GSI GROUP INC
Form 10-Q
December 13, 2010

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 2, 2010

Or

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

For the transition period from to

Commission File No. 000-25705

GSI Group Inc.

(Exact name of registrant as specified in its charter)

New Brunswick, Canada	**98-0110412**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
125 Middlesex Turnpike Bedford, Massachusetts, USA	**01730**
(Address of principal executive offices)	**(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (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	x

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

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 x No ¨

As of October 31, 2010, there were 100,026,395 of the Registrant s common shares, no par value, issued and outstanding.

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GSI GROUP INC.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

GSI GROUP INC.

(DEBTORS-IN-POSSESSION)

CONSOLIDATED BALANCE SHEETS

(In thousands of U.S. dollars, except share data)

(Unaudited)

	July 2, 2010	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 87,373	$ 63,328
Accounts receivable, net of allowance of $650 and $1,776, respectively	55,247	47,037
Income taxes receivable	22,334	24,192
Inventories	64,077	65,596
Deferred tax assets	6,364	6,370
Deferred cost of goods sold	6,317	30,070
Prepaid expenses and other current assets	4,962	5,479
Total current assets	246,674	242,072
Property, plant and equipment, net of accumulated depreciation and amortization of $50,199 and $49,227, respectively	47,519	49,502
Deferred tax assets	23,032	22,876
Investments in auction rate securities		11,272
Other assets	3,766	4,983
Intangible assets, net	57,195	61,509
Goodwill	44,578	44,578
Total Assets	$ 422,764	$ 436,792
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 26,726	$ 13,430
Income taxes payable	1,177	518
Accrued compensation and benefits	7,752	5,084
Deferred revenue	16,124	55,755
Deferred tax liabilities	826	831
Other accrued expenses	27,101	14,234
Total current liabilities	79,706	89,852
Deferred revenue	244	
Deferred tax liabilities	25,868	25,848
Accrued restructuring, net of current portion	788	1,256
Income taxes payable	6,210	6,088
Accrued pension liability	4,422	4,838

Other liabilities	2,806	4,039
Total long term liabilities	40,338	42,069
Liabilities subject to compromise	219,252	220,560
Total liabilities	339,296	352,481
Commitments and contingencies (Note 12)		
Stockholders Equity:		
Common shares, no par value; Authorized shares: unlimited; Issued and outstanding: 47,901,978 and 47,843,229 respectively	330,896	330,896
Additional paid-in capital	13,470	12,610
Accumulated deficit	(255,112)	(256,046)
Accumulated other comprehensive loss	(6,119)	(3,430)
Total GSI Group Inc. stockholders equity	83,135	84,030
Noncontrolling interest	333	281
Total stockholders equity	83,468	84,311
Total Liabilities and Stockholders Equity	$ 422,764	$ 436,792

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

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GSI GROUP INC.

(DEBTORS-IN-POSSESSION)

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands of U.S. dollars, except share and per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Sales	$ 85,737	$ 62,904	$ 200,352	$ 126,812
Cost of goods sold	47,681	38,451	113,258	78,760
Gross profit	38,056	24,453	87,094	48,052
Operating expenses:				
Research and development and engineering	7,399	6,870	14,764	15,001
Selling, general and administrative	17,573	14,601	35,145	29,439
Amortization of purchased intangible assets	1,126	1,600	2,254	3,220
Restructuring, restatement related costs and other	1,011	3,090	1,679	11,390
Pre-petition professional fees		1,280		1,950
Total operating expenses	27,109	27,441	53,842	61,000
Income (loss) from operations	10,947	(2,988)	33,252	(12,948)
Interest income	25	89	50	229
Interest expense	(5,747)	(7,055)	(11,555)	(14,231)
Foreign exchange transaction gains (losses)	(106)	(1,382)	263	(1,341)
Other income	1,081	889	1,686	162
Income (loss) from continuing operations before reorganization items and income taxes	6,200	(10,447)	23,696	(28,129)
Reorganization items	(10,617)		(20,247)	
Income (loss) from continuing operations before income taxes	(4,417)	(10,447)	3,449	(28,129)
Income tax provision (benefit)	638	(734)	2.463	(1,656)
Income (loss) from continuing operations	(5,055)	(9,713)	986	(26,473)
Loss from discontinued operations, net of tax		(132)		(132)
Consolidated net income (loss)	(5,055)	(9,845)	986	(26,605)
Less: Net (income) loss attributable to noncontrolling interest	(11)	(14)	(52)	5
Net income (loss) attributable to GSI Group Inc.	$ (5,066)	$ (9,859)	$ 934	$ (26,600)
Income (loss) from continuing operations attributable to GSI Group Inc. per common share:				
Basic	$ (0.11)	$ (0.20)	$ 0.02	$ (0.56)
Diluted	$ (0.11)	$ (0.20)	$ 0.02	$ (0.56)
Loss from discontinued operations attributable to GSI Group, Inc. per common share:				
Basic	$	$	$	$

Diluted	$		$		$		$	
Net income (loss) attributable to GSI Group Inc. per common share:								
Basic	$	(0.11)	$	(0.21)	$	0.02	$	(0.56)
Diluted	$	(0.11)	$	(0.21)	$	0.02	$	(0.56)
Weighted average common shares outstanding basic		47,902		47,733		47,879		47,662
Weighted average common shares outstanding diluted		47,902		47,733		47,943		47,662
Amounts attributable to GSI Group Inc.:								
Income (loss) from continuing operations	$	(5,066)	$	(9,727)	$	934	$	(26,468)
Loss from discontinued operations				(132)				(132)
Net income (loss)	$	(5,066)	$	(9,859)	$	934	$	(26,600)

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

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GSI GROUP INC.

(DEBTORS-IN-POSSESSION)

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

(Unaudited)

	Six Months Ended	
	July 2, 2010	**July 3, 2009**
Cash flows from operating activities:		
Consolidated net income (loss)	$ 986	$ (26,605)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Loss from operations of discontinued operations		132
Depreciation and amortization	7,505	9,265
Provision for uncollectible receivables	(591)	240
Provision for inventory obsolescence	3,414	847
Step-up value of acquired inventory sold		139
Share based compensation	1,090	1,326
Deferred income taxes	149	(177)
Earnings from equity investment	(622)	(235)
Loss (gain) on sale of property and assets	40	(207)
Gain on sale of auction rate securities	(988)	(1,749)
Non-cash interest expense		2,569
Non-cash restructuring charges	40	25
Changes in operating assets and liabilities:		
Accounts receivable	(5,044)	8,721
Inventories	(2,074)	1,752
Deferred cost of goods sold	23,753	11,105
Prepaid expenses and other current assets	471	2,100
Deferred revenue	(39,387)	(23,436)
Deferred rent	(250)	(160)
Accounts payable, accrued expenses and income taxes receivable and payable	26,136	(5,189)
Changes in other non-current assets and liabilities	(83)	(1,555)
Cash provided by (used in) operating activities of discontinued operations		(132)
Cash used in operating activities	14,545	(21,224)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(1,196)	(536)
Proceeds from the sale of auction rate securities	11,408	13,264
Proceeds from the sale of property, plant and equipment		492
Cash provided by investing activities	10,212	13,220
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	(199)	38
Increase (decrease) in cash and cash equivalents	24,045	(7,966)
Cash and cash equivalents, beginning of period	63,328	69,001

Cash and cash equivalents, end of period	$ 87,373	$ 61,035
Supplemental disclosure of cash flow information:		
Cash paid for reorganization items	$ 13,486	$
Cash paid for interest	$	$ 11,250
Cash paid for income taxes	$ 857	$ 454
Income tax refunds received	$ 1,753	$ 7,442
Supplemental disclosure of non cash investing activity:		
Auction rate securities	$	$ 764
Supplemental disclosure of non cash financing activity:		
Debt issuance costs	$ 460	$

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

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GSI GROUP INC.

