

GSI GROUP INC
Form 10-Q
August 05, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 3, 2015

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)

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

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(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 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.

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

As of July 31, 2015, there were 34,410,418 of the Registrant's common shares, no par value, issued and outstanding.

GSI GROUP INC.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

GSI GROUP INC.

CONSOLIDATED BALANCE SHEETS

(In thousands of U.S. dollars or shares)

(Unaudited)

	July 3, 2015	December 31, 2014
ASSETS		
Current Assets		
Cash and cash equivalents	\$81,051	\$ 51,146
Accounts receivable, net of allowance of \$253 and \$282, respectively	54,379	51,494
Inventories	60,410	62,943
Income taxes receivable	5,025	5,906
Deferred tax assets	6,124	5,971
Prepaid expenses and other current assets	5,644	5,236
Assets of discontinued operations	—	631
Total current assets	212,633	183,327
Property, plant and equipment, net	37,780	40,088
Deferred tax assets	2,801	2,912
Other assets	13,578	14,604
Intangible assets, net	67,278	67,242
Goodwill	98,358	90,746
Total assets	\$432,428	\$ 398,919
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Current portion of long-term debt	\$7,500	\$ 7,500
Accounts payable	26,942	25,592
Income taxes payable	5,299	1,189
Deferred tax liabilities	208	208
Accrued expenses and other current liabilities	22,037	19,401
Liabilities of discontinued operations	—	324
Total current liabilities	61,986	54,214
Long-term debt	108,750	107,500
Deferred tax liabilities	2,509	35
Income taxes payable	6,339	7,097
Other liabilities	18,257	18,819
Total liabilities	197,841	187,665
Commitments and Contingencies (Note 13)		
Stockholders' Equity:		
Common shares, no par value; Authorized shares: unlimited;	423,856	423,856

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Issued and outstanding: 34,409 and 34,219, respectively		
Additional paid-in capital	29,536	28,590
Accumulated deficit	(202,221)	(225,165)
Accumulated other comprehensive loss	(16,584)	(16,456)
Total GSI Group Inc. stockholders' equity	234,587	210,825
Noncontrolling interest	—	429
Total stockholders' equity	234,587	211,254
Total liabilities and stockholders' equity	\$432,428	\$ 398,919

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

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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 3, 2015	June 27, 2014	July 3, 2015	June 27, 2014
Revenue	\$ 96,494	\$ 96,905	\$ 191,108	\$ 176,038
Cost of revenue	55,149	58,254	109,757	105,282
Gross profit	41,345	38,651	81,351	70,756
Operating expenses:				
Research and development and engineering	7,840	7,525	16,055	13,382
Selling, general and administrative	20,922	21,410	42,990	41,028
Amortization of purchased intangible assets	1,852	2,876	3,741	4,620
Restructuring, acquisition and divestiture related costs	416	360	2,853	1,178
Total operating expenses	31,030	32,171	65,639	60,208
Operating income from continuing operations	10,315	6,480	15,712	10,548
Interest income (expense), net	(1,375)	(1,375)	(2,772)	(2,212)
Foreign exchange transaction gains (losses), net	(3,153)	(61)	(2,636)	(80)
Other income (expense), net	20,034	419	20,763	1,000
Income from continuing operations before income taxes	25,821	5,463	31,067	9,256
Income tax provision	6,310	2,057	8,110	2,994
Income from continuing operations	19,511	3,406	22,957	6,262
Loss from discontinued operations, net of tax	(13)	(2,678)	(13)	(4,544)
Consolidated net income	19,498	728	22,944	1,718
Less: Net income attributable to noncontrolling interest	—	(3)	—	(10)
Net income attributable to GSI Group Inc.	\$ 19,498	\$ 725	\$ 22,944	\$ 1,708
Earnings per common share from continuing operations:				
Basic	\$ 0.56	\$ 0.10	\$ 0.66	\$ 0.18
Diluted	\$ 0.56	\$ 0.10	\$ 0.66	\$ 0.18
Loss per common share from discontinued operations:				
Basic	\$ (0.00)	\$ (0.08)	\$ (0.00)	\$ (0.13)
Diluted	\$ (0.00)	\$ (0.08)	\$ (0.00)	\$ (0.13)
Earnings per common share attributable to GSI Group Inc.:				
Basic	\$ 0.56	\$ 0.02	\$ 0.66	\$ 0.05
Diluted	\$ 0.56	\$ 0.02	\$ 0.66	\$ 0.05
Weighted average common shares outstanding—basic	34,630	34,378	34,567	34,304
Weighted average common shares outstanding—diluted	35,029	34,707	35,014	34,690

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

GSI GROUP INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands of U.S. dollars)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 3,	June 27,	July 3,	June 27,
	2015	2014	2015	2014
Consolidated net income	\$ 19,498	\$ 728	\$ 22,944	\$ 1,718
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax (1)	3,958	1,006	(548)	943
Pension liability adjustments, net of tax (2)	(309)	(50)	420	14
Total other comprehensive income (loss)	3,649	956	(128)	957
Total consolidated comprehensive income (loss)	23,147	1,684	22,816	2,675
Less: Comprehensive income attributable to				
noncontrolling interest	—	(3)	—	(10)
Comprehensive income (loss) attributable to GSI Group Inc.	\$ 23,147	\$ 1,681	\$ 22,816	\$ 2,665

(1) The tax effect on this component of comprehensive income was \$0.5 million for the three and six months ended July 3, 2015 and \$0.2 million for the three and six months ended June 27, 2014.

(2) The tax effect on this component of comprehensive income was not material for all periods presented. See Note 4 for the total amount of pension liability adjustments reclassified out of accumulated other comprehensive income (loss).

