forward-looking statements are also identified by words such as expects, anticipates, intends, plans, projects similar expressions.

Actual results could materially differ from such statements due to the following factors: materially adverse changes in economic or industry conditions generally (including capital markets) or in the markets served by the Company, the development and use of new technology and the actions of competitors. There are additional risk factors that could affect the Company's business, results of operations or financial condition. Investors are encouraged to review the risk factors set forth in the Company's most recent Annual Report as filed with the Securities and Exchange Commission on August 28, 2012, and set forth herein.

***Introduction***

II-VI Incorporated (II-VI, the Company, we, us or our), the worldwide leader in engineered materials and opto-electronic components, is a vertically-integrated manufacturing company that creates and markets products for diversified markets including industrial manufacturing, military and aerospace, high-power electronics, optical communications, medical and thermoelectronics applications.

The Company generates revenues, earnings and cash flows from developing, manufacturing and marketing engineered materials and opto-electronic components for precision use in industrial, military, optical communications, photovoltaic, medical, semiconductor and consumer applications. We also generate revenue, earnings and cash flows from government-funded research and development contracts relating to the development and manufacture of new technologies, materials and products.

Our customer base includes original equipment manufacturers (OEMs), laser end users, system integrators of high-power lasers, manufacturers of equipment and devices for industrial, optical communications, security and monitoring applications, U.S. government prime contractors, various U.S. government agencies and thermoelectric solutions suppliers.

Effective July 1, 2012, the Company changed its reportable segments in accordance with how the Company's chief operating decision maker receives and reviews financial information. Effective July 1, 2012, VLOC has been included in the Military & Materials operating segment for financial reporting purposes. Prior to July 1, 2012, the Company's VLOC business unit was included in the Near-Infrared Optics operating segment. The Company has revised the consolidated segment information for all periods presented in this Quarterly Report on Form 10-Q to reflect this reclassification.

***Critical Accounting Estimates***

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America and the Company's discussion and analysis of its financial condition and results of operations require the Company's management to make judgments, assumptions and estimates that affect the amounts reported in its condensed consolidated financial statements and accompanying notes. Note 1 of the Notes to Consolidated Financial Statements in the Company's most recent Annual Report describes the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates.

Management believes the Company's critical accounting estimates are those related to revenue recognition, allowance for doubtful accounts, warranty reserves, inventory valuation, valuation of long-lived assets including acquired intangibles and goodwill, accrual of bonus and profit sharing estimates, accrual of income tax liability estimates and accounting for share-based payments. Management believes these estimates to be critical because they are both important to the portrayal of the Company's financial condition and results of operations, and they require management to make judgments and estimates about matters that are inherently uncertain.

The Company recognizes revenues in accordance with U.S. GAAP. Revenues for product shipments are realizable when we have persuasive evidence of a sales arrangement, the product has been shipped or delivered, the sale price is fixed or determinable and collectability is reasonably assured. Title and risk of loss passes from the Company to its customer at the time of shipment in most cases with the exception of certain customers. For these customers title does not pass and revenue is not recognized until the customer has received the product at its physical location. The Company's revenue recognition policy is consistently applied across the Company's segments, product lines and



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geographical locations. Further, we do not have post shipment obligations such as training or installation, customer acceptance provisions, credits and discounts, rebates and price protection or other similar privileges. Our distributors and agents are not granted price protection. Our distributors and agents, who comprise less than 10% of consolidated revenue, have no additional product return rights beyond the right to return defective products that are covered by our warranty policy.

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We believe our revenue recognition practices are consistent with Staff Accounting Bulletin ( SAB ) 104 and that we have adequately considered the requirements of Accounting Standards Codification ( ASC ) 605 Revenue Recognition. Revenues generated from transactions other than product shipments are contract-related and have historically accounted for less than 5% of the Company's consolidated revenues.

We establish an allowance for doubtful accounts and warranty reserves based on historical experience and believe the collection of revenues, net of these reserves, is reasonably assured. Our allowance for doubtful accounts and warranty reserve balances at December 31, 2012 were \$1.5 million and \$1.2 million, respectively. Our reserve estimates have historically been proven to be materially correct based upon actual charges incurred. The Company had one customer that represented 11% and 12%, respectively, of total accounts receivable as of December 31, 2012 and June 30, 2012.

**New Accounting Standards**

See Note 2. Recent Accounting Pronouncements, to our unaudited financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements.