(DEBTORS-IN-POSSESSION)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization, Presentation and Significant Events

GSI Group Inc. (GSIG) and its subsidiaries (collectively the Company) designs, develops, manufactures and sells photonics-based solutions (consisting of lasers, laser systems and electro-optical components), precision motion devices, associated precision motion control technology and systems. The Company s customers incorporate its technology into their products or manufacturing processes, for a wide range of applications in a variety of markets, including: industrial, scientific, electronics, semiconductor, medical and aerospace. The Company operates in three segments: Precision Technology, Semiconductor Systems, and Excel. The Excel segment was established in August 2008 following the Company s acquisition of Excel Technology, Inc. (Excel), a designer, manufacturer and marketer of photonics-based solutions. The Company s principal markets are in North America, Europe, Japan and Asia-Pacific. The Company exists under the laws of New Brunswick, Canada.

Chapter 11 Bankruptcy Filing

On November 20, 2009 (the Petition Date), 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 (the Chapter 11 Petitions) under Chapter 11 of the United States Bankruptcy Code (the Bankruptcy Code) in the United States Bankruptcy Court for the District of Delaware (the Bankruptcy Court) (the Chapter 11 Cases).

Following the Petition Date, the Debtors continued to operate their business as debtors-in-possession under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Bankruptcy Court.

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 plan documents.

On July 23, 2010 (the Effective Date) 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. Refer to Note 15 to Consolidated Financial Statements for additional information concerning the Chapter 11 Cases including a description of material agreements the Company entered into on the Effective Date pursuant to the terms of the Final Chapter 11 Plan.

Listing of Common Shares

Prior to November 4, 2009, the Company s common shares were traded on the NASDAQ Global Select Market under the symbol GSIG . From November 5, 2009 through November 19, 2009, the Company s common shares were quoted on Pink OTC Markets, Inc., under the trading symbol GSIG . Following the Company s filing of the Chapter 11 Petitions on November 20, 2009, its common shares were quoted on Pink OTC Markets, Inc. under the trading symbol GSIGQ . Following the Company s emergence from bankruptcy on July 23, 2010, its common shares have been quoted on Pink OTC Markets Inc., under the trading symbol LASR.PK .

Going Concern

On November 20, 2009, GSIG, together with two of its wholly-owned United States subsidiaries, voluntarily filed petitions for relief under Chapter 11 of the United States Bankruptcy Code. Under the Bankruptcy Code, the Company s status as a bankruptcy debtor automatically accelerated the payment of the debt arising under the $210.0 million of 11% unsecured senior notes due 2013 (the 2008 Senior Notes). Accordingly, this debt has been classified as part of liabilities subject to compromise as of July 2, 2010 and December 31, 2009 in the Company s accompanying consolidated balance sheets. Operating in bankruptcy imposed significant risks and uncertainties on the Company s business.

However, the Company emerged from bankruptcy on July 23, 2010 and, in connection therewith, completed a rights offering (the Rights Offering) pursuant to which it sold common shares for approximately $64.9 million in cash proceeds (the Cash Proceeds). The proceeds from the Rights Offering were used to pay down a portion of the obligations due with respect to the 2008 Senior Notes. The remaining obligations due with respect to the 2008 Senior Notes for unpaid principal and accrued interest were satisfied through the issuance of the Company s common shares, the payment of cash and the issuance of the new 12.25% Senior Secured PIK Election Notes (the New Notes) which mature in July 2014. As a result of the Company s emergence from bankruptcy and the associated restructuring of its debt obligations, the Company believes it has sufficient liquidity to fund its operations through at least July 2011.

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GSI GROUP INC.

(DEBTORS-IN-POSSESSION)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

2. Bankruptcy Disclosures

As discussed in Note 1 to Consolidated Financial Statements, GSIG and two of its United States subsidiaries filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. On May 27, 2010, the Bankruptcy Court entered an order confirming and approving the Final Chapter 11 Plan for the Debtors and the Final Chapter 11 Plan became effective and the transactions contemplated under the Final Chapter 11 Plan were consummated on July 23, 2010. Presented below are condensed combined financial statements of the Debtors and information concerning liabilities subject to compromise under the Final Chapter 11 Plan, pre-petition professional fees and reorganization items.

The Company has prepared the accompanying consolidated financial statements in accordance with Accounting Standard Codification (ASC) 852, Reorganizations and on a going-concern basis, which assumes 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.

Condensed Combined Financial Statements

Since the consolidated financial statements of the Company include entities not in Chapter 11 reorganization proceedings, the following presents condensed combined financial information of the entities in Chapter 11 reorganization proceedings. The condensed combined financial information has been prepared, in all material aspects, on the same basis as the consolidated financial statements of the Company.

Basis of Presentation

The financial statements contained within this note represent the condensed combined financial statements for the Debtors only. The Company s non-Debtor subsidiaries are treated as non-consolidated subsidiaries in these financial statements and as such their net income (loss) is included as Equity income (loss) from non-Debtor subsidiaries, net of tax in the statement of operations and their net assets are included as Investments in non-Debtor subsidiaries in the balance sheets.

Intercompany Transactions

Intercompany transactions between Debtors have been eliminated in the financial statements contained herein. Intercompany transactions with the Debtor s non-Debtor subsidiaries have not been eliminated in the financial statements and are reflected as Liabilities to non-Debtor subsidiaries, net .

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GSI GROUP INC.

(DEBTORS-IN-POSSESSION)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

GSI Group Inc.

CONDENSED COMBINED DEBTORS-IN-POSSESSION BALANCE SHEETS

(In thousands of U.S. dollars)

(Unaudited)

	July 2, 2010	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$ 23,147	$ 10,809
Accounts receivable, net	13,272	8,788
Income taxes receivable	24,612	26,071
Inventories	15,848	19,105
Deferred cost of goods sold	3,293	27,485
Other current assets	1,484	2,424
Total current assets	81,656	94,682
Property, plant and equipment, net of accumulated depreciation and amortization	12,454	13,727
Investments in non-Debtor subsidiaries	289,609	291,300
Other assets	17,927	17,599
Total assets	$ 401,646	$ 417,308
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Liabilities to non-Debtor subsidiaries, net	$ 3,526	$ 6,611
Accounts payable	15,327	3,643
Accrued compensation and benefits	1,924	1,191
Deferred revenue	8,689	50,104
Other accrued expenses	19,647	6,892
Total current liabilities	49,113	68,441
Liabilities to non-Debtor subsidiaries, net	40,968	34,671
Other liabilities	8,845	9,325
Liabilities subject to compromise	219,252	220,560
Total liabilities	318,178	332,997
Stockholders equity:	83,468	84,311

Total liabilities and stockholders equity	$ 401,646	$ 417,308

GSI Group Inc.

