

GSI GROUP INC
Form 10-Q
November 05, 2014

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 September 26, 2014

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

As of October 27, 2014, there were 34,211,282 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)

	September 26, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 53,549	\$ 60,980
Accounts receivable, net of allowance of \$435 and \$575, respectively	56,673	48,552
Inventories	62,815	58,290
Income taxes receivable	5,251	5,715
Deferred tax assets	8,699	6,351
Prepaid expenses and other current assets	4,392	5,134
Assets of discontinued operations	631	16,088
Total current assets	192,010	201,110
Property, plant and equipment, net	39,634	31,303
Deferred tax assets	438	519
Other assets	14,131	9,426
Intangible assets, net	93,543	65,293
Goodwill	110,783	71,156
Total assets	\$450,539	\$ 378,807
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Current portion of long-term debt	\$7,500	\$ 7,500
Accounts payable	31,223	24,361
Income taxes payable	2,305	1,018
Deferred tax liabilities	172	214
Accrued expenses and other current liabilities	19,078	22,288
Liabilities of discontinued operations	1,437	6,398
Total current liabilities	61,715	61,779
Long-term debt	114,375	64,000
Deferred tax liabilities	4,636	—
Income taxes payable	7,484	5,596
Other liabilities	13,551	5,029
Total liabilities	201,761	136,404
Commitments and Contingencies (Note 13)		
Stockholders' Equity:		

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Common shares, no par value; Authorized shares: unlimited;		
Issued and outstanding: 34,209 and 33,991, respectively	423,856	423,856
Additional paid-in capital	27,968	25,383
Accumulated deficit	(194,680)	(200,913)
Accumulated other comprehensive loss	(8,795)	(6,342)
Total GSI Group Inc. stockholders' equity	248,349	241,984
Noncontrolling interest	429	419
Total stockholders' equity	248,778	242,403
Total liabilities and stockholders' equity	\$450,539	\$ 378,807

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

GSI GROUP INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

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

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
Sales	\$ 94,656	\$ 79,858	\$ 270,694	\$ 234,698
Cost of sales	54,973	45,697	160,255	136,667
Gross profit	39,683	34,161	110,439	98,031
Operating expenses:				
Research and development and engineering	7,735	6,031	21,117	17,962
Selling, general and administrative	21,512	19,006	62,540	57,069
Amortization of purchased intangible assets	2,843	1,772	7,463	5,625
Restructuring and acquisition related costs	771	1,553	1,949	4,724
Total operating expenses	32,861	28,362	93,069	85,380
Operating income from continuing operations	6,822	5,799	17,370	12,651
Interest income (expense), net	(1,453)	(841)	(3,665)	(2,660)
Foreign exchange transaction gains (losses), net	1,030	(1,723)	950	(963)
Other income (expense), net	733	542	1,733	1,204
Income from continuing operations before income taxes	7,132	3,777	16,388	10,232
Income tax provision	2,013	1,533	5,007	4,954
Income from continuing operations	5,119	2,244	11,381	5,278
Loss from discontinued operations, net of tax	(273)	(185)	(4,817)	(1,643)
Loss on disposal of discontinued operations, net of tax	(321)	(281)	(321)	(592)
Consolidated net income	4,525	1,778	6,243	3,043
Less: Net income (loss) attributable to noncontrolling interest	—	12	(10)	(42)
Net income attributable to GSI Group Inc.	\$ 4,525	\$ 1,790	\$ 6,233	\$ 3,001
Earnings per common share from continuing operations:				
Basic	\$ 0.15	\$ 0.07	\$ 0.33	\$ 0.15
Diluted	\$ 0.15	\$ 0.07	\$ 0.33	\$ 0.15
Loss per common share from discontinued operations:				
Basic	\$ (0.02)	\$ (0.02)	\$ (0.15)	\$ (0.07)
Diluted	\$ (0.02)	\$ (0.02)	\$ (0.15)	\$ (0.07)
Earnings per common share attributable to GSI Group Inc.:				
Basic	\$ 0.13	\$ 0.05	\$ 0.18	\$ 0.08
Diluted	\$ 0.13	\$ 0.05	\$ 0.18	\$ 0.08
Weighted average common shares outstanding—basic	34,389	34,102	34,333	34,058
Weighted average common shares outstanding—diluted	34,793	34,417	34,725	34,325

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		Nine Months Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
Consolidated net income	\$ 4,525	\$ 1,778	\$ 6,243	\$ 3,043
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax (1)	(3,845)	3,764	(2,902)	(2,016)
Pension liability adjustments, net of tax (2)	435	(370)	449	802
Total other comprehensive income (loss)	(3,410)	3,394	(2,453)	(1,214)
Total consolidated comprehensive income	1,115	5,172	3,790	1,829
Less: Comprehensive (income) loss attributable to				
noncontrolling interest	—	12	(10)	(42)
Comprehensive income attributable to GSI Group Inc.	\$ 1,115	\$ 5,184	\$ 3,780	\$ 1,787

(1) The tax effect on this component of comprehensive income was \$0.4 million and \$0.2 million for the three and nine months ended September 26, 2014, respectively. The impact was zero and \$1.3 million for the three and nine months ended September 27, 2013, respectively.