**Results of Operations (millions except per-share data)**

The following tables set forth bookings and select items from our Condensed Consolidated Statements of Earnings for the three and six months ended December 31, 2012 and 2011, respectively:

	Three Months Ended December 31, 2012		Three Months Ended December 31, 2011	
Bookings	\$ 127.1		\$ 116.9	
		<b>% of Revenues</b>		<b>% of Revenues</b>
Total Revenues	\$ 125.9	100.0%	\$ 126.8	100.0%
Cost of goods sold	79.0	62.7	83.3	65.7
Gross margin	46.9	37.3	43.5	34.3
Operating Expenses:				
Internal research and development	5.6	4.4	5.0	3.9
Selling, general and administrative	26.3	20.9	24.2	19.1
Interest and other, net	(4.3)	(3.4)	(1.4)	(1.1)
Earnings before income tax	19.3	15.3	15.7	12.4
Income taxes	6.8	5.4	2.2	1.7
Net earnings	12.5	9.9	13.5	10.6
Net earnings attributable to noncontrolling interests	0.3		0.2	
Net earnings attributable to II-VI Incorporated	\$ 12.2	9.7%	\$ 13.3	10.5%
Diluted earnings per share	\$ 0.19		\$ 0.21	

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	Six Months Ended December 31, 2012		Six Months Ended December 31, 2011	
Bookings	\$ 241.5		\$ 247.1	
		<b>% of</b>		<b>% of</b>
		<b>Revenues</b>		<b>Revenues</b>
Total Revenues	\$ 258.2	100.0%	\$ 265.1	100.0%
Cost of goods sold	162.5	62.9	166.7	62.9
Gross margin	95.7	37.1	98.5	37.1
Operating Expenses:				
Internal research and development	11.2	4.3	10.2	3.8
Selling, general and administrative	53.0	20.5	51.0	19.2
Interest and other, net	(5.1)	(2.0)	(3.0)	(1.1)
Earnings before income tax	36.6	14.2	40.3	15.2
Income taxes	11.0	4.3	8.0	3.0
Net earnings	25.6	9.9	32.2	12.1
Net earnings attributable to noncontrolling interests	0.7		0.4	
Net earnings attributable to II-VI Incorporated	\$ 24.9	9.6%	\$ 31.9	12.0%
Diluted earnings per share	\$ 0.39		\$ 0.50	

**Executive Summary**

Worldwide economic uncertainty remained prevalent as further fiscal and political uneasiness in the U.S. and abroad contributed to a cautious customer base across most markets. The Company remained focused on its long-term growth initiatives, completing three acquisitions during the three months ended December 31, 2012. We believe these acquisitions will provide long-term growth prospects and the potential for broadening current product offerings while realizing synergies and providing the Company an opportunity to enter new markets. Net earnings attributable to II-VI Incorporated for the three months ended December 31, 2012 decreased to \$12.2 million (\$0.19 per-share diluted) compared to \$13.3 million (\$0.21 per-share diluted) for the same period last fiscal year. Net earnings attributable to II-VI Incorporated for the six months ended December 31, 2012 decreased to \$24.9 million (\$0.39 per-share diluted) compared to \$31.9 million (\$0.50 per-share diluted) for the same period last fiscal year. During the three and six months ended December 31, 2012, the Company realized higher revenues and gross margins at Photop and Photop Aegis as well as income of \$5.2 million from a contractual settlement with a former contract manufacturer related to the October 2011 flooding in Thailand. These favorable operating results were offset by low gross margins at PRM caused by reduced revenues and selling prices of selenium and tellurium, transaction costs incurred related to the three recently completed acquisitions as well as high worldwide tax expense related to interim tax adjustments that were recorded in accordance with current accounting standards.

**Consolidated**

**Bookings.** Bookings are defined as customer orders received that are expected to be converted to revenues over the next twelve months. For long-term customer orders, the Company does not include in bookings the portion of the customer order that is beyond twelve months, due to the inherent uncertainty of an order that far out in the future. Bookings for the three months ended December 31, 2012 increased 9% to \$127.1 million, compared to \$116.9 million for the same period last fiscal year. Excluding bookings from the current quarter acquisitions, the increase in overall bookings during the three months ended December 31, 2012 compared to the same period last fiscal year was mostly the result of increased demand for Photop products as well as higher order volume within the core Infrared Optics business, particularly in North America. These increases were somewhat offset by reduced bookings at PRM caused by lower pricing and order volumes of selenium and tellurium, a \$2.2 million order cancellation at WBG from a customer who ceased operations and reduced demand at HIGHYAG. Bookings for the six months ended December 31, 2012 decreased 2% to \$241.5 million, compared to \$247.1 million for the same period last fiscal year. Excluding bookings from the current quarter acquisitions, the decrease in overall bookings was mostly attributable to PRM and VLOC within the Company's Military & Materials operating segment as well as reduced orders at Marlow and WBG within the Company's Advanced Products

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operating segment. PRM experienced lower bookings as a result of reduced orders and pricing for selenium and tellurium while bookings at VLOC were unfavorably impacted by reduced demand for military products, mostly as a result of the federal budget uncertainty and potential sequestration. Within the Advanced Products Group segment, the previously referenced order cancellation at WBG as well as reduced end user demand for Marlow's gesture recognition product line put additional downward pressure on bookings. These

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decreases were offset somewhat by booking increases at Photop for its green laser device products within the Company's Near-Infrared Optics segment.