CONDENSED COMBINED DEBTORS-IN-POSSESSION STATEMENT OF OPERATIONS

(In thousands of U.S. dollars)

(Unaudited)

	For the period from April 3, 2010 through July 2, 2010	For the period from January 1, 2010 through July 2, 2010
Sales	$ 25,897	$ 85,613
Cost of goods sold	13,964	48,670
Gross profit	11,933	36,943
Operating expenses:		
Research and development and engineering	2,834	5,544
Selling, general and administrative	7,990	14,732
Amortization of purchased intangible assets	132	264
Restructuring, restatement related costs and other	993	1,680
Total operating expenses	11,949	22,220
Income (loss) from operations	(16)	14,723
Interest expense, net	(5,739)	(11,542)
Other income, net	18,794	18,400
Equity income (loss) from non-Debtor subsidiaries, net of tax	(7,503)	(399)
Income from continuing operations before reorganization items and income taxes	5,536	21,182
Reorganization items	(10,616)	(20,246)
Income (loss) from continuing operations before income taxes	(5,080)	936
Income tax benefit	(25)	(50)
Net income (loss)	$ (5,055)	$ 986

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GSI GROUP INC.

(DEBTORS-IN-POSSESSION)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

GSI Group Inc.

CONDENSED COMBINED DEBTORS-IN-POSSESSION STATEMENT OF CASH FLOWS

(In thousands of U.S. dollars)

(Unaudited)

	For the period from January 1, 2010 through July 2, 2010
Cash flows from operating activities:	
Net income	$ 986
Adjustments to reconcile net income to net cash from operating activities	4,172
Changes in assets and liabilities	7,748
Cash provided by operating activities	12,906
Cash flows from investing activities:	
Cash provided by (used in) investing activities	(55)
Cash flows from financing activities:	
Payments for debt issuance costs	(513)
Cash used in financing activities	(513)
Increase in cash and cash equivalents	12,338
Cash and cash equivalents, beginning of period	10,809
Cash and cash equivalents, end of period	$ 23,147

Liabilities Subject to Compromise

As a result of the Chapter 11 filing, the payment of pre-petition indebtedness may be subject to compromise or other treatment under the Final Chapter 11 Plan as described in more detail below. Generally, actions to enforce or otherwise affect payment of pre-petition liabilities are stayed. Although pre-petition claims are generally stayed, at a hearing held on November 24, 2009, the Bankruptcy Court approved the Debtors first day motions generally designed to stabilize the Debtors operations and cover, among other things, human capital obligations, supplier relations, customer relations, business operations, tax matters, cash management, utilities, case management and retention of professionals.

The Company s undisputed post-petition claims are being paid in the ordinary course of business. In addition, the Debtors may reject pre-petition executory contracts and unexpired leases with respect to the Debtors operations, with the approval of the Bankruptcy Court. Damages resulting from rejection of executory contracts and unexpired leases are treated as general unsecured claims and are classified as liabilities subject to compromise upon rejection. On January 20, 2010, the Bankruptcy Court established February 24, 2010 as the bar date for non-governmental units and May 19, 2010 as the bar date for governmental units. The bar date is the date by which claims against the Debtors arising prior to the Debtors Chapter 11 filings must be filed if the claimants wish to receive any distribution in the Chapter 11 Cases. On January 25, 2010, the

Debtors commenced notification, including publication, to all known actual and potential creditors informing them of the bar date and the required procedures with respect to the filing of proofs of claim with the Bankruptcy Court.

Liabilities subject to compromise consisted of the following (in thousands):

	July 2, 2010	December 31, 2009
2008 Senior Notes	$ 210,000	$ 210,000
Accrued interest on 2008 Senior Notes	6,001	6,001
Other	3,251	4,559
Total	$ 219,252	$ 220,560

A description of the transactions that were consummated on the Final Chapter 11 Plan Effective Date, including, but not limited to, the cancellation of the 2008 Senior Notes, payment of interest accrued on the 2008 Senior Notes, issuance of new senior secured notes, cancellation of shares of common stock issued and outstanding, issuance of new shares of common stock and payments made for all undisputed general unsecured pre-petition claims is included in Note 15 to Consolidated Financial Statements. As of July 2, 2010, the Company was completing the process of evaluating disputed claims.

All pre-petition claims are considered liabilities subject to compromise as of July 2, 2010 and December 31, 2009. The amounts classified as liabilities subject to compromise may be subject to future adjustments depending on actions of the applicable courts, further developments with respect to disputed claims, or other events.

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GSI GROUP INC.

(DEBTORS-IN-POSSESSION)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Pre-Petition Professional Fees

Pre-petition professional fees represent retention costs incurred prior to the bankruptcy filing for financial and legal advisors to assist in the analysis of debt restructuring alternatives, as well as costs incurred by the Company of financial and legal advisors retained by the noteholders pursuant to certain binding agreements between the two parties. Pre-petition professional fees incurred were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Professional fees	$	$ 1,280	$	$ 1,950
Total	$	$ 1,280	$	$ 1,950

Reorganization Items

Reorganization items represent expense or income 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 were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Professional fees	$ 10,525	$	$ 20,155	$
Other	92	$	92	$
Total	$ 10,617	$	$ 20,247	$

3. Summary of Significant Accounting Policies

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, 2009, 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.

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 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.

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GSI GROUP INC.

(DEBTORS-IN-POSSESSION)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation in the consolidated financial statements and notes thereto as of and for the three and six months ended July 2, 2010. The Company reclassified $1.1 million from inventories, prepaid expenses and other current assets, and accrued expenses to deferred cost of goods sold as of December 31, 2009. These reclassifications had no effect on the Company s previously reported results of operations, financial position and cash flows.

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 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 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.

Cash and Cash Equivalents

Cash equivalents consist principally of money market funds invested in U.S. Treasury Securities and repurchase agreements of U.S. Treasury Securities that have original maturities of 90 days or less. The Company does not believe it is exposed to any significant credit risk related to its cash equivalents.

Financial Instruments and Fair Value Measurements

Financial instruments with remaining maturities within one year from the balance sheet date are classified as current. Financial instruments with remaining maturities more than one year from the balance sheet date are classified as long-term.

Long-Term Investments

As of July 2, 2010, the Company had liquidated all of its previously held auction rate securities. As of December 31, 2009, the Company held auction rate securities, recorded at a fair value of $11.3 million, and with a par value of $13.0 million. These auction rate notes were student loans backed by the federal government and were privately insured. From April 3, 2009 through July 3, 2009, the Company recorded $0.2 million of other comprehensive income attributable to the change in unrealized gains relating to assets still held at July 3, 2009. From January 1, 2009 through July 3, 2009, the Company recorded $0.8 million of other comprehensive income attributable to the change in unrealized gains relating to assets still held at July 3, 2009.

