

GSI GROUP INC
Form 10-Q
August 11, 2011
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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 July 1, 2011

Or

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

For the transition period from to

Commission File No. 001-35083

GSI Group Inc.

(Exact name of registrant as specified in its charter)

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New Brunswick, Canada
(State or other jurisdiction of
incorporation or organization)
125 Middlesex Turnpike
Bedford, Massachusetts, USA
(Address of principal executive offices)

98-0110412
(I.R.S. Employer
Identification No.)
01730
(Zip Code)

(781) 266-5700
(Registrant's telephone number, including area code)

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 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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) 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 by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

As of July 29, 2011, there were 33,359,764 of the Registrant's common shares, no par value, issued and outstanding.

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GSI GROUP INC.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****GSI GROUP INC.****CONSOLIDATED BALANCE SHEETS****(In thousands of U.S. dollars, except share data)****(Unaudited)**

| | July 1, 2011 | December 31, 2010 |
|---|-------------------------|------------------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 73,999 | \$ 56,781 |
| Accounts receivable, net of allowance of \$563 and \$696, respectively | 58,339 | 55,110 |
| Income taxes receivable | 21,984 | 21,920 |
| Inventories | 71,112 | 66,721 |
| Deferred tax assets | 4,319 | 4,226 |
| Deferred cost of goods sold | 3,138 | 7,789 |
| Prepaid expenses and other current assets | 6,125 | 5,580 |
| Total current assets | 239,016 | 218,127 |
| Property, plant and equipment, net of accumulated depreciation of \$59,379 and \$55,336, respectively | 43,623 | 45,402 |
| Deferred tax assets | 1,729 | 1,445 |
| Other assets | 5,799 | 4,476 |
| Intangible assets, net | 49,269 | 53,139 |
| Goodwill | 44,578 | 44,578 |
| Total Assets | \$ 384,014 | \$ 367,167 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts payable | \$ 19,465 | \$ 19,766 |
| Income taxes payable | 2,835 | 1,785 |
| Accrued compensation and benefits | 10,939 | 7,988 |
| Deferred revenue | 7,195 | 15,006 |
| Deferred tax liabilities | 11 | |
| Other accrued expenses | 14,782 | 14,717 |
| Total current liabilities | 55,227 | 59,262 |
| Debt | 108,107 | 107,575 |
| Deferred revenue | 360 | 402 |
| Deferred tax liabilities | 8,486 | 8,373 |
| Accrued restructuring, net of current portion | 471 | 769 |
| Income taxes payable | 7,275 | 6,644 |
| Accrued pension liability | 2,663 | 3,044 |
| Other liabilities | 1,490 | 2,420 |
| Commitments and contingencies (Note 12) | | |
| Stockholders' Equity: | | |

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| | | |
|---|------------|------------|
| Common shares, no par value; Authorized shares: unlimited; Issued and outstanding: 33,352,192 and 33,342,169 respectively | 423,856 | 423,856 |
| Additional paid-in capital | 16,415 | 14,655 |
| Accumulated deficit | (240,460) | (256,733) |
| Accumulated other comprehensive loss | (269) | (3,429) |
| Total GSI Group Inc. stockholders equity | 199,542 | 178,349 |
| Noncontrolling interest | 393 | 329 |
| Total stockholders equity | 199,935 | 178,678 |
| Total Liabilities and Stockholders Equity | \$ 384,014 | \$ 367,167 |

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

Table of Contents**GSI GROUP INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands of U.S. dollars or shares, except per share amounts)****(Unaudited)**

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|------------------|-----------------|
| | July 1, 2011 | July 2, 2010 | July 1, 2011 | July 2, 2010 |
| Sales | \$ 101,370 | \$ 85,737 | \$ 193,228 | \$ 200,352 |
| Cost of goods sold | 56,377 | 47,681 | 108,341 | 113,258 |
| Gross profit | 44,993 | 38,056 | 84,887 | 87,094 |
| Operating expenses: | | | | |
| Research and development and engineering | 7,946 | 7,399 | 16,117 | 14,764 |
| Selling, general and administrative | 21,254 | 17,573 | 40,522 | 35,145 |
| Amortization of purchased intangible assets | 987 | 1,126 | 1,979 | 2,254 |
| Restructuring, restatement related costs and other | (61) | 1,011 | 122 | 1,679 |
| Post-emergence professional fees | 94 | | 233 | |
| Total operating expenses | 30,220 | 27,109 | 58,973 | 53,842 |
| Income from operations | 14,773 | 10,947 | 25,914 | 33,252 |
| Interest income | 19 | 25 | 39 | 50 |
| Interest expense | (3,414) | (5,747) | (7,084) | (11,555) |
| Foreign exchange transaction gains (losses), net | (123) | (106) | (815) | 263 |
| Other income (expense), net | 358 | 1,081 | 1,388 | 1,686 |
| Income from operations before reorganization items and income taxes | 11,613 | 6,200 | 19,442 | 23,696 |
| Reorganization items | | (10,617) | | (20,247) |
| Income (loss) from operations before income taxes | 11,613 | (4,417) | 19,442 | 3,449 |
| Income tax provision | 1,538 | 638 | 3,105 | 2,463 |
| Consolidated net income (loss) | 10,075 | (5,055) | 16,337 | 986 |
| Less: Net income attributable to noncontrolling interest | (9) | (11) | (64) | (52) |
| Net income (loss) attributable to GSI Group Inc. | \$ 10,066 | \$ (5,066) | \$ 16,273 | \$ 934 |
| Net income (loss) attributable to GSI Group Inc. per common share: | | | | |
| Basic | \$ 0.30 | \$ (0.32) | \$ 0.49 | \$ 0.06 |
| Diluted | \$ 0.30 | \$ (0.32) | \$ 0.48 | \$ 0.06 |
| Weighted average common shares outstanding basic | 33,478 | 15,967 | 33,464 | 15,960 |
| Weighted average common shares outstanding diluted | 33,595 | 15,967 | 33,564 | 15,981 |

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

Table of Contents**GSI GROUP INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands of U.S. dollars)****(Unaudited)**

| | Six Months Ended | |
|--|-------------------------|-------------------------|
| | July 1, 2011 | July 2, 2010 |
| Cash flows from operating activities: | | |
| Consolidated net income | \$ 16,337 | \$ 986 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization | 7,699 | 7,505 |
| Provision (recoveries) for uncollectible receivables | (61) | (591) |
| Provision for inventory obsolescence | 3,259 | 3,414 |
| Share-based compensation | 1,760 | 1,090 |
| Deferred income taxes | (253) | 149 |
| Earnings from equity investment | (1,413) | (622) |
| Loss on disposal of assets | 85 | 40 |
| Gain on sale of auction rate securities | | (988) |
| Non-cash interest expense | 459 | |
| Non-cash restructuring charges | 34 | 40 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (2,620) | (5,044) |
| Inventories | (6,455) | (2,074) |
| Deferred cost of goods sold | 4,651 | 23,753 |
| Prepaid expenses and other current assets | (451) | 471 |
| Deferred revenue | (7,853) | (39,387) |
| Accounts payable, accrued expenses and income taxes receivable and payable | 3,834 | 26,136 |
| Other non-current assets and liabilities | (1,122) | (333) |
| Cash provided by operating activities | 17,890 | 14,545 |
| Cash flows from investing activities: | | |
| Purchases of property, plant and equipment | (1,698) | (1,196) |
| Proceeds from the sale of auction rate securities | | 11,408 |
| Cash provided by (used in) investing activities | (1,698) | 10,212 |
| Cash flows from financing activities: | | |
| Payments for debt issuance costs | | (513) |
| Cash used in financing activities | | (513) |
| Effect of exchange rates on cash and cash equivalents | 1,026 | (199) |
| Increase in cash and cash equivalents | 17,218 | 24,045 |
| Cash and cash equivalents, beginning of period | 56,781 | 63,328 |
| Cash and cash equivalents, end of period | \$ 73,999 | \$ 87,373 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 6,605 | \$ |
| Cash paid for income taxes | \$ 1,106 | \$ 857 |
| Income tax refunds received | \$ 14 | \$ 1,753 |

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| | | |
|--|--------|-----------|
| Cash paid for reorganization items | \$ | \$ 13,486 |
| Supplemental disclosure of non cash financing activity: | | |
| Debt issuance costs | \$ | \$ 460 |
| Issuance of PIK notes | \$ 532 | \$ |

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

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF JULY 1, 2011

(Unaudited)

1. Organization and Presentation

GSI Group Inc. (*GSIG*) and its subsidiaries (collectively *the Company*) design, develop, manufacture and sell laser-based solutions (consisting of lasers and laser systems), precision motion control devices and associated precision technologies, and semiconductor systems. The Company's technology is incorporated into customer products or manufacturing processes for a wide range of applications in a variety of markets, including: industrial, electronics, medical, semiconductor, scientific, and aerospace. The Company's products enable customers to make advances in materials and processing technology and to meet extremely precise manufacturing specifications. The Company exists under the laws of New Brunswick, Canada and serves principal markets in North America, Europe and Asia-Pacific. The Company realigned the structure of its internal organization during the three months ended April 1, 2011 in a manner that caused the composition of its reportable segments to change to the following three segments: Laser Products, Precision Motion and Technologies and Semiconductor Systems. The Company's reportable segment financial information has been restated to reflect the updated reportable segment structure for all periods presented. See Note 13 to Consolidated Financial Statements for further information about the Company's reportable segments.

Listing of Common Shares

On February 9, 2011, the Company's common shares were approved for listing on The NASDAQ Global Select Market. The Company's common shares began trading on The NASDAQ Global Select Market on February 14, 2011 under the symbol *GSIG* . As a result of the NASDAQ listing, the Company is no longer subject to the additional 2% per annum interest penalty relating to the reporting default under its 12.25% Senior Secured PIK Election Notes.

Basis of Presentation

These consolidated financial statements have been prepared by the Company in U.S. dollars and in accordance with U.S. generally accepted accounting principles, applied on a consistent basis.

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission (*SEC*), and the instructions to Form 10-Q and the provisions of Regulation S-X pertaining to interim financial statements. Accordingly, certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America (*GAAP*) have been condensed or omitted pursuant to such rules and regulations. The consolidated financial statements and notes included in this report should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC.

The interim consolidated financial statements include the accounts of the Company. Intercompany transactions and balances have been eliminated. In the opinion of management, all adjustments and accruals necessary for a fair presentation have been made and include only normal recurring adjustments and accruals. The results for interim periods are not necessarily indicative of results to be expected for the year or for any future periods.

On December 29, 2010, the Company effected a one-for-three reverse stock split. All share data and per share amounts have been retroactively adjusted for the reverse stock split in the accompanying consolidated financial statements and notes thereto for all periods presented.

Basis of Consolidation

The consolidated financial statements include the accounts of GSI Group Inc. and its wholly owned subsidiaries. The accounts include a 50% owned joint venture, Excel Laser Technology Private Limited (*Excel SouthAsia JV*), since it is a variable interest entity and the Company is the primary beneficiary of the joint venture. The accompanying consolidated financial statements of the Company include the assets, liabilities, revenue, and expenses of Excel SouthAsia JV over which the Company exercises control. The Company records noncontrolling interest in its

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consolidated statements of operations for the ownership interest of the minority owners of Excel SouthAsia JV. Financial information related to the joint venture is not considered material to the consolidated financial statements. Intercompany accounts and transactions have been eliminated.

Table of Contents**2. Bankruptcy Disclosures**

On November 20, 2009, GSIG and two of its wholly-owned United States subsidiaries, GSI Group Corporation (GSI US) and MES International, Inc. (MES) and, collectively with GSIG and GSI US, the Debtors), filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware (the Bankruptcy Court) (the Chapter 11 Cases). On May 24, 2010, the Debtors filed with the Bankruptcy Court a modified joint Chapter 11 plan of reorganization for the Debtors, which was further supplemented on May 27, 2010 (as supplemented, the Final Chapter 11 Plan). On May 27, 2010, the Bankruptcy Court entered an order confirming and approving the Final Chapter 11 Plan and the Final Chapter 11 Plan became effective and the transactions contemplated under the Final Chapter 11 Plan were consummated on July 23, 2010.

Upon the Company s emergence from bankruptcy on July 23, 2010, the Company was not required to apply fresh-start accounting under Accounting Standards Codification (ASC) 852, Reorganizations (ASC 852). From the Company s bankruptcy filing on November 20, 2009 through the date of emergence, the Company prepared the consolidated financial statements in accordance with ASC 852 and on a going-concern basis, which assumed continuity of operations, realization of assets and satisfaction of liabilities in the ordinary course of business.

ASC 852 requires that the financial statements for periods subsequent to a Chapter 11 filing separate transactions and events that are directly associated with the reorganization from the ongoing operations of the business. Accordingly, all transactions (including, but not limited to, all professional fees, realized gains and losses and provisions for losses) directly associated with the reorganization and restructuring of the businesses are reported separately in the financial statements. All such costs are reported in reorganization items in the accompanying consolidated statements of operations for the three and six months ended July 2, 2010, with no comparable amounts for the three and six months ended July 1, 2011.

The Final Chapter 11 Plan deleveraged the Company s balance sheet by reducing debt and increasing stockholders equity. The financial restructuring was accomplished through a debt-for-equity exchange and by using the proceeds from a shareholder rights offering and cash on hand to reduce outstanding indebtedness. A summary of the significant transactions affecting the Company s capital structure as a result of the effectiveness of the Final Chapter 11 Plan is described in Note 2 to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 30, 2011. Presented below is information concerning post-emergence professional fees and reorganization items, as applicable, incurred during the three and six months ended July 1, 2011 and July 2, 2010.

Post-Emergence Professional Fees

Post-emergence professional fees represent costs incurred subsequent to bankruptcy emergence for financial and legal advisors to assist with matters in finalizing the bankruptcy process, including bankruptcy claim matters. Post-emergence professional fees totaled \$0.1 million and \$0.2 million during the three and six months ended July 1, 2011, respectively, with no comparable amount during the three and six months ended July 2, 2010.

Reorganization Items

Reorganization items represent amounts that were recorded in the consolidated financial statements as a result of the bankruptcy proceedings. Reorganization items were incurred starting with the date of the bankruptcy filing. Reorganization items totaled \$10.6 million and \$20.2 million during the three and six months ended July 2, 2010, respectively, with no comparable amounts during the three and six months ended July 1, 2011.

3. Summary of Significant Accounting Policies

The accounting policies underlying the accompanying unaudited consolidated financial statements are those set forth in Note 3 to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 30, 2011. Those policies are not presented herein, except to the extent that new policies have been adopted, or there is current period activity to disclose.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial

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statements and the reported amounts of sales and expenses during the reporting periods. On an ongoing basis, the Company evaluates its estimates, assumptions and judgments, including those related to revenue recognition; allowance for doubtful accounts; inventory costing and reserves; the assessment of warranty

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reserves; the valuation of goodwill, intangible assets and other long-lived assets; accounting for business combinations; share-based payments; employee benefit plans; accounting for restructuring activities; accounting for income taxes and related valuation allowances; and, accounting for loss contingencies. Actual results could differ significantly from those estimates.

Long-Term Investments

As of July 1, 2011 and December 31, 2010, the Company had liquidated all of its previously held auction rate securities. These auction rate notes were student loans backed by the federal government and were privately insured. During the three months ended July 2, 2010, the Company sold \$10.0 million in par value of its auction rate securities valued at \$8.0 million for \$8.7 million in proceeds, which resulted in the recognition of realized gains of \$0.7 million related to the sale of these securities. During the six months ended July 2, 2010, the Company sold \$13.0 million in par value of its auction rate securities valued at \$10.4 million for \$11.4 million in proceeds, which resulted in the recognition of realized gains of \$1.0 million related to the sale of these securities. The gains realized upon the sale of the auction rate securities are recorded in other income (expense), net in the accompanying consolidated statements of operations for the three and six months ended July 2, 2010. The Company determines the cost of a security sold and the amount to be reclassified out of accumulated other comprehensive income (loss) into earnings based on the specific identification method. During the three and six months ended July 2, 2010, the Company reclassified \$0.4 million and \$0.6 million, respectively, out of accumulated other comprehensive income (loss) into earnings related to the sale of the Company's auction rate securities. There were no auction rate securities held as of July 1, 2011 or December 31, 2010.

As of July 1, 2011 and December 31, 2010, the Company had a 25.1% equity investment in a privately held company located in the United Kingdom, valued at \$3.7 million and \$2.2 million at July 1, 2011 and December 31, 2010, respectively, and included in other assets in the accompanying consolidated balance sheets. The Company accounts for this investment using the equity method and recognized income of \$0.4 million and \$0.4 million for the three months ended July 1, 2011 and July 2, 2010, respectively, and \$1.4 million and \$0.6 million for the six months ended July 1, 2011 and July 2, 2010, respectively, which are included in other income (expense), net in the accompanying consolidated statements of operations.