**Revenues.** Revenues for the three months ended December 31, 2012 decreased 1% to \$125.9 million, compared to \$126.8 million for the same period last fiscal year. Revenues for the six months ended December 31, 2012 decreased 3% to \$258.2 million, compared to \$265.1 million for the same period last fiscal year. Excluding revenues from the recently completed acquisitions, the decrease in revenues for the three and six months ended December 31, 2012 compared to the same periods last fiscal year was attributable to PRM and VLOC within the Military & Materials segment and Marlow within the Advanced Products Group segment. These decreases in revenue were somewhat offset by higher revenue at Photop and Photop Aegis within the Near-Infrared Optics segment. PRM revenue decreased as a result of lower shipment volumes and selling prices to customers for both selenium and tellurium while revenue at VLOC decreased as a result of lower product demand for military applications. Marlow experienced lower shipment volume of gesture recognition product as a result of decreased demand, while higher revenue levels at Photop and Photop Aegis were the result of increased sales volumes related to their optical communication product portfolios.

**Gross margin.** Gross margin for the three months ended December 31, 2012 was \$46.9 million or 37.3% of total revenues, compared to \$43.5 million or 34.3% of total revenues, for the same period last fiscal year. The increase in gross margin was mostly attributable to Photop and Photop Aegis, which realized higher margins from increased revenues and a larger concentration of high-margin optical communication products. In addition, Photop and Photop Aegis benefited from increased operating efficiency which allowed the businesses to realize favorable absorption of manufacturing overhead costs when compared to the prior year period, which was severely impacted by the October 2011 Thailand flood. Furthermore, Photop Aegis realized a favorable cost of sales adjustment of \$0.8 million related to proceeds received from the contractual settlement with its former contract manufacturer relating to the October 2011 Thailand flood, specifically, recovery of previously impaired equipment and inventory that was damaged during the flood. Somewhat offsetting the favorable margin at Photop and Photop Aegis were lower gross margins within the Company's Infrared Optics segment, which was impacted by higher input prices of raw materials used in production. In addition, the Company's Marlow business unit realized lower gross margins as a result of declining sales of its gesture recognition product line which had historically yielded a high gross margin. Gross margin for the six months ended December 31, 2012 was \$95.7 million or 37.1% of total revenues, compared to \$98.5 million or 37.1% of total revenues, for the same period last fiscal year.

**Internal research and development.** Company-funded internal research and development expenses for the three months ended December 31, 2012 were \$5.6 million or 4.4% of revenues, compared to \$5.0 million or 3.9% of revenues, for the same period last fiscal year. Company-funded internal research and development expenses for the six months ended December 31, 2012 were \$11.2 million, or 4.3% of revenues, compared to \$10.2 million, or 3.8% of revenues, for the same period last fiscal year. This increase in Company-funded internal research and development expenses was primarily the result of ongoing research and development investment at Photop and Photop Aegis within the Near-Infrared Optics segment. Photop is focusing research and development efforts on high-end components and module products to satisfy future high-speed network requirements. Photop Aegis continues to invest in new product development of high performance flexible bandwidth optical channel monitors and high-power fiber laser couplers and combiners. In addition, the acquisition of M Cubed contributed to the increase in internal research and development expense for the three and six months ended December 31, 2012.

**Selling, general and administrative.** Selling, general and administrative expenses for the three months ended December 31, 2012 were \$26.3 million or 20.9% of revenues, compared to \$24.2 million or 19.1% of revenues, for the same period last fiscal year. Selling, general and administrative expenses for the six months ended December 31, 2012 were \$53.0 million or 20.5% of revenues, compared to \$51.0 million or 19.2% of revenues, for the same period last fiscal year. Selling, general and administrative expense as a percentage of revenues increased during the three and six months ended December 31, 2012 compared to the same periods last fiscal year, mostly as a result of pre-tax transaction expenses of \$0.8 million and \$1.1 million, respectively, incurred related to the three acquisitions that were completed during the quarter ended December 31, 2012.

**Interest and other, net.** Interest and other, net for the three and six months ended December 31, 2012 was income of \$4.3 million and \$5.1 million, respectively. Included in interest and other, net for the three and six months ended December 31, 2012 are earnings from the Company's equity investment in Fuxin, interest income on excess cash reserves, gains on the deferred compensation plan and net foreign currency losses. As these items were mostly offsetting, the majority of interest and other, net for the three and six months ended December 31, 2012 was the result of \$4.4 million of other income related to the contractual settlement related to the Thailand flooding that occurred in October 2011. Interest and other, net for the three and six months ended December 31, 2011 was income of \$1.4 million and \$3.0 million, respectively. The majority of interest and other, net for the three months ended December 31, 2011 was the result of foreign currency gains of approximately \$0.9 million. The majority of interest and other, net for the six months ended December 31, 2011 was the result of foreign currency gains of approximately \$0.6 million as well as a \$1.4 million gain related to the sale of precious metals inventory used in the production process. In addition, the Company benefited from earnings of equity investments, gains on the deferred compensation plan and interest income on excess cash reserves during the three and six months ended December 31, 2011.