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 three months ended July 3, 2009, the Company sold $14.9 million in par value of its auction rate securities valued at $11.3 million for $13.0 million in proceeds, which resulted in the recognition of realized gains of approximately $1.7 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. During the six months ended July 3, 2009, the Company sold $15.2 million in par value of its auction rate securities valued at $11.5 million for $13.3 million in proceeds, which resulted in the recognition of realized gains of approximately $1.8 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 and July 3, 2009. 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. During the three and six months ended July 3, 2009, the Company reclassified $0.4 million out of accumulated other comprehensive income (loss) into earnings related to the sale of the Company s auction rate securities.

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At July 2, 2010 and December 31, 2009, the Company had a 25.1% equity investment in a privately held company located in the United Kingdom, valued at $1.9 million and $1.4 million at July 2, 2010 and December 31, 2009, respectively, and included in other assets in the accompanying consolidated balance sheets. The Company uses the equity method to record the results of this entity. In relation to this investment, the Company recognized income of $0.4 million and $0.2 million for the three months ended July 2, 2010 and July 3, 2009, respectively, which are included in other income (expense), net in the accompanying consolidated statements of operations. In relation to this investment, the Company recognized income of $0.6 million and $0.2 million for the six months ended July 2, 2010 and July 3, 2009, respectively, which are included in other income (expense), net in the accompanying consolidated statements of operations.

Fair Value Measurements

On January 1, 2008, the Company adopted ASC 820, Fair Value Measurements and Disclosures with no impact to its consolidated results and financial position. ASC 820 defines fair value, establishes a framework for measuring fair value, and enhances 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.

On January 1, 2009, the Company implemented the guidance in ASC 820 related to all nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities. However, no significant nonrecurring fair value measurements were conducted during the three and six months ended July 2, 2010 or July 3, 2009 other than the annual impairment test for goodwill and indefinite-lived intangible assets, for which no impairment loss was recognized.

The following table summarizes the Company s assets and liabilities, as of July 2, 2010, that are measured at fair value on a recurring basis (in thousands):

	July 2, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Cash equivalents(1)	$ 6,575	$ 6,575	$	$

Total	$ 6,575	$ 6,575	$	$

(1) Cash equivalents are valued at quoted market prices in active markets.

The following table summarizes the Company s assets and liabilities, as of December 31, 2009, that are measured at fair value on a recurring basis (in thousands):

	December 31, 2009	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Cash equivalents(1)	$ 12,863	$ 12,863	$	$
Auction rate securities(2)	11,272			11,272
Total	$ 24,135	$ 12,863	$	$ 11,272

(1) Cash equivalents are valued at quoted market prices in active markets.

(2) Auction rate securities are valued based on assumptions that market participants might use in their estimates of fair value (including, among other factors, underlying collateral and lack of liquidity).

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The following table summarizes the activity during the three months ended July 2, 2010 with respect to the auction rate securities, where fair value is determined by Level 3 inputs (in thousands):

Balance at December 31, 2009	$ 11,272
Sales	(11,408)
Gross realized gains, included in other income (expense), net	988
Reclassifications out of accumulated other comprehensive income	(852)
Balance at July 2, 2010	$

See Note 6 to Consolidated Financial Statements for discussion of the estimated fair value of the Company s 2008 Senior Notes.

Accounts Receivable and Allowance

Trade accounts receivable are recorded at the invoiced amount. The Company generally does not require collateral for trade accounts receivable. The Company maintains an allowance for doubtful accounts. The allowance for doubtful accounts is based on the Company s best estimate of the amount of probable credit losses resulting from the inability of the Company s customers to make required payments. The Company determines the allowance based on a variety of factors including the age of amounts outstanding relative to their contractual due date, specific customer factors, and other known risks and economic trends in industries. Charges booked to the allowance for doubtful accounts are recorded as selling, general and administrative expenses, and are recorded in the period that they are determined to be uncollectible.

Inventories

Inventories, which include materials and conversion costs, are stated at the lower of cost or market, using the first-in, first-out method. Market is defined as replacement cost for raw materials and net realizable value for other inventories. Demo inventory is recorded at the lower of cost or its net realizable value.

Property, Plant and Equipment

Property, plant and equipment are stated at cost, adjusted for any impairment, less accumulated depreciation. The Company uses the straight-line method to calculate the depreciation of its fixed assets over their estimated useful lives. Estimated useful lives for buildings and improvements range from 3 to 60 years and for machinery and equipment from 1 to 13 years. Leasehold improvements are amortized over the lesser of their useful lives or lease terms, including any renewal period options that are expected to be exercised. Repairs and maintenance are expensed as incurred.

The Company undertakes a review of its property, plant and equipment carrying values whenever events or circumstances indicate that the carrying amounts may not be recoverable. The Company relies on the guidance included in ASC 360-10-35-15, Impairment or Disposal of Long-Lived Assets when conducting these reviews. No impairment charges related to property, plant and equipment were recorded during the three and six months ended July 2, 2010 or July 3, 2009.

Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price in a business combination over the fair value of the acquired tangible and intangible net assets. In connection with its acquisition of Excel, the Company acquired certain trade names that are classified as intangible assets with indefinite lives. Goodwill and indefinite-lived intangibles are not amortized but they are required to be assessed for impairment at least annually to ensure their current fair values exceed their carrying values.

The Company also has certain intangible assets that are amortized over their estimated useful lives. These definite-lived intangible assets were acquired in connection with the Company s historic business combinations. The Company s most significant intangible assets are acquired technology, customer relationships, and trademarks and trade names. All definite-lived intangible assets are amortized over the periods in which their economic benefits are expected to be realized. In addition to the Company s review of the carrying values of intangible assets, the Company also reviews the useful life assumptions, including the classification of certain intangible assets as indefinite-lived , on a periodic basis to determine if changes in circumstances warrant revisions to them.

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The Company s product lines generally correspond with its reporting units which is the level at which the Company evaluates its goodwill, intangible assets and other long-lived assets for impairment. All of the Company s goodwill and intangible assets reside in the Precision Technology and Excel segments.

Impairment Charges

Impairment analyses of goodwill and indefinite-lived intangible assets are conducted in accordance with ASC 350, Intangibles Goodwill and Other . The Company tests its goodwill balances annually in the beginning of the second quarter or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. In performing the test, the Company utilizes the two-step approach which requires a comparison of the carrying value of each of the Company s reporting units to the fair value of these reporting units. If the carrying value of a reporting unit exceeds its fair value, the Company calculates the implied fair value of the reporting unit s goodwill and compares it to the goodwill s carrying value. If the carrying value of goodwill exceeds its implied fair value, an impairment charge is recorded for the difference. The fair value of a reporting unit is estimated based on a discounted cash flow (DCF) approach. The DCF approach requires that the Company forecast future cash flows for each of the reporting units and discount the cash flow streams based on a weighted average cost of capital (WACC) that is derived, in part, from comparable companies within similar industries. The DCF calculations also include a terminal value calculation that is based upon an expected long-term growth rate for the applicable reporting unit. The carrying values of each reporting unit include assets and liabilities which relate to the reporting unit s operations. Additionally, reporting units that benefit from corporate assets or liabilities are allocated a portion of those corporate assets and liabilities on a systematic, proportional basis.