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

GSI GROUP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

(Unaudited)

	Six Months Ended	
	July 3, 2015	June 27, 2014
Cash flows from operating activities:		
Consolidated net income	\$22,944	\$1,718
Less: Loss from discontinued operations, net of tax	13	4,544
Income from continuing operations	22,957	6,262
Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation and amortization	9,385	11,151
Provision for inventory excess and obsolescence	801	602
Share-based compensation	2,533	2,434
Deferred income taxes	172	(1,250)
Earnings from equity-method investment	(1,121)	(989)
Gain on disposal of business	(19,638)	—
Non-cash restructuring and acquisition related charges	261	553
Other	574	1,023
Changes in assets and liabilities which (used) provided cash, excluding effects from businesses purchased or classified as discontinued operations:		
Accounts receivable	(5,243)	(429)
Inventories	(3,841)	60
Income taxes receivable, prepaid expenses and other current assets	1,745	215
Accounts payable, income taxes payable, accrued expenses and other current liabilities	7,184	583
Other non-current assets and liabilities	(1,201)	(291)
Cash provided by operating activities of continuing operations	14,568	19,924
Cash provided by (used in) operating activities of discontinued operations	(13)	121
Cash provided by operating activities	14,555	20,045
Cash flows from investing activities:		
Purchases of property, plant and equipment	(2,133)	(2,589)
Acquisition of businesses, net of cash acquired	(13,048)	(93,656)
Proceeds from sale of business, net of transaction costs	30,623	—
Proceeds from the sale of property, plant and equipment	116	52
Cash provided by (used in) investing activities of continuing operations	15,558	(96,193)
Cash used in investing activities of discontinued operations	—	(898)
Cash provided by (used in) investing activities	15,558	(97,091)

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Cash flows from financing activities:		
Borrowings under revolving credit facility	13,000	77,000
Repayments of long-term debt and revolving credit facility	(11,750)	(13,750)
Payments for debt issuance costs	—	(712)
Payments of withholding taxes from stock-based awards	(1,382)	(1,508)
Capital lease payments	(348)	(540)
Other financing activities	118	439
Cash provided by (used in) financing activities of continuing operations	(362)	60,929
Cash provided by financing activities of discontinued operations	—	—
Cash provided by (used in) financing activities	(362)	60,929
Effect of exchange rates on cash and cash equivalents	154	144
Increase (decrease) in cash and cash equivalents	29,905	(15,973)
Cash and cash equivalents, beginning of period	51,146	60,980
Cash and cash equivalents, end of period	\$81,051	\$45,007
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$2,011	\$1,608
Cash paid for income taxes	\$3,661	\$2,032
Income tax refunds received	\$17	\$109

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

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF JULY 3, 2015

(Unaudited)

1. Basis of Presentation

GSI Group Inc. and its subsidiaries (collectively referred to as the “Company”, “we”, “us”, “our”) design, develop, manufacture and sell precision photonic and motion control components and subsystems to Original Equipment Manufacturers (“OEMs”) in the medical and advanced industrial markets. The Company is a leader in highly engineered enabling technologies, including CO2 laser sources, laser scanning and beam delivery products, optical data collection and machine vision technologies, medical visualization and informatics solutions, and precision motion control products. The Company specializes in collaborating with OEM customers to adapt its component and subsystem technologies to deliver highly differentiated performance in their applications.

The accompanying unaudited interim consolidated financial statements have been prepared in U.S. dollars and pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”), 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 U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The interim consolidated financial statements and notes included in this report should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. In the opinion of management, these interim consolidated financial statements include all adjustments and accruals of a normal and recurring nature necessary to fairly state the results of the interim periods presented. The results for interim periods are not necessarily indicative of results to be expected for the full year or for any future periods.

During the quarter ended July 3, 2015, the Company deconsolidated its 50% owned joint venture, Excel Laser Technology Private Limited (the “India JV”), as a result of an agreement executed in June 2015 to sell 100% of the Company’s interest in the India JV. The accounts of the India JV were previously included in discontinued operations in the consolidated financial statements.

The Company owns 41% of Laser Quantum Ltd. (“Laser Quantum”), a privately held company located in the United Kingdom. The Company records the results of this entity under the equity method as it does not have a controlling interest in the entity.

The Company’s unaudited 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 31.

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, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. The Company evaluates its estimates based on historical experience, current

conditions and various other assumptions that it believes are reasonable under the circumstances. Estimates and assumptions are reviewed on an on-going basis and the effects of revisions are reflected in the period in which they are deemed to be necessary. Actual results could differ significantly from those estimates.

Recent Accounting Pronouncements

Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity

In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-08, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.” ASU 2014-08 provides guidance on determining when disposals can be presented as discontinued operations. ASU 2014-08 requires that only disposals representing a strategic shift that has (or will have) a major effect on an entity’s operations and financial results should be presented as discontinued operations. A strategic shift may include a disposal of a major line of business, a major equity method investment or a major part of an entity. Additionally, ASU 2014-08 requires expanded disclosures regarding discontinued operations. ASU 2014-08 is effective prospectively for reporting periods beginning after December 15, 2014. The Company adopted this pronouncement in January 2015.

Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement

In April 2015, the FASB issued ASU 2015-05, “Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement,” which provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 will be effective for annual and interim reporting periods beginning after December 15, 2015, with early adoption permitted. Upon adoption, an entity may apply the new guidance either retrospectively or prospectively to all arrangements entered into or materially modified after the effective date. The Company is currently evaluating the impact of ASU 2015-05 on the Company's consolidated financial statements.

Simplifying the Presentation of Debt Issuance Costs

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs." ASU 2015-03 requires debt issuance related costs to be presented in the balance sheet as a direct deduction from the carrying amount of the associated debt liability, consistent with the presentation of a debt discount. ASU 2015-03 will be effective on a retrospective basis for annual and interim reporting periods beginning after December 15, 2015, with early adoption permitted. The adoption of this amendment is not expected to have a material impact on the Company's consolidated financial statements.

Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers", which provides guidance for revenue recognition. ASU 2014-09 supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") 605, "Revenue Recognition," and requires entities to recognize revenue in a way that depicts the transfer of goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 will be effective for annual and interim reporting periods beginning after December 15, 2016. Early adoption is not permitted. Upon adoption, an entity may apply the new guidance either retrospectively to each prior reporting period presented or retrospectively only to customer contracts not yet completed as of the date of adoption with the cumulative effect of initially applying the standard recognized in beginning retained earnings at the date of the initial application. In July 2015, the FASB reached a decision to defer the effective date of ASU 2014-09 by one year, with the option of early adoption as of the original effective date. The deferral will result in ASU 2014-09 being effective for annual and interim reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact of the new standard on the Company's consolidated financial statements.

Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements - Going Concern (Subtopic 205-40)," which requires management to assess a company's ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. ASU 2014-15 will be effective for annual reporting periods ending after December 15, 2016. Early application is permitted. The Company does not expect the adoption of ASU 2014-15 to have any impact on the Company's consolidated financial statements.

2. Business Combinations

On February 19, 2015, the Company acquired 100% of the outstanding stock of Applimotion Inc. (“Applimotion”), a Loomis, California based provider of advanced precision motor and motion control technology to OEM customers in the advanced industrial and medical markets, for a total purchase price of \$14.0 million, net of working capital adjustments. The purchase price includes \$13.0 million in cash paid for the acquisition and \$1.0 million estimated fair value of future contingent consideration payable upon the achievement of certain revenue targets for fiscal years 2015 to 2017. The undiscounted range of possible contingent consideration is zero to \$4.0 million. The Company expects that the addition of Applimotion will enable the Company to offer a broader range of motion control technologies and integrated solutions to customers. The Company recognized Applimotion acquisition costs of less than \$0.1 million and \$0.2 million during the three and six months ended July 3, 2015, respectively. Acquisition-related costs are included in restructuring, acquisition and divestiture related costs in the consolidated statements of operations.

The acquisition of Applimotion has been accounted for as a business combination. The allocation of the purchase price is based upon the estimated fair value of assets acquired and liabilities assumed as of the acquisition date. The fair values of intangible assets were based on valuations using an income approach, with estimates and assumptions provided by management of Applimotion and the Company. The process for estimating the fair values of identifiable intangible assets and the contingent consideration liability requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill.

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

The total purchase price was allocated as follows (in thousands):

	Purchase Price Allocation
Cash	\$ 317
Accounts receivable	1,821
Inventory	2,041
Prepaid expenses and other current assets	89
Property and equipment	308
Intangible assets	6,071
Goodwill	7,612
Total assets acquired	18,259
Accounts payable	964
Other liabilities	717
Deferred tax liabilities	2,248
Total liabilities assumed	3,929
Total assets acquired and liabilities assumed	14,330
Less: cash acquired	317
Total purchase price, net of cash acquired	14,013
Less: contingent consideration	965
Net cash used for acquisition of business	\$ 13,048

The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Developed technology	\$ 2,684	10 years
Customer relationships	2,066	10 years
Non-compete covenant	684	4 years
Backlog	637	1 year
Total	\$ 6,071	

The purchase price allocation resulted in \$7.6 million of goodwill and \$6.1 million of identifiable intangible assets, none of which is expected to be deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are

expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flow potential attributable to: (i) Applimotion's ability to grow their business with existing and new customers, (ii) the potential to realize cost improvements due to scale and more efficient operations, (iii) the opportunity to serve customers with integrated assemblies that feature products from both Applimotion and the Company and, (iv) the potential to sell the Company's products into Applimotion's customer base.

The results of the Applimotion acquisition were included in the Company's results of operations beginning on February 19, 2015. The pro forma financial information reflecting the operating results of Applimotion, as if it had been acquired on January 1, 2014, is not presented herein as it would not differ materially from the operating results of the Company as reported for 2014. Applimotion is included in the Company's Precision Motion reportable segment.

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

3. Discontinued Operations and Divestitures

In June 2015, the Company finalized an agreement to divest its 50% owned joint venture, the India JV, and recorded a pre-tax loss of less than \$0.1 million in operating loss from discontinued operations, net of tax during the three months ended July 3, 2015. All assets, liabilities, accumulated other comprehensive income and non-controlling interest of the India JV were derecognized as of the date of the agreement.

On April 15, 2015, the Company completed the sale of certain assets and liabilities of its JK Lasers business, previously included in the Laser Products reportable segment, for approximately \$30.6 million in cash, received upon closing, net of transaction costs. As of July 3, 2015, the working capital adjustments had not yet been settled and were estimated to be a cash payment of \$1.0 million to the buyer. During the three months ended July 3, 2015, the Company recognized a pre-tax gain on sale of \$19.6 million in other income (expense), net on the consolidated statement of operations. The JK Lasers business divestiture does not qualify for discontinued operations accounting treatment.

In July 2014, the Company completed the sale of certain assets and liabilities of its Scientific Lasers business for approximately \$6.5 million in cash, net of working capital adjustments. In accordance with the purchase and sale agreement, \$1.5 million of the sales proceeds is held in escrow until January 2016. The \$1.5 million escrow is included in prepaid expenses and other current assets on the balance sheet as of July 3, 2015 and other long-term assets as of December 31, 2014.

Assets and liabilities of discontinued operations as of December 31, 2014 included the balances of the India JV. There were no assets and liabilities of discontinued operations as of July 3, 2015. The major components of the assets and liabilities of discontinued operations as of December 31, 2014, respectively, were as follows (in thousands):

	December 31, 2014	
Accounts receivable, net	\$	95
Inventories		161
Prepaid and other current assets		8
Other assets		367
Assets of discontinued operations	\$	631
Accounts payable	\$	16
		74

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Accrued expenses and other current liabilities	
Other liabilities	234
Liabilities of discontinued operations	\$ 324

The following table presents the operating results which are reported as discontinued operations in the Company's consolidated statements of operations (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2015	June 27, 2014	July 3, 2015	June 27, 2014
Revenue from discontinued operations	\$ —	\$ 6,271	\$ —	\$ 10,287
Operating loss from discontinued operations, before income tax	\$ (13)	\$ (2,136)	\$ (13)	\$ (4,987)
Operating loss from discontinued operations, net of tax	\$ (13)	\$ (2,678)	\$ (13)	\$ (4,544)

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

4. Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) was as follows (in thousands):

	Total accumulated other comprehensive income (loss)	Foreign currency translation adjustments	Pension liability
Balance at December 31, 2014	\$ (16,456)	\$ (5,615)	\$(10,841)
Other comprehensive income (loss)	(897)	(882)	(15)
Amounts reclassified from other comprehensive income (loss) ⁽¹⁾	769	334	435
Balance at July 3, 2015	\$ (16,584)	\$ (6,163)	\$(10,421)

(1) The amounts reclassified from other comprehensive income (loss) were included in selling, general and administrative expenses and loss from discontinued operations, net of tax in the consolidated statements of operations.