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**Income taxes.** The Company's year-to-date effective income tax rate at December 31, 2012 and 2011 was 30.0% and 20.0%, respectively. The variations between the Company's effective tax rates and the U.S. statutory rate of 35.0% were primarily due to the consolidation of the Company's foreign operations, which are subject to income taxes at lower statutory rates. A change in the mix of

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pretax income from these various tax jurisdictions could have a material impact on the Company's effective tax rate. During the six months ended December 31, 2012, the Company recorded certain interim tax adjustments in accordance with current accounting standards. As a result, the Company recorded additional income tax expense of \$1.2 million during the three months ended December 31, 2012. In addition, the Company experienced a shift in earnings to higher tax jurisdictions resulting in a higher effective tax rate for the period. During the three months ended December 31, 2011, certain of the Company's Photop subsidiaries received notification of approval of high-technology status in China. As a result, these subsidiaries benefited from a preferential tax rate of 15% which resulted in an income tax benefit of \$1.3 million, which was recorded during the three months ended December 31, 2011. In addition, the Company recorded an income tax benefit of \$0.7 million during the three months ended December 31, 2011, from the reversal of a tax liability related to an uncertain tax position as a result of the completion of an examination by the United States Internal Revenue Service.

**Segment Reporting**

Effective July 1, 2012, the Company's VL0C business unit has been included in the Military & Materials operating segment for financial reporting purposes in accordance with how the Company's chief operating decision maker receives and reviews financial information. Prior to July 1, 2012, VL0C was included in the Near-Infrared Optics operating segment. The Company has revised the consolidated segment information to reflect this reclassification for all periods presented in Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report on Form 10-Q.

Bookings, revenues and segment earnings for the Company's reportable segments are discussed below. Segment earnings differ from income from operations in that segment earnings exclude certain operational expenses included in other expense (income) net as reported. Management believes segment earnings to be a useful measure as it reflects the results of segment performance over which management has direct control and is used by management in its evaluation of segment performance. See Note 11. Segment Reporting, to our unaudited financial statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for further information on the Company's reportable segments and for the reconciliation of segment earnings to net earnings.

**Infrared Optics (millions)**

	Three Months Ended		% Increase (Decrease)	Six Months Ended		% (Decrease)
	December 31,			December 31,		
	2012	2011		2012	2011	
<b>Bookings</b>	\$ 44.6	\$ 43.8	2%	\$ 92.1	\$ 94.9	(3)%
<b>Revenues</b>	\$ 45.4	\$ 46.8	(3)%	\$ 97.0	\$ 97.6	(1)%
<b>Segment earnings</b>	\$ 10.5	\$ 11.5	(8)%	\$ 22.4	\$ 23.8	(6)%

The Company's Infrared Optics segment includes the combined operations of Infrared Optics and HIGHYAG.

Bookings for the three months ended December 31, 2012 for Infrared Optics increased 2% to \$44.6 million, compared to \$43.8 million for the same period last fiscal year. Bookings for the six months ended December 31, 2012 for Infrared Optics decreased 3% to \$92.1 million, compared to \$94.9 million for the same period last fiscal year. The relatively consistent bookings for the three and six months ended December 31, 2012 compared to the same periods last fiscal year was primarily driven by stagnant world-wide component optics demand from OEMs for new high-power CO<sub>2</sub> laser systems as well as decreased laser utilization in North America. Economic uncertainty in Japan and Europe combined with fiscal uncertainty in the U.S. resulted in a cautious customer base across industrial markets.

Revenues for the three months ended December 31, 2012 for Infrared Optics decreased 3% to \$45.4 million, compared to \$46.8 million for the same period last fiscal year. Revenues for the six months ended December 31, 2012 for Infrared Optics decreased 1% to \$97.0 million, compared to \$97.6 million for the same period last fiscal year. These decreases in revenue for the three and six months ended December 31, 2012 compared to the same periods last fiscal year were a reflection of cautious buying patterns from customers in Asia and Europe.

Segment earnings for the three months ended December 31, 2012 for Infrared Optics decreased 8% to \$10.5 million, compared to \$11.5 million for the same period last fiscal year. Segment earnings for the six months ended December 31, 2012 for Infrared Optics decreased 6% to \$22.4 million, compared to \$23.8 million for the same period last fiscal year. These decreases in segment earnings for the three and six months ended December 31, 2012 compared to the same periods last fiscal year are the result of reduced gross margins caused by higher raw material input prices, lower revenue volume and a higher level of allocated corporate expenses related to the transaction costs incurred by the Company associated with its recently completed acquisitions.





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	Three Months Ended			Six Months Ended		
	December 31, 2012	December 31, 2011	% Increase	December 31, 2012	December 31, 2011	% Increase
<b>Bookings</b>	\$ 35.7	\$ 30.0	19%	\$ 70.8	\$ 61.8	15%
<b>Revenues</b>	\$ 37.0	\$ 32.5	14%	\$ 77.6	\$ 63.5	22%
<b>Segment earnings</b>	\$ 5.1	\$ 2.4	115%	\$ 12.9	\$ 4.9	160%

The Company's Near-Infrared Optics segment includes the combined operations of Photop, Photop Aegis and Photop AOFR. The above results include the operating results of the Oclaro business and interleaver product line since the December 2012 date of acquisition for the three and six months ended December 31, 2012.