As mentioned above, the Company s indefinite-lived intangible assets represent trade names that were acquired in the August 2008 Excel acquisition. The Company assesses these indefinite-lived intangible assets for impairment on an annual basis as of the beginning of the second quarter, and more frequently if indicators are present or changes in circumstances suggest that impairment may exist. The Company will also periodically reassess these indefinite-lived intangible assets continuing classification as indefinite-lived. The fair values of the Company s indefinite-lived intangible assets are determined using the relief from royalty method, based on forecasted revenues. If the fair value of an intangible asset is less than its carrying value, an impairment charge is recorded to reflect the difference between the carrying value and the fair value of the impaired asset.

Intangible assets with definite lives are amortized over their estimated useful lives. The carrying amounts of definite-lived intangible assets and other long-lived assets are reviewed for impairment whenever changes in events or circumstances indicate their carrying values may not be recoverable. The impairment analyses are conducted in accordance with ASC 360-10-35-15. The recoverability of carrying value is determined by comparison of the reporting unit s carrying value to its future undiscounted cash flows. When this test indicates the potential for impairment, a fair value assessment is performed.

Once impairment is determined and measured, an impairment charge is recorded to reflect the difference between the carrying value and the fair value of the impaired asset. In addition to evaluating the impairment of goodwill and intangible assets, the Company also assesses its other long-lived assets for impairment. This process is discussed above under Property, plant and equipment.

The most recent annual goodwill and indefinite-lived intangible asset impairment test was performed as of the beginning of the second quarter of 2010 noting no impairment. No impairment charges were recorded during the three and six months ended July 2, 2010 or July 3, 2009.

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.

The Company follows the provisions of ASC 605-25, Multiple Element Arrangements for all multiple element arrangements. Under ASC 605-25, the Company assesses whether the deliverables 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 exist for all of the undelivered elements in a multiple element

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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 has been delivered.

Although certain of the Company s products contain operating and application software, the Company has determined the software element is incidental in accordance with ASC 985-605, Software Revenue Recognition .

The Company determines the unit of accounting for certain transactions based on the guidance in ASC 985-605. In particular, 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. For those standard configurations where acceptance criteria, if any, exist and are demonstrated prior to shipment, revenue is recorded at the time of shipment. For those cases where acceptance criteria cannot be demonstrated prior to shipment of a product or if a significant amount of fees are due upon acceptance, the Company recognizes revenue upon customer acceptance. Acceptance is generally required for sales of Semiconductor Systems segment products to Japanese customers, sales of New Products , which 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.

Precision Technology and Excel revenue transactions include 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. Revenue is generally recognized under the multiple units shipped methodology described above.

The Company s Semiconductor Systems segment also sells spare parts and consumable items, which are not subject to acceptance criteria. Revenue for these spare parts and consumable items is generally recognized under the multiple units shipped methodology described above.

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 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.

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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 significant deferred revenue included in its accompanying consolidated balance sheets, with balances (including both current and long-term amounts) of $16.4 million and $55.8 million as of July 2, 2010 and December 31, 2009, respectively. A significant majority of these amounts relate to arrangements whereby the entire arrangement has been accounted for as deferred revenue, as there is no fair value for one or more of the undelivered elements. Upon the final delivery of the undelivered element(s) of the arrangement, the revenue will be recorded for that arrangement. To a much lesser extent, the deferred revenue balances relate to either: (a) the unrecognized portion of a multiple element arrangements that is being recognized into revenue over a ratable basis as associated services are performed; (b) arrangements not currently recognizable due to the arrangement not being fixed and determinable at its inception; (c) the future amortization to revenue of extended warranty contracts and preventative maintenance plans; (d) revenue deferrals for product shipments with FOB destination shipping terms; and (e) deposits from customers against future orders. The classification of deferred revenue, and deferred cost of goods sold, is based on the Company s expectations relative to when the revenue will be recognized, based on facts known to the Company as of the date its financial statements are released.

Deferred Cost of Goods Sold

The Company defers the corresponding direct costs associated with the deferred revenue. These deferred costs have been recorded as deferred cost of goods sold in the accompanying consolidated balance sheets and are reflected in the consolidated statements of operations as cost of goods sold when the related revenue is expected to be recognized. These costs represent the direct and incremental costs that are attributable to the product whose revenue is being deferred.

Research and Development and Engineering Costs

Internal costs relating to research and development and engineering costs incurred for new products and enhancements to existing products are expensed as incurred.

Product Warranty

The Company generally warrants its products for material and labor to repair and service the system. The standard warranty is generally a period of up to 12 months, with the exception of two product lines, DRC Encoders and JK Lasers, both being product lines that are included in the Precision Technology segment, and which have a warranty period of 24 months. The accounting for warranty provisions is discussed above in Revenue Recognition .

Share-Based Compensation

The Company has stock-based compensation plans which are more fully described in Note 8 to Consolidated Financial Statements. The Company recognizes the fair value of all share-based payments to employees as expense.

Shipping & Handling Costs

Shipping and handling costs are recorded in cost of goods sold.

Advertising Costs

Advertising costs are expensed as incurred.

Foreign Currency Translation

The financial statements of the Company and its subsidiaries outside the United States have been translated into United States dollars in accordance with ASC 830, Foreign Currency Matters . Assets and liabilities of foreign operations are translated from foreign currencies into United States dollars at the exchange rates in effect on the balance sheet date.

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Sales and expenses are translated at the average exchange rate in effect for the period. Accordingly, gains and losses resulting from translating foreign currency financial statements are reported as a separate component of other comprehensive income (loss) in stockholders equity. Foreign currency transaction gains and losses are included in net income (loss) in the accompanying consolidated statements of operations. These amounts arose primarily from transactions denominated in currencies other than the functional currency.

Restructuring, Restatement Related Costs and Other

In accounting for its restructuring activities, the Company follows the provisions of ASC 420, Exit or Disposal Cost Obligations . In accounting for these obligations, the Company makes assumptions related to the amounts of employee severance, benefits, and related costs and to the time period over which facilities will remain vacant, sublease terms, sublease rates and discount rates. Estimates and assumptions are based on the best information available at the time the obligation has arisen. These estimates are reviewed and revised as facts and circumstances dictate; changes in these estimates could have a material effect on the amount previously expensed against the Company s earnings, and currently accrued on the Company s consolidated balance sheet.

The costs incurred related to third parties, including auditors, attorneys, forensic accountants, and other advisors for 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 (FCPA) investigation have been included within the Company s restructuring, restatement related costs and other charges in the accompanying consolidated statements of operations.

Pre-Petition Professional Fees

Pre-petition professional fees represent costs incurred prior to the Company s bankruptcy filing related to the financial and legal advisors retained by the Company to assist in the analysis of debt restructuring alternatives, as well as costs incurred by the Company related to financial and legal advisors retained by the noteholders pursuant to certain binding agreements between the two parties.