(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)

	Nine Months Ended	
	September 30, 2014	September 27, 2013
Cash flows from operating activities:		
Consolidated net income	\$6,243	\$ 3,043
Less: Loss from discontinued operations, net of tax	5,138	2,235
Income from continuing operations	11,381	5,278
Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations:		
Depreciation and amortization	17,495	14,792
Provision for inventory excess and obsolescence	704	1,407
Share-based compensation	3,412	4,170
Deferred income taxes	(1,653)	2,166
Earnings from equity investment	(1,707)	(1,181)
Non-cash interest expense	982	735
Non-cash restructuring and acquisition related charges	944	19
Other non-cash items	496	1,059
Changes in assets and liabilities which (used) provided cash, excluding effects from businesses purchased or classified as held for sale:		
Accounts receivable	(835)	(6,330)
Inventories	116	(636)
Prepaid expenses, income taxes receivable and other current assets	911	13,955
Accounts payable, accrued expenses, income taxes payable and other current liabilities	1,706	5,244
Other non-current assets and liabilities	463	645
Cash provided by operating activities of continuing operations	34,415	41,323
Cash used in operating activities of discontinued operations	(761)	(6,875)
Cash provided by operating activities	33,654	34,448
Cash flows from investing activities:		
Purchases of property, plant and equipment	(3,783)	(2,962)
Acquisition of businesses, net of cash acquired and escrow recovery	(88,238)	(82,653)
Proceeds from the sale of property, plant and equipment	57	255
Cash used in investing activities of continuing operations	(91,964)	(85,360)
Cash provided by investing activities of discontinued operations	4,344	12,439
Cash used in investing activities	(87,620)	(72,921)
Cash flows from financing activities:		

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Borrowings under revolving credit facility	77,000	60,000
Repayments of long-term debt and revolving credit facility	(26,625)	(31,625)
Payments for debt issuance costs	(712)	(145)
Payments of withholding taxes from stock-based awards	(1,605)	(820)
Capital lease payments	(938)	(608)
Excess tax benefits from stock-based awards	210	—
Other financing activities	261	—
Cash provided by financing activities of continuing operations	47,591	26,802
Cash provided by financing activities of discontinued operations	—	—
Cash provided by financing activities	47,591	26,802
Effect of exchange rates on cash and cash equivalents	(1,056)	(427)
Decrease in cash and cash equivalents	(7,431)	(12,098)
Cash and cash equivalents, beginning of period	60,980	65,788
Cash and cash equivalents, end of period	\$53,549	\$ 53,690
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$2,644	\$ 1,674
Cash paid for income taxes	\$3,944	\$ 1,935
Income tax refunds received	\$150	\$ 12,607
Supplemental disclosure of non-cash financing activity:		
Assets acquired under capital lease obligations	\$9,133	\$ -

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

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF SEPTEMBER 26, 2014

(Unaudited)

1. Nature of Operations and Summary of Significant Accounting Policies

GSI Group Inc. and its subsidiaries (collectively referred to as the “Company”) design, develop, manufacture and sell precision photonic and motion control components and subsystems to Original Equipment Manufacturers (OEM’s) in the medical equipment and advanced industrial technology markets. Our highly engineered enabling technologies include 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.

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 financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. In the opinion of management, these interim consolidated financial statements include all adjustments and accruals of a normal and recurring nature necessary for a fair presentation of 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.

The interim consolidated financial statements include the accounts of the Company and its 50% owned joint venture, Excel Laser Technology Private Limited (the “India JV”), which is reported as discontinued operations in the Company’s consolidated statements of operations. Intercompany transactions and balances have been eliminated. During the second quarter of 2013, the Company’s ownership percentage in a privately held company located in the United Kingdom, Laser Quantum Ltd. (“Laser Quantum”), increased from approximately 25% to 41% as a result of a share buy-back program by Laser Quantum. The Company continues to record 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 sales 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

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

In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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 an impact on the Company's financial statements.

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

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. The Company is currently evaluating the impact of the new standard on the Company’s financial statements.

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

In April 2014, the FASB issued 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 will be effective prospectively for reporting periods beginning after December 15, 2014, with early adoption permitted. The Company will adopt this pronouncement in January 2015. The adoption of this amendment is not expected to have a material impact on the Company’s consolidated financial statements.

2. Discontinued Operations

On July 15, 2014, the Company completed the sale of certain assets and liabilities of its Scientific Lasers business operating under the Continuum brand name 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 Company has recorded the \$1.5 million escrow in other long term assets on the balance sheet.

In 2013, the Company consummated the sale of certain assets and liabilities of the Semiconductor Systems business for \$8.6 million in cash, net of working capital adjustments.

The major components of the assets and liabilities of discontinued operations as of September 26, 2014 and December 31, 2013, respectively, are as follows (in thousands):

	September 26, 2014	December 31, 2013
Accounts receivable, net	\$ 95	\$ 5,361
Inventories	161	8,454
Prepaid and other current assets	8	247
Other assets	367	2,026
Assets of discontinued operations	\$ 631	\$ 16,088
Accounts payable	\$ 16	\$ 2,393
Accrued expenses and other current liabilities	1,188	2,295
Other liabilities	233	1,710
Liabilities of discontinued operations	\$ 1,437	\$ 6,398

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

Assets and liabilities of discontinued operations as of September 26, 2014 include the balances of the India JV. In addition, liabilities of discontinued operations as of September 26, 2014 include a \$0.6 million working capital settlement that is due to the buyers of the Scientific Lasers business.