Bookings for the three months ended December 31, 2012 for Near-Infrared Optics increased 19% to \$35.7 million, compared to \$30.0 million for the same period last fiscal year. Bookings for the six months ended December 31, 2012 for Near-Infrared Optics increased 15% to \$70.8 million, compared to \$61.8 million for the same period last fiscal year. The increase in bookings for the three and six months ended December 31, 2012 compared to the same periods last fiscal year was primarily driven by increased demand for Photop's green laser devices.

Revenues for the three months ended December 31, 2012 for Near-Infrared Optics increased 14% to \$37.0 million, compared to \$32.5 million for the same period last fiscal year. Revenues for the six months ended December 31, 2012 for Near-Infrared Optics increased 22% to \$77.6 million, compared to \$63.5 million for the same period last fiscal year. The increase in revenues for the three and six months ended December 31, 2012 compared to the same periods last fiscal year was primarily driven by higher shipment volumes at both Photop and Photop Aegis which was pervasive across the majority of their product lines. In addition, Photop Aegis realized increased shipment volume as they were successful in re-establishing their manufacturing capabilities which were severely constrained during the prior year due to the October 2011 flooding in Thailand.

Segment earnings for the three months ended December 31, 2012 for Near-Infrared Optics increased 115% to \$5.1 million, compared to \$2.4 million for the same period last fiscal year. Segment earnings for the six months ended December 31, 2012 for Near-Infrared Optics increased 160% to \$12.9 million, compared to \$4.9 million for the same period last fiscal year. The increase in segment earnings for the three and six months ended December 31, 2012 compared to the same periods last fiscal year was driven by higher sales volumes at both Photop and Photop Aegis as well as production and operational efficiencies realized in recovering from the Thailand flood that occurred in October 2011.

*Military & Materials (millions)*

	Three Months Ended			Six Months Ended		
	December 31, 2012	December 31, 2011	% Increase (Decrease)	December 31, 2012	December 31, 2011	% (Decrease)
<b>Bookings</b>	\$ 27.5	\$ 31.5	(13)%	\$ 45.2	\$ 57.9	(22)%
<b>Revenues</b>	\$ 21.4	\$ 30.6	(30)%	\$ 45.3	\$ 61.4	(26)%
<b>Segment earnings (loss)</b>	\$ (1.1)	\$ (1.1)	1%	\$ (3.2)	\$ 1.0	(415)%

The Company's Military & Materials segment includes the combined operations of EEO, PRM, VLOC, MLA and LightWorks. LightWorks was acquired near the end of the quarter ended December 31, 2012 and had no contribution to the segment's operating results during the three and six months ended December 31, 2012.

Bookings for the three months ended December 31, 2012 for Military & Materials decreased 13% to \$27.5 million, compared to \$31.5 million for the same period last fiscal year. The decrease in bookings for the three months ended December 31, 2012 compared to the same period last fiscal year was primarily driven by reduced orders for selenium and tellurium at PRM as well as lower index pricing of these materials. Bookings for the six months ended December 31, 2012 for Military & Materials decreased 22% to \$45.2 million, compared to \$57.9 million for the same period last fiscal year. The decrease in bookings for the six months ended December 31, 2012 compared to the same period last fiscal year is attributable to the aforementioned demand weakness at PRM.

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Revenues for the three months ended December 31, 2012 for Military & Materials decreased 30% to \$21.4 million, compared to \$30.6 million for the same period last fiscal year. Revenues for the six months ended December 31, 2012 for Military & Materials decreased 26% to \$45.3 million, compared to \$61.4 million for the same period last fiscal year. The decrease in revenues for the three and six months ended December 31, 2012 compared to the same periods last fiscal year was primarily due to lower product demand for both tellurium and selenium at PRM as well as lower shipments at VLOC resulting from reduced military orders.

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Segment earnings (loss) for the three months ended December 31, 2012 for Military & Materials was a segment loss of \$1.1 million, and was consistent with the same period last fiscal year. Segment earnings (loss) for the six months ended December 31, 2012 for Military & Materials was a segment loss of \$3.2 million, compared to segment earnings of \$1.0 million for the same period last fiscal year. The unfavorable change in segment earnings (loss) for the six months ended December 31, 2012 was mostly due to the reduced revenues and gross margins at PRM and VLOC. The unfavorable gross margin at PRM was negatively impacted by lower selling prices of selenium and tellurium to customers driven by lower index prices of these materials and VLOC's gross margin was negatively impacted due to unfavorable absorption of manufacturing overhead costs.

**Advanced Products Group (millions)**

	Three Months Ended		% Increase (Decrease)	Six Months Ended		% Increase (Decrease)
	December 31,			December 31,		
	2012	2011		2012	2011	
<b>Bookings</b>	\$ 19.4	\$ 11.6	67%	\$ 33.4	\$ 32.6	3%
<b>Revenues</b>	\$ 22.1	\$ 16.8	31%	\$ 38.3	\$ 42.6	(10)%
<b>Segment earnings (loss)</b>	\$ 0.3	\$ 1.5	(77)%	\$ (0.5)	\$ 7.5	(106)%

The Company's Advanced Products Group includes the combined operations of Marlow, WBG, WMG and M Cubed. The above results include the operating results of M Cubed since the November 2012 date of acquisition in the three and six months ended December 31, 2012.