Accumulated Other Comprehensive Loss

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

	July 2, 2010	December 31, 2009
Foreign currency translation adjustments	$ (389)	$ 1,867
Unrealized gain on auction rate securities, net of tax		568
Pension liability, net of tax	(5,730)	(5,865)
Total accumulated other comprehensive loss	$ (6,119)	$ (3,430)

Comprehensive Loss

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

	Three Months Ended		Six Months Ended	
	July 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Consolidated net income (loss)	$ (5,055)	$ (9,845)	$ 986	$ (26,605)
Foreign currency translation adjustments (1)	(581)	4,834	(2,256)	2,411
Unrealized gain (loss) on auction rate securities, net of tax	(306)	(213)	(568)	766
Pension liability, net of tax	66	53	135	(1,423)
Consolidated comprehensive loss	(5,876)	(5,171)	(1,703)	(24,851)
Less: Comprehensive (income) loss attributable to noncontrolling interest	(11)	(14)	(52)	5
Comprehensive loss attributable to GSI Group Inc.	$ (5,887)	$ (5,185)	$ (1,755)	$ (24,846)

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

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Net Income (Loss) Per Common Share

Basic net income (loss) 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 and restricted stock 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 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Weighted average common shares outstanding - basic	47,902	47,733	47,879	47,662
Dilutive potential common shares (1)			64	
Weighted average common shares outstanding - diluted	47,902	47,733	47,943	47,662
Excluded from diluted common shares calculation stock options and restricted stock that are anti-dilutive	797	713	833	925

(1) Due to the Company s net loss position for the three months ended July 2, 2010 and for the three and six months ended July 3, 2009, all potentially dilutive shares are excluded as their effect would have been anti-dilutive.

Accounting for Income Taxes

The liability method is used to account for income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the differences are expected to be recovered or settled. A valuation allowance is established to reduce the deferred tax assets if it is more likely than not that some or all of the related tax benefits will not be realized in the future.

Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

Fair Value Measurements

On January 1, 2010, the Company adopted ASU 2010-06, Improving Disclosures about Fair Value Measurement , which requires interim disclosures regarding significant transfers in and out of Level 1 and Level 2 fair value measurements. Additionally, this ASU requires disclosure for each class of assets and liabilities and disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements. These disclosures are required for fair value measurements that fall in either Level 2 or Level 3. Further, the ASU requires separate presentation of purchases, sales, issuances and settlements in the Level 3 rollforward of the fair value measurements. The Company adopted the interim disclosure requirements under this ASU on January 1, 2010, with the exception of the separate presentation in the Level 3 activity rollforward, which is not effective until fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company s adoption of ASU 2010-06 did not have an impact on the Company s financial position, results of operations or cash flows.

Subsequent Events

On April 4, 2009, the Company adopted ASC 855, Subsequent Events , which establishes general standards of accounting for, and disclosure of, events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855 originally required all companies to disclose the date through which subsequent events have been evaluated for disclosure and recognition. In February 2010, the FASB issued an amendment to ASC 855 (ASU 2010-09, Subsequent Events-Amendments to Certain Recognition and Disclosure Requirements), which removed the requirement for an SEC filer to disclose the date through which subsequent events have been evaluated for disclosure and

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recognition in issued and revised financial statements. ASU 2010-09 was effective for the Company immediately. The Company s adoption of ASC 855 did not have an impact on the Company s financial position, results of operations or cash flows. The Company adopted ASU 2010-09 in February 2010, but its adoption did not have an impact on its financial position, results of operations or cash flows.

Recently Issued Accounting Pronouncements

Revenue Recognition

In September 2009, the FASB issued ASU 2009-13, Multiple-Deliverable Revenue Arrangements . ASU 2009-13 amends existing revenue recognition accounting pronouncements that are currently within the scope of ASC 605-25, Multiple Element Arrangements . ASU 2009-13 provides two significant changes to the existing multiple element revenue recognition guidance. First, this guidance removes the requirement to have objective and reliable evidence of fair value for undelivered elements in an arrangement and will result in more deliverables being treated as separate units of accounting. The second change modifies the manner in which the transaction consideration is allocated across the separately identified deliverables. These changes may result in entities recognizing more revenue up-front, and entities will no longer be able to apply the residual method and defer the fair value of undelivered elements. Upon adoption, each separate unit of accounting must have an estimated selling price, which can be based on management s estimate when there is no other means to determine the fair value of that undelivered item, and the arrangement consideration is allocated based on the elements relative selling price. This accounting guidance is effective no later than fiscal years beginning on or after June 15, 2010 but may be early adopted as of the first quarter of an entity s fiscal year. Entities may elect to adopt this accounting guidance either through prospective application to all revenue arrangements entered into or materially modified after the date of adoption or through a retrospective application to all revenue arrangements for all periods presented in the financial statements. The Company is currently evaluating the impact that its adoption of ASU 2009-13 will have on its financial position, results of operations and cash flows. The Company anticipates that it will adopt ASU 2009-13 effective January 1, 2011 on a prospective basis.

4. 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 six months ended July 2, 2010. Goodwill by reportable segment is as follows (in thousands):

	Reportable Segment		
	Excel	Precision Technology	Total
Balance at December 31, 2009	$ 35,333	$ 9,245	$ 44,578
Balance at July 2, 2010	$ 35,333	$ 9,245	$ 44,578

Intangible Assets

As of July 2, 2010, intangible assets consisted of the following (in thousands):

	July 2, 2010			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (Years)
Amortizable intangible assets:				
Patents and acquired technology	$ 61,139	$ (41,484)	$ 19,655	5.9
Customer relationships	33,121	(12,850)	20,271	8.8
Customer backlog	2,355	(2,355)		
Non-compete agreements	4,870	(3,309)	1,561	1.1
Trademarks, trade names and other	5,648	(2,967)	2,681	8.7
Amortizable intangible assets	107,133	(62,965)	44,168	7.2
Non-amortizable intangible assets:				
Trade names	13,027		13,027	
Totals	$ 120,160	$ (62,965)	$ 57,195	

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As of December 31, 2009, intangible assets consisted of the following (in thousands):

	December 31, 2009			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (Years)
Amortizable intangible assets:				
Patents and acquired technology	$ 61,463	$ (39,807)	$ 21,656	6.4
Customer relationships	33,121	(11,516)	21,605	9.3
Customer backlog	2,355	(2,355)		
Non-compete agreements	4,870	(2,543)	2,327	1.6
Trademarks, trade names and other	5,746	(2,852)	2,894	9.2
Amortizable intangible assets	107,555	(59,073)	48,482	7.6
Non-amortizable intangible assets:				
Trade names	13,027		13,027	
Totals	$ 120,582	$ (59,073)	$ 61,509	

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 $1.1 million and $1.6 million for the three months ended July 2, 2010 and July 3, 2009, respectively, and $2.3 million and $3.2 million for the six months ended July 2, 2010 and July 3, 2009, 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 the three months ended July 2, 2010 and July 3, 2009, and $1.9 million for the six months ended July 2, 2010 and July 3, 2009.