5. Earnings per Share

Basic earnings (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 earnings per common share, the denominator also includes the dilutive effect of outstanding restricted stock units determined using the treasury stock method. Dilutive effects of contingently issuable shares are included in the weighted average dilutive share calculation when the contingencies have been resolved. For periods in which net losses are generated, the dilutive potential common shares are excluded from the calculation of diluted earnings per share as the effect would be anti-dilutive.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	July 3, 2015	June 27, 2014	July 3, 2015	June 27, 2014
Numerators:				
Income from continuing operations	\$ 19,511	\$ 3,406	\$ 22,957	\$ 6,262
Loss from discontinued operations	(13)	(2,678)	(13)	(4,544)

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Less: Income attributable to noncontrolling interest	—	(3)	—	(10)
Loss from discontinued operations attributable to GSI Group Inc.	(13)	(2,681)	(13)	(4,554)
Net income attributable to GSI Group Inc.	\$ 19,498	\$ 725	\$ 22,944	\$ 1,708

Denominators:

Weighted average common shares outstanding— basic	34,630	34,378	34,567	34,304
Dilutive potential common shares	399	329	447	386
Weighted average common shares outstanding— diluted	35,029	34,707	35,014	34,690
Antidilutive common shares excluded from above	—	—	—	44

Basic Earnings (Loss) per Common Share:

From continuing operations	\$ 0.56	\$ 0.10	\$ 0.66	\$ 0.18
From discontinued operations	\$ (0.00)	\$ (0.08)	\$ (0.00)	\$ (0.13)
Basic earnings per share attributable to GSI Group Inc.	\$ 0.56	\$ 0.02	\$ 0.66	\$ 0.05

Diluted Earnings (Loss) per Common Share:

From continuing operations	\$ 0.56	\$ 0.10	\$ 0.66	\$ 0.18
From discontinued operations	\$ (0.00)	\$ (0.08)	\$ (0.00)	\$ (0.13)
Diluted earnings per share attributable to GSI Group Inc.	\$ 0.56	\$ 0.02	\$ 0.66	\$ 0.05

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

Common Stock Repurchases

In October 2013, the Company's Board of Directors authorized a share repurchase plan under which the Company may repurchase outstanding shares of the Company's common stock up to an aggregate amount of \$10.0 million. The shares may be repurchased from time to time, at the Company's discretion, based on ongoing assessment of the capital needs of the business, the market price of the Company's common stock, and general market conditions. Shares may also be repurchased through an accelerated stock purchase agreement, on the open market or in privately negotiated transactions in accordance with applicable federal securities laws. Repurchases may be made under certain SEC regulations, which would permit common stock to be purchased when the Company would otherwise be prohibited from doing so under insider trading laws. The share repurchase plan does not obligate the Company to acquire any particular amount of common stock. No time limit was set for the completion of the share repurchase program, and the program may be suspended or discontinued at any time. As of December 31, 2014, the Company had cumulatively repurchased 50 thousand shares of its common stock for an aggregate amount of \$0.5 million. There have been no share repurchases to date in 2015.

6. Fair Value Measurements

ASC 820, "Fair Value Measurements," establishes a fair value hierarchy based on the following three levels of inputs:

- 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 Company's cash equivalents are investments in money market accounts, which represent the only asset the Company measures at fair value on a recurring basis. The Company determines the fair value of our cash equivalents using a market approach based on quoted prices in active markets which is classified as Level 1. The contingent consideration is classified as Level 3 as the fair value is based on unobservable inputs. The fair values of cash, accounts receivable, income taxes receivable, accounts payable, income taxes payable, accrued expenses and other current liabilities approximate their carrying values because of their short-term nature.

The following table summarizes the fair values of our financial assets and liabilities as of July 3, 2015 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	\$ 2,581	\$ 2,581	\$ —	\$ —

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Total Assets	\$ 2,581	\$ 2,581	\$ —	\$ —
Liabilities				
Contingent consideration	\$ 965	\$ —	\$ —	\$ 965
Total Liabilities	\$ 965	\$ —	\$ —	\$ 965

The following table summarizes the fair values of our financial assets as of December 31, 2014 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	\$ 2,255	\$ 2,255	\$ —	\$ —

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

Contingent consideration relates to the Company's acquisition of Applimotion on February 19, 2015. The former shareholders of Applimotion are eligible to receive contingent consideration based on the achievement of certain revenue targets for fiscal years 2015 to 2017. If such targets are achieved, the contingent consideration will be payable in cash in two installments in 2017 and 2018, respectively. The estimated fair value of the contingent consideration was determined based on the Monte Carlo valuation method and has been recorded as part of the purchase price as of the acquisition date. Subsequent changes in the estimated fair value of this contingent liability will be recorded in the consolidated statement of operations as acquisition related costs until the liability is fully settled. There have been no changes to the fair value of the contingent consideration since the acquisition date. The estimated fair value of the contingent consideration is reported as a long-term liability in the consolidated balance sheet.

See Note 9 to Consolidated Financial Statements for a discussion of the estimated fair value of the Company's outstanding debt.

7. Goodwill and Intangible Assets

Goodwill

Goodwill is recorded when the consideration for a business combination exceeds the fair value of net tangible and identifiable intangible assets acquired. The Company tests its goodwill balances annually for impairment as of the beginning of the second quarter or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. The Company performed its annual goodwill impairment test at the beginning of the second quarter of 2015 and noted no impairment of goodwill.