Bookings for the three months ended December 31, 2012 for the Advanced Products Group increased 67% to \$19.4 million, compared to \$11.6 million for the same period last fiscal year. The increase in bookings for the three months ended December 31, 2012 compared to the same period last fiscal year was primarily due to the additional bookings of M Cubed. Bookings for the six months ended December 31, 2012 for the Advanced Products Group increased 3% to \$33.4 million, compared to \$32.6 million for the same period last fiscal year. Excluding M Cubed, bookings decreased \$6.1 million for the six month period as the Company's Marlow business unit experienced reduced orders due to a significant reduction in demand for the gesture recognition product line. Furthermore, the Company's WBG business unit was impacted by a \$2.2 million order cancellation from one of its customers who recently announced that it would cease operations.

Revenues for the three months ended December 31, 2012 for the Advanced Products Group increased 31% to \$22.1 million, compared to \$16.8 million for the same period last fiscal year. Revenues for the six months ended December 31, 2012 for the Advanced Products Group decreased 10% to \$38.3 million, compared to \$42.6 million for the same period last fiscal year. Excluding M Cubed, revenues decreased \$2.0 million and \$11.7 million, respectively, for the three and six months ended December 31, 2012, primarily due to lower shipment volumes of gesture recognition and telecommunication products at Marlow. In addition, WBG experienced lower shipments of semi-insulating silicon carbide substrates used for radio frequency applications due to reduced customer demand in the wireless infrastructure market and the defense sector.

Segment earnings for the three months ended December 31, 2012 decreased 77% to \$0.3 million, compared to segment earnings of \$1.5 million for the same period last fiscal year. Segment (loss) earnings for the six months ended December 31, 2012 decreased 106% to a segment loss of \$0.5 million, compared to segment earnings of \$7.5 million for the same period last fiscal year. The unfavorable change in segment earnings for the three and six months ended December 31, 2012 compared to the same periods last fiscal year was primarily due to the lower revenues as well as declining gross margin at Marlow resulting from unfavorable product mix as higher margin gesture recognition sales have declined.

**Liquidity and Capital Resources**

Historically, our primary source of cash has been provided through operations. Other sources of cash include proceeds received from the exercises of stock options and long-term borrowings. Our historical uses of cash have been for capital expenditures, purchases of businesses, payment of principal and interest on outstanding debt obligations and purchases of treasury stock. Supplemental information pertaining to our sources and uses of cash for the periods indicated is presented as follows:

**Table of Contents****Sources (uses) of Cash (millions):**

	<b>Six Months Ended December 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Net cash provided by operating activities</b>	\$ 61.0	\$ 42.9
<b>Net proceeds on long-term borrowings</b>	112.0	0.7
<b>Proceeds received on contractual settlement</b>	2.4	
<b>Proceeds from exercises of stock options</b>	1.6	0.5
<b>Proceeds from the collection of note receivable</b>	1.4	
<b>Purchase of business, net of cash acquired</b>	(126.4)	(46.1)
<b>Additions to property, plant and equipment</b>	(13.2)	(23.1)
<b>Purchases of treasury shares</b>	(10.8)	
<b>Other</b>	(0.1)	(0.5)

Cash provided by operating activities was \$61.0 million for the six months ended December 31, 2012, compared to cash provided by operating activities of \$42.9 million for the same period last fiscal year. The increase in cash provided by operating activities was the result of stronger working capital management, specifically in the areas of accounts receivable and inventory.

Net cash used in investing activities was \$135.7 million for the six months ended December 31, 2012, compared to net cash used of \$69.2 million for the same period last fiscal year. The majority of the change in net cash used in investing activities was the result of increased spending on current year acquisitions partially offset by reduced capital spending.

Net cash provided by financing activities for the six months ended December 31, 2012 consisted mostly of \$112.0 million of net borrowings on long-term debt offset somewhat by cash used to repurchase Company stock under the approved share repurchase program. Net cash provided by financing activities during the six months ended December 31, 2011 consisted mostly of net proceeds on long-term borrowings of \$0.7 million and proceeds from the exercise of stock options of \$0.5 million.

In October 2012, the Company exercised the accordion feature of its \$50 million unsecured credit facility to increase the size of its credit facility from \$50 million to \$80 million. Except for the increase in size, the credit facility continued pursuant to its existing terms and conditions. The Company used a portion of its increased available credit facility to finance the acquisition of M Cubed.

In November 2012, the Company entered into a new credit agreement. The Company's new credit facility is a \$140 million unsecured line of credit which under certain conditions may be expanded by an additional \$35 million. The revolving credit facility has an expiration date of November 2017 and has interest rates of LIBOR, as defined in the agreement, plus 0.75% to LIBOR plus 1.75% based on the Company's ratio of consolidated indebtedness to consolidated EBITDA; however until the date when the Company submits its compliance certificate for the period ending June 30, 2013, interest accrues at LIBOR plus 1.25%. The December 31, 2012 interest rate was 1.46% on the outstanding borrowings. Additionally, the facility is subject to certain covenants, including those relating to minimum interest coverage and maximum leverage ratios. As of December 31, 2012, the Company was in compliance with all covenants.