Goodwill and Intangible Assets

As described in more detail in Note 3 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 30, 2011, the Company assesses goodwill and intangible assets for impairment on an annual basis and whenever events or changes in circumstances indicate impairment may exist. The Company completed annual tests for impairment as of the beginning of the second quarter of 2011 and 2010, and determined that goodwill and intangible assets were not impaired.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, risk of loss has passed to the customer and collection of the resulting receivable is reasonably assured. Revenue recognition requires judgment and estimates, which may affect the amount and timing of revenue recognized in any given period.

On January 1, 2011, the Company adopted the provisions of Accounting Standards Update (ASU) 2009-13, Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements (ASU 2009-13). ASU 2009-13 addresses the accounting for multiple-element arrangements by providing two significant changes. First, this guidance removes the requirement to have objective and reliable evidence of fair value for undelivered elements in an arrangement and results in more elements being treated as separate units of accounting. Specifically, this guidance amends the criteria in Subtopic 605-25, Revenue Recognition-Multiple-Element Arrangements (ASC 605-25), for separating consideration in multiple-element arrangements. This guidance establishes a selling price hierarchy for determining the selling price of an element, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) management's best estimate. Management's best estimate for the Company was based on factors such as gross margin, volume discounts, new strategic customers, geography, customer class and competitive pressures. The second change modifies the manner in which the transaction consideration is allocated across the separately identified elements. Entities are no longer able to apply the residual method of allocation and instead the arrangement consideration is required to be allocated at the inception of the arrangement to all elements using the relative selling price method. The relative selling price method uses the weighted average of the selling price and applies that to the contract value to establish the consideration for each element.

For transactions entered into prior to the adoption of ASU 2009-13, the Company follows the provisions of ASC 605-25 for all multiple-element arrangements. Under the guidance prior to ASU 2009-13, the Company assesses whether the elements specified in a multiple-element arrangement should be treated as separate units of accounting for revenue recognition purposes and whether objective and reliable evidence of fair value exists for these separate units of accounting. The Company applies the residual method when objective and reliable evidence of fair value exists for all of the undelivered elements in a multiple-element arrangement. When objective and reliable evidence of fair value does not

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exist for all of the undelivered elements in a multiple-element arrangement, the Company recognizes revenue under the multiple units shipped methodology, whereby revenue is recognized in each period based upon the lowest common percentage of the products shipped in the period. This approximates a proportional performance model of revenue recognition. This generally results in a partial deferral of revenue to a later reporting period. No revenue is recognized unless one or more units of each product have been delivered.

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On January 1, 2011, the Company adopted the provisions of ASU 2009-14, Software (Topic 985) Certain Revenue Arrangements That Include Software Elements (ASU 2009-14). ASU 2009-14 changes revenue recognition for tangible products containing software and hardware elements. Specifically, tangible products containing software and hardware that function together to deliver the tangible products' essential functionality are scoped out of the existing software revenue recognition guidance and will be accounted for under the multiple-element arrangements revenue recognition guidance under ASU 2009-13. With the adoption of ASU 2009-14, the Company concluded that when there is software included in tangible products, it is essential to the functionality of the tangible product. It is therefore outside the scope of ASC 985-605, Software Revenue Recognition (ASC 985-605) as amended. Prior to the adoption of ASU 2009-14, although certain of the Company's products contain operating and application software, the Company had determined the software element was incidental in accordance with ASC 985-605.

Based on the guidance in ASC 985-605, multiple purchase orders may be deemed to be interrelated and considered to constitute a multiple-element arrangement for accounting purposes.

Semiconductor Systems transactions are generally multiple-element arrangements which may include hardware, software, installation, training, an initial standard warranty, and optional extended warranty arrangements. The Company generally designs, markets and sells these products as standard configurations. Typically, revenue is recorded at the time of shipment or acceptance, which is the same under pre and post-adoption of ASU 2009-13. Acceptance is generally required for sales of Semiconductor Systems segment products to Japanese customers and sales of New Products. New Products are considered by the Company, for purposes of revenue recognition determination, to be either (a) a product that is newly released to all customers, including a product which may have been existing previously, but which has been substantially upgraded with respect to its features or functionality; or, (b) the sale of an existing product to a customer who has not previously purchased that product. The Company follows a set of predetermined criteria when changing the classification of a New Product to a standard configuration whereby acceptance criteria are considered to be demonstrated at the time of shipment.

The Laser Products and Precision Motion and Technologies segments have revenue transactions that are comprised of both single-element and multiple-element transactions. Multiple-element transactions may include two or more products and occasionally also contain installation, training or preventative maintenance plans. For multiple-element transactions entered into or materially modified after January 1, 2011, revenue is recognized under ASU 2009-13, generally upon shipment using the relative selling price method. For all other multiple-element transactions, revenue is generally recognized under the multiple units shipped methodology described above. Single-element transactions are generally recognized upon shipment.

The Company's Semiconductor Systems segment also sells spare parts and consumable items, which are not subject to acceptance criteria. For multiple-element transactions entered into or materially modified after January 1, 2011, revenue is recognized under ASU 2009-13, generally upon shipment using the relative selling price method. For all other multiple-element transactions, revenue is generally recognized under the multiple units shipped methodology described above. Single-element transactions are generally recognized upon shipment.

Installation is generally a routine process that occurs within a short period of time from delivery and the Company has concluded that this obligation is inconsequential and perfunctory. As such, for transactions that include installation, and for which customer acceptance has not been deemed necessary in order to record the revenue, the cost of installation is accrued at the time product revenue is recorded and no related revenue is deferred. Historically, the costs of installation have not been significant.

The initial standard warranty for product sales is accounted for under the provisions of ASC 450, Contingencies, as the Company has the ability to ascertain the probable likelihood of the liability, and can estimate the amount of the liability. A provision for the estimated cost related to warranty is recorded to cost of goods sold at the time revenue is recognized. The Company's estimate of costs to service the warranty obligations are based on historical experience and expectations of future conditions. To the extent the Company experiences increased warranty claims or increased costs associated with servicing those claims, revisions to the estimated warranty liability are recorded as increases or decreases to the accrual at that time, with an offsetting entry recorded to cost of goods sold.

The Company also sells optional extended warranty services, and preventative maintenance contracts, at the time of their product purchase. The Company accounts for these agreements in accordance with provisions of ASC 605-20-25-3, Separately Priced Extended Warranty and Product Maintenance Contracts, under which it recognizes the separately priced extended warranty and preventative maintenance fees over the associated period.

The Company, at the request of its customers, may at times perform professional services for its customers, generally for the maintenance and repairs of products previously sold to those customers. These services are usually in the form of time and materials based contracts which are short in their duration. Revenue for time and material services is recorded at the

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completion of services requested under a customer's purchase order. Customers may, at times subsequent to the initial product sale, purchase a service contract whereby services, including preventative maintenance plans, are provided over a defined period, generally one year. Revenue for such service contracts are recorded ratably over the period of the contract.

The Company typically negotiates trade discounts and agreed terms in advance of order acceptance and records any such items as a reduction of revenue. The Company's revenue recognition policy allows for revenue to be recognized under arrangements where the payment terms are 180 days or less, presuming all other revenue recognition criteria have been met. From time to time, based on the Company's review of customer creditworthiness and other factors, the Company may provide its customers with payment terms that exceed 180 days. To the extent all other revenue recognition criteria have been met, the Company recognizes revenue for these extended payment arrangements as the payments become due.

The Company has deferred revenue included in its accompanying consolidated balance sheets, with balances (including both current and long-term amounts) of \$7.6 million and \$15.4 million as of July 1, 2011 and December 31, 2010, respectively. The deferred revenue balance is primarily comprised of pre ASU 2009-13 multiple-element arrangements, delivered over multiple periods, whereby there is no fair value for one or more of the undelivered element(s) and arrangements where acceptance has not been received. To a much lesser extent, the deferred revenue balances relate to either: (a) the unrecognized portion of multiple-element arrangements that are being recognized into revenue ratably as associated services are performed; (b) arrangements not currently recognizable due to the arrangement not being fixed and determinable at its inception; (c) revenue deferrals for product shipments with FOB destination shipping terms; and (d) the future amortization of revenue related to extended warranty contracts and preventative maintenance plans. The classification of deferred revenue and deferred cost of goods sold is based on the Company's expectations with respect to when the revenue will be recognized, based on facts known to the Company as of the date its financial statements are released.

The Company had certain pre ASU 2009-13 multiple-element arrangements outstanding, delivered over multiple periods, in which the Company recognized \$9.9 million and \$26.2 million in revenue for the three and six months ended July 1, 2011, respectively. The \$9.9 million includes \$4.2 million of net revenue with net gross profit of \$1.6 million resulting from the recognition of \$4.6 million that had been deferred as of April 1, 2011, offset by \$0.4 million of additional deferrals during the quarter from orders placed prior to January 1, 2011. The \$26.2 million includes \$6.4 million of net revenue with net gross profit of \$2.8 million resulting from the recognition of \$9.0 million that had previously been deferred, offset by \$2.6 million of additional deferrals during the quarter from orders placed prior to January 1, 2011. As of July 1, 2011, the Company has \$2.5 million in deferred revenue related to these arrangements, the majority of which is expected to be recognized throughout the remainder of 2011. Such arrangements will continue to be accounted for under the prior accounting standards until they are completed. For multiple-element arrangements, delivered over multiple periods, which were entered into after the adoption of ASU 2009-13, the Company recognized \$13.3 million and \$17.2 million in revenue for the three and six months ended July 1, 2011, respectively, with no deferrals related to the adoption of ASU 2009-13 as of July 1, 2011.

Accumulated Other Comprehensive Loss

The following table provides the details of accumulated other comprehensive loss at (in thousands):

| | July 1, 2011 | December 31, 2010 |
|---|-----------------|-------------------|
| Foreign currency translation adjustments | \$ 5,577 | \$ 2,568 |
| Pension liability, net of tax | (5,846) | (5,997) |
| Total accumulated other comprehensive loss | \$ (269) | \$ (3,429) |

Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows (in thousands):

| Three Months Ended | | Six Months Ended | |
|--------------------|-----------------|------------------|-----------------|
| July 1, 2011 | July 2, 2010 | July 1, 2011 | July 2, 2010 |

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| | | | | |
|--|-----------|------------|-----------|------------|
| Consolidated net income (loss) | \$ 10,075 | \$ (5,055) | \$ 16,337 | \$ 986 |
| Foreign currency translation adjustments (1) | 784 | (581) | 3,009 | (2,256) |
| Net reclassifications of investments, net of tax | | (306) | | (568) |
| Pension liability, net of tax | 76 | 66 | 151 | 135 |
| Consolidated comprehensive income (loss) | 10,935 | (5,876) | 19,497 | (1,703) |
| Less: Comprehensive income attributable to noncontrolling interest | (9) | (11) | (64) | (52) |
| Comprehensive income (loss) attributable to GSI Group Inc. | \$ 10,926 | \$ (5,887) | \$ 19,433 | \$ (1,755) |

- (1) The foreign currency translation adjustments are primarily related to the movement in the British Pound, Japanese Yen and European Union Euro.

Table of Contents**Net Income (Loss) Per Common Share**

Basic net income (loss) attributable to GSI Group Inc. per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period. For diluted net income per common share, the denominator also includes any dilutive outstanding stock options, restricted stock awards and restricted stock units determined using the treasury stock method. Potentially dilutive securities are excluded from the diluted earnings per share computation to the extent they are anti-dilutive. Common and common share equivalent disclosures are (in thousands):

| | Three Months Ended | | Six Months Ended | |
|--|---------------------------|-------------------------|-------------------------|-------------------------|
| | July 1, 2011 | July 2, 2010 | July 1, 2011 | July 2, 2010 |
| Weighted average common shares outstanding - basic | 33,478 | 15,967 | 33,464 | 15,960 |
| Dilutive potential common shares (1) | 117 | | 100 | 21 |
| Weighted average common shares outstanding - diluted | 33,595 | 15,967 | 33,564 | 15,981 |
| Excluded from diluted common shares calculation - weighted stock options, restricted stock awards and restricted stock units that are anti-dilutive | 117 | 266 | 85 | 278 |

- (1) Due to the Company's net loss position for the three months ended July 2, 2010, all potentially dilutive shares are excluded as their effect would have been anti-dilutive.

Recent Accounting Pronouncements**Recently Adopted Accounting Pronouncements**

On January 1, 2011, the Company adopted ASU 2009-13, *Multiple-Deliverable Revenue Arrangements* and ASU 2009-14, *Certain Revenue Arrangements that Include Software Elements*. The impact of the Company's adoption of these pronouncements is discussed in the revenue recognition policy within this Note 3 to Consolidated Financial Statements.

Recently Issued Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) amended ASC 220, *Presentation of Comprehensive Income*. This amendment will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. It eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amended guidance, which must be applied retroactively, is effective for interim and annual periods beginning after December 15, 2011, with earlier adoption permitted. This ASU impacts presentation only and will have no effect on our financial condition, results of operations or cash flows.

In May 2011, the FASB amended ASC 820, *Fair Value Measurement*. This amendment is intended to result in convergence between U.S. GAAP and International Financial Reporting Standards (IFRS) requirements for measurement of and disclosures about fair value. This guidance clarifies the application of existing fair value measurements and disclosures, and changes certain principles or requirements for fair value measurements and disclosures. The amendment is effective for interim and annual periods beginning after December 15, 2011. The adoption of this amendment will not have a material impact on our consolidated financial statements.

Table of Contents**4. Fair Value Measurements**

The Company applies the guidance in ASC 820, which defines fair value, establishes a framework for measuring fair value, and specifies disclosures about fair value measurements. Fair value is defined as the price that would be received for an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. Valuation techniques must maximize the use of observable inputs and minimize the use of unobservable inputs.

ASC 820 establishes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the third is considered unobservable:

Level 1. Quoted prices for identical assets or liabilities in active markets which the Company can access.

Level 2. Observable inputs other than those described in Level 1.

Level 3. Unobservable inputs.

The fair values of cash, accounts receivable, income taxes receivable, accounts payable, income taxes payable, accrued compensation and benefits, and other accrued expenses, approximate their carrying values because of their short-term nature. Cash equivalents, primarily money market accounts, represent the only asset the Company measures at fair value on a recurring basis. Cash equivalents of \$5.7 million and \$7.8 million as of July 1, 2011 and December 31, 2010, respectively, are classified as Level 1 in the fair value hierarchy because they are valued at quoted prices in active markets.

The Company conducted nonrecurring fair value measurements for the annual impairment tests for goodwill and intangible assets as of the beginning of the second quarter of 2011 and 2010, and determined that goodwill and intangible assets were not impaired.

See Note 7 to Consolidated Financial Statements for discussion of the estimated fair value of the Company's debt instruments.

5. Goodwill and Intangible Assets***Goodwill***

Goodwill is recorded when the consideration for an acquisition exceeds the fair value of net tangible and identifiable intangible assets acquired. There were no changes in the carrying amount of goodwill during the three or six months ended July 1, 2011. Goodwill by reportable segment as of July 1, 2011 and December 31, 2010 is as follows (in thousands):

| | Reportable Segment | | |
|------------------------------------|---------------------------|--|--------------|
| | Laser Products | Precision Motion and Technologies | Total |
| Goodwill | \$ 67,926 | \$ 108,306 | \$ 176,232 |
| Accumulated impairment of goodwill | (54,099) | (77,555) | (131,654) |
| | \$ 13,827 | \$ 30,751 | \$ 44,578 |

Intangible Assets

As of July 1, 2011, intangible assets consisted of the following (in thousands):

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July 1, 2011

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Weighted Average Remaining Life (Years) |
|---|-----------------------------|-----------------------------|---------------------------|--|
| Amortizable intangible assets: | | | | |
| Patents and acquired technology | \$ 61,580 | \$ (45,748) | \$ 15,832 | 5.1 |
| Customer relationships | 33,215 | (15,446) | 17,769 | 8.0 |
| Customer backlog | 2,355 | (2,355) | | |
| Non-compete agreements | 4,870 | (4,659) | 211 | 0.2 |
| Trademarks, trade names and other | 5,760 | (3,330) | 2,430 | 7.7 |
| Amortizable intangible assets | 107,780 | (71,538) | 36,242 | 6.7 |
| Non-amortizable intangible assets: | | | | |
| Trade names | 13,027 | | 13,027 | |
| Totals | \$ 120,807 | \$ (71,538) | \$ 49,269 | |

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As of December 31, 2010, intangible assets consisted of the following (in thousands):

| | December 31, 2010 | | | Weighted Average Remaining Life (Years) |
|---|-----------------------------|-----------------------------|---------------------------|--|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | |
| Amortizable intangible assets: | | | | |
| Patents and acquired technology | \$ 61,298 | \$ (43,546) | \$ 17,752 | 5.5 |
| Customer relationships | 33,121 | (14,183) | 18,938 | 8.4 |
| Customer backlog | 2,355 | (2,355) | | |
| Non-compete agreements | 4,870 | (4,001) | 869 | 0.7 |
| Trademarks, trade names and other | 5,696 | (3,143) | 2,553 | 8.2 |
| Amortizable intangible assets | 107,340 | (67,228) | 40,112 | 6.9 |
| Non-amortizable intangible assets: | | | | |
| Trade names | 13,027 | | 13,027 | |
| Totals | \$ 120,367 | \$ (67,228) | \$ 53,139 | |

All definite-lived intangible assets are amortized on a straight-line basis over their remaining life. Amortization expense for customer relationships, customer backlog, non-compete agreements and definite-lived trademarks, trade names and other is included in operating expenses in the accompanying consolidated statements of operations and was \$1.0 million and \$1.1 million for the three months ended July 1, 2011 and July 2, 2010, respectively, and \$2.0 million and \$2.3 million for the six months ended July 1, 2011 and July 2, 2010, respectively. Amortization expense for the patents and acquired technology is included in cost of goods sold in the accompanying consolidated statements of operations and was \$1.0 million for each of the three months ended July 1, 2011 and July 2, 2010, and \$2.0 million and \$1.9 million, respectively, for the six months ended July 1, 2011 and July 2, 2010.