Estimated amortization expense for each succeeding period after July 2, 2010 is as follows (in thousands):

Year Ending December 31,	Cost of Goods Sold	Operating Expenses	Total
2010 (6 months from July 2, 2010)	$ 1,922	$ 2,180	$ 4,102
2011	3,805	3,513	7,318
2012	3,165	2,644	5,809
2013	3,165	2,644	5,809
2014	3,165	2,558	5,723
Thereafter	4,433	10,974	15,407
Total	$ 19,655	$ 24,513	$ 44,168

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(Unaudited)

5. Supplementary Balance Sheet Information

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

Inventories

	July 2, 2010	December 31, 2009
	(In thousands)	
Raw materials	$ 35,916	$ 34,982
Work-in-process	14,887	14,905
Finished goods	10,110	11,116
Demo inventory	2,417	3,751
Consigned inventory	747	842
Total inventories	$ 64,077	$ 65,596

Prepaid Expenses and Other Current Assets

	July 2, 2010	December 31, 2009
	(In thousands)	
Prepaid expenses	$ 2,707	$ 3,830
Other current assets	2,255	1,649
Total	$ 4,962	$ 5,479

Other Accrued Expenses

	July 2, 2010	December 31, 2009
	(In thousands)	
Accrued interest	$ 14,173	$ 2,631
Accrued warranty	3,559	3,140
Accrued professional fees	3,360	3,143
Accrued third party sales commissions	227	266
Customer deposits	724	1,112
Accrued restructuring, current portion	989	1,194
Accrued litigation settlements	115	403

Deferred rent, current portion	1,325	343
Other	2,629	2,002
Total	$ 27,101	$ 14,234

Accrued Warranty

	July 2, 2010	July 3, 2009
	(In thousands)	
Balance at beginning of the year	$ 3,140	$ 3,793
Charged to costs and expenses	2,466	723
Use of provision	(1,965)	(1,403)
Foreign currency exchange rate changes	(82)	122
Balance at end of period	$ 3,559	$ 3,235

Other Liabilities

	July 2, 2010	December 31, 2009
	(In thousands)	
Deferred rent	$ 2,806	$ 4,039
Total	$ 2,806	$ 4,039

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

6. Debt

On August 20, 2008 (the Closing Date), the Company issued to various investors $210.0 million of unsecured senior notes pursuant to the terms of an indenture (the 2008 Senior Note Indenture), along with detachable warrants (the Warrants) for the purchase of 5,882,520 of the Company s common shares, for collective net proceeds to the Company of $203.5 million. The proceeds were used to fund a portion of the Company s acquisition of Excel, and the 2008 Senior Notes carry a fixed interest rate of 11.0%. The Warrants were net exercised by the holders in October 2008, in exchange for 5,858,495 common shares of the Company. The Company ascribed a fair value to the Warrants in the amount of $26.3 million as of the Closing Date and recognized this amount as debt discount that was being amortized over the term of the 2008 Senior Notes. The fair value was based upon the Black-Scholes option pricing model, assuming a risk-free interest rate of 3.0%, an expected term of 5.0 years, a volatility rate of 85.0% and a 0.0% dividend yield. In addition, the Company incurred $6.5 million in issuance fees.

The 2008 Senior Notes pay interest semi-annually on February 15th and August 15th and mature in August 2013. Following the first anniversary of the Closing Date, the Company had the right to redeem up to 50% of the 2008 Senior Notes at par without penalty. Following the third anniversary of the Closing Date, the Company had the right to redeem up to 100% of the 2008 Senior Notes at par without penalty. The 2008 Senior Note Indenture contained covenants that restricted the Company s ability to incur additional indebtedness, pay dividends, create liens, make investments, sell assets, repurchase securities, or engage in specified transactions with affiliates.

As discussed in Note 1 to Consolidated Financial Statements, GSIG and two of its wholly-owned United States subsidiaries filed for bankruptcy on November 20, 2009. Accordingly, the 2008 Senior Notes are classified as a liability subject to compromise in accordance with ASC 852 in the Company s accompanying consolidated balance sheets as of July 2, 2010 and December 31, 2009.

In accordance with the reclassification of the 2008 Senior Notes after the November 20, 2009 bankruptcy filing to liabilities subject to compromise, the Company recorded write-offs related to the remaining unamortized portion of the discount attributable to the Warrants and deferred debt financing costs in order to record the 2008 Senior Notes at the expected amount of the allowed claims. The aggregate amount of the write-off related to the remaining unamortized portion of the discount attributable to the Warrants totaled $21.4 million, while the write-off related to the remaining unamortized portion of the deferred debt financing costs totaled $4.9 million. Both the write-off related to the remaining unamortized portion of the debt discount attributable to the Warrants and the write-off related to the deferred debt financing costs were recorded as reorganization items during the quarter ended December 31, 2009. For the three months ended July 2, 2010 and July 3, 2009, the total amount recorded to interest expense, including accretion of the debt discount attributable to the Warrants and amortization of the debt issuance costs during 2009, was $5.7 million and $7.1 million, respectively. For the six months ended July 2, 2010 and July 3, 2009, the total amount recorded to interest expense, including accretion of the debt discount attributable to the Warrants and amortization of the debt issuance costs during 2009, was $11.5 million and $14.2 million, respectively.

During the third quarter of 2008, the Company failed to timely file its annual and quarterly reports. Pursuant to a Registration Rights Agreement (the RRA) with the Warrant holders, the Company notified the Warrant holders that it was indefinitely suspending its registration statement on Form S-3. Under the RRA, monetary penalties accrue and are payable to the Warrant holders for failure to maintain an effective registration statement, subject to certain terms and conditions more specifically set forth therein. The Company incurred penalties under the RRA beginning in the fourth quarter of 2008 through the date of the Company s filing for Chapter 11 bankruptcy protection on November 20, 2009. The Company had accrued the maximum penalty due under the RRA of $3.8 million, including $0.9 million and $1.9 million during the three and six months ended July 3, 2009, respectively. However, as a result of the Company s filing for Chapter 11 bankruptcy protection on November 20, 2009, the Company reversed the existing balance of the Warrant penalty accrual as part of its reclassification of the 2008 Senior Notes as liabilities subject to compromise.

Pursuant to the Final Chapter 11 Plan, on July 23, 2010 upon emergence from bankruptcy, $74.9 million of the 2008 Senior Notes were repaid in cash, $28.1 million were exchanged for approximately 15.6 million common shares, and the remaining 2008 Senior Notes were cancelled and replaced by $107.0 million in aggregate principal amount of 12.25% Senior Secured PIK Election Notes which mature on July 23, 2014. See

Note 15 to Consolidated Financial Statements for information concerning transactions related to the Chapter 11 Cases.

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Fair Value of Debt

No public trades of the 2008 Senior Notes occurred during the six months ended July 2, 2010. The Company engaged in ongoing negotiations regarding the value of the 2008 Senior Notes and an appropriate restructuring plan throughout this time period with the lender group and others. Thus, although the actual value of the 2008 Senior Notes may have varied materially if trading had taken place, the Company estimates that the fair value of the 2008 Senior Notes as of July 2, 2010 was its associated par value.

7. Stockholders Equity

Capital Stock

The authorized capital of the Company consists of an unlimited number of common shares without nominal or par value. Holders of common shares are entitled to one vote per share. Holders of common shares are entitled to receive dividends, if and when declared by the Board of Directors, and to share ratably in its assets legally available for distribution to the stockholders in the event of liquidation. Holders of common shares have no redemption or conversion rights.