The following table summarizes changes in goodwill during the six months ended July 3, 2015 (in thousands):

Balance at beginning of the period	\$90,746
Goodwill acquired from the Applimotion acquisition	7,612
Balance at end of the period	\$98,358

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Goodwill acquired from the Applimotion acquisition is reflected in the Precision Motion segment. Goodwill by reportable segment as of July 3, 2015 was as follows (in thousands):

	Reportable Segment			Precision	Total
	Laser	Vision			
	Products	Technologies	Motion		
Goodwill	\$ 132,954	\$ 82,730	\$ 33,903		\$ 249,587
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)		(151,229)
Total	\$ 30,493	\$ 51,008	\$ 16,857		\$ 98,358

Goodwill by reportable segment as of December 31, 2014 was as follows (in thousands):

	Reportable Segment			Precision	Total
	Laser	Vision			
	Products	Technologies	Motion		
Goodwill	\$ 132,954	\$ 82,730	\$ 26,291		\$ 241,975
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)		(151,229)
Total	\$ 30,493	\$ 51,008	\$ 9,245		\$ 90,746

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

Intangible Assets

Intangible assets as of July 3, 2015 and December 31, 2014, respectively, are summarized as follows (in thousands):

	July 3, 2015			December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizable intangible assets:						
Patents and acquired technologies	\$80,908	\$(64,274)	\$16,634	\$78,253	\$(62,010)	\$16,243
Customer relationships	65,102	(34,275)	30,827	63,029	(31,531)	31,498
Customer backlog	2,447	(2,083)	364	1,810	(1,641)	169
Non-compete covenant	2,514	(613)	1,901	1,830	(366)	1,464
Trademarks and trade names	10,209	(5,684)	4,525	10,205	(5,364)	4,841
Amortizable intangible assets	161,180	(106,929)	54,251	155,127	(100,912)	54,215
Non-amortizable intangible assets:						
Trade names	13,027	—	13,027	13,027	—	13,027
Totals	\$174,207	\$(106,929)	\$67,278	\$168,154	\$(100,912)	\$67,242

All definite-lived intangible assets are amortized either on a straight-line basis or an economic benefit basis over their remaining useful life. Amortization expense for customer relationships and definite-lived trademarks, trade names and other intangibles is included in operating expenses in the accompanying consolidated statements of operations. Amortization expense for patents and acquired technologies is included in cost of revenue in the accompanying consolidated statements of operations. Amortization expense is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2015	June 27, 2014	July 3, 2015	June 27, 2014
Amortization expense – cost of revenue	\$1,174	\$1,614	\$2,293	\$2,915
Amortization expense – operating expenses	1,852	2,876	3,741	4,620
Total amortization expense	\$3,026	\$4,490	\$6,034	\$7,535

Estimated amortization expense for each of the five succeeding years and thereafter as of July 3, 2015 was as follows (in thousands):

	Operating		
Year Ending December 31,	Cost of Revenue	Expenses	Total
2015 (remainder of year)	\$ 2,349	\$ 3,704	\$6,053
2016	3,550	7,259	10,809
2017	3,229	6,637	9,866
2018	1,754	6,003	7,757
2019	1,487	4,008	5,495
Thereafter	4,265	10,006	14,271
Total	\$ 16,634	\$ 37,617	\$54,251

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

8. Supplementary Balance Sheet Information

The following tables provide the details of selected balance sheet items as of the periods indicated (in thousands):

Inventories

	July 3,	December 31,
	2015	2014
Raw materials	\$38,418	\$ 38,934
Work-in-process	10,621	9,899
Finished goods	9,727	11,945
Demo and consigned inventory	1,644	2,165
Total inventories	\$60,410	\$ 62,943

Accrued Expenses and Other Current Liabilities

	July 3,	December 31,
	2015	2014
Accrued compensation and benefits	\$8,809	\$ 7,741
Accrued warranty	3,539	3,044
Accrued professional services	1,580	1,827
Other	8,109	6,789
Total	\$22,037	\$ 19,401

Accrued Warranty

	Six Months Ended	
	July 3,	June 27,
	2015	2014
Balance at beginning of the period	\$ 3,044	\$ 3,315

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Provision charged to cost of revenue	1,524	976
Acquisition related warranty accrual	94	90
Use of provision	(730)	(973)
Divestiture of JK Lasers	(392)	—
Foreign currency exchange rate changes	(1)	8
Balance at end of period	\$ 3,539	\$ 3,416

Other Long Term Liabilities

	July 3,	December 31,
	2015	2014
Capital lease obligations	\$9,269	\$ 9,507
Accrued pension liabilities	5,305	6,037
Other	3,683	3,275
Total	\$18,257	\$ 18,819

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

9. Debt

Debt consisted of the following (in thousands):

	July 3, 2015	December 31, 2014
Senior Credit Facilities – term loan	\$31,250	\$ 35,000
Senior Credit Facilities – revolving credit facility	85,000	80,000
Total Senior Credit Facilities	\$ 116,250	\$ 115,000

Senior Credit Facilities

The Company's amended and restated senior secured credit agreement (the "Amended and Restated Credit Agreement") provides for a \$50.0 million, 5-year term loan facility due in quarterly installments of \$1.9 million beginning in January 2013 and a \$175.0 million, 5-year revolving credit facility (collectively, the "Senior Credit Facilities") that matures in December 2017. Quarterly installments due in the next twelve months under the term loan amount to \$7.5 million and are classified as a current liability in the consolidated balance sheet.

The Company is required to satisfy certain financial and non-financial covenants under the Amended and Restated Credit Agreement. The Company is in compliance with these covenants as of July 3, 2015.

Fair Value of Debt

As of July 3, 2015 and December 31, 2014, the outstanding balance of the Company's debt approximated its fair value based on current rates available to the Company for debt of the same maturity.

10. Share-Based Compensation

The table below summarizes activities relating to restricted stock units issued and outstanding under the Company's Amended and Restated 2010 Incentive Plan during the six months ended July 3, 2015:

Restricted	Weighted
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	Stock Units	Average Grant
	(In thousands)	Date Fair Value
Unvested at December 31, 2014	749	\$ 10.80
Granted	305	\$ 13.34
Vested	(299)) \$ 11.08
Forfeited	(42)) \$ 11.03
Unvested at July 3, 2015	713	\$ 11.76
Expected to vest as of July 3, 2015	693	

The total fair value of restricted stock units that vested during the six months ended July 3, 2015, based on the market price of the underlying stock on the date of vesting, was \$3.8 million.

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

The table below summarizes share-based compensation expense recorded in income from continuing operations in the consolidated statements of operations (in thousands):

	Three Months Ended		Six Months Ended	
	July 3,	June 27,	July 3,	June 27,
	2015	2014	2015	2014
Selling, general and administrative	\$ 832	\$ 914	\$ 2,316	\$ 2,270
Research and development and engineering	31	45	80	95
Cost of revenue	73	36	137	69
Restructuring, acquisition and divestiture related costs	(277)	258	(321)	304
Total share-based compensation expense	\$ 659	\$ 1,253	\$ 2,212	\$ 2,738

The expense recorded during each of the three and six-month periods ended July 3, 2015 and June 27, 2014, respectively, included \$0.5 million related to deferred stock units granted to the members of the Company's Board of Directors, pursuant to the Company's Amended and Restated 2010 Incentive Plan. The expense associated with the respective deferred stock units was recognized in full on the date of grant, as the deferred stock units were fully vested and non-forfeitable upon grant.