Estimated amortization expense for each succeeding period after July 1, 2011 is as follows (in thousands):

| Year Ending December 31, | Cost of | | Total |
|-----------------------------------|------------------|-----------------------|------------------|
| | Goods Sold | Operating Expenses | |
| 2011 (6 months from July 1, 2011) | \$ 1,903 | \$ 1,537 | \$ 3,440 |
| 2012 | 3,165 | 2,652 | 5,817 |
| 2013 | 3,165 | 2,652 | 5,817 |
| 2014 | 3,165 | 2,565 | 5,730 |
| 2015 | 2,065 | 2,395 | 4,460 |
| Thereafter | 2,369 | 8,609 | 10,978 |
| Total | \$ 15,832 | \$ 20,410 | \$ 36,242 |

6. Supplementary Balance Sheet Information

The following tables provide the details of selected balance sheet items as of the periods indicated:

Inventories

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| | July 1, 2011 | December 31, 2010 |
|-----------------------|-----------------|-------------------------|
| | (In thousands) | |
| Raw materials | \$ 37,888 | \$ 37,315 |
| Work-in-process | 18,060 | 16,613 |
| Finished goods | 11,568 | 10,261 |
| Demo inventory | 2,379 | 1,249 |
| Consigned inventory | 1,217 | 1,283 |
| Total inventories | \$ 71,112 | \$ 66,721 |

Table of Contents**Prepaid Expenses and Other Current Assets**

| | July 1, 2011 | December 31, 2010 |
|----------------------|-----------------|-------------------------|
| | (In thousands) | |
| Prepaid expenses | \$ 4,869 | \$ 4,803 |
| Other current assets | 1,256 | 777 |
| Total | \$ 6,125 | \$ 5,580 |

Other Accrued Expenses

| | July 1, 2011 | December 31, 2010 |
|--|------------------|-------------------------|
| | (In thousands) | |
| Accrued interest | \$ 1,655 | \$ 1,647 |
| Accrued warranty | 3,715 | 3,977 |
| Accrued professional fees | 1,460 | 2,165 |
| Accrued third party sales commissions | 554 | 497 |
| Customer deposits | 2,442 | 1,241 |
| Accrued restructuring, current portion | 983 | 797 |
| Deferred rent, current portion | 1,325 | 1,325 |
| Accrued VAT | 238 | 540 |
| Other | 2,410 | 2,528 |
| Total | \$ 14,782 | \$ 14,717 |

Accrued Warranty

| | Six Months Ended | |
|--|------------------|-----------------|
| | July 1, 2011 | July 2, 2010 |
| | (In thousands) | |
| Balance at beginning of period | \$ 3,977 | \$ 3,140 |
| Charged to costs and expenses | 1,382 | 2,466 |
| Use of provision | (1,723) | (1,965) |
| Foreign currency exchange rate changes | 79 | (82) |
| Balance at end of period | \$ 3,715 | \$ 3,559 |

Other Liabilities

| | July 1, 2011 | December 31, 2010 |
|--|-----------------|-------------------------|
|--|-----------------|-------------------------|

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| | (In thousands) | |
|---------------|-----------------|-----------------|
| Deferred rent | \$ 1,490 | \$ 2,151 |
| Accrued PIK | | 269 |
| Total | \$ 1,490 | \$ 2,420 |

7. Debt

12.25% Senior Secured PIK Election Notes

Upon the emergence from bankruptcy, GSI US issued \$107.0 million in aggregate principal amount of 12.25% Senior Secured PIK Election Notes, which mature on July 23, 2014 (the "New Notes"), pursuant to that certain Indenture (the "New Indenture"), by and among GSI US, as issuer, the Guarantors named therein (including GSIG and MES) and The Bank of New York Mellon Trust Company, N.A., as trustee.

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Interest accrues on the New Notes at a rate of 12.25% per year and is payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year, commencing on August 15, 2010. GSI US may elect to pay the interest in cash, or, under certain conditions, by increasing the principal amount of the New Notes or issuing additional notes on the same terms and conditions as the existing New Notes (PIK). However, the Company is required to pay cash interest if its fixed charge coverage ratio is greater than 1.75 to 1.00. Furthermore, until the Company became current in its reporting obligations under the Securities Exchange Act of 1934, as amended (the Exchange Act) and until the Company's common shares were listed on an Eligible Market (as defined in the New Indenture), the rate of interest under the New Notes was increased by an additional 2% per annum (Default Rate), payable by PIK beginning after August 15, 2010. Additionally, the interest rate on the New Notes may be increased under certain defaults, as defined in the New Indenture. Interest PIK notes issued and PIK payments in lieu of cash payments accrue interest at a rate of 13% per annum. The Company became current in its reporting obligations under the Exchange Act on December 13, 2010 with the filing of its Form 10-Q for the quarter-ended October 1, 2010. On February 14, 2011, the Company's common shares were listed on The NASDAQ Global Select Market under the trading symbol GSIG . Accordingly, as of February 14, 2011, the 2% per annum additional interest penalty ceased. PIK notes issued to noteholders as a result of the 2% penalty from August 15, 2010 to February 14, 2011 totaled \$1.1 million and are classified as debt in the accompanying balance sheet as of July 1, 2011.

On July 18, 2011, GSI US provided formal notice that it had elected to optionally redeem \$35.0 million in aggregate principal amount (constituting 32% of the currently outstanding \$108.1 million in aggregate principal amount) of its outstanding New Notes, including PIK notes, in accordance with the terms of the New Indenture, pursuant to which the New Notes were issued. In accordance with the New Indenture, the redemption price for the New Notes being redeemed will be 100% of the principal amount of such New Notes, plus accrued and unpaid interest thereon, if any, to, but not including, August 17, 2011, the redemption date. After consummation of this redemption, \$73.1 million in aggregate principal amount of the New Notes, including PIK notes, will remain outstanding. The redemption will be financed from a portion of the available cash and cash equivalents of the Company and its subsidiaries.

Interest expense on the New Notes for the three and six months ended July 1, 2011 was \$3.4 million and \$7.1 million, respectively, including PIK interest of \$0.3 million during the six months ended July 1, 2011. The PIK interest relates to the additional 2% assessment per annum as described above, which ceased in February 2011. As of July 1, 2011, accrued interest totaled \$1.7 million, which is classified as other accrued expenses in the accompanying consolidated balance sheet as of July 1, 2011. A \$0.5 million PIK note was issued in February 2011 and is classified as debt in the accompanying consolidated balance sheet as of July 1, 2011. The Company recorded interest expense of \$5.7 million and \$11.5 million for the three and six months ended July 2, 2010, respectively, related to the \$210.0 million of 11% unsecured senior notes due 2013 (the 2008 Senior Notes), which were restructured upon bankruptcy emergence, as described in Note 2 and Note 8 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 30, 2011.

Deferred Financing Costs

In connection with the issuance of the New Notes, the Company capitalized \$1.6 million in deferred financing costs, which are included in other assets in the accompanying consolidated balance sheet as of July 1, 2011. These deferred financing costs are being amortized to interest expense on a straight-line basis over the four year contractual term of the New Notes. As of July 1, 2011, the unamortized portion of the deferred financing costs was \$1.2 million. Non-cash interest expense related to the amortization of the deferred financing costs for the three and six months ended July 1, 2011 was \$0.1 million and \$0.2 million, respectively.

Guarantees

Each Guarantor, as defined in the New Indenture, jointly and severally, unconditionally guarantees (each a Note Guarantee and collectively the Note Guarantees) the due and punctual payment of the principal of and interest on the New Notes, when due and payable, whether at maturity, by acceleration or otherwise, the due and punctual payment of interest on the overdue principal of and interest on the New Notes, the due and punctual payment of all other Obligations, as defined in the New Indenture, and the due and punctual performance of all obligations of the Company in accordance with the terms of the New Indenture. Furthermore, each Guarantor, as defined in the New Indenture, jointly and severally, unconditionally guarantees that in the event of any extension of time of payment or renewal of any of the New Notes or any of such other Obligations, as defined in the New Indenture, with respect to the New Notes, amounts due will be promptly paid in full when due or performed in accordance with the terms of the extension or renewal, at stated maturity, by acceleration or otherwise. Further discussion of the Note Guarantees is provided in Note 8 to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 30, 2011.

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As of July 1, 2011, the maximum potential amount of future payments the Guarantors could be required to make under the Note Guarantees is the principal amount of the New Notes plus all unpaid, but accrued interest thereon, including all PIK and Default Rate interest. However, as of July 1, 2011, the Guarantors are not expected to be required to perform under the Note Guarantees.

Fair Value of Debt

The Company emerged from bankruptcy with \$107.0 million of 12.25% Senior Secured PIK Election Notes, plus an additional \$1.1 million of PIK notes, issued from August 15, 2010 to February 14, 2011, which mature on July 23, 2014. Since the date the New Notes were issued, trading activity with respect to New Notes has been limited. As of July 1, 2011, the estimated fair value of the Company's New Notes approximated \$120.0 million. As of December 31, 2010, the estimated fair value of the Company's New Notes approximated \$113.4 million. These fair value estimates represent the value at which the Company estimates the lenders could trade the debt within the financial markets, and does not represent the settlement value of these long-term debt liabilities to the Company. The fair value of the New Notes will continue to fluctuate each period and these fluctuations may have little to no correlation to the Company's outstanding debt balances. The Company estimated the appropriate market yield for the New Notes based on yields for comparable issues and market indices. Using this market yield, the Company calculated the present value of future interest and principal payments to estimate the fair value of the New Notes. Fair value estimates are made at a specific point in time based on relevant market information. These estimates are subjective in nature and involve uncertainties and matters of significant judgments and therefore cannot be determined with precision. Changes in market conditions, valuation assumptions or approach could significantly affect these estimates.

8. Share-Based Compensation**Equity Compensation Plans**

As of July 1, 2011, the Company has one active equity compensation plan, the GSI Group Inc. 2010 Incentive Award Plan (the 2010 Incentive Plan), under which it may grant stock-based compensation awards to employees, consultants and directors. As of July 1, 2011, there are 2,092,659 shares available for future issuance under the 2010 Incentive Plan. Additionally, the Company has other equity compensation plans under which there are awards outstanding, but under which no further awards may be made as such plans were cancelled upon the Company's emergence from bankruptcy on July 23, 2010 (collectively referred to herein as the Pre-2010 Incentive Plans). Such equity compensation plans are described in Note 10 in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year-ended December 31, 2010, filed with the SEC on March 30, 2011. There have been no material modifications made to the Company's equity compensation plans during the three or six months ended July 1, 2011.

2010 Incentive Plan

The table below summarizes activity relating to restricted stock units issued and outstanding under the 2010 Incentive Plan during the six months ended July 1, 2011:

| | Number of Shares (In thousands) | Weighted Average Grant Date Fair Value |
|-------------------------------------|---------------------------------------|---|
| Unvested at December 31, 2010 | 333 | \$ 9.87 |
| Granted | 435 | 11.62 |
| Vested | | |
| Forfeited | (5) | 10.30 |
| Unvested at July 1, 2011 | 763 | \$ 10.86 |
| Expected to vest as of July 1, 2011 | 760 | \$ 10.87 |

Pre-2010 Incentive Plans

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The table below summarizes activity relating to restricted stock awards issued and outstanding under the Pre-2010 Incentive Plans during the six months ended July 1, 2011:

| | Number of Shares (In thousands) | Weighted Average Grant Date Fair Value |
|-------------------------------|--|---|
| Unvested at December 31, 2010 | 31 | \$ 11.36 |
| Granted | | |
| Vested | (10) | 24.30 |
| Forfeited | (6) | 8.12 |
| Unvested at July 1, 2011 | 15 | \$ 3.84 |

Table of Contents**Share-Based Compensation Expense**

The Company recognized share-based compensation expense totaling \$0.8 million and \$0.4 million during the three months ended July 1, 2011 and July 2, 2010, respectively, and \$1.8 million and \$1.1 million during the six months ended July 1, 2011 and July 2, 2010, respectively. Stock compensation expense is primarily included in selling, general, and administrative expense in the Company's consolidated statements of operations and as an increase to additional paid-in capital on the Company's consolidated balance sheets. As the awards granted are issuable to the holder, typically subject to vesting provisions, with no consideration payable by the holder, the grant date fair value per share is based on the quoted price of the Company's common stock on the date of the grant and is generally the basis for which compensation expense is recognized. The restricted stock awards and restricted stock units for which the Company has recorded expense during the three and six months ended July 1, 2011 and July 2, 2010, have generally been issued with a three-year vesting period and vest based solely on service conditions. Accordingly, the Company recognizes compensation expense on a straight-line basis over the requisite service period. The Company reduces the compensation expense by an estimated forfeiture rate which is based on anticipated forfeitures and actual experience.

Additionally, the expense recorded during the six months ended July 1, 2011 includes compensation expense for 42,536 deferred stock units granted to the members of the Company's Board of Directors, pursuant to the Company's 2010 Incentive Plan, of approximately \$0.6 million, which was recognized in full on the date of grant, as the deferred stock units are fully vested and nonforfeitable on the date of grant. There were no deferred stock units granted during the three months ended July 1, 2011 or the three or six months ended July 2, 2010. Approximately \$0.1 million and \$0.4 million of the compensation expense recognized during the three and six month periods ended July 1, 2011 and July 2, 2010, respectively, relates to expense recognized upon the acceleration of vesting of all outstanding but unvested restricted stock awards or units that had previously been granted to certain of the Company's former executives as of the respective effective dates of termination. The expense recorded during the three and six months ended July 2, 2010 includes (\$0.1) million and \$0.2 million, respectively, of compensation expense related to awards granted under the Pre-2010 Incentive Plans that were accounted for as share-based liabilities under ASC 718, *Stock Compensation*, until settled through the issuance of common shares, forfeited due to termination of service or reclassified to additional paid in capital, upon the Company's emergence from bankruptcy on July 23, 2010. Accordingly, no share-based liability remains as of July 1, 2011 or December 31, 2010. No awards were accounted for as share-based liabilities during the three or six months ended July 1, 2011.

As of July 1, 2011, there was \$7.2 million of unrecognized compensation related to unvested restricted stock units and unvested restricted stock awards. This amount is expected to be recognized over a weighted-average period of 2.6 years. To the extent the actual forfeiture rate is different from what the Company has anticipated, the share-based compensation expense related to these awards will differ from these expectations.

9. Employee Benefit Plans**U.K. Defined Benefit Pension Plan**

The net periodic pension cost for the U.K defined benefit pension plan includes the following components (in thousands):

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|-----------------|
| | July 1, 2011 | July 2, 2010 | July 1, 2011 | July 2, 2010 |
| Components of the net periodic pension cost: | | | | |
| Interest cost | \$ 382 | \$ 351 | \$ 757 | \$ 724 |
| Expected return on plan assets | (398) | (339) | (789) | (699) |
| Amortization of loss | 57 | 49 | 113 | 101 |
| Net periodic pension cost | \$ 41 | \$ 61 | \$ 81 | \$ 126 |

Table of Contents**Japan Defined Benefit Pension Plan**

The net periodic pension cost for the Japan defined benefit pension plan includes the following components (in thousands):

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|--------------|------------------|---------------|
| | July 1, 2011 | July 2, 2010 | July 1, 2011 | July 2, 2010 |
| Components of the net periodic pension cost: | | | | |
| Service cost | \$ 51 | \$ 46 | \$ 101 | \$ 93 |
| Interest cost | 7 | 6 | 14 | 12 |
| Amortization of unrecognized transition obligation | 19 | 17 | 38 | 34 |
| Net periodic pension cost | \$ 77 | \$ 69 | \$ 153 | \$ 139 |

10. Income Taxes

At the end of each interim reporting period, the Company determines its estimated annual effective tax rate based on facts known at that time. The estimated annual effective tax rate is applied to the year-to-date pre-tax income at the end of each interim period. The tax effect of significant unusual items is reflected in the period in which they occur. Since the Company is incorporated in Canada, it is required to use Canada's statutory tax rate of 27.0% in the determination of the estimated annual effective tax rate. The Company's reported effective tax rate for operations of 16.0% for the six months ended July 1, 2011 differed from the expected Canadian federal statutory rate of 27.0% primarily due to the income earned in jurisdictions with varying tax rates, an increase in the Company's liability for uncertain tax positions, and the release of a portion of the Company's valuation allowance.