The Company's Yen denominated line of credit is a 500 million Yen facility that has a five-year term through June 2016 and has an interest rate equal to LIBOR, as defined in the loan agreement, plus 0.625% to 1.50%. Additionally, the facility is subject to certain covenants, including those relating to minimum interest coverage and maximum leverage ratios. As of December 31, 2012, the Company was in compliance with all covenants.

The Company had aggregate availability of \$20.2 million and \$42.3 million under its lines of credit as of December 31, 2012 and June 30, 2012, respectively. The amounts available under the Company's lines of credit are reduced by outstanding letters of credit. As of December 31, 2012 and June 30, 2012, total outstanding letters of credit supported by the credit facilities were \$1.1 million and \$0.9 million, respectively.

The weighted average interest rate of total borrowings was 1.2% for the three and six months ended December 31, 2012 and was 1.0% for the three and six months ended December 31, 2011.

The Company's cash position, borrowing capacity and debt obligations for the periods indicated were as follows (\$000's):

	December 31, 2012	June 30, 2012
<b>Cash and cash equivalents</b>	\$ 162.8	\$ 134.9
<b>Available borrowing capacity</b>	20.2	42.3
<b>Total debt obligations</b>	124.5	12.8

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The Company believes cash flow from operations, existing cash reserves and available borrowing capacity will be sufficient to fund its working capital needs, capital expenditures and internal and external growth objectives for the next twelve months. The Company's cash and cash equivalent balances are generated and held in numerous locations throughout the world, including amounts held outside the United States. As of December 31, 2012 and June 30, 2012, the Company held approximately \$119 million and \$97 million, respectively, of cash and cash equivalents outside of the United States. Cash balances held outside the United States could be repatriated to the United States, but, under current law, would potentially be subject to United States federal income taxes, less applicable foreign tax credits. The Company has not recorded deferred income taxes related to undistributed earnings outside of the United States as the earnings of the Company's foreign subsidiaries are indefinitely reinvested.

**Contractual Obligations**

The following table presents information about our contractual obligations and commitments as of December 31, 2012.

**Tabular-Disclosure of Contractual Obligations**

Contractual Obligations (\$000)	Total	Payments Due By Period			
		Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term debt obligations	\$ 124,482	\$	\$	\$ 124,482	\$
Interest payments <sup>(1)</sup>	8,019	894	3,566	3,559	
Capital lease obligations					
Operating lease obligations <sup>(2)</sup>	70,186	10,175	16,681	9,262	34,068
Purchase obligations <sup>(3)</sup>	20,448	15,241	4,989	218	
Other long-term liabilities reflected on the registrant's balance sheet					
<b>Total</b>	<b>\$ 223,135</b>	<b>\$ 26,310</b>	<b>\$ 25,236</b>	<b>\$ 137,521</b>	<b>\$ 34,068</b>

(1) Variable rate interest obligations are based on the interest rate in place at December 31, 2012.

(2) Includes an obligation for the use of two parcels of land related to PRM. The lease obligation extends through the years 2039 and 2056.

(3) A purchase obligation is defined as an agreement to purchase goods or services that is enforceable and legally binding on the Company and that specifies all significant terms, including fixed or minimum quantities to be purchased; minimum or variable price provisions, and the approximate timing of the transaction. These amounts are primarily comprised of open purchase order commitments to vendors for the purchase of supplies and materials, and unpaid purchase prices for the Company's acquisition of LightWorks.

The \$3.1 million gross unrecognized income tax benefit at December 31, 2012 is excluded from the table above. The Company is not able to reasonably estimate the amount by which the liability will increase or decrease over time; however, at this time, the Company does not expect a significant payment related to these obligations within the next year.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Foreign Exchange Risks**

The Company is exposed to market risks arising from adverse changes in foreign currency exchange rates and interest rates. In the normal course of business, the Company uses a variety of techniques and derivative financial instruments as part of its overall risk management strategy primarily focused on its exposure to the Japanese Yen. No significant changes have occurred in the techniques and instruments used other than those described below.

Changes in the foreign currency exchange rates of these currencies had an immaterial impact on the results of operations for all periods presented.