In March 2014, the Company granted restricted stock units in an aggregate of 180,000 shares as employment incentive awards related to an acquisition. These restricted stock units are performance based awards and would vest after two years if certain financial targets and service conditions have been achieved. During the second quarter ended July 3, 2015, these financial targets were no longer deemed probable and the cumulative expense was reversed.

11. Income Taxes

The Company determines its estimated annual effective tax rate at the end of each interim period based on full-year forecasted pre-tax income and 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 effective tax rate on income from continuing operations of 24.4% and 26.1%, respectively, for the three and six-month periods ended July 3, 2015 differ from the Canadian statutory rate of 27.0% primarily due to the JK Lasers gain, mix of income earned in jurisdictions with varying tax rates, losses in jurisdictions with a full valuation allowance, and the impact of discrete items for the period. The Company's effective tax rate on income from

continuing operations of 37.7% and 32.3%, respectively, for the three and six-month periods ended June 27, 2014 differ from the Canadian statutory rate of 27.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, losses in jurisdictions with a valuation allowance which are not benefitted in the income tax provision during the period, and recognition of net tax benefit associated with uncertain tax positions upon expiration of statute of limitations.

The Company maintains a valuation allowance on some of its deferred tax assets in certain jurisdictions. A valuation allowance is required when, based upon an assessment of various factors, including recent operating loss history, anticipated future earnings, and prudent and reasonable tax planning strategies, it is more likely than not that some portion of the deferred tax assets will not be realized.

In conjunction with the Company's ongoing review of its actual results and anticipated future earnings, the Company continuously reassesses the possibility of releasing the remaining valuation allowance currently in place on its deferred tax assets. A release would be reported as a reduction to income tax expense without any impact on cash flows in the quarter in which it is released.

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

12. Restructuring, Acquisition and Divestiture Related Costs

The following table summarizes restructuring, acquisition and divestiture related costs in the accompanying consolidated statements of operations (in thousands):

	Three Months Ended		Six Months Ended	
	July 3,	June 27,	July 3,	June 27,
	2015	2014	2015	2014
2011 restructuring	\$ 270	\$ (122)	\$ 653	\$ (94)
2013 restructuring	—	(66)	—	(66)
2015 restructuring	114	—	1,484	—
Total restructuring charges	384	(188)	2,137	(160)
Acquisition charges	57	45	264	748
Acquisition related incentive compensation	(532)	503	(612)	590
Divestiture related charges	507	—	1,064	—
Total acquisition and divestiture related charges	32	548	716	1,338
Total restructuring, acquisition and divestiture related costs	\$ 416	\$ 360	\$ 2,853	\$ 1,178

2011 Restructuring

In November 2011, the Company announced a strategic initiative (“2011 restructuring”), which aimed to consolidate operations to reduce the Company’s cost structure and improve operational efficiency. As part of this initiative, the Company eliminated facilities through the consolidation of certain manufacturing, sales and distribution facilities and the exit of Semiconductor and Laser Systems businesses. The Company substantially completed the 2011 restructuring program by the end of 2013. Restructuring costs for the three and six months ended July 3, 2015 included facility costs related to the Company’s vacant Orlando, Florida facility, which the Company owns and was previously occupied by the Laser Systems business. These costs were recorded in the Unallocated Corporate and Shared Services Costs segment.

2015 Restructuring

During the first quarter of 2015, the Company initiated a program to eliminate redundant costs, as a result of acquisition and divestiture activities, to better align our operations to our strategic growth plans, to further integrate our business lines, and as a consequence of our productivity initiatives. During the three and six months ended July 3, 2015, the Company incurred restructuring costs of \$0.1 million and \$1.5 million, respectively, related to the 2015 restructuring plan. Restructuring costs incurred during the six months ended July 3, 2015 of \$0.6 million, \$0.5 million, \$0.1 million and \$0.3 million related to the Laser Products, Vision Technologies, Precision Motion and Unallocated

Corporate and Shared Services Costs reportable segments, respectively.

Rollforward of Accrued Expenses Related to Restructuring

The following table summarizes the accrual activities, by component, related to the Company's restructuring plans recorded in the accompanying consolidated balance sheets (in thousands):

	Total	Severance	Facility	Depreciation	Other
Balance at December 31, 2014	\$231	\$ 102	\$ 105	\$ —	\$24
Restructuring charges	2,137	1,343	99	582	113
Cash payments	(1,090)	(881)	(176)	—	(33)
Non-cash write-offs and other adjustments	(577)	5	—	(582)	—
Balance at July 3, 2015	\$701	\$ 569	\$ 28	\$ —	\$ 104

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

13. Commitments and Contingencies

Leases

The Company leases certain equipment and facilities under operating and capital lease agreements. There have been no material changes to the Company's leases through July 3, 2015 from those discussed in Note 15 to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

Purchase Commitments

There have been no material changes to the Company's purchase commitments from those discussed in Note 15 to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

Legal Proceedings

The Company is 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.

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, 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. Certain of our officers and directors are also a party to indemnification agreements with the Company. These indemnification agreements provide, among other things, that the director and officer 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 indemnification agreements provide 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 agreements also set 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.

14. Segment Information

The Company evaluates the performance of, and allocates resources to, its segments based on revenue, gross profit and operating profit. The Company's reportable segments have been identified based on commonality of end markets, customers, applications and technologies amongst the Company's individual product lines, which is consistent with the Company's operating structure, associated management structure, and management compensation programs.

We operate in three reportable segments: Laser Products, Vision Technologies (formerly known as Medical Technologies), and Precision Motion. The reportable segments and their principal activities are summarized below.