As part of the process of preparing the consolidated financial statements, the Company is required to estimate its income tax provision (benefit) in each of the jurisdictions in which it operates. This process involves estimating the current income tax provision (benefit) together with assessing the future effects of temporary differences resulting from differing treatment of items for tax and accounting purposes. The Company recognizes deferred tax assets and liabilities based on the differences between the financial statement carrying amount and the tax bases of assets and liabilities.

The Company records a valuation allowance if it is more likely than not that a portion of its deferred tax assets will not be realized. The Company has considered historical losses, future taxable income, and expected reversals of existing temporary differences in assessing the need for a valuation allowance.

The Company has not provided any income taxes or withholding taxes on the undistributed earnings foreign subsidiaries as such earnings have been indefinitely reinvested in the business. In general, the determination of the amount of the unrecognized deferred tax liability related to the undistributed earnings is not practicable because of the complexities associated with its hypothetical calculation.

As of July 1, 2011, the Company's gross unrecognized tax benefits totaled approximately \$5.5 million, all of which, if recognized, would favorably affect its effective tax rate. As of December 31, 2010, the Company's gross unrecognized tax benefits totaled approximately \$5.1 million, all of which, if recognized, would favorably affect its effective tax rate. The Company is currently under examination in the United States for tax years from 2000 to 2008. It is reasonably possible that the U.S. examination for the periods from 2000 to 2008 will be completed during the next 12 months, which would result in a decrease of approximately \$0 to \$4.3 million in the Company's balance of unrecognized tax benefits as a result of a settlement. The Company believes that there are no other jurisdictions in which the outcome of unresolved issues or claims is likely to be material to its results of operations, financial position or cash flows.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of July 1, 2011 and December 31, 2010, the Company had approximately \$1.8 million and \$1.6 million, respectively, of accrued interest and penalties related to uncertain tax positions. During the three months ended July 1, 2011 and July 2, 2010, the Company recognized approximately \$0.1 million and \$0.1 million, respectively, in interest and penalties. During the six months ended July 1, 2011 and July 2, 2010, the Company recognized approximately \$0.2 million and \$0.1 million, respectively, in interest and penalties.

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The Company files state and federal income tax returns in the United States and in foreign jurisdictions. Generally, the Company is no longer subject to United States federal, state or local, or foreign income tax examinations by tax authorities for the years before 2000 as these years have been effectively settled. Currently, the Company is under examination in the United States for tax years from 2000 to 2008. The Company's income tax returns may be reviewed in the following countries and for the following periods under the appropriate statute of limitations: United States (2009-present), Canada (2004-present), United Kingdom (2007-present), China (2008-present), Japan (2005-present) and Germany (2007-present).

11. Restructuring, Restatement Related Costs and Other

The following table summarizes restructuring, restatement related costs and other in the accompanying consolidated statements of operations:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|-----------------|
| | July 1, 2011 | July 2, 2010 | July 1, 2011 | July 2, 2010 |
| | (In thousands) | | | |
| United Kingdom restructuring | \$ | \$ | \$ | \$ (70) |
| Germany restructuring | (75) | 18 | 60 | 69 |
| Bedford restructuring | | | | 1 |
| Restructuring | (75) | 18 | 60 | |
| Restatement related costs and other | 14 | 993 | 62 | 1,679 |
| Total restructuring, restatement related costs and other | \$ (61) | \$ 1,011 | \$ 122 | \$ 1,679 |

Restructuring

The Company's initial estimate for its liability for ongoing costs associated with workforce reductions and abandoned lease facilities are recorded at fair value. Generally, the expense and liability recorded is calculated using discounted cash flows of the Company's estimated ongoing severance obligations and lease obligations, including contractual rental and build-out commitments, net of estimated sublease rentals, offset by related sublease costs. In estimating the expense and liability for its lease obligations, the Company estimated: (i) The costs to be incurred to satisfy rental and build-out commitments under the lease, (ii) The lead time necessary to sublease the space, (iii) The projected sublease rental rates, and (iv) The anticipated duration of subleases. The Company used a credit adjusted risk free rate of approximately 5.25% to discount the estimated cash flows for obligations with payments due in excess of one year.

The Company reviews its assumptions and estimates quarterly and updates its estimates of the liability as changes in circumstances require. The Company's estimates have changed in the past, and may change in the future, resulting in additional adjustments to the estimate of the liability, and the effect of any such adjustments could be material. Changes to the Company's estimate of the liability are recorded as additional restructuring expense (benefit). In addition, because the Company's estimate of the liability includes the application of a discount rate to reflect the time-value of money, the Company records imputed interest costs related to the liability each period. These costs are reflected in restructuring expense (benefit) on the accompanying consolidated statements of operations.

Germany Restructuring

As a result of restructuring programs undertaken in 2000 through 2004, and the subsequent sublease of the Company's Munich, Germany facility within the Precision Motion and Technologies segment in May 2007 through the end of its lease term, the Company carried a \$2.1 million accrual for the cost of this lease as of December 31, 2009. As noted above, the Company regularly reviews its assumptions with respect to excess space, including contractual lease payments and expected proceeds from the sublessor. During the year-ended December 31, 2009, the Company determined that it would no longer recover sublease payments from the subtenant. Accordingly, the previous estimate of future sublease payments was revised. As a result, the Company recorded an additional restructuring charge of \$1.3 million during the year-ended December 31, 2009 related to revised sublease assumptions. The \$0.1 million of expense recognized during the six months ended July 2, 2010 relates primarily to accretion charges recorded during the period. No significant adjustments were recorded during the three months ended July 2, 2010. During the three and six months ended July 1, 2011, the Company recorded \$(0.1) million and \$0.1 million, respectively, restructuring (benefit) charge related to revised future lease payment assumptions. As of July 1, 2011, cumulative expense related to this restructuring plan is \$4.6 million. The remaining accrual of \$1.3 million will be paid ratably over the remaining term of the lease, which expires

in January 2013.

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In the second quarter of 2008, the Company implemented a plan to close its Novi, Michigan facility, which provided U.S. sales, applications and service support to a product line included in the Company's Laser Products segment. The Novi facility was consolidated within the Company's Bedford, Massachusetts facility. In connection with this action, the Company recorded a restructuring charge of \$1.4 million during the year ended December 31, 2008, consisting of \$0.7 million for employee severance costs and \$0.7 million in lease abandonment and related costs. The majority of the employee severance payments were made in 2008, and the remaining amounts were paid in 2009. The lease costs are being paid ratably over the duration of the lease, which ends in November 2012.

Restatement Related Costs and Other

During the three and six months ended July 1, 2011 and July 2, 2010, the Company incurred costs for professional services performed in connection with the restatement of the Company's previously issued financial statements as reported in its Annual Report on Form 10-K for the year-ended December 31, 2008 and its Quarterly Report on Form 10-Q for the quarter ended September 26, 2008, including, the SEC investigation, certain shareholder actions and the internal Foreign Corrupt Practices Act investigation. These costs are charged to expense as incurred and are included in the Company's restructuring, restatement related costs and other charges for the respective periods in the accompanying consolidated statements of operations. The costs incurred were less than \$0.1 million and \$1.0 million for the three months ended July 1, 2011 and July 2, 2010, respectively, and \$0.1 million and \$1.7 million for the six months ended July 1, 2011 and July 2, 2010, respectively.

Rollforward of Accrued Expenses Related to Restructuring

The following table summarizes the accrual activity related to the Company's restructuring charges recorded on the accompanying consolidated balance sheets (in thousands):

| | |
|--|-----------------|
| Balance at December 31, 2010 | \$ 1,566 |
| Restructuring charges (benefits), net | 60 |
| Cash payments | (391) |
| Non-cash write-offs or other adjustments | 219 |
| Balance at July 1, 2011 | \$ 1,454 |

As of July 1, 2011 and December 31, 2010, \$0.5 million and \$0.8 million, respectively, of accrued restructuring charges were included in long-term liabilities classified as accrued restructuring, net of current portion in the accompanying consolidated balance sheets. The current portion of accrued restructuring charges is included in other accrued expenses. See Note 6 to Consolidated Financial Statements.

12. Commitments and Contingencies*Operating leases*

The Company leases certain equipment and facilities under operating lease agreements. Such operating leases are described in Note 14 in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 30, 2011. There have been no material changes to the Company's operating leases or other commitments through July 1, 2011 from those discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, filed with the SEC on March 30, 2011.

Line of Credit

As of July 1, 2011 and December 31, 2010, the Company had an outstanding line of credit to secure standby letters of credit that were issued for certain facility operating leases, customer prepayments, warranty obligations, customs duties and bid bonds. The total amount available under the line of credit is 500,000 Euros, of which 175,000 Euros and 430,000 Euros was available at July 1, 2011 and December 31, 2010, respectively.

Legal Proceedings

During the third quarter of 2005, the Company's French subsidiary, GSI Lumonics SARL (GSI France), filed for bankruptcy protection, which was granted on July 7, 2005. On April 18, 2006, the commercial court of Le Creusot (France) ordered GSI France to pay approximately 0.7 million Euros to SCGI in the context of a claim filed by SCGI that a Laserdyne 890 system delivered in 1999 had unresolved technical problems. No appeal was lodged. On May 6, 2011, GSI Group Ltd. was served

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with summons from the official receiver of GSI France demanding that GSI Group Ltd. and the Company's German subsidiary, GSI Lumonics GmbH, appear before the Paris commercial court. The receiver claims (i) that the bankruptcy proceedings initiated against GSI France in 2005 should be extended to GSI Group Ltd. and GSI Lumonics GmbH on the ground that GSI France's decisions were actually made by GSI Group Ltd. and that GSI Lumonics GmbH made financial advances for no consideration, which would reveal in both cases confusion of personhood, or (ii) alternatively, that GSI Group Ltd. be ordered to pay approximately 3.1 million Euros (i.e. the aggregate of GSI France's liabilities, consisting primarily of approximately 0.7 million Euros to SCGI and approximately 2.4 million Euros to GSI Lumonics GmbH). The Company is investigating the matter but currently does not believe a loss is probable. Accordingly, nothing has been accrued in the Company's accompanying consolidated financial statements with respect to this claim.

On December 12, 2008, in connection with the delayed filing of its results for the quarter ended September 26, 2008, and the announcement of a review of revenue transactions, a putative shareholder class action alleging federal securities violations was filed in the United States District Court for the District of Massachusetts (U.S. District Court) against the Company, a former officer and a then-current officer and director. The complaint alleged that the Company and the individual defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and sought recovery of damages in an unspecified amount. In May 2010, the parties reached an agreement in principle to settle the litigation. The settlement covered purchasers of the common stock of the Company between February 27, 2007 and June 30, 2009. On February 22, 2011, the U.S. District Court entered an order granting final approval of the settlement in the putative shareholder class action. The Company's contribution to the settlement amount was limited to the Company's self-insured retention under its directors and officers liability insurance policy.

The Company is also subject to various legal proceedings and claims that arise in the ordinary course of business. The Company does not believe that the outcome of these claims will have a material adverse effect upon its financial condition or results of operations but there can be no assurance that any such claims, or any similar claims, would not have a material adverse effect upon its financial condition or results of operations.

Chapter 11 Cases

On November 20, 2009, the Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for Delaware. On May 27, 2010, the Bankruptcy Court entered an order confirming and approving the Final Chapter 11 Plan for the Debtors and the Plan Documents (as defined in the Final Chapter 11 Plan). On July 23, 2010, the Debtors consummated their reorganization through a series of transactions contemplated by the Final Chapter 11 Plan, and the Final Chapter 11 Plan became effective pursuant to its terms. While the Chapter 11 Cases are still open as a technical matter, the Company no longer has any legal or material financial constraint relating to those cases, and expects to obtain final closing (legal conclusion) of those cases prior to the end of the 2011 calendar year.

On April 5, 2010, the IRS filed amended proofs of claim aggregating approximately \$7.7 million with the Bankruptcy Court. On July 13, 2010, the Company filed a complaint, *GSI Group Corporation v. United States of America*, in Bankruptcy Court in an attempt to recover refunds totaling approximately \$18.8 million in federal income taxes the Company asserts it overpaid to the IRS relating to tax years 2000 through 2008, together with applicable interest. The complaint includes an objection to the IRS' proofs of claim which the Company believes are not allowable claims and should be expunged in their entirety. Those tax proceedings remain pending, and their resolution in the ordinary course will not be affected by the expected closing of the Chapter 11 Cases.

On May 13, 2010, the SEC filed a proof of claim in an indeterminate amount for penalties, disgorgement, and prejudgment interest arising from possible violations of the federal securities laws. As noted below, the SEC had been conducting a formal investigation into certain pre-bankruptcy transactions and practices involving the Company and sent a Wells Notice to the Company on September 16, 2010. Based on its investigation, the SEC indicated in its proof of claim that it may file a civil action against the Company in an appropriate forum.

On May 16, 2011, the Company agreed to settle with the SEC, without admitting or denying the findings of the SEC, by consenting to the entry of an administrative order that requires the Company to cease and desist from committing or causing any violations and any future violations of the reporting, books and records, and internal controls provisions of the Securities Exchange Act of 1934. The SEC did not charge the Company with fraud nor did the SEC require the Company to pay a civil penalty or other money damages as part of the settlement. The settlement results from the conclusion of an investigation that began on May 14, 2009 when the SEC notified the Company that it was conducting a formal investigation relating to its historical accounting practices and the restatement of its historical consolidated financial statements. The settlement completely resolves the SEC investigation as it relates to the Company.

In addition, under the terms of the Final Chapter 11 Plan, the Company was obligated to make additional payments to the holders of 2008 Senior Notes claims in its Chapter 11 Cases if the amount of certain claims under the Final Chapter 11 Plan exceeded \$22.5 million. The additional payment, if any, would equal approximately \$1.00 for each dollar by which the \$22.5 million cap amount was exceeded. As the Company did not believe it was probable that its losses under these claims

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exceeded \$22.5 million, nothing had been accrued in the Company's consolidated financial statements with respect to this potential obligation. On June 2, 2011, the Bankruptcy Court entered an order fixing the amount of the additional payment at zero. The order is a final determination that the Company has no actual or contingent future liability for any such payment.

Guarantees and Indemnifications

In the normal course of its operations, the Company executes agreements that provide for indemnification and guarantees to counterparties in transactions such as business dispositions, the sale of assets, sale of products and operating leases. Additionally, the by-laws of the Company require it to indemnify certain current or former directors, officers, and employees of the Company against expenses incurred by them in connection with each proceeding in which he or she is involved as a result of serving or having served in certain capacities. Indemnification is not available with respect to a proceeding as to which it has been adjudicated that the person did not act in good faith in the reasonable belief that the action was in the best interests of the Company. On June 5, 2009, the Board of Directors of the Company approved a form of indemnification agreement to be implemented by the Company with respect to its directors and officers. The form of indemnification agreement provides, among other things, that each director and officer of the Company who signs the indemnification agreement shall be indemnified to the fullest extent permitted by applicable law against all expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred by such officer or director in connection with any proceeding by reason of his or her relationship with the Company. In addition, the form of indemnification agreement provides for the advancement of expenses incurred by such director or officer in connection with any proceeding covered by the indemnification agreement, subject to the conditions set forth therein and to the extent such advancement is not prohibited by law. The indemnification agreement also sets out the procedures for determining entitlement to indemnification, the requirements relating to notice and defense of claims for which indemnification is sought, the procedures for enforcement of indemnification rights, the limitations on and exclusions from indemnification, and the minimum levels of directors' and officers' liability insurance to be maintained by the Company.

Credit Risks and Other Uncertainties

The Company maintains financial instruments such as cash and cash equivalents and trade receivables. From time to time, certain of these instruments may subject the Company to concentrations of credit risk whereby one institution may hold a significant portion of the cash and cash equivalents, or one customer may compose a large portion of the accounts receivable balances.

There was no concentration of credit risk related to the Company's position in trade accounts receivable as of either July 1, 2011 or December 31, 2010. No individual customer represented 10% or more of the Company's outstanding accounts receivable as of July 1, 2011 or December 31, 2010. Credit risk with respect to trade accounts receivable is generally minimized because of the diversification of the Company's operations, as well as its large customer base and its geographical dispersion.

Certain of the components and materials included in the Company's laser systems and optical products are currently obtained from single source suppliers. There can be no assurance that a disruption of this outside supply would not create substantial manufacturing delays and additional cost to the Company.

The Company's operations involve a number of other risks and uncertainties including, but not limited to, the cyclicity of the semiconductor and electronics markets, the effects of general economic conditions, rapidly changing technology, and international operations. Additionally, the sales of some of the Company's individual product lines, particularly its laser businesses, are attributable to orders received from governmental entities or research institutions whose budgeting and funding cycles may be different from those of the Company's commercial and industrial customers.