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		Nine Months Ended	
	September 26,	September 27,	September 26,	September 27,
	2014	2013	2014	2013
Sales from discontinued operations	\$ 225	\$ 5,625	\$ 10,512	\$ 28,296
Loss from discontinued operations, before income tax	\$ (1,256)	\$ (152)	\$ (6,243)	\$ (2,831)
Loss from discontinued operations, net of tax	\$ (273)	\$ (185)	\$ (4,817)	\$ (1,643)
Loss on disposal of discontinued operations, net of tax	\$ (321)	\$ (281)	\$ (321)	\$ (592)

The loss from discontinued operations during the three months ended September 26, 2014 includes a \$0.5 million fair value write-down of the India JV. The Company is currently in negotiations with the joint venture partner to dissolve the joint venture. The loss from discontinued operations during the nine months ended September 26, 2014 includes a \$3.0 million fair value write-down of the Scientific Lasers business to its fair value less costs to sell and the \$0.5 million fair value write-down of the India JV.

3. Business Combinations

On March 14, 2014, the Company completed the acquisition of JADAK LLC, JADAK Technologies, Inc. and Advanced Data Capture Corporation (together, "JADAK"), a North Syracuse, New York-based provider of optical data collection and machine vision technologies to OEM medical device manufacturers, for \$93.7 million in cash, net of working capital adjustments. The Company expects that the addition of JADAK will enable the Company to offer a broader range of highly engineered enabling technologies to leading medical equipment manufacturers. Acquisition-related costs are included in restructuring and acquisition related costs in the consolidated statements of operations. Acquisition related costs are as follows (in thousands):

Three Months Nine Months Cumulative

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	Ended September 26, 2014	Ended September 26, 2014	Costs September 26, 2014
Acquisition-related costs \$		— \$ 668	\$ 975

The acquisition of JADAK has been accounted for as a business combination. The allocation of the purchase price is based upon a valuation of assets and liabilities acquired. Assets acquired and liabilities assumed have been recorded at their estimated fair values 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 JADAK and the Company. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill. The Company's estimates and assumptions in determining the estimated fair values of certain assets and liabilities are subject to change within the measurement period (up to one year from the acquisition date) as a result of additional information obtained with regards to facts and circumstances that existed as of the acquisition date. The purchase price allocation is preliminary and the primary areas of the purchase price allocation that are not yet finalized relate to income taxes and the amount of residual goodwill.

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

Based upon a preliminary valuation, the total purchase price was allocated as follows (in thousands):

	Purchase Price Allocation
Cash	\$ 1,140
Accounts receivable	7,907
Inventory	6,791
Property and equipment	904
Intangible assets	40,250
Goodwill	45,045
Other assets	1,979
Total assets acquired	104,016
Accounts payable	3,057
Other liabilities	2,074
Deferred tax liabilities	4,089
Total liabilities assumed	9,220
Total purchase price	94,796
Less cash acquired	(1,140)
Total purchase price, net of cash acquired	\$ 93,656

During the third quarter of 2014, the Company made adjustments to the preliminary purchase price allocation primarily related to the inventory valuation and an adjustment to other liabilities, resulting in an increase in goodwill of \$0.6 million.

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

	Estimated Fair Value	Weighted Average Amortization Period
Customer relationships	\$ 23,570	20 years
Developed technology	10,910	10 years
Trademarks and trade names	2,130	10 years
Backlog	1,810	1 year

Non-compete covenant	1,830	5 years
Total	\$ 40,250	

The purchase price allocation resulted in \$45.0 million of goodwill and \$40.3 million of identifiable intangible assets, \$63.1 million 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) JADAK's ability to develop and market new products and technologies, (ii) JADAK's ability to develop relationships with new customers, and (iii) expected sales synergies from cross-selling current and future product offerings of both JADAK and the Company to OEM customers.

The operating results of JADAK have been included in our consolidated statement of operations since the acquisition date. JADAK has contributed sales of \$14.9 million and \$32.6 million for the three and nine months ended September 26, 2014, respectively, and operating income from continuing operations of \$1.2 million and \$2.3 million for the three and nine months ended September 26, 2014, respectively. The pro forma information for all periods presented below includes the effects of business combination accounting resulting from the acquisition of JADAK, including amortization charges from acquired intangible assets, interest expense on borrowings in connection with the acquisition, earn-out expenses, and the related tax effects as though the acquisition had been consummated at the beginning of 2013. These pro forma results exclude the impact of transaction costs and the related tax effects included in the historical results. The pro forma financial information is presented for comparative information

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

purposes only and is not necessarily indicative of the results of operations that would have been achieved if the acquisition had actually taken place at the beginning of 2013.