Laser Products

The Laser Products segment designs, manufactures and markets photonics-based solutions, including CO2 laser sources, laser scanning and beam delivery products, to customers worldwide. The segment serves highly demanding photonics-based applications such as industrial material processing, and medical and life science imaging and laser procedures. The vast majority of the segment's

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

Vision Technologies

The Vision Technologies segment designs, manufactures and markets a range of medical grade technologies, including visualization solutions, imaging informatics products, optical data collection and machine vision technologies, thermal printers, and light and color measurement instrumentation, to customers worldwide. The vast majority of the segment's product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

Precision Motion

The Precision Motion segment designs, manufactures and markets optical encoders, precision motor and motion control technology, air bearing spindles and precision machined components to customers worldwide. The vast majority of the segment's product offerings are sold into the advanced industrial market and, to a lesser extent, the medical market. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

Reportable Segment Financial Information

Revenue, gross profit, gross profit margin, operating income (loss) from continuing operations, and depreciation and amortization by reportable segments are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 3,	June 27,	July 3,	June 27,
	2015	2014	2015	2014
Revenue				
Laser Products	\$ 42,190	\$ 43,828	\$ 87,145	\$ 85,688
Vision Technologies	31,216	34,791	62,327	57,158
Precision Motion	23,088	18,286	41,636	33,192
Total	\$ 96,494	\$ 96,905	\$ 191,108	\$ 176,038

	Three Months Ended		Six Months Ended	
	July 3,	June 27,	July 3,	June 27,
	2015	2014	2015	2014

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Gross Profit				
Laser Products	\$ 18,950	\$ 17,155	\$ 38,325	\$ 34,168
Vision Technologies	12,158	13,838	24,671	22,727
Precision Motion	10,611	7,949	19,076	14,365
Unallocated Corporate and Shared Services	(374)	(291)	(721)	(504)
Total	\$ 41,345	\$ 38,651	\$ 81,351	\$ 70,756

	Three Months Ended		Six Months Ended	
	July 3,	June	July 3,	June
	2015	2014	2015	2014
Gross Profit Margin				
Laser Products	44.9 %	39.1 %	44.0 %	39.9 %
Vision Technologies	38.9 %	39.8 %	39.6 %	39.8 %
Precision Motion	46.0 %	43.5 %	45.8 %	43.3 %
Total	42.8 %	39.9 %	42.6 %	40.2 %

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF JULY 3, 2015

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 3,	June 27,	July 3,	June 27,
	2015	2014	2015	2014
Operating Income (Loss) from Continuing Operations				
Laser Products	\$ 10,046	\$ 6,847	\$ 18,441	\$ 13,971
Vision Technologies	(14)	38	(668)	(79)
Precision Motion	5,803	4,086	9,940	6,729
Unallocated Corporate and Shared Services	(5,520)	(4,491)	(12,001)	(10,073)
Total	\$ 10,315	\$ 6,480	\$ 15,712	\$ 10,548

	Three Months Ended		Six Months Ended	
	July 3,	June 27,	July 3,	June 27,
	2015	2014	2015	2014
Depreciation and Amortization				
Laser Products	\$ 1,397	\$ 1,554	\$ 2,979	\$ 3,220
Vision Technologies	2,082	3,716	4,340	5,807
Precision Motion	689	505	1,162	1,007
Unallocated Corporate and Shared Services	455	547	904	1,117
Total	\$ 4,623	\$ 6,322	\$ 9,385	\$ 11,151

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, expected benefits of the Applimotion acquisition; our belief that the Purchasing Managers Index (PMI) may provide an indication of the impact of general economic conditions on our sales into the advanced industrial end market; expectations regarding the 2015 restructuring program, including our reinvestment plans; 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; changes in accounting principles and changes in actual or assumed tax liabilities; and expectations regarding tax exposure. 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, but not limited to, the following: the PMI may not provide an indication of the impact of general economic conditions on our sales into the advanced industrial end market in any particular period or at all; economic and political conditions and the effects of these conditions on our customers' businesses and level of business activity; our significant dependence upon our customers' capital expenditures, which are subject to cyclical market fluctuations; our dependence upon our ability to respond to fluctuations in product demand; our ability to continually innovate and successfully commercialize our innovations; failure to introduce new products in a timely manner; customer order timing and other similar factors beyond our control; disruptions or breaches in security of our information technology systems; changes in interest rates, credit ratings or foreign currency exchange rates; risk associated with our operations in foreign countries; our increased use of outsourcing in foreign countries; our failure to comply with local import and export regulations in the jurisdictions in which we operate; our exposure to the credit risk of some of our customers and in weakened markets; our reliance on third party distribution channels; violations of our intellectual property rights and our ability to protect our intellectual property against infringement by third parties; risk of losing our competitive advantage; our failure to successfully integrate recent and future acquisitions into our business or grow acquired businesses; our ability to make divestitures that provide business benefits; our ability to attract and retain key personnel; our restructuring and realignment activities and disruptions to our operations as a result of consolidation of our operations; product defects or problems integrating our products with other vendors' products; disruptions in the supply of certain key components and other goods from our suppliers; production difficulties and product delivery delays or disruptions; our compliance, or our failure to comply, with various federal, state and foreign regulations; changes in governmental regulation of our business or products; effects of compliance with conflict minerals regulations; our compliance, or failure to comply, with environmental regulations; our failure to implement new information technology systems and software successfully; our failure to realize the full value of our intangible assets; our ability to utilize our net operating loss carryforwards and other tax attributes; changes in tax laws, and fluctuations in our effective tax rates; being subject to U.S. federal income taxation even though we are a non-U.S. corporation; any need for additional capital to adequately respond to business challenges or opportunities and repay or refinance our existing indebtedness, which may not be available on acceptable terms or at all; volatility in the market price for our common shares; our ability to access cash and other assets of our subsidiaries; the influence of certain significant shareholders over our business; provisions of our articles of incorporation may delay or prevent a change in control; our significant existing indebtedness may limit our ability to engage in certain activities; and our failure to maintain appropriate internal controls in the future. Other important risk factors that could affect the outcome of the events set forth in these statements and that could affect the Company's operating results and financial condition are discussed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014

under the heading “Risk Factors.” 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 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

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

Business Overview

We design, develop, manufacture and sell precision photonics and motion control components and subsystems to Original Equipment Manufacturers (“OEM”) in the medical and advanced industrial markets. We are a leader in highly engineered enabling technologies, including CO2 laser sources, laser scanning and beam delivery products, optical data collection and machine vision technologies, medical visualization and informatics solutions, and precision motion control products. We specialize in collaborating with OEM customers to adapt our component and subsystem technologies to deliver highly differentiated performance in their applications.