13. Segment Information***Reportable Segments***

The Company operates in three reportable segments: Laser Products, Precision Motion and Technologies and Semiconductor Systems. The Company's chief operating decision maker is the Chief Executive Officer. As a result of the Chief Executive Officer's reassessment of the Company's operating and reporting structure, the Company realigned the structure of its internal organization into three distinct operating divisions, each reporting to a separate divisional manager, during the three months ended April 1, 2011. Consequently, the realignment caused the composition of the Company's reportable segments to change during the three months ended April 1, 2011, with the exception of the Semiconductor Systems segment. The Semiconductor Systems segment has remained unchanged from prior periods. The new structure allows the Company to prioritize its investments, align its resources to meet the demands of the markets the Company serves,

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optimize business performance and maximize opportunities for collaboration and synergy within each segment. The Company evaluates the performance of and allocates resources to its segments based on sales and gross profit. The Company's reportable segments have been identified based on commonality of end markets, customers and technologies amongst the Company's individual product lines, which is consistent with the Company's operating structure and associated management structure. The Company's reportable segment financial information has been restated to reflect the updated reportable segment structure for all periods presented. The Company's reportable segments and their principal activities consist of the following:

Laser Products

The Laser Products segment designs, manufactures, and markets photonics-based solutions, consisting of lasers and laser-based systems, to customers worldwide. The Laser Products segment provides the industrial, scientific, medical, packaging, aerospace and homeland security markets with applications that include cutting, welding, drilling, micro-machining, scientific research, remote sensing, surface marking, and deep engraving of metal and plastic parts. Many of the products are customized for the customer. The Laser Products segment sells these products both directly utilizing a highly technical sales force and indirectly through resellers and distributors.

Precision Motion and Technologies

The Precision Motion and Technologies segment designs, manufactures and markets air bearing spindles, encoders, precision motion devices, thermal printers, and light and color measurement systems to customers worldwide. The majority of these products are based on the segment's core competencies in precision motion and motion control technologies. The vast majority of the segment's product offerings are sold to original equipment manufacturers (OEMs). These products are used in the electronics, aerospace, materials processing, data storage, imaging and other light industrial markets. The Precision Motion and Technologies segment sells these products both directly utilizing a highly technical sales force and indirectly through resellers and distributors.

Semiconductor Systems

The Semiconductor Systems segment designs, develops and sells production systems that process semiconductor wafers using laser beams and high precision technology. The systems manufactured by the Company's Semiconductor Systems segment are sold to integrated device manufacturers and wafer processors. The Semiconductor Systems segment's systems perform laser-based processing on all of the following types of semiconductors: general wafers used for logic or memory purposes, dynamic random access memory (DRAM, Not And or NAND) chips and high performance analog chips.

Reportable Segment Financial Information

| | Three Months Ended | | Six Months Ended | |
|-----------------------------------|--------------------|-----------------|------------------|-----------------|
| | July 1, 2011 | July 2, 2010 | July 1, 2011 | July 2, 2010 |
| | (In thousands) | | | |
| Sales | | | | |
| Laser Products | | | | |
| External | \$ 35,105 | \$ 30,850 | \$ 65,801 | \$ 59,294 |
| Intersegment | 565 | 359 | 1,095 | 627 |
| Precision Motion and Technologies | | | | |
| External | 52,638 | 43,583 | 103,266 | 83,083 |
| Intersegment | 136 | 247 | 367 | 437 |
| Semiconductor Systems | | | | |
| External | 13,627 | 11,304 | 24,161 | 57,975 |
| Intersegment | | | | |
| Intersegment sales elimination | (701) | (606) | (1,462) | (1,064) |
| Total | \$ 101,370 | \$ 85,737 | \$ 193,228 | \$ 200,352 |

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| | Three Months Ended | | Six Months Ended | |
|-----------------------------------|--------------------|------------------|------------------|------------------|
| | July 1, 2011 | July 2, 2010 | July 1, 2011 | July 2, 2010 |
| | (In thousands) | | | |
| Gross Profit | | | | |
| Laser Products | | | | |
| External | \$ 13,990 | \$ 11,423 | \$ 24,785 | \$ 22,359 |
| Intersegment | 334 | 204 | 642 | 358 |
| Precision Motion and Technologies | | | | |
| External | 25,120 | 22,649 | 49,067 | 43,241 |
| Intersegment | 81 | 110 | 201 | 198 |
| Semiconductor Systems | | | | |
| External | 5,883 | 3,984 | 11,035 | 21,494 |
| Intersegment | | | | |
| Intersegment sales elimination | (415) | (314) | (843) | (556) |
| Total | \$ 44,993 | \$ 38,056 | \$ 84,887 | \$ 87,094 |

The Company reports operating expenses and its assets on a consolidated basis to the chief operating decision maker.

14. Related Party Transactions

K. Peter Heiland, a member of the Company's Board of Directors since July 23, 2010, is the owner and manager of JEC II Associates, LLC, a privately held investment company and a significant shareholder of the Company, and was the founder and President of Integrated Dynamics Engineering GmbH (IDE). IDE is a developer and manufacturer of vibration control products, magnetic field compensation systems, acoustic enclosures and robotics. During the three and six months ended July 1, 2011, the Company's Semiconductor Systems segment purchased subassemblies from IDE on terms no more favorable than similar transactions with other of the Company's suppliers.

Michael Katzenstein, Chief Restructuring Officer of the Company from December 14, 2010 through May 31, 2011 and from May 6, 2010 through July 23, 2010, and principal executive officer and member of the Company's Board of Directors from July 23, 2010 through December 14, 2010, is employed by FTI Consulting, Inc. (FTI). The Company engaged FTI in May 2010 to provide for the services of Mr. Katzenstein and certain other temporary employees and management services to support Mr. Katzenstein in his role. From May 2010 to February 2011, Mr. Katzenstein reported directly to the Board of Directors, and beginning in February 2011 Mr. Katzenstein reported to the Company's Chief Executive Officer. On July 28, 2011, the Company and FTI agreed to terminate FTI's engagement as of August 5, 2011. As part of that agreement on July 28, 2011, the Company and FTI agreed that Michael Katzenstein's services as the Company's Chief Restructuring Officer were terminated as of May 31, 2011.

The Company has a separate ongoing arrangement with another segment of FTI, which commenced in November 2009, to provide certain accounting and financial reporting services. This segment of FTI reports directly to the Board of Directors. As a result of these arrangements, the Company incurred fees owed to FTI for services rendered during the three and six months ended July 1, 2011.

Byron O. Pond, a member of the Company's Board of Directors, is also on the Board of Directors and a shareholder of ECRM, Inc. ECRM, Inc. is a manufacturer of laser-based systems used by the printing and publishing industry and a customer of the Company. Additionally, Richard B. Black, the Chairman of the Company prior to the Company's emergence from Chapter 11 bankruptcy protection on July 23, 2010, is the President and Chief Executive Officer of ECRM, Inc. All sales to ECRM, Inc. were made pursuant to the Company's standard contract terms and conditions. The transactions with ECRM, Inc. during the three and six months ended July 1, 2011 were on terms and conditions that were consistent with similar transactions consummated in previous periods.

Prior to the Company's emergence from bankruptcy on July 23, 2010, Sumitomo Heavy Industries Ltd. (Sumitomo), was a significant shareholder of the Company. The Company has recorded sales to and raw material purchases from Sumitomo. The transactions with Sumitomo were on terms believed to be no more or less favorable than similar transactions with other customers and suppliers.

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The following table summarizes the related party transactions in the consolidated statements of operations (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|------------------|-----------------|
| | July 1, 2011 | July 2, 2010 | July 1, 2011 | July 2, 2010 |
| Sales to ECRM, Inc. | \$ 74 | \$ 1 | \$ 77 | \$ 23 |
| Sales to Sumitomo Heavy Industries Ltd. | * | 432 | * | 935 |
| Purchases from Sumitomo Heavy Industries Ltd. | * | 18 | * | 18 |
| Purchases from Integrated Dynamics Engineering Gmbh | 70 | 122 | 155 | 139 |
| Services from FTI Consulting, Inc.** | 866 | 2,150 | 2,271 | 2,150 |

* Not a related party during this period.

** During the three months ended July 1, 2011 and July 2, 2010, \$0.5 million and \$1.1 million, respectively, relates to the accounting and financial reporting services and \$0.4 million and \$1.1 million, respectively, relates to the chief restructuring officer and related services. During the six months ended July 1, 2011 and July 2, 2010, \$1.3 million and \$1.1 million, respectively, relates to the accounting and financial reporting services and \$1.0 million and \$1.1 million, respectively, relates to the chief restructuring officer and related services.

The following table summarizes the related party transactions on the consolidated balance sheets (in thousands):

| | July 1, | December |
|--|---------|-------------|
| | 2011 | 31, 2010 |
| Accounts receivable from ECRM, Inc. | \$ 12 | \$ 45 |
| Accounts receivable from Sumitomo Heavy Industries Ltd. | * | 182 |
| Accounts payable to Sumitomo Heavy Industries Ltd. | * | |
| Accounts payable to Integrated Dynamics Engineering Gmbh | 2 | 88 |
| Accounts payable to FTI Consulting, Inc.** | 161 | 1,000 |

* Not a related party during this period.

** As of July 1, 2011, approximately \$0.1 million relates to the accounting and financial reporting services and approximately \$0.1 relates to the chief restructuring officer and related services. As of December 31, 2010, approximately \$0.9 million relates to the accounting and financial reporting services and approximately \$0.1 relates to the chief restructuring officer and related services.

15. Subsequent Events***Redemption of \$35.0 million of New Notes***

On July 18, 2011, GSI US provided formal notice that it had elected to optionally redeem \$35.0 million in aggregate principal amount (constituting 32% of the currently outstanding \$108.1 million in aggregate principal amount) of its outstanding New Notes, including PIK notes, in accordance with the terms of the New Indenture, pursuant to which the New Notes were issued. In accordance with the New Indenture, the redemption price for the New Notes being redeemed will be 100% of the principal amount of such New Notes, plus accrued and unpaid interest thereon, if any, to, but not including, August 17, 2011, the redemption date. After consummation of this redemption, \$73.1 million in aggregate principal amount of the New Notes, including PIK notes, will remain outstanding. The redemption will be financed from a portion of the available cash and cash equivalents of the Company and its subsidiaries.

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Departure of Chief Restructuring Officer

On July 28, 2011, the Company and FTI agreed to terminate FTI's engagement to provide certain temporary employees to the Company for post-petition crisis and turnaround management services as of August 5, 2011. As part of that agreement on July 28, 2011, the Company and FTI agreed that Michael Katzenstein's services as the Company's Chief Restructuring Officer were terminated as of May 31, 2011.

Appointment of Executive Officers

On August 8, 2011, the Company appointed Jamie Bader, President and Group Executive of the Company's Precision Motion and Technologies segment, and David Clarke, Group Executive of the Company's Laser Products segment, a vice-president and officer of the Company.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with the Consolidated Financial Statements and Notes included in Item 1 of this Quarterly Report on Form 10-Q. The MD&A contains certain forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. In addition to historical financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. These forward-looking statements include, but are not limited to, anticipated financial performance; expected liquidity and capitalization; drivers of revenue growth; management's plans and objectives for future operations, expenditures and product development and investments in research and development; business prospects; potential of future product releases; anticipated sales performance; industry trends; market conditions; changes in accounting principles and changes in actual or assumed tax liabilities; expectations regarding tax exposure; anticipated reinvestment of future earnings; anticipated expenditures in regard to the Company's benefit plans; future acquisitions and dispositions and anticipated benefits from prior acquisitions; anticipated outcomes of legal proceedings and litigation matters; and anticipated use of currency hedges. These forward-looking statements are neither promises nor guarantees, but involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks described in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, and elsewhere in such Annual Report on Form 10-K. In this Quarterly Report on Form 10-Q, the words anticipates , believes , expects , intends , future , could , estimates , plans , would , should , potential , continues , and similar words or expressions (as well as other words or expressions referencing future events, conditions or circumstances) identify forward-looking statements. Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date they are made. Management and the Company disclaim any obligation to publicly update or revise any such statement to reflect any change in its expectations or in events, conditions, or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those contained in the forward-looking statements.

Accounting Period

GSI Group Inc. and its subsidiaries (collectively referred to as the Company , we , us , our) interim financial statements are prepared on a quarterly basis ending on the Friday closest to the end of the calendar quarter, with the exception of the fourth quarter which always ends on December 31st.

Business Overview

We design, develop, manufacture and sell laser-based solutions (consisting of lasers and laser systems), precision motion control devices and associated precision technologies, and semiconductor systems. Our customers incorporate our technology into their products or manufacturing processes for a wide range of applications in a variety of markets, including: industrial, electronics, medical, semiconductor, scientific, and aerospace. Our products enable customers to make advances in materials and processing technology and to meet extremely precise manufacturing specifications. Our products are grouped into three segments: Laser Products, Precision Motion and Technologies, and Semiconductor Systems. We strive to create shareholder value through:

Driving profitable organic sales growth through our participation in attractive end markets;

Delivering a continual stream of successful new product launches incorporating differentiated technology;

Generating high levels of cash flow from operations;

Broadening our product and service offerings through the acquisition of innovative and complementary technologies and solutions;
and

Attracting, retaining and developing talented and motivated employees.

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We realigned the structure of our internal organization during the quarter ended April 1, 2011 in a manner that caused the composition of our reportable segments to change to the following three strategic operating segments: Laser Products, Precision Motion and Technologies and Semiconductor Systems. Our reportable segment financial information has been restated to reflect the updated reportable segment structure for all periods presented.

The Laser Products segment designs, manufactures, and markets photonics-based solutions, consisting of lasers and laser-based systems, to customers worldwide. This segment serves highly demanding photonics based applications such as cutting, welding, marking, engraving, micro-machining, and scientific research. The Precision Motion and Technologies segment designs, manufactures and markets air bearing spindles, encoders, thermal printers, precision motion devices, and

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light and color measurement systems to customers worldwide. The vast majority of this segment's product offerings are sold to original equipment manufacturers (OEMs) based on the segment's core competencies in precision motion and motion control technologies. The Semiconductor Systems segment designs, develops and sells production systems that process semiconductor wafers using laser beams and high precision motion technology. The systems we manufacture are sold to integrated device manufacturers and wafer processors. The systems perform laser-based processing on all of the following types of semiconductors: general wafers used for logic or memory purposes, dynamic random access memory (DRAM, Not And or NAND) chips and high performance analog chips.

Strategy

We strive to expand our presence in the markets we serve both through profitable organic growth and strategic acquisitions. This strategy led to our acquisition of Excel Technologies, Inc. (Excel) in the third quarter of 2008. The acquisition of Excel represented a major step in our effort to penetrate attractive markets that depend on photonics-based solutions. The acquisition also allowed our Laser Products and Precision Motion and Technologies segments to expand our presence in several markets. Our primary focus in the near term will be on the implementation of significant productivity initiatives, the continued development and introduction of new products identifying new market opportunities for new and existing products, and refocusing the product platforms to drive profitable growth. In addition, we may explore potential divestments of non-strategic businesses.

Significant Events*Settlement of SEC Investigation*

On May 16, 2011, we agreed to settle with the United States Securities and Exchange Commission (SEC), without admitting or denying the findings of the SEC, by consenting to the entry of an administrative order that requires the Company to cease and desist from committing or causing any violations and any future violations of the reporting, books and records, and internal controls provisions of the Securities Exchange Act of 1934. The SEC did not charge the Company with fraud nor did the SEC require the Company to pay a civil penalty or other money damages as part of the settlement. The settlement results from the conclusion of an investigation that began on May 14, 2009 when the SEC notified the Company that it was conducting a formal investigation relating to its historical accounting practices and the restatement of its historical consolidated financial statements. The settlement completely resolves the SEC investigation as it relates to the Company.

Resolution of Additional Payment Provision Under the Final Chapter 11 Plan

Under the terms of the modified joint Chapter 11 Plan of Reorganization, as supplemented (the Final Chapter 11 Plan), the Company was obligated to make additional payments to the holders of the \$210.0 million of 11% unsecured senior notes due 2013 (the 2008 Senior Notes) claims in its Chapter 11 bankruptcy proceedings if the amount of certain claims under the Final Chapter 11 Plan exceeded \$22.5 million. The additional payment, if any, would equal approximately \$1.00 for each dollar by which the \$22.5 million cap amount was exceeded. As the Company did not believe it was probable that its losses under these claims exceeded \$22.5 million, nothing had been accrued in the Company's consolidated financial statements with respect to this potential obligation. On June 2, 2011, the U.S. Bankruptcy Court for the District of Delaware entered an order fixing the amount of the additional payment at zero. The order is a final determination that the Company has no actual or contingent future liability for any such payment.