	Three Months Ended		Nine Months Ended	
	September 26,	September 27,	September 26,	September 27,
	2014	2013	2014	2013
Sales	\$ 94,656	\$ 93,681	\$ 281,725	\$ 273,429
Income from continuing operations	\$ 5,342	\$ 2,591	\$ 12,404	\$ 4,859
Earnings per share from continuing operations - Basic	\$ 0.15	\$ 0.08	\$ 0.35	\$ 0.14
Earnings per share from continuing operations - Diluted	\$ 0.15	\$ 0.08	\$ 0.35	\$ 0.14

4. Accumulated Other Comprehensive Income (Loss)

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

	Total accumulated other comprehensive income (loss)	Foreign currency translation adjustments	Pension liability
Balance at December 31, 2013	\$ (6,342)	\$ 1,353	\$(7,695)
Other comprehensive income (loss)	(2,783)	(2,902)	119
Amounts reclassified from other comprehensive income (loss) ⁽¹⁾	330	—	330
Balance at September 26, 2014	\$ (8,795)	\$ (1,549)	\$(7,246)

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

5. Earnings per Share

Basic earnings per common share is computed by dividing net income 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. 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. Dilutive effects of contingently issuable shares are included in the weighted average dilutive share calculation when the contingencies have been resolved.

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

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

	Three Months Ended September 26, 2014		September 27, 2013		Nine Months Ended September 26, 2014		September 27, 2013	
Numerators:								
Income from continuing operations	\$ 5,119	\$ 2,244	\$ 11,381	\$ 5,278				
Consolidated loss from discontinued operations	(594)	(466)	(5,138)	(2,235)				
Less: income (loss) attributable to noncontrolling interest	—	12	(10)	(42)				
Loss from discontinued operations attributable to GSI Group Inc.	(594)	(454)	(5,148)	(2,277)				
Net income attributable to GSI Group Inc.	\$ 4,525	\$ 1,790	\$ 6,233	\$ 3,001				
Denominators:								
Weighted average common shares outstanding— basic	34,389	34,102	34,333	34,058				
Dilutive potential common shares	404	315	392	267				
Weighted average common shares outstanding— diluted	34,793	34,417	34,725	34,325				
Antidilutive common shares excluded from above	—	37	29	327				
Basic Earnings (Loss) per Common Share:								
From continuing operations	\$ 0.15	\$ 0.07	\$ 0.33	\$ 0.15				
From discontinued operations	\$(0.02)	\$(0.02)	\$(0.15)	\$(0.07)				
Basic earnings per share attributable to GSI Group Inc.	\$ 0.13	\$ 0.05	\$ 0.18	\$ 0.08				
Diluted Earnings (Loss) per Common Share:								
From continuing operations	\$ 0.15	\$ 0.07	\$ 0.33	\$ 0.15				
From discontinued operations	\$(0.02)	\$(0.02)	\$(0.15)	\$(0.07)				
Diluted earnings per share attributable to GSI Group Inc.	\$ 0.13	\$ 0.05	\$ 0.18	\$ 0.08				

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, 2013, the Company cumulatively repurchased 50 thousand shares of its common stock in the open market for a weighted average share price of \$10.49 per share. There were no share repurchases during the nine months ended September 26, 2014.

6. Fair Value Measurements

ASC 820, "Fair Value Measurements," 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.

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

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. 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 as of September 26, 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	\$ 1,413	\$ 1,413	\$ —	\$ —

The following table summarizes the fair values of our financial assets as of December 31, 2013 (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	\$ 3,078	\$ 3,078	\$ —	\$ —

See Note 9 to Consolidated Financial Statements for 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 2014 and noted no impairment of goodwill.

On September 24, 2014, we received a payment of \$5.4 million, the full remaining amount held in an escrow account established upon the closing of the acquisition of NDS Surgical Imaging, LLC (“NDS”) in January 2013. The escrow recovery resulted from the Company’s claims for a breach of certain terms of the January 15, 2013 Securities Purchase Agreement for the acquisition of NDS. The escrow recovery was accounted for as a reduction to goodwill as the \$5.4 million payment was clearly and directly related to the acquisition price. The following table summarizes changes in goodwill for the nine months ended September 26, 2014 (in thousands):

Balance at beginning of the period	\$71,156
Goodwill acquired from the JADAK acquisition	45,045
Recovery of escrow from the NDS acquisition	(5,418)
Balance at end of period	\$110,783

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

Goodwill acquired from the JADAK acquisition and the recovery of escrow from the NDS acquisition is reflected in the Medical Technologies segment. Goodwill by reportable segment as of September 26, 2014 is as follows (in thousands):

	Reportable Segment			
	Laser	Medical	Precision	Total
	Products	Technologies	Motion	
Goodwill	\$132,954	\$ 83,192	\$26,291	\$242,437
Accumulated impairment of goodwill	(102,461)	(12,147)	(17,046)	(131,654)
Total	\$30,493	\$ 71,045	\$9,245	\$110,783

Goodwill by reportable segment as of December 31, 2013 is as follows (in thousands):

	Reportable Segment			
	Laser	Medical	Precision	Total
	Products	Technologies	Motion	
Goodwill	\$132,954	\$ 43,565	\$26,291	\$202,810
Accumulated impairment of goodwill	(102,461)	(12,147)	(17,046)	(131,654)
Total	\$30,493	\$ 31,418	\$9,245	\$71,156