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In the normal course of business, the Company enters into foreign currency forward exchange contracts with its banks. The purpose of these contracts is to hedge ordinary business risks regarding foreign currencies on product sales. Foreign currency exchange contracts are used to limit transactional exposure to changes in currency exchange rates. The Company enters into foreign currency forward contracts that permit it to sell specified amounts of foreign currencies expected to be received from its export sales for pre-established U.S. dollar amounts at specified dates. The forward contracts are denominated in the same foreign currencies in which export sales are denominated. These contracts provide the Company with an economic hedge in which settlement will occur in future periods and which otherwise would expose the Company to foreign currency risk. The Company monitors its positions and the credit ratings of the parties to these contracts. While the Company may be exposed to potential losses due to risk in the event of non-performance by the counterparties to these financial instruments, it does not currently anticipate such losses. The Company currently has a 500 million

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## **Table of Contents**

Yen revolving credit facility to help minimize the foreign currency exposure in Japan. A change in the interest rate of 1% for this Yen loan would have changed the interest expense by an immaterial amount for the three months ended December 31, 2012. A 10% change in the Yen to dollar exchange rate would have changed revenues in the range from a decrease of \$0.7 million to an increase of \$0.8 million for the three months ended December 31, 2012 and a decrease of \$1.4 million to an increase of \$1.7 million for the six months ended December 31, 2012.

For II-VI Singapore Pte., Ltd. and its subsidiaries, II-VI Suisse S.a.r.l., PRM and Photop AOFR, the functional currency is the U.S. dollar. Gains and losses on the remeasurement of the local currency financial statements are included in net earnings. Foreign currency remeasurement was immaterial for all periods presented.

For all other foreign subsidiaries, the functional currency is the local currency. Assets and liabilities of those operations are translated into U.S. dollars using period-end exchange rates, while income and expenses are translated using the average exchange rates for the reporting period. Translation adjustments are recorded as accumulated other comprehensive income within shareholders' equity.

## **Interest Rate Risks**

As of December 31, 2012, the total borrowings of \$124 million were from a line of credit borrowing of \$121 million denominated in U.S. dollars and a line of credit of \$3 million denominated in Japanese Yen. As such, the Company is exposed to market risks arising from changes in interest rates. A change in the interest rate of these borrowings of 1% would have had an immaterial impact on the Company's financial results for the three and six months ended December 31, 2012.

## **Commodity Risk**

We are exposed to price risks for our tellurium and selenium raw materials. Also, some of our raw materials are sourced from a limited number of suppliers. As a result, we remain exposed to price changes in the raw materials used in such processes. As of December 31, 2012, a 10% decrease in the index price of tellurium and selenium would have caused an additional inventory write-down of approximately \$1.4 million, or \$0.02 per-share diluted.

## **Item 4. CONTROLS AND PROCEDURES**

The Company's management evaluated, with the participation of Francis J. Kramer, the Company's President and Chief Executive Officer, and Craig A. Creaturo, the Company's Chief Financial Officer and Treasurer, the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report on Form 10-Q. The Company's disclosure controls were designed to provide reasonable assurance that information required to be disclosed in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. However, the controls have been designed to provide reasonable assurance of achieving the controls' stated goals. Based on that evaluation, Messrs. Kramer and Creaturo concluded that the Company's disclosure controls and procedures are effective at the reasonable assurance level as of the end of the period covered by this report. No changes in the Company's internal control over financial reporting were implemented during the Company's most recently completed fiscal quarter that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1A. RISK FACTORS**

In addition to the risk factors and other information set forth in this report, carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report for the year ended June 30, 2012, which could materially affect our business, financial condition or future results. Those risk factors included in our Annual Report are not the only risks facing the Company. Additional risks and uncertainties not currently known or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.





**Table of Contents****Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table sets forth repurchases of our common stock during the quarter ended December 31, 2012:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (a)	Dollar Value of Shares That May Yet be Purchased Under the Plan or Program
October 1, 2012 to October 31, 2012		\$		\$ 14,088,000
November 1, 2012 to November 30, 2012	300,000	\$ 16.47	300,000	\$ 9,147,000
December 1, 2012 to December 31, 2012		\$		\$ 9,147,000
Total	300,000	\$ 16.47	300,000	

- (a) A share repurchase program of up to \$25 million was approved by the Board of Directors and announced on May 31, 2012. The repurchase program has no expiration date.

**Item 6. EXHIBITS**

Exhibit Number	Description of Exhibit	Reference
10.1	\$140,000,000 Revolving Credit Facility, First Amended and Restated Credit Agreement by and among II-VI Incorporated and The Guarantors Party Thereto and The Banks Party Thereto and PNC Bank, National Association, as Administrative Agent, dated as of November 16, 2012.	Incorporated herein by reference is exhibit 10.1 to II-VI's Current Report on Form 8-K (File No. 000-16195) filed on November 21, 2012.
10.2	II-VI Incorporated 2012 Omnibus Incentive Plan.	Incorporated herein by reference is exhibit 10.01 to II-VI's Current Report on Form 8-K (File No. 000-16195) filed on November 5, 2012.
31.01	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, and Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith.
31.02	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, and Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith.
32.01	Certification of the Chief Executive Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. § 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith.
32.02	Certification of the Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. § 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith.

101 Interactive Data File

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**SIGNATURES**

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

II-VI INCORPORATED  
(Registrant)

Date: February 8, 2013

By: /s/ Francis J. Kramer  
Francis J. Kramer  
President and Chief Executive Officer

Date: February 8, 2013

By: /s/ Craig A. Creaturo  
Craig A. Creaturo  
Chief Financial Officer and Treasurer

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