Redemption of \$35.0 Million of New Notes

On July 18, 2011, we provided formal notice that the Company had elected to optionally redeem \$35.0 million in aggregate principal amount (constituting 32% of the currently outstanding \$108.1 million in aggregate principal amount) of its outstanding 12.25% Senior Secured PIK Election Notes, which mature on July 23, 2014 (the New Notes), including PIK notes, in accordance with the terms of the Indenture, pursuant to which the New Notes were issued (New Indenture). In accordance with the New Indenture, the redemption price for the New Notes being redeemed will be 100% of the principal amount of such New Notes, plus accrued and unpaid interest thereon, if any, to, but not including, August 17, 2011, the redemption date. After consummation of this redemption, \$73.1 million in aggregate principal amount of the New Notes, including PIK notes, will remain outstanding.

Table of Contents*Departure of Chief Restructuring Officer*

On July 28, 2011, the Company and FTI agreed to terminate FTI's engagement to provide certain temporary employees to the Company for post-petition crisis and turnaround management services as of August 5, 2011. As part of that agreement on July 28, 2011, the Company and FTI agreed that Michael Katzenstein's services as the Company's Chief Restructuring Officer were terminated as of May 31, 2011.

Appointment of Executive Officers

Effective as of August 8, 2011, we appointed Jamie Bader, President and Group Executive of our Precision Motion and Technologies segment, and David Clarke, Group Executive of our Laser Products segment, a vice-president and officer of the Company.

Overview of Financial Results

As a result of our filing and emergence from bankruptcy, our financial results in 2011 and 2010 differ significantly from each other and from those in prior periods. During the six months ended July 1, 2011, we reported net income of \$16.3 million, compared to net income of \$0.9 million during the six months ended July 2, 2010. Overall sales for the six months ended July 1, 2011 decreased \$7.1 million compared to the six months ended July 2, 2010 primarily as a result of \$42.9 million of revenue recognized in our Semiconductor Systems segment in the six months ended July 2, 2010 as compared to \$0.4 million in the six months ended July 1, 2011 that had been deferred from orders placed by customers prior to 2009, but had not been recognized in the period in which the order was shipped due to previously undelivered elements or unresolved commitments. The revenue related to these orders was recognized once the final deliverables or commitments were resolved. Gross profit on these sales was \$18.3 million and \$0.2 million for the six months ended July 2, 2010 and July 1, 2011, respectively.

Our operating results during the six months ended July 2, 2010 included bankruptcy reorganization items totaling \$20.2 million, with no comparable amounts in 2011. Included in our operating results for the six months ended July 1, 2011 are other non-recurring items, including a charge of \$0.1 million in connection with restructuring, restatement related costs, and other expenses, compared to \$1.7 million during the six months ended July 2, 2010. In addition, our interest expense decreased from \$11.6 million during the six months ended July 2, 2010 to \$7.1 million during the six months ended July 1, 2011 as a result of our emergence from bankruptcy and subsequent decrease in outstanding debt, which was reduced from \$210.0 million to \$107.0 million during the third quarter of 2010.

Results of Operations for the Three Months Ended July 1, 2011 Compared with the Three Months Ended July 2, 2010

The following table sets forth our unaudited results of operations as a percentage of sales for the periods indicated:

| | Three Months Ended | |
|--|---------------------------|-------------------------|
| | July 1, 2011 | July 2, 2010 |
| | (Unaudited) | (Unaudited) |
| Sales | 100.0% | 100.0% |
| Cost of goods sold | 55.6 | 55.6 |
| Gross profit | 44.4 | 44.4 |
| Operating expenses: | | |
| Research and development and engineering | 7.8 | 8.6 |
| Selling, general and administrative | 21.0 | 20.5 |
| Amortization of purchased intangible assets | 1.0 | 1.3 |
| Restructuring, restatement related costs and other | (0.1) | 1.2 |
| Post-emergence professional fees | 0.1 | 0.0 |
| Total operating expenses | 29.8 | 31.6 |
| Income from operations | 14.6 | 12.8 |
| Interest income | 0.0 | 0.0 |

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| | | |
|---|-------|--------|
| Interest expense | (3.4) | (6.7) |
| Foreign exchange transaction gains (losses), net | (0.1) | (0.1) |
| Other income, (expense), net | 0.3 | 1.2 |
| Income from operations before reorganization items and income taxes | 11.4 | 7.2 |
| Reorganization items | 0.0 | (12.4) |
| Income (loss) from operations before income taxes | 11.4 | (5.2) |
| Income tax provision | 1.5 | 0.7 |
| Consolidated net income (loss) | 9.9 | (5.9) |
| Less: Net income attributable to noncontrolling interest | (0.0) | (0.0) |
| Net income (loss) attributable to GSI Group Inc. | 9.9% | (5.9)% |

Table of Contents**Sales**

The following table sets forth external sales by reportable segment for the periods noted (dollars in thousands):

| | Three Months Ended | | | |
|-----------------------------------|---------------------------|-------------------------|--------------------------------|------------------------------|
| | July 1, 2011 | July 2, 2010 | Increase (Decrease) | Percentage Change |
| Laser Products | \$ 35,105 | \$ 30,850 | \$ 4,255 | 13.8% |
| Precision Motion and Technologies | 52,638 | 43,583 | 9,055 | 20.8% |
| Semiconductor Systems | 13,627 | 11,304 | 2,323 | 20.6% |
| Total | \$ 101,370 | \$ 85,737 | \$ 15,633 | 18.2% |

Sales of the various product lines that comprise our Laser Products segment increased by \$4.2 million, or 13.8%, from \$30.9 million during the three months ended July 2, 2010 to \$35.1 million for the three months ended July 1, 2011. Sales increased among most of the laser product lines due to stronger demand versus the prior year, primarily in fiber lasers and our laser products for the scientific and industrial markets.

Sales of the various product lines that comprise our Precision Motion and Technologies segment increased by \$9.0 million, or 20.8%, from \$43.6 million during the three months ended July 2, 2010 to \$52.6 million for the three months ended July 1, 2011. The sales increase was largely the result of strong growth in our air bearing spindles components businesses, which serve a variety of industries including electronics, industrial, medical, and scientific markets. We also had strong growth in our optical scanning devices, including galvanometer technology which provides scientific and OEM optical scanning solutions. These sales increases were partially offset by a decrease in sales in our encoder product line due to weaker demand in the data storage industry.

Semiconductor Systems segment sales transactions are generally multiple element arrangements that are accounted for in accordance with the provisions of Accounting Standards Codification (ASC) 605-25, Multiple Element Arrangements. Due to the multiple element nature of Semiconductor Systems segment sales transactions, revenue recognized in any given period may not correspond to shipments. Semiconductor Systems segment revenues increased by \$2.3 million, or 20.6%, from \$11.3 million during the three months ended July 2, 2010, to \$13.6 million during the three months ended July 1, 2011 primarily due to increased demand for systems in our memory and wafer marking product lines.

Gross Profit

The following table sets forth the external gross profit and external gross profit percentage for each of our reportable segments for the periods noted (dollars in thousands):

| | Three Months Ended | |
|-----------------------------------|---------------------------|-------------------------|
| | July 1, 2011 | July 2, 2010 |
| Gross profit: | | |
| Laser Products | \$ 13,990 | \$ 11,423 |
| Precision Motion and Technologies | 25,120 | 22,649 |
| Semiconductor Systems | 5,883 | 3,984 |
| Total | \$ 44,993 | \$ 38,056 |
| Gross profit percentages: | | |
| Laser Products | 39.9% | 37.0% |
| Precision Motion and Technologies | 47.7% | 52.0% |
| Semiconductor Systems | 43.2% | 35.2% |
| Total | 44.4% | 44.4% |

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Gross profit as a percentage of sales can be influenced by a number of factors, including product mix, pricing from competitors, manufacturing efficiencies and utilization, volume, costs for raw materials and outsourced manufacturing, warranty costs and charges related to excess and obsolete inventory, at any particular time.

During the three months ended July 1, 2011, gross profit of the Laser Products segment increased by \$2.6 million, or 22.5%, from \$11.4 million during the three months ended July 2, 2010 to \$14.0 million during the three months ended July 1, 2011. The Laser Products segment's gross profit margin was 39.9% during the three months ended July 1, 2011, compared with a gross profit margin of 37.0% during the three months ended July 2, 2010. The overall increase in gross profit and gross profit percentage was primarily attributable to the overall increase in sales and product mix.

During the three months ended July 1, 2011, gross profit of the Precision Motion and Technologies segment increased by \$2.5 million, or 10.9%, from \$22.6 million during the three months ended July 2, 2010 to \$25.1 million during the three months ended July 1, 2011, primarily driven by the overall 20.8% increase in gross sales. The Precision Motion and Technologies segment's gross profit margin was 47.7% during the three months ended July 1, 2011, compared with a gross profit margin of 52.0% during the three months ended July 2, 2010. The overall decrease in gross profit percentage was primarily attributable to the decrease in sales of our higher margin encoder products for the data storage industry, and to a lesser extent our product mix in other product lines, which combined to offset the 20.8% increase in sales.

During the three months ended July 1, 2011, gross profit of the Semiconductor Systems segment increased by \$1.9 million, or 47.7%, from \$4.0 million during the three months ended July 2, 2010 to \$5.9 million during the three months ended July 1, 2011. The Semiconductor System segment's gross profit margin was 43.2% during the three months ended July 1, 2011, compared with a gross profit margin of 35.2% during the three months ended July 2, 2010. The increase in the Semiconductor Systems segment gross profit margin and gross profit percentage was primarily attributable to higher utilization and absorption, and favorable product mix in the three months ended July 1, 2011 as compared to the three months ended July 2, 2010.

Operating Expenses

| | Three Months Ended | | Increase (Decrease) | Percentage Change |
|--|--------------------|-----------------|------------------------|----------------------|
| | July 1, 2011 | July 2, 2010 | | |
| Research and development and engineering | \$ 7,946 | \$ 7,399 | \$ 547 | 7.4% |
| Selling, general and administrative | 21,254 | 17,573 | 3,681 | 20.9% |
| Amortization of purchased intangible assets | 987 | 1,126 | (139) | (12.3)% |
| Restructuring, restatement related costs and other | (61) | 1,011 | (1,072) | (106.0)% |
| Post-emergence professional fees | 94 | | 94 | 100.0% |
| Total | \$ 30,220 | \$ 27,109 | \$ 3,111 | 11.5% |

Research and Development and Engineering Expenses

Research and development and engineering (R&D) expenses are primarily comprised of materials, labor and other employee-related expenses. R&D expenses were \$7.9 million, or 7.8% of sales, during the three months ended July 1, 2011 compared with \$7.4 million, or 8.6% of sales, during the three months ended July 2, 2010. R&D expenses, in terms of total dollars, increased as a result of higher project spending for development of new products and technologies, while the decrease in terms of percentage of sales was primarily due to the growth in overall sales.

Table of Contents*Selling, General and Administrative Expenses*

Selling, general and administrative (SG&A) expenses include costs for sales and marketing, sales administration, finance, human resources, legal, information systems, facilities and executive management, and includes personnel related costs, commissions, advertising, legal, tax, accounting and other professional fees. SG&A expenses were \$21.3 million during the three months ended July 1, 2011, representing 21.0% of sales compared to \$17.6 million, or 20.5% of sales, during the three months ended July 2, 2010. SG&A expenses, in terms of total dollars and as a percentage of sales, increased primarily as a result of an increase in sales commissions due to the overall increase in sales, an increase in variable compensation bonuses due to improved financial performance and an increase in eligible participants under our annual incentive plan, an increase in personnel in accounting, finance and IT, and an increase in stock compensation.

Amortization of Purchased Intangible Assets

Amortization of purchased intangible assets, excluding the amortization for core technology that is included in cost of goods sold, was \$1.0 million, or 1.0% of sales, during the three months ended July 1, 2011, compared with \$1.1 million, or 1.3% of sales, during the three months ended July 2, 2010. The decrease in terms of total dollars and as a percentage of sales was due to the completion of amortization of certain intangibles during the second half of 2010 and the increase in overall sales for the reasons previously discussed.

Restructuring, Restatement Related Costs and Other

We recorded restructuring, restatement related costs and other charges of \$(0.1) million and \$1.0 million during the three months ended July 1, 2011 and July 2, 2010, respectively.

Restructuring

During the three months ended July 1, 2011, we recorded a \$0.1 million restructuring benefit related to revised assumptions for our abandoned lease at a German facility, with no comparable amount for the three months ended July 2, 2010.

Restatement Related Costs and Other

During the three months ended July 1, 2011 and July 2, 2010, we incurred costs related to third parties for professional services performed in connection with the restatement of our previously issued financial statements as reported in our Form 10-K for the year-ended December 31, 2008 and our Form 10-Q for the quarter ended September 26, 2008, including, the SEC investigation, certain shareholder actions and the internal Foreign Corrupt Practices Act investigation. These costs totaled less than \$0.1 million during the three months ended July 1, 2011, primarily related to legal fees associated with the SEC investigation, as compared to \$1.0 million during the three months ended July 2, 2010, also primarily related to legal fees associated with the SEC investigation.

Interest Income, Interest Expense, Foreign Exchange Transaction Gains (Losses), Net and Other Income (Expense), Net

| | Three Months Ended | | | |
|---|--------------------|-------------------|-----------------|----------------------|
| | July 1, 2011 | July 2, 2010 | Change | Percentage Change |
| Interest income | \$ 19 | \$ 25 | \$ (6) | (24.0)% |
| Interest expense | (3,414) | (5,747) | 2,333 | (40.6)% |
| Foreign exchange transactions gains (losses), net | (123) | (106) | (17) | 16.0% |
| Other income (expense), net | 358 | 1,081 | (723) | 66.9% |
| Total | \$ (3,160) | \$ (4,747) | \$ 1,587 | (33.4)% |

Interest Expense

Interest expense was \$3.4 million during the three months ended July 1, 2011, as compared to interest expense of \$5.7 million during the three months ended July 2, 2010. The decrease in interest expense was attributable to the reduction of our debt from \$210.0 million to \$107.0 million as part of our emergence from bankruptcy in the third quarter of 2010. The decrease in interest expense was partially offset by a higher interest

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rate on the \$107.0 million debt. In addition, during the three months ended July 1, 2011, we incurred \$0.1 million of non-cash interest expense related to the amortization of deferred financing costs, with no comparable amounts for the three months ended July 2, 2010.

Table of Contents*Foreign Exchange Transaction Gains (Losses), Net*

Foreign exchange currency transaction losses, net, were \$0.1 million during the three months ended July 1, 2011, compared to net losses of \$0.1 million during the three months ended July 2, 2010 due to a consistent weak performance of the U.S. dollar against several foreign currencies in the first quarter of 2011 and 2010.

Other Income (Expense), Net

Other income (expense), net, was \$0.4 million during the three months ended July 1, 2011, compared to \$1.1 million during the three months ended July 2, 2010. During the three months ended July 1, 2011, we recognized \$0.4 million in earnings on our equity investment. During the three months ended July 2, 2010, we recognized a \$0.7 million gain on the sale of a portion of our remaining auction rate securities and \$0.4 million in earnings on our equity investment.

Reorganization Items

Reorganization items represent expense or income amounts that are recorded in the consolidated financial statements as a result of the bankruptcy proceedings. Reorganization items, comprised of professional fees totaling \$10.6 million, were incurred during the three months ended July 2, 2010 with no comparable amount for the three months ended July 1, 2011. See Note 2 to Consolidated Financial Statements.

Income Taxes

The effective tax rate on the income from operations for the three months ended July 1, 2011, was a provision of 13.2% compared with a provision of 14.4% on the loss from operations for the three months ended July 2, 2010. The effective tax rate for the three months ended July 1, 2011 reflects our estimated annual effective tax rate and differs from the Canadian statutory rate primarily due to the income earned in jurisdictions with varying tax rates, an increase in our liability for uncertain tax positions, and the release of a portion of our valuation allowance.