Intangible Assets

Intangible assets as of September 26, 2014 and December 31, 2013, respectively, are summarized as follows (in thousands):

	September 26, 2014			December 31, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizable intangible assets:						
Patents and acquired technologies	\$79,279	\$ (60,726)	\$ 18,553	\$68,500	\$ (56,327)	\$ 12,173

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Customer relationships	79,112	(29,716)	49,396	55,585	(24,340)	31,245
Customer backlog	3,078	(2,391)	687	1,269	(1,269)	—
Non-compete covenant	1,830	(250)	1,580	—	—	—
Trademarks and trade names	15,478	(5,178)	10,300	13,378	(4,530)	8,848
Amortizable intangible assets	178,777	(98,261)	80,516	138,732	(86,466)	52,266
Non-amortizable intangible assets:						
Trade names	13,027	—	13,027	13,027	—	13,027
Totals	\$191,804	\$ (98,261)	\$ 93,543	\$151,759	\$ (86,466)	\$ 65,293

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, customer backlog, non-compete covenant, 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 goods sold in the accompanying consolidated statements of operations. Amortization expense is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 26, 2014		September 26, 2013	
	2014	2013	2014	2013
Amortization expense – cost of sales	\$ 1,614	\$ 1,343	\$ 4,529	\$ 3,937
Amortization expense – operating expenses	2,843	1,772	7,463	5,625
Total amortization expense	\$ 4,457	\$ 3,115	\$ 11,992	\$ 9,562

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

Estimated amortization expense for each of the five succeeding years and thereafter as of September 26, 2014 is as follows (in thousands):

Year Ending December 31,	Operating		
	Cost of Sales	Expenses	Total
2014 (remainder of year)	\$ 1,614	\$ 2,800	\$4,414
2015	4,787	9,454	14,241
2016	3,376	9,222	12,598
2017	2,883	8,259	11,142
2018	1,350	7,378	8,728
Thereafter	4,543	24,850	29,393
Total	\$ 18,553	\$ 61,963	\$80,516

8. Supplementary Balance Sheet Information

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

Inventories

	September 26, December 31,	
	2014	2013
Raw materials	\$ 38,281	\$ 34,749
Work-in-process	11,069	9,744
Finished goods	11,403	10,682
Demo and consigned inventory	2,062	3,115
Total inventories	\$ 62,815	\$ 58,290

Accrued Expenses and Other Current Liabilities

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September 26, December 31,

	2014	2013
Accrued compensation and benefits	\$ 7,592	\$ 8,624
Accrued warranty	3,223	3,315
Customer deposits	524	551
Other	7,739	9,798
Total	\$ 19,078	\$ 22,288

Accrued Warranty

Nine Months Ended
September 26, September 27,

	2014	2013
Balance at beginning of the period	\$ 3,315	\$ 2,204
Provision charged to cost of sales	1,361	1,382
Acquisition related warranty accrual	90	998
Use of provision	(1,529)	(1,280)
Foreign currency exchange rate changes	(14)	1
Balance at end of period	\$ 3,223	\$ 3,305

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

9. Debt

Debt consisted of the following (in thousands):

	September 26,	December 31,
	2014	2013
Senior Credit Facilities – term loan	\$ 36,875	\$ 42,500
Senior Credit Facilities – revolving credit facility	85,000	29,000
Total Senior Credit Facilities	\$ 121,875	\$ 71,500

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 \$75.0 million, 5-year, revolving credit facility (collectively, the "Senior Credit Facilities") that matures in December 2017. Quarterly installments due in the next twelve months amount to \$7.5 million and are classified as a current liability in the consolidated balance sheet. On February 10, 2014, the Company entered into a fourth amendment to the Amended and Restated Credit Agreement (the "Fourth Amendment"). The Fourth Amendment increases the revolving credit facility commitment under the Amended and Restated Credit Agreement by \$100 million from \$75 million to \$175 million and resets the accordion feature to \$100 million for future expansion.

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 September 26, 2014.

Fair Value of Debt

As of September 26, 2014 and December 31, 2013, 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 2010 Incentive Award Plan during the nine months ended September 26, 2014:

	Restricted	Weighted
	Stock Units	Average Grant
	(In thousands)	Date Fair Value
Unvested at December 31, 2013	809	\$ 10.20
Granted	316	\$ 12.31
Vested	(346)	\$ 10.83
Forfeited	(5)	\$ 10.25
Unvested at September 26, 2014	774	\$ 10.78
Expected to vest as of September 26, 2014	755	

The total fair value of restricted stock units that vested during the nine months ended September 26, 2014 was \$4.3 million based on the market price of the underlying stock on the day of vesting.