Shareholders Rights Plan

At the annual meeting of shareholders held on May 15, 2008, shareholders approved a resolution approving the continuation, amendment and restatement of the Company s shareholders rights plan.

Prior to the 2008 annual meeting of shareholders, the Board of Directors of the Company approved an amended and restated shareholder rights plan agreement to be dated May 15, 2008 (the Rights Plan), if approved by shareholders at such meeting. The Rights Plan was originally approved by the Company s shareholders on May 26, 2005 and its continued existence had to be approved and confirmed by independent shareholders on or before the date of the Company s 2008 annual meeting of shareholders or the Rights Plan would expire.

The amended and restated shareholder rights plan continues to create a right (which is only triggered if a person or a control group acquires 20% or more of the Company s issued and outstanding publicly traded common shares) for each shareholder, other than the acquiring person or its associates or affiliates, to acquire additional common shares of the Company at one-half of the then market price at the time of exercise. The net effect of an exercise is to dilute the prospective acquirer s share position, and inhibits a change of control event unless the Rights Plan has been withdrawn or the buyer makes a bid that is permitted by the terms of the plan.

The Rights Plan is intended to give the Company s Board of Directors more time and control over any sale process and increase the likelihood of maximizing shareholder value. The Rights Plan was cancelled in connection with the Company s emergence from the Chapter 11 proceedings. See Note 15 to Consolidated Financial Statements.

Stock Repurchase Plan

In December 2005, the Company s Board of Directors authorized a stock repurchase program providing for the repurchase of up to $15.0 million in shares of the Company s common shares. In February 2008, the Company s Board of Directors authorized an increase in the stock repurchase program up to a total of $40.0 million. The Company repurchased and retired 772,467 shares, 816,830 shares, and 381,300 shares in 2008, 2007, and 2006, respectively, at an aggregate cost of $6.4 million, $7.8 million, and $3.8 million, respectively. The program was suspended in May 2008 as a result of the Company s decision to acquire Excel. At July 2, 2010, $21.9 million remains available for future Company purchases under this program. In connection with the Chapter 11 Cases, the stock repurchase program was cancelled. See Note 15 to Consolidated Financial Statements.

8. Share-Based Compensation

The Company has several share-based compensation plans, including the 2006 Equity Incentive Plan, under which stock-based grants may be issued and several other plans under which no new grants will be made. The 2006 Equity Incentive Plan provides for grants of various stock-based awards including, but not limited to, stock options, stock appreciation rights and restricted stock. Since 2006, the Company has issued only restricted stock in the form of time and performance-based grants to senior executives, key employees and directors.

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2006 Equity Incentive Plan

On May 15, 2006, shareholders of the Company approved the 2006 Equity Incentive Plan which provides for the sale or grant of various awards of, or the value of, the Company s common shares including stock options, stock appreciation rights, restricted stock and performance shares and units, performance-based awards, and stock grants, to officers, directors, employees and certain consultants to the Company. The maximum number of shares of the Company s common shares which may be issued pursuant to the 2006 Equity Incentive Plan is 9,406,000 shares, including a 2,500,000 share increase as approved by the Company s shareholders at the May 2008 annual meeting, and subject to adjustment in the event of certain corporate events and reduced by the number of shares already issued pursuant to awards under the Company s 1992 and 1995 Equity Incentive Plans. The plan has a ten-year term. As of July 2, 2010, there were 4,246,784 common shares available for future issuance under this plan. All unvested restricted stock awards and unexercised options to purchase shares of common stock related to the Company s 2006 Equity Incentive Plan that were outstanding on the date of the Company s emergence from bankruptcy were assumed by the reorganized Company upon emergence, other than those held by the Company s directors who did not continue as members of the reorganized Company s Board of Directors following emergence. Such assumed restricted stock awards and options will be honored by the Company as if they had originally been granted for the issuance of the Company s post-emergence common shares. The Company s 2006 Equity Incentive Plan was cancelled upon the Company s emergence from bankruptcy. Accordingly, no shares remain available for future issuance under this plan as of July 23, 2010. See Note 15 to Consolidated Financial Statements.

The Company recorded compensation expense related to restricted stock awards issued under the 2006 Equity Incentive Plan totaling $0.4 million in the three month periods ended July 2, 2010 and July 3, 2009, and $1.1 million and $1.3 million in the six month periods ended July 2, 2010 and July 3, 2009, respectively. Approximately ($0.1) million of the compensation expense recognized during the three month period ended July 2, 2010 and approximately $0.2 million of the compensation expense recognized during the six month period ended July 2, 2010 relates to awards that are accounted for as share-based liabilities under ASC 718. The share-based liabilities relate to the Company s obligations arising from its commitment to issue shares of restricted stock and common stock to the members of its pre-emergence Board of Directors as compensation for their services provided as members of the Company s Board of Directors. The associated liability is reported within other accrued expenses in the accompanying consolidated balance sheets as of July 2, 2010 and December 31, 2009. The expense associated with the Company s share-based liabilities is reported within selling, general and administrative expense in the accompanying consolidated statements of operations for the three and six month periods ended July 2, 2010. No awards were accounted for as share-based liabilities during the three or six month periods ended July 3, 2009. Approximately $0.4 million of the compensation expense recognized during the three and six month periods ended July 2, 2010 relates to expense recognized upon the acceleration of vesting of all outstanding but unvested restricted stock awards that had previously been granted to the Company s former Chief Executive Officer as of the effective date of termination on May 25, 2010.

No issuances were made under the 2006 Equity Incentive Plan during the six months ended July 2, 2010. Stock compensation expense is primarily included in selling, general, and administrative expenses, and as an increase to additional paid-in capital on the Company s consolidated balance sheets. As the restricted stock is issuable to the holder, subject to vesting provisions, with no consideration payable by the holder, the grant date fair value per share is based on the quoted stock price on the date of the grant.

It is the Company s policy to issue new shares for equity awards pursuant to the 2006 Equity Incentive Plan. For awards that vest based solely on service conditions, the Company recognizes compensation expense on a straight-line basis over the requisite service period, which is generally from the grant of the awards through the end of the vesting period. For awards with vesting that is contingent upon the achievement of performance conditions, the Company recognizes compensation expense on a straight-line basis over the requisite service period, which is generally from the grant of the awards through the end of the vesting period, for each separately vesting tranche of the award. Restricted stock awards have generally been issued with a three-year vesting period. The Company reduces the compensation expense by an estimated forfeiture rate which is based on actual experience. The Company assesses the likelihood that performance-based shares will be earned based on the probability of meeting the performance criteria. For those performance-based awards that are deemed probable of achievement, expense is recorded, and for those awards that are deemed not probable of achievement, no expense is recorded. The Company assesses the probability of achievement each quarter.

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The table below summarizes activity relating to restricted stock awards issued under the 2006 Equity Incentive Plan:

	Restricted Stock Awards (in thousands)	Weighted-Average Grant Date Fair Value
Nonvested restricted stock at December 31, 2009	410	$ 8.90
Granted		$
Vested		