Results of Operations for the Six Months Ended July 1, 2011 Compared to the Six Months Ended July 2, 2010

The following table sets forth our unaudited results of operations as a percentage of sales for the periods indicated:

| | Six Months Ended | |
|--|--------------------------------|--------------------------------|
| | July 1, 2011 (Unaudited) | July 2, 2010 (Unaudited) |
| Sales | 100.0% | 100.0% |
| Cost of goods sold | 56.1 | 56.5 |
| Gross profit | 43.9 | 43.5 |
| Operating expenses: | | |
| Research and development and engineering | 8.3 | 7.4 |
| Selling, general and administrative | 21.0 | 17.6 |
| Amortization of purchased intangible assets | 1.0 | 1.1 |
| Restructuring, restatement related costs and other | 0.1 | 0.8 |
| Post-emergence professional fees | 0.1 | 0.0 |
| Total operating expenses | 30.5 | 26.9 |
| Income from operations | 13.4 | 16.6 |
| Interest income | 0.0 | 0.0 |
| Interest expense | (3.7) | (5.8) |
| Foreign exchange transaction gains (losses), net | (0.4) | 0.1 |
| Other income (expense), net | 0.7 | 0.9 |

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| | | |
|---|-------|--------|
| Income from operations before reorganization items and income taxes | 10.0 | 11.8 |
| Reorganization items | (0.0) | (10.1) |
| Income from operations before income taxes | 10.0 | 1.7 |
| Income tax provision | 1.6 | 1.2 |
| Consolidated net income | 8.4 | 0.5 |
| Less: Net income attributable to noncontrolling interest | (0.0) | (0.0) |
| Net income attributable to GSI Group Inc. | 8.4% | 0.5% |

Table of Contents**Sales**

The following table sets forth external sales by reportable segment for the periods noted (dollars in thousands):

| | July 1, 2011 | Six Months Ended | | Percentage Change |
|-----------------------------------|-----------------|------------------|------------------------|----------------------|
| | | July 2, 2010 | Increase (Decrease) | |
| Laser Products | \$ 65,801 | \$ 59,294 | \$ 6,507 | 11.0% |
| Precision Motion and Technologies | 103,266 | 83,083 | 20,183 | 24.3% |
| Semiconductor Systems | 24,161 | 57,975 | (33,814) | (58.3)% |
| Total | \$ 193,228 | \$ 200,352 | \$ (7,124) | (3.6)% |

Sales of the various product lines that comprise our Laser Products segment increased by \$6.5 million, or 11.0%, from \$59.3 million during the six months ended July 2, 2010 to \$65.8 million for the six months ended July 1, 2011. Sales increased among most of the laser product lines due to stronger demand, primarily in fiber lasers and our laser products for the scientific and industrial markets.

Sales of the various product lines that comprise our Precision Motion and Technologies segment increased by \$20.2 million, or 24.3%, from \$83.1 million during the six months ended July 2, 2010 to \$103.3 million for the six months ended July 1, 2011. The sales increase was largely the result of strong growth in our air bearing spindles components and optical scanning devices. These sales increases were partially offset by a decrease in sales in our encoder product line due to weaker demand in the data storage industry.

Semiconductor Systems segment sales transactions are generally multiple element arrangements that are accounted for in accordance with the provisions of ASC 605-25. Due to the multiple element nature of Semiconductor Systems segment sales transactions, revenue recognized in any given period may not correspond to shipments. Semiconductor Systems segment revenues decreased by \$33.8 million, or 58.3%, from \$58.0 million during the six months ended July 2, 2010, to \$24.2 million during the six months ended July 1, 2011. Sales for the six months ended July 2, 2010 included \$42.9 million that had been deferred from orders placed by customers prior to 2009, but had not been recognized in the period in which the order was shipped due to previously undelivered elements or unresolved commitments. The final remaining \$0.4 million of revenue deferred on these orders was recognized during the six months ended July 1, 2011. Exclusive of these transactions, we experienced increased demand for systems in our memory and wafer marking product lines during the six months ended July 1, 2011 compared to the six months ended July 2, 2010.

Gross Profit

The following table sets forth the external gross profit and external gross profit percentage for each of our reportable segments for the periods noted (dollars in thousands):

| | Six Months Ended | |
|-----------------------------------|------------------|--------------|
| | July 1, 2011 | July 2, 2010 |
| Gross profit: | | |
| Laser Products | \$ 24,785 | \$ 22,359 |
| Precision Motion and Technologies | 49,067 | 43,241 |
| Semiconductor Systems | 11,035 | 21,494 |
| Total | \$ 84,887 | \$ 87,094 |
| Gross profit percentages: | | |
| Laser Products | 37.7% | 37.7% |
| Precision Motion and Technologies | 47.5% | 52.0% |
| Semiconductor Systems | 45.7% | 37.1% |

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Total

43.9%

43.5%

34

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Gross profit as a percentage of sales can be influenced by a number of factors, including product mix, pricing from competitors, manufacturing efficiencies and utilization, volume, costs for raw materials and outsourced manufacturing, warranty costs and charges related to excess and obsolete inventory, at any particular time.

During the six months ended July 1, 2011, gross profit of the Laser Products segment increased by \$2.4 million, or 10.9%, from \$22.4 million during the six months ended July 2, 2010 to \$24.8 million during the six months ended July 1, 2011. The Laser Products segment's gross profit margin was 37.7% during the six months ended July 1, 2011, compared with a gross profit margin of 37.7% during the six months ended July 2, 2010. The overall increase in gross profit was due to the growth in sales, and the consistent gross profit percentage was primarily attributable to product mix, which resulted in improved margins during the second quarter of 2011 compared to the first quarter of 2011.

During the six months ended July 1, 2011, gross profit of the Precision Motion and Technologies segment increased by \$5.9 million, or 13.5%, from \$43.2 million during the six months ended July 2, 2010 to \$49.1 million during the six months ended July 1, 2011, primarily driven by the overall 24.3% increase in gross sales. The Precision Motion and Technologies segment's gross profit margin was 47.5% during the six months ended July 1, 2011, compared with a gross profit margin of 52.0% during the six months ended July 2, 2010. The overall increase in gross profit was due to the overall net increase in sales, while the decrease in gross profit percentage was primarily attributable to the decrease in sales of our higher margin encoders for the data storage industry, and certain production inefficiencies in some of our product lines, which combined to offset the 24.3% increase in sales.

During the six months ended July 1, 2011, gross profit of the Semiconductor Systems segment decreased by \$10.5 million, or 48.7%, from \$21.5 million during the six months ended July 2, 2010 to \$11.0 million during the six months ended July 1, 2011, primarily as a result of the impact of the \$42.9 million of revenue recognized in the six months ended July 2, 2010 related to orders received prior to 2009, as compared to the final remaining \$0.4 million recognized in the six months ended July 1, 2011. The Semiconductor System segment's gross profit margin was 45.7% during the six months ended July 1, 2011, compared with a gross profit margin of 37.1% during the six months ended July 2, 2010. The increase in the Semiconductor Systems segment gross profit margin percentage was primarily attributable to higher utilization and absorption (exclusive of the impact of the \$42.9 million of revenue recognized from orders placed and shipped prior to 2009), favorable product mix, and lower excess, obsolete and warranty costs in the three months ended July 1, 2011 as compared to the three months ended July 2, 2010.

Operating Expenses

| | Six Months Ended | | Increase (Decrease) | Percentage Change |
|--|------------------|------------------|------------------------|----------------------|
| | July 1, 2011 | July 2, 2010 | | |
| Research and development and engineering | \$ 16,117 | \$ 14,764 | \$ 1,353 | 9.2% |
| Selling, general and administrative | 40,522 | 35,145 | 5,377 | 15.3% |
| Amortization of purchased intangible assets | 1,979 | 2,254 | (275) | (12.2)% |
| Restructuring, restatement related costs and other | 122 | 1,679 | (1,557) | (92.7)% |
| Post-emergence professional fees | 233 | | 233 | 100.0% |
| Total | \$ 58,973 | \$ 53,842 | \$ 5,131 | 9.5% |

Research and Development and Engineering Expenses

Research and development and engineering expenses are primarily comprised of labor and other employee-related expenses. R&D expenses were \$16.1 million, or 8.3% of sales, during the six months ended July 1, 2011 compared with \$14.8 million, or 7.4% of sales, during the six months ended July 2, 2010. R&D expenses, in terms of total dollars, increased as a result of increased headcount and higher project spending for development of new products and technologies, while the increase in terms of percentage of sales was primarily due to the decrease in overall sales.

Selling, General and Administrative Expenses

Selling, general and administrative expenses include costs for sales and marketing, sales administration, finance, human resources, legal, information systems, facilities and executive management, and includes personnel related costs, commissions, advertising, legal, tax, accounting and other professional fees. SG&A expenses were \$40.5 million during the six months ended July 1, 2011, representing 21.0% of sales compared to \$35.1 million, or 17.6% of sales, during the six months ended July 2, 2010. SG&A expenses, in terms of total dollars and as a

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percentage of sales, increased primarily as a result of an increase in sales commissions due to increased selling activities, an increase in variable compensation bonuses due to improved financial performance and an increase in eligible participants under our annual incentive plan and

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performance in the first half of 2011 compared to the first half of 2010, which included the recognition of \$42.9 million of revenue recognized from orders placed and shipped prior to 2009. SG&A also increased due to an increase in personnel in accounting, finance and IT and an increase in stock compensation.

Amortization of Purchased Intangible Assets

Amortization of purchased intangible assets, excluding the amortization for core technology that is included in cost of goods sold, was \$2.0 million, or 1.0% of sales, during the six months ended July 1, 2011, compared with \$2.3 million, or 1.1% of sales, during the six months ended July 2, 2010. The decrease in terms of total dollars was due to the completion of amortization of certain intangibles during the second half of 2010.

Restructuring, Restatement Related Costs and Other

We recorded restructuring, restatement related costs and other charges of \$0.1 million and \$1.7 million during the six months ended July 1, 2011 and July 2, 2010, respectively.

Restructuring

During the six months ended July 1, 2011, we recorded a \$0.1 million restructuring charge related to revised assumptions for our abandoned lease at a German facility, with no comparable amount for the six months ended July 2, 2010.

Restatement Related Costs and Other

During the six months ended July 1, 2011 and July 2, 2010, we incurred costs related to third parties for professional services performed in connection with the restatement of our previously issued financial statements as reported in our Form 10-K for the year-ended December 31, 2008 and our Form 10-Q for the quarter ended September 26, 2008, including, the SEC investigation, certain shareholder actions and the internal Foreign Corrupt Practices Act investigation. These costs totaled \$0.1 million during the six months ended July 1, 2011, primarily related to legal fees associated with the SEC investigation, as compared to \$1.7 million during the six months ended July 2, 2010, primarily related to legal fees associated with the SEC investigation and accounting and tax fees associated with the restatement of our previously issued financials.

Interest Income, Interest Expense, Foreign Exchange Transaction Gains (Losses), Net and Other Income (Expense), Net

| | Six Months Ended | | | |
|---|-------------------------|-------------------------|-----------------|------------------------------|
| | July 1, 2011 | July 2, 2010 | Change | Percentage Change |
| Interest income | \$ 39 | \$ 50 | \$ (11) | (22.0)% |
| Interest expense | (7,084) | (11,555) | 4,471 | (38.7)% |
| Foreign exchange transactions gains (losses), net | (815) | 263 | (1,078) | (409.9)% |
| Other income, net | 1,388 | 1,686 | (298) | (17.7)% |
| Total | \$ (6,472) | \$ (9,556) | \$ 3,084 | (32.3)% |

Interest Expense

Interest expense was \$7.1 million during the six months ended July 1, 2011, as compared to interest expense of \$11.6 million during the six months ended July 2, 2010. The decrease in interest expense was attributable to the reduction of our debt from \$210.0 million to \$107.0 million as part of our emergence from bankruptcy in the third quarter of 2010. The decrease in interest expense was partially offset by a higher interest rate on the \$107.0 million debt. In addition, during the six months ended July 1, 2011 we incurred \$0.5 million of non-cash interest expense of which \$0.3 million was related to reporting default PIK interest of 2% on the new debt and \$0.2 million was related to the amortization of deferred financing costs, with no comparable amounts for the six months ended July 2, 2010.

Foreign Exchange Transaction Gains (Losses), Net

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Foreign exchange currency transaction losses, net, were \$0.8 million during the six months ended July 1, 2011, compared to gains, net of \$0.3 million during the six months ended July 2, 2010 due to the weakening of the U.S. dollar against several foreign currencies in the first quarter of 2011 as compared to the strengthening of the U.S. dollar in the first quarter of 2010.

Table of Contents***Other Income (Expense), Net***

Other income (expense), net, was \$1.4 million during the six months ended July 1, 2011, compared to \$1.7 million during the six months ended July 2, 2010. During the six months ended July 1, 2011, we recognized \$1.4 million in earnings on our equity investment. During the six months ended July 2, 2010, other income is primarily comprised of recognition of a \$1.0 million gain on the sale of our remaining auction rate securities and \$0.6 million in earnings on our equity investment.

Reorganization Items

Reorganization items represent expense or income amounts that are recorded in the consolidated financial statements as a result of the bankruptcy proceedings. Reorganization items, comprised of professional fees totaling \$20.2 million, were incurred during the six months ended July 2, 2010 with no comparable amount for the six months ended July 1, 2011. See Note 2 to Consolidated Financial Statements.

Income Taxes

The effective tax rate on the income from operations for the six months ended July 1, 2011, was a provision of 16.0% compared with a provision of 71.4% on income from operations for the six months ended July 2, 2010. The effective tax rate for the six months ended July 1, 2011 reflects our estimated annual effective tax rate and differs from the Canadian statutory rate primarily due to the income earned in jurisdictions with varying tax rates, an increase in our liability for uncertain tax positions, and the release of a portion of our valuation allowance.

Liquidity and Capital Resources

On November 20, 2009, our holding company, GSI Group Inc. (GSI), and two of our wholly-owned United States subsidiaries, GSI Group Corporation (GSI US) and MES International, Inc. (MES), and, collectively with GSI and GSI US, the Debtors filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware.

Upon our emergence from bankruptcy on July 23, 2010, GSI US issued \$107.0 million of 12.25% Senior Secured PIK Election Notes, which mature in July 2014. Interest accrues on the New Notes at a rate of 12.25% per year and is payable quarterly in arrears on February 15, May 15, August 15 and November 15 of each year, commencing on August 15, 2010. We may elect to pay the interest in cash, or, under certain conditions, by increasing the principal amount of the New Notes or issuing additional notes on the same terms and conditions as the existing New Notes (PIK). However, we are required to pay cash interest if our fixed charge coverage ratio is greater than 1.75 to 1.00. The interest rate on the New Notes may be increased upon certain defaults, as defined in the New Indenture. Interest PIK notes issued and PIK payments in lieu of cash payments accrue at a rate of 13%. If the New Notes remain outstanding until their scheduled maturity date in 2014, annual interest expense on the New Notes would be approximately \$13.2 million per year from 2011 to 2013 and \$7.5 million in 2014. Cash paid for interest on the New Notes was \$6.6 million for the six months ended July 1, 2011. The New Notes may be repaid at any time without penalty.

On July 18, 2011, we provided formal notice that we had elected to optionally redeem \$35.0 million in aggregate principal amount (constituting 32% of the currently outstanding \$108.1 million in aggregate principal amount) of our outstanding New Notes, including PIK notes, in accordance with the terms of the New Indenture, pursuant to which the New Notes were issued. In accordance with the New Indenture, the redemption price for the New Notes being redeemed will be 100% of the principal amount of such New Notes, plus accrued and unpaid interest thereon, if any, to, but not including, August 17, 2011, the redemption date. After consummation of this redemption, \$73.1 million in aggregate principal amount of the New Notes, including PIK notes, will remain outstanding.

The redemption will be financed from a portion our available cash and cash equivalents. As of July 1, 2011, prior to the pending redemption of \$35 million in aggregate principal amount of our outstanding New Notes, our cash and cash equivalents balance was approximately \$74.0 million. We continue to pursue a refinancing of all of the \$73.1 million in aggregate principal amount of such remaining New Notes, which we currently expect to complete in the third quarter of 2011.

As a result of our emergence from bankruptcy, the associated restructuring of our debt obligations, and our current level of business activity, we believe we will have sufficient liquidity to fund our operations through at least the end of 2012. However, our ability to make payments on or to refinance our indebtedness and to fund planned capital expenditures and research and development efforts will depend on our ability to generate cash in the future and have access to capital markets. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

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We cannot assure you that our business will generate sufficient cash flow from operations, that currently anticipated cost savings and operating improvements will be realized on schedule or that future borrowings will be available to us in an amount sufficient to enable us to pay our indebtedness or to fund our other liquidity needs. We or our affiliates may from time to time refinance, retire or repurchase our outstanding debt through cash purchases and/or exchanges for equity securities, in open market purchases, privately negotiated transactions, tender offers, redemptions under the terms of our outstanding debt or otherwise. Such refinancing, repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material and could have a material effect on the trading market for such debt and on our liquidity, cash flows and capital commitments and resources. We may need to refinance all or a portion of our indebtedness before it matures, including the New Notes on or before their maturity in 2014. Under the terms of the New Indenture, GSI US may obtain a working capital facility of up to \$40 million with the consent of the noteholders, whose consent cannot be unreasonably withheld. To the extent the aggregate principal amount of the outstanding indebtedness under the working capital facility exceeds \$20 million, or upon certain asset sales, GSIG or GSI US will be required to offer to use such excess working capital proceeds or excess net proceeds, as applicable, to make an offer to purchase a portion of the New Notes at 100% of the principal amount thereof. We cannot assure you that we will be able to refinance any of our indebtedness, including the New Notes, on commercially reasonable terms or at all. See **Risks Relating to Our Common Shares and Our Capital Structure**. To service our indebtedness and fund our operations, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control included in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on March 30, 2011.