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(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 September 26, 2014		Nine Months Ended September 27, 2014	
	2014	2013	2014	2013
Selling, general and administrative	\$ 886	\$ 1,249	\$ 3,156	\$ 3,951
Research and development and engineering	49	48	144	129
Cost of sales	43	32	112	90
Restructuring and acquisition related costs	268	—	572	—
Total share-based compensation expense	\$ 1,246	\$ 1,329	\$ 3,984	\$ 4,170

The expense recorded during each of the nine months ended September 26, 2014 and September 27, 2013 includes \$0.5 million related to deferred stock units granted to the members of the Company's Board of Directors, pursuant to the Company's 2010 Incentive Award 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 connection with the JADAK acquisition on March 14, 2014, the Company acquired 100% of the outstanding stock of JADAK. In addition to the total purchase price, the Company granted restricted stock units in an aggregate of 180,000 shares to the four former owner-managers of JADAK as employment inducement awards. These restricted stock units are performance based awards and will vest after two years if certain financial targets have been achieved.

On May 15, 2014, the Company's shareholders approved the amendment and restatement of the 2010 Incentive Award Plan. The Amended and Restated Incentive Award Plan increases the amount of shares authorized for issuance under the plan from 2,898,613 shares to 4,398,613 shares, extends the term of the plan through April 9, 2024, allows the Company to continue to grant awards intended to constitute "performance-based compensation" for purposes of Section 162(m) of the Internal Revenue Code of 1986, as amended, and includes certain provisions that reflect good corporate governance practices.

11. Income Taxes

The Company determines its estimated annual effective tax rate at the end of each interim period based on facts known at that time. The estimated annual effective tax rate is applied to the year-to-date pre-tax income at the end of

each interim period. The tax effect of significant unusual items is reflected in the period in which they occur. Since the Company is incorporated in Canada, it is required to use Canada's statutory tax rate of 27.0% in the determination of the estimated annual effective tax rate.

The Company's effective tax rate on income from continuing operations of 28.2% and 30.6% for the three and nine months ended September 26, 2014, respectively, 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 full valuation allowance, and the impact of discrete items for the period. The Company's effective tax rate on income from continuing operations of 40.6% and 48.4% for the three and nine months ended September 27, 2013, respectively, differ from the Canadian statutory rate primarily due to the 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 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.

On September 13, 2013, the IRS released final tangible property regulations under Sections 162(a) and 263(a) of the Internal Revenue Code of 1986 (the "Code"), regarding the deduction and capitalization of expenditures related to tangible property. In

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

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addition, the IRS proposed regulations under Section 168 of the Code regarding dispositions of tangible property. These final and proposed regulations will be effective for the Company's fiscal year ending December 31, 2014. The Company is in the process of reviewing the regulations and the related impact on its consolidated financial statements.

12. Restructuring and Acquisition Related Costs

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

	Three Months Ended		Nine Months Ended	
	September 26, 2014	September 27, 2013	September 26, 2014	September 27, 2013
2011 restructuring	\$ 233	\$ (2)	\$ 139	\$ 1,320
2013 restructuring	—	1,449	(66)	2,205
Germany restructuring	—	—	—	7
Total restructuring charges	\$ 233	\$ 1,447	\$ 73	\$ 3,532
Acquisition charges	\$ 26	\$ 106	\$ 774	\$ 1,192
JADAK earn-out costs	512	—	1,102	—
Total acquisition related charges	\$ 538	\$ 106	\$ 1,876	\$ 1,192
Total restructuring and acquisition related costs	\$ 771	\$ 1,553	\$ 1,949	\$ 4,724

2011 Restructuring

In November 2011, the Company announced a strategic initiative (“2011 restructuring”), which aimed to consolidate operations to reduce our cost structure and improve operational efficiency. As part of this initiative, the Company eliminated facilities through consolidation of certain manufacturing, sales and distribution facilities and exit of Semiconductor and Laser Systems businesses. The Company substantially completed the 2011 restructuring program by the end of 2013. During the three and nine months ended September 26, 2014, the Company recorded restructuring costs from facilities exited as part of our 2011 restructuring program. The restructuring costs during the three months ended September 26, 2014 increased as a result of the Company's tenant exiting the Orlando, Florida facility, which the Company owns. The Company recorded \$0.1 million and \$0.4 million in depreciation expense for the Orlando, Florida facility during the three and nine months ended September 26, 2014, 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	Other
Balance at December 31, 2013	\$1,272	\$ 585	\$ 648	\$ 39
Restructuring charges	73	(79)	68	84
Cash payments	(765)	(441)	(249)	(75)
Non-cash write-offs and other adjustments	(374)	—	(374)	—
Balance at September 26, 2014	\$206	\$ 65	\$ 93	\$ 48

In accordance with the guidance in ASC 420, "Exit or Disposal Cost Obligations," the Company records lease termination accruals based on market estimates, including the time period for which facilities will remain vacant, sublease terms, sublease rates and discount rates. The Company reviews prior estimates and current market data available to determine the appropriate value of these liabilities at period end.