Reportable Segments

We operate in three reportable segments: Laser Products, Vision Technologies (formerly known as Medical Technologies), and Precision Motion. The reportable segments and their principal activities are summarized below.

Laser Products

Our Laser Products segment designs, manufactures and markets photonics-based solutions, including CO2 laser sources, and laser scanning and beam delivery products, to customers worldwide. The segment serves highly demanding photonics-based applications such as industrial material processing, and medical and life science imaging and laser procedures. The vast majority of the segment’s product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

Vision Technologies

Our Vision Technologies segment designs, manufactures and markets a range of medical grade technologies, including visualization solutions, imaging informatics products, optical data collection and machine vision technologies, thermal printers, and light and color measurement instrumentation, to customers worldwide. The vast majority of the segment’s product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

Precision Motion

Our Precision Motion segment designs, manufactures and markets optical encoders, precision motor and motion control technology, air bearing spindles and precision machined components, to customers worldwide. The vast majority of the segment’s product offerings are sold into the advanced industrial market and, to a lesser extent, the medical market. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

End Markets

We primarily operate in two end markets: the advanced industrial market and the medical market.

Advanced Industrial Market

As of the six months ended July 3, 2015, the advanced industrial market accounted for approximately 60% of the Company's revenue. Revenue from our advanced industrial market products are affected by a number of factors, including changing technology requirements and preferences of our customers, the financial condition of our advanced industrial customers, and general economic conditions. We believe that the Purchasing Managers Index (PMI) on manufacturing activity specific to different regions around the world may provide an indication of the impact of general economic conditions on our sales into the advanced industrial market.

Medical Market

As of the six months ended July 3, 2015, the medical market accounted for approximately 40% of the Company's revenue. Our revenue from sales to the medical market is generally affected by hospital and other health care provider capital spending, changes in regulatory requirements and laws, aggregation of purchasing by healthcare networks, and demographics.

Strategy

Our strategy is to drive sustainable, profitable growth through short-term and long-term initiatives, including:

- improving our business mix to increase medical sales as a percentage of total revenue by:
- introducing new products aimed at attractive medical applications such as minimally invasive and robotic surgery, ophthalmology, patient monitoring, drug delivery, diagnostic testing and life science research;
- cross selling our entire product offerings to the leading medical manufacturers; and
- pursuing complementary medical technology acquisitions;
- increasing our penetration of high growth advanced industrial applications such as laser materials processing, robotics, automation, metrology, and via hole drilling by working closely with OEM customers to launch application specific products that closely match the requirements of each application;
- broadening our portfolio of precision motion control products and capabilities through increased new product development investment in motion control product lines, expanded sales and marketing channels to reach target customers, and acquisitions of additional motion control product technologies used by existing customers;
- broadening our product and service offerings through the acquisition of innovative and complementary technologies and solutions in medical and advanced industrial applications;
- upgrading our existing operations to expand profit margins and improve customer satisfaction by implementing lean manufacturing principles and strategic sourcing across our major production sites; and
- attracting, retaining, and developing talented and motivated employees.

Significant Events and Updates

Acquisition of Applimotion

On February 19, 2015, we acquired 100% of the outstanding stock of Applimotion Inc. ("Applimotion"), a Loomis, California based provider of advanced precision motor and motion control technology to OEM customers in the advanced industrial and medical markets, for a total purchase price of \$14.0 million, net of working capital adjustments. This total purchase price includes \$13.0 million in cash paid upon closing of the acquisition and \$1.0 million in estimated fair value of future contingent consideration payable upon the achievement of certain revenue

targets for the fiscal years 2015 to 2017. The undiscounted range of contingent consideration is zero to \$4.0 million. Applimotion specializes in motor applications that require highly precise and dynamic motion control. The acquisition enhances our strategic position in precision motion control by enabling us to offer a broader range of motion control technologies and integrated solutions. Applimotion is included in our Precision Motion reportable segment.

JK Lasers Divestiture

On April 15, 2015, we completed the sale of our JK Lasers business for \$30.6 million in cash, received upon closing, net of transaction costs, and recognized a \$19.6 million pre-tax gain on sale during the three months ended July 3, 2015. As of July 3, 2015,

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the working capital adjustments had not yet been settled and were estimated to be a cash payment of \$1.0 million to the buyer. We expect to settle the working capital adjustments in the third quarter of 2015. During the three and six months ended July 3, 2015, we incurred \$0.5 million and \$1.1 million, respectively, of consulting fees related to the JK Lasers business divestiture, which are included in restructuring, acquisition and divestiture related costs in the consolidated statement of operations. The JK Lasers business divestiture does not qualify for discontinued operations accounting treatment.

2015 Restructuring

During the first quarter of 2015, the Company initiated a program to eliminate redundant costs, as a result of acquisition and divestiture activities, to better align our operations to our strategic growth plans, to further integrate our business lines, and as a consequence of our productivity initiatives. We incurred severance costs related to the 2015 restructuring amounting to \$0.1 million in the three months ended July 3, 2015 and \$1.3 million in the six months ended July 3, 2015. We principally intend to reallocate resources and reinvest these savings into higher growth businesses and lower cost regions.

Results of Operations for the Three and Six Months Ended July 3, 2015 Compared with the Three and Six Months Ended June 27, 2014

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

	Three Months Ended		Six Months Ended	
	July 3,	June 27,	July 3,	June 27,
	2015	2014	2015	2014
Revenue	100.0 %	100.0 %	100.0 %	100.0 %
Cost of revenue	57.2	60.1	57.4	59.8
Gross profit	42.8	39.9	42.6	40.2
Operating expenses:				
Research and development and engineering	8.1	7.7	8.4	7.6
Selling, general and administrative	21.7	22.1	22.5	23.3
Amortization of purchased intangible assets	1.9	3.0	2.0	2.6
Restructuring, acquisition and divestiture related costs	0.4	0.4	1.5	0.7
Total operating expenses	32.1	33.2	34.4	34.2
Operating income from continuing operations	10.7	6.7	8.2	6.0
Interest income (expense), net	(1.4)			