As a result of the non-timely filing of our Annual Reports on Form 10-K for the years ended December 31, 2008 and 2009 and our Quarterly Reports on Form 10-Q for the quarters ended September 26, 2008, April 3, 2009, July 3, 2009, October 2, 2009, April 2, 2010, July 2, 2010 and October 1, 2010 with the SEC, we will be ineligible to register our securities on Form S-3 for sale by us or resale by others until January 1, 2012 so long as we remain timely in our SEC reporting obligations. While we may use Form S-1 to raise capital or complete acquisitions, the use of Form S-1 could increase transaction costs and adversely impact our ability to raise capital or complete acquisitions of other companies in a timely manner.

Cash Flows for Six Months Ended July 1, 2011 and July 2, 2010

Cash and cash equivalents totaled \$74.0 million at July 1, 2011, compared to \$56.8 million at December 31, 2010. The increase in cash and cash equivalents is primarily related to stronger sales and profitability.

Cash provided by operating activities during the six months ended July 1, 2011 was \$17.9 million, compared to \$14.5 million during the six months ended July 2, 2010, an increase of \$3.4 million. The increase in cash provided by operating activities was primarily attributable to the following factors:

For the six months ended July 1, 2011, we recorded consolidated net income of \$16.3 million, compared to \$1.0 million during the six months ended July 2, 2010, before non-cash adjustments to reconcile net income to net cash from operating activities. Non-cash adjustments to reconcile net income to cash provided by operating activities totaled \$11.6 million for the six months ended July 1, 2011, compared to \$10.0 million for the six months ended July 2, 2010.

Cash used in operations as a result of net changes in our operating assets and liabilities totaled \$10.0 million during the six months ended July 1, 2011, compared to cash provided by operations of \$3.5 million during the six months ended July 2, 2010 and included the following items:

An increase in our accounts receivable during the six months ended July 1, 2011 resulted in a use of cash of \$2.6 million, compared to a use of cash of \$5.0 million during the six months ended July 2, 2010.

An increase in our inventory balance during the six months ended July 1, 2011 resulted in a use of cash of \$6.5 million, compared to a use of cash of \$2.1 million during the six months ended July 2, 2010.

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The net change to deferred revenue and related deferred cost of goods sold resulted in a use of cash of \$3.2 million during the six months ended July 1, 2011, compared to \$15.6 million during the six months ended July 2, 2010, a net change of \$12.4 million.

A net increase in accounts payable and accrued expenses provided \$2.2 million of cash during the six months ended July 1, 2011, compared to \$23.6 million cash provided during the six months ended July 2, 2010. The increase in our accounts payable and accrued expenses in 2010 was due to the deferral of payments on certain of our liabilities while we were in bankruptcy, including the interest payments on our \$210.0 million debt.

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Tax refunds were less than \$0.1 million during the six months ended July 1, 2011, compared to \$1.8 million during the six months ended July 2, 2010.

Cash used in investing activities was \$1.7 million during the six months ended July 1, 2011, compared to cash provided by investing activities of \$10.2 million during the six months ended July 2, 2010 and included the following items:

We used \$1.7 million of cash during the six months ended July 1, 2011 for capital expenditures, compared to \$1.2 million during the six months ended July 2, 2010.

We sold \$13.0 million in par value auction rate securities for proceeds of \$11.4 million during the six months ended July 2, 2010, with no comparable amount during the six months ended July 1, 2011.

We did not have any cash related financing activities in the six months ended July 1, 2011. Cash used in financing activities related to payments made for debt issuances costs and totaled \$0.5 million during the six months ended July 2, 2010.

In addition to cash flows from operating and investing activities, exchange rate changes resulted in an increase of \$1.0 million in our cash balances during the six months ended July 1, 2011, compared to a \$0.2 million decrease during the six months ended July 2, 2010.

Other Liquidity Matters

Pension Plans

We maintain two plans that are considered to be defined benefit plans under the provisions of ASC 715, *Defined Benefit Plans*, a plan in the U.K. (the *U.K. Plan*), and a plan in Japan. Our funding policy is to fund pensions and other benefits based on actuarial methods as permitted by regulatory authorities. The results of funding valuations depend on the assumptions that we make with regard to attributes such as asset returns, rates of members' benefits increases, mortality, retail price inflation and other market driven changes. The assumptions used represent one estimate of a possible future outcome. The final cost to us will be determined by events as they actually become known. Because of the underfunded positions that our pension plans currently have and potential changes in the actual outcomes relative to our assumptions, we may have to increase payments to fund these plans in the future.

In the U.K., funding valuations are conducted every three years in order to determine the future level of contributions. Our latest funding valuation was completed in October 2010 and based on the results of the valuation, we are increasing our annual contributions to the U.K. Plan from approximately \$0.6 million to \$0.8 million annually through 2020. The Japanese plan includes a guarantee of return of principal and yearly interest 0.75%; therefore, there are no significant fluctuations in this plan. See Note 9 to Consolidated Financial Statements for further information about these plans.

As a result of the covenant that exists between our U.K. subsidiary and the Plan Trustees regarding the funding of the U.K. Plan, our ability to transfer assets outside our U.K. subsidiary, and its wholly owned subsidiary in China, may be limited.

Off-Balance Sheet Arrangements, Contractual Obligations

Contractual Obligations

Historically, our contractual obligations have primarily consisted of the principal and interest associated with our 12.25% Senior Secured PIK Election Notes due 2014, operating leases, purchase commitments and pension obligations. Such contractual obligations are described in our Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to Consolidated Financial Statements, each included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on March 30, 2011. Through July 1, 2011, we have not entered into any material new or modified contractual obligations since the end of the fiscal year ended December 31, 2010.

Off-Balance Sheet Arrangements

Through July 1, 2011, we have not entered into any off-balance sheet arrangements or material transactions with unconsolidated entities or other persons.

Critical Accounting Policies and Estimates

The critical accounting policies that we believe impact significant judgments and estimates used in the preparation of our consolidated financial statements presented in this report are described in our Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to Consolidated Financial Statements, each included in our

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Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on March 30, 2011. Other than the adoption of certain revenue guidance as discussed below, there have been no material changes to our critical accounting policies through July 1, 2011 from those discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on March 30, 2011.

During the three months ended April 1, 2011, we adopted the guidance in Accounting Standards Update (ASU) ASU 2009-13, Multiple-Deliverable Revenue Arrangements (ASU 2009-13) and ASU 2009-14, Certain Revenue Arrangements that Include Software Elements (ASU 2009-14). We adopted ASU 2009-13 and ASU 2009-14 effective January 1, 2011 on a prospective basis. The adoption of these standards is more fully discussed in Note 3 to Consolidated Financial Statements.

Recent Accounting Pronouncements

See Note 3 to Consolidated Financial Statements for recent accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our primary market risk exposures are foreign currency exchange rate fluctuation and interest rate sensitivity. During the quarter ended July 1, 2011, there have been no material changes to the information included under Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on March 30, 2011.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 under the Exchange Act, our management carried out an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures, as of July 1, 2011, the end of the period covered by this report. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) were not effective as of July 1, 2011, because of the following material weakness in our internal control over financial reporting, which is more fully described in Item 9A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 and incorporated by reference herein, and which has not been remediated as of July 1, 2011:

Inadequate and ineffective controls over the financial statement close process.

Changes in Internal Control Over Financial Reporting

We are taking corrective actions to remediate the material weakness listed above, including remediation actions described in Item 9A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 and incorporated by reference herein. However, as of July 1, 2011, we have not completed the remediation of the above material weakness.

Other than as noted above, there has been no change in our internal control over financial reporting that occurred during our fiscal quarter ended July 1, 2011 that has materially affected, or is reasonably likely to materially affect, such internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

During the third quarter of 2005, the Company's French subsidiary, GSI Lumonics SARL (GSI France), filed for bankruptcy protection, which was granted on July 7, 2005. On April 18, 2006, the commercial court of Le Creusot (France) ordered GSI France to pay approximately 0.7 million Euros to SCGI in the context of a claim filed by SCGI that a Laserdyne 890 system delivered in 1999 had unresolved technical problems. No appeal was lodged. On May 6, 2011, GSI Group Ltd. was served with summons from the official receiver of GSI France demanding that GSI Group Ltd. and the Company's German subsidiary, GSI Lumonics GmbH, appear before the Paris commercial court. The receiver claims (i) that the bankruptcy proceedings initiated against GSI France in 2005 should be extended to GSI Group Ltd. and GSI Lumonics GmbH on the ground that GSI France's decisions were actually made by GSI Group Ltd. and that GSI Lumonics GmbH made financial advances for no consideration, which would reveal in both cases confusion of personhood, or (ii) alternatively, that GSI Group Ltd. be ordered to pay approximately 3.1 million Euros (i.e. the aggregate of GSI France's liabilities, consisting primarily of approximately 0.7 million Euros to SCGI and approximately 2.4 million Euros to GSI Lumonics GmbH). The Company is investigating the matter but currently does not believe a loss is probable. Accordingly, nothing has been accrued in the Company's accompanying consolidated financial statements with respect to this claim.

On December 12, 2008, in connection with the delayed filing of its results for the quarter ended September 26, 2008, and the announcement of a review of revenue transactions, a putative shareholder class action alleging federal securities violations was filed in the United States District Court for the District of Massachusetts (U.S. District Court) against the Company, a former officer and a then-current officer and director. The complaint alleged that the Company and the individual defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, and sought recovery of damages in an unspecified amount. In May 2010, the parties reached an agreement in principle to settle the litigation. The settlement covered purchasers of the common stock of the Company between February 27, 2007 and June 30, 2009. On February 22, 2011, the U.S. District Court entered an order granting final approval of the settlement in the putative shareholder class action. The Company's contribution to the settlement amount was limited to the Company's self-insured retention under its directors and officers liability insurance policy.

The Company is also subject to various legal proceedings and claims that arise in the ordinary course of business. The Company does not believe that the outcome of these claims will have a material adverse effect upon its financial condition or results of operations but there can be no assurance that any such claims, or any similar claims, would not have a material adverse effect upon its financial condition or results of operations.

Chapter 11 Cases

On November 20, 2009, the Debtors filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for Delaware (the Bankruptcy Court) (the Chapter 11 Cases). On May 27, 2010, the Bankruptcy Court entered an order confirming and approving a modified joint Chapter 11 plan of reorganization for the Debtors, which was further supplemented (as supplemented, the Final Chapter 11 Plan) and the Plan Documents (as defined in the Final Chapter 11 Plan). On July 23, 2010, the Debtors consummated their reorganization through a series of transactions contemplated by the Final Chapter 11 Plan, and the Final Chapter 11 Plan became effective pursuant to its terms. While the Chapter 11 Cases are still open as a technical matter, the Company no longer has any legal or material financial constraint relating to those cases, and expects to obtain final closing (legal conclusion) of those cases prior to the end of the 2011 calendar year. See Note 12 to Consolidated Financial Statements for additional information on claims and Note 2 to Consolidated Financial Statements for additional information on the Chapter 11 Cases.

On April 5, 2010, the IRS filed amended proofs of claim aggregating approximately \$7.7 million with the Bankruptcy Court. On July 13, 2010, the Company filed a complaint, *GSI Group Corporation v. United States of America*, in Bankruptcy Court in an attempt to recover refunds totaling approximately \$18.8 million in federal income taxes the Company asserts it overpaid to the IRS relating to tax years 2000 through 2008, together with applicable interest. The complaint includes an objection to the IRS' proofs of claim which the Company believes are not allowable claims and should be expunged in their entirety. Those tax proceedings remain pending, and their resolution in the ordinary course will not be affected by the expected closing of the Chapter 11 Cases.

In addition, under the terms of the Final Chapter 11 Plan, the Company was obligated to make additional payments to the holders of 2008 Senior Notes claims in its Chapter 11 Cases if the amount of certain claims under the Final Chapter 11 Plan exceeded \$22.5 million. The additional payment, if any, would equal approximately \$1.00 for each dollar by which the \$22.5 million cap amount was exceeded. As the Company did not believe it was probable that its losses under these claims exceeded \$22.5 million, nothing had been accrued in the Company's consolidated

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financial statements with respect to this potential obligation. On June 2, 2011, the Bankruptcy Court entered an order fixing the amount of the additional payment at zero. The order is a final determination that the Company has no actual or contingent future liability for any such payment.

Settlement of SEC Investigation

On May 16, 2011, the Company agreed to settle with the SEC, without admitting or denying the findings of the SEC, by consenting to the entry of an administrative order that requires the Company to cease and desist from committing or causing any violations and any future violations of the reporting, books and records, and internal controls provisions of the Securities Exchange Act of 1934. The SEC did not charge the Company with fraud nor did the SEC require the Company to pay a civil penalty or other money damages as part of the settlement. The settlement results from the conclusion of an

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investigation that began on May 14, 2009 when the SEC notified the Company that it was conducting a formal investigation relating to its historical accounting practices and the restatement of its historical consolidated financial statements. The settlement completely resolves the SEC investigation as it relates to the Company.

Item 1A. Risk Factors

The Company's risk factors are described in Part I, Item 1A, "Risk Factors", of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on March 30, 2011. There have been no material changes in the risks affecting the Company since the filing of such Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. [Removed and Reserved]**Item 5. Other Information**

None.

Item 6. Exhibits*List of Exhibits*

See the Company's SEC filings on Edgar at: <http://www.sec.gov/> for all Exhibits.

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | | Filed Herewith |
|-------------------|--|---------------------------|-----------|---------|----------|-------------------|
| | | Form | File No. | Exhibit | Date | |
| 3.1 | Certificate and Articles of Continuance of the Registrant, dated March 22, 1999. | S-4/A | 333-71449 | Annex H | 2/11/99 | |
| 3.2 | By-Laws of the Registrant, as amended | 10-Q | 000-25705 | 3.2 | 4/13/10 | |
| 3.3 | Articles of Reorganization of the Registrant, dated July 23, 2010. | 8-K | 000-25705 | 3.1 | 07/23/10 | |
| 3.4 | Articles of Amendment of the Registrant, dated December 29, 2010. | 8-K | 000-25705 | 3.1 | 12/29/10 | |
| 4.8 | Indenture, dated as of July 23, 2010, by and among GSI Group Corporation, as Issuer, the Guarantors named therein and The Bank of New York Mellon Trust Company, N.A., as trustee. | 8-K | 000-25705 | 4.1 | 7/23/10 | |

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| | | | | | | |
|------|--|-----|-----------|------|-----------|---|
| 4.9 | Registration Rights Agreement, by and between the Registrant and the Common Shareholders named therein, dated as of July 23, 2010. | 8-K | 000-25705 | 4.2 | 7/23/10 | |
| 10.1 | Severance Agreement, dated as of April 25, 2011, by and between GSI Group Inc. and David Clarke. | | | | | * |
| 10.2 | Letter Agreement, dated as of June 21, 2011, between GSI Group Inc. and Anthony Bellantuoni. | 8-K | 001-35083 | 10.1 | 6/22/2011 | |
| 10.3 | Offer Letter, dated June 23, 2011, between GSI Group Inc. and Jamie Bader. | | | | | * |
| 31.1 | Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | | * |
| 31.2 | Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | | * |

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| | | |
|---------|---|---|
| 32.1 | Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | * |
| 32.2 | Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | * |
| 101.INS | XBRL Instance Document. | |
| 101.CAL | XBRL Calculation Linkbase Document. | |
| 101.DEF | XBRL Definition Linkbase Document. | |
| 191.LAB | XBRL Labels Linkbase Document. | |
| 101.PRE | XBRL Presentation Linkbase Document. | |

This exhibit constitutes a management contract, compensatory plan, or arrangement.

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets at July 1, 2011 and December 31, 2010, (ii) Consolidated Statements of Operations for the three and six months ended July 1, 2011 and July 2, 2010, (iii) Consolidated Statements of Cash Flows for the six months ended July 1, 2011 and July 2, 2010, and (iv) Notes to Consolidated Financial Statements.

The XBRL related information in Exhibits 101 to this Quarterly Report on Form 10-Q shall not be deemed filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended and is not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of those sections.

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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.

GSI Group Inc. (Registrant)

| | Name | Title | Date |
|-----|---|--|-----------------|
| /s/ | John A. Roush John A. Roush | Director, Chief Executive Officer | August 11, 2011 |
| /s/ | Robert Buckley Robert Buckley | Chief Financial Officer (Principal Accounting Officer) | August 11, 2011 |

Table of Contents**EXHIBIT INDEX**

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| 191.LAB | XBRL Labels Linkbase Document. | | | | | |
| 101.PRE | XBRL Presentation Linkbase Document. | | | | | |

This exhibit constitutes a management contract, compensatory plan, or arrangement. Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language):

(i) Consolidated Balance Sheets at July 1, 2011 and December 31, 2010, (ii) Consolidated Statements of Operations for the three and six months ended July 1, 2011 and July 2, 2010, (iii) Consolidated Statements of Cash Flows for the six months ended July 1, 2011 and July 2, 2010, and (iv) Notes to Consolidated Financial Statements.

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The XBRL related information in Exhibits 101 to this Quarterly Report on Form 10-Q shall not be deemed filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended and is not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of those sections.