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

(Unaudited)

13. Commitments and Contingencies

Leases

The Company leases certain equipment and facilities under operating and capital lease agreements. Excluding the outstanding lease commitment assumed by the buyer of the Scientific Lasers business and the leases acquired as part of the JADAK acquisition, there have been no material changes to the Company's leases from those discussed in Note 16 to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. The Scientific Lasers facility lease commitment as of the disposal date was \$3.0 million which was assigned to the buyer. In May 2014, JADAK moved into a new facility which was recorded as a capital lease. The current and long-term portions of the capital lease have been included in accrued expenses and other current liabilities and other long-term liabilities, respectively. Future minimum lease payments under the operating and capital leases for JADAK are as follows (in thousands):

Year Ending December 31,	Operating Lease	Capital Lease ⁽¹⁾
2014 (remainder of year)	\$ 17	\$ 201
2015	69	803
2016	—	803
2017	—	831
2018	—	860
Thereafter	—	9,928
Total minimum lease payments	\$ 86	\$ 13,426

(1)Capital lease payments include interest payments of \$4.6 million.

Purchase Commitments

Excluding JADAK's purchase commitments, there have been no material changes to the Company's purchase commitments from those discussed in Note 16 to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. As of September 26, 2014, JADAK had unconditional commitments primarily for inventory purchases of \$5.1 million. These purchase commitments are expected to be incurred as follows: \$3.3 million in the remainder of 2014, and \$1.8 million in 2015.

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 an indemnification agreement 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

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

AS OF SEPTEMBER 26, 2014

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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 sales, 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.

We operate in three reportable segments: Laser Products, Medical Technologies, and Precision Motion. The reportable segments and their principal activities consist of the following:

Laser Products

Our Laser Products segment designs, manufactures and markets photonics-based solutions 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 business sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

Medical Technologies

Our Medical 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, air bearing spindles and precision machined components to customers worldwide. The vast majority of the segment's product offerings are sold into the electronics, industrial and, to a lesser extent, the medical markets. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

Reportable Segment Financial Information

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

	Three Months Ended September 26 September 27,		Nine Months Ended September 26 September 27,	
	2014	2013	2014	2013
Sales				
Laser Products	\$ 45,806	\$ 44,714	\$ 131,494	\$ 123,311
Medical Technologies	32,680	19,718	89,838	65,410
Precision Motion	16,170	15,426	49,362	45,977
Total	\$ 94,656	\$ 79,858	\$ 270,694	\$ 234,698

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AS OF SEPTEMBER 26, 2014

(Unaudited)

	Three Months Ended September 26 , September 27,		Nine Months Ended September 26 , September 27,	
	2014	2013	2014	2013
Gross Profit				
Laser Products	\$ 20,269	\$ 19,252	\$ 54,437	\$ 51,436
Medical Technologies	12,945	7,535	35,672	25,271
Precision Motion	6,776	7,429	21,141	21,487
Corporate, Shared Services and Unallocated	(307)	(55)	(811)	(163)
Total	\$ 39,683	\$ 34,161	\$ 110,439	\$ 98,031

	Three Months Ended September 26, 2014		September 27, 2013		Nine Months Ended September 26, 2014		September 27, 2013	
Gross Profit Margin								
Laser Products	44.2	%	43.1	%	41.4	%	41.7	%
Medical Technologies	39.6	%	38.2	%	39.7	%	38.6	%
Precision Motion	41.9	%	48.2	%	42.8	%	46.7	%
Total	41.9	%	42.8	%	40.8	%	41.8	%

	Three Months Ended September 26 , September 27,		Nine Months Ended September 26 , September 27,	
	2014	2013	2014	2013
Operating Income from Continuing Operations				
Laser Products	\$ 9,857	\$ 7,734	\$ 23,828	\$ 17,868
Medical Technologies	(1,115)	(469)	(1,194)	1,375
Precision Motion	2,796	3,223	9,525	9,657
Corporate, Shared Services and Unallocated	(4,716)	(4,689)	(14,789)	(16,249)
Total	\$ 6,822	\$ 5,799	\$ 17,370	\$ 12,651

	Three Months Ended September 26, 27,		Nine Months Ended September 26, 27,	
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	2014	2013	2014	2013
Depreciation and Amortization				
Laser Products	\$ 1,618	\$ 1,701	\$4,838	\$ 4,735
Medical Technologies	3,745	2,143	9,552	6,762
Precision Motion	444	486	1,451	1,471
Corporate, Shared Services and Unallocated	537	455	1,654	1,824
Total	\$ 6,344	\$ 4,785	\$17,495	\$ 14,792

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 loss from the sale of the Scientific Lasers business; 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; expectations regarding tax exposure; anticipated reinvestment of future earnings; anticipated benefits from prior acquisitions; anticipated outcomes of legal proceedings and litigation matters; efforts to reduce working capital needs; and anticipated use of currency hedges. These forward-looking statements are neither promises nor guarantees, but involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including, but not limited to, the following: 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; 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; 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, 2013 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

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

Business Overview

We design, develop, manufacture and sell precision photonic and motion control components and subsystems to Original Equipment Manufacturers (“OEMs”) in the medical equipment and advanced industrial technology markets. We specialize in collaborating with OEM customers to adapt our component and subsystem technologies to deliver highly differentiated performance in their applications. In March 2014, we acquired JADAK, a North Syracuse, New York-based provider of optical data collection and machine vision technologies to OEM medical device manufacturers, for \$93.7 million in cash, net of working capital adjustments. The JADAK product line is reported as part of our Medical Technologies segment.

We operate in three reportable segments: Laser Products, Medical Technologies, and Precision Motion. The reportable segments and their principal activities consist of the following:

Our Laser Products segment designs, manufactures and markets photonics-based solutions 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 business sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

Our Medical 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.

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

Strategy

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

- broadening our product and service offerings through the acquisition of innovative and complementary technologies and solutions;
- driving sustainable and predictable profitable growth by improving our business mix to increase medical sales, maintain industrial sales and reduce microelectronics sales as a percentage of total revenue;
- upgrading our existing operations to drive profitable growth through our continuous improvement productivity and customer satisfaction programs, and through strategic divestitures; and expanding our business through strategic acquisitions;
- strengthening our strategic position in medical technologies, lasers, and precision motion technology platforms through continual investment in differentiated new products and solutions;
- leveraging our breadth of product offerings with numerous shared customers to strengthen key customer relationships, increase our penetration of key customers, and drive increased sales; and
- attracting, retaining, and developing talented and motivated employees.

Significant Events and Updates

Escrow Recovery

On September 24, 2014, we received a payment of \$5.4 million, the full remaining amount held in the escrow account established upon the closing of the acquisition of NDS in January 2013. The escrow recovery resulted from the Company's claims for a breach of certain terms of the January 15, 2013 Securities Purchase Agreement for the acquisition of NDS. The escrow recovery was accounted for as a reduction to goodwill as the \$5.4 million payment was clearly and directly related to the acquisition price. The escrow recovery resulted in a final adjusted NDS purchase price of \$75.4 million.

Acquisition of JADAK

On March 14, 2014, we completed the acquisition of JADAK, a North Syracuse, New York-based provider of optical data collection and machine vision technologies to OEM medical device manufacturers, for \$93.7 million in cash, net of working capital adjustments. The addition of the JADAK technology platforms expands our portfolio of highly-differentiated enabling technologies. JADAK provides data collection and machine vision solutions to its customers, which primarily consist of OEM medical device manufacturers. JADAK's products are based on technologies that include barcode components and scanners, machine vision cameras, RFID technology, magnetic stripe readers, portable platforms and associated software. JADAK's products are highly engineered, application-specific components that are developed and manufactured to meet the extremely high performance and quality requirements of major medical OEMs. JADAK's products are used in medical equipment to increase safety and reduce medical errors by verifying patient identity, validating the specified therapy or function, and enhancing the accuracy of the medical procedure.

Discontinued Operations

On July 15, 2014, we completed the sale of certain assets and liabilities of our Scientific Lasers business operating under the Continuum brand name for \$6.5 million in cash, net of working capital adjustments, and recognized a \$0.3 million loss on sale during the three months ended September 26, 2014. The loss from discontinued operations of \$5.1 million during the nine months ended September 26, 2014 includes a \$3.0 million fair value write-down of the Scientific Lasers business to its estimated fair value less cost to sell. The Scientific Lasers purchase and sale agreement requires \$1.5 million of the sales proceeds to be held in escrow that can be utilized as indemnification for certain representations and warranties claims against the Company until the expiration of the escrow arrangement in January 2016. The Company has recorded the \$1.5 million escrow in other long term assets on the balance sheet.

Results of Operations for the Three and Nine Months Ended September 26, 2014 Compared with the Three and Nine Months Ended September 27, 2013

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

	Three Months Ended September 26, 2014		September 27, 2013		Nine Months Ended September 26, 2014		September 27, 2013	
	2014	2013	2014	2013	2014	2013	2014	2013
Sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of sales	58.1		57.2		59.2		58.2	
Gross profit	41.9		42.8		40.8		41.8	
Operating expenses:								
Research and development and engineering	8.2		7.6		7.8		7.7	
Selling, general and administrative	22.7		23.8		23.1		24.3	
Amortization of purchased intangible assets	3.0		2.2		2.8		2.4	
Restructuring and acquisition related costs	0.8		1.9		0.7		2.0	
Total operating expenses	34.7		35.5		34.4		36.4	

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Operating income from continuing operations	7.2	7.3	6.4	5.4
Interest income (expense), net	(1.5)	(1.1)	(1.4)	(1.1)
Foreign exchange transaction gains (losses), net	1.1	(2.2)	0.4	(0.4)
Other income (expense), net	0.7	0.7	0.7	0.5
Income from continuing operations before income taxes	7.5	4.7	6.1	4.4
Income tax provision	2.1	1.9	1.9	2.1
Income from continuing operations	5.4	2.8	4.2	2.3
Loss from discontinued operations, net of tax	(0.3)	(0.2)	(1.8)	(0.7)
Loss on disposal of discontinued operations, net of tax	(0.3)	(0.4)	(0.1)	(0.3)
Consolidated net income	4.8	2.2	2.3	1.3
Less: Net income (loss) attributable to noncontrolling interest	0.0	0.0	0.0	0.0
Net income attributable to GSI Group Inc.	4.8 %	2.2 %	2.3 %	1.3 %

Overview of Financial Results

Total sales for the three and nine months ended September 26, 2014 increased 18.5% and 15.3%, respectively, versus the prior year comparable periods. Our JADAK acquisition accounted for an 18.7% and 13.9% increase during the three and nine months ended September 26, 2014, respectively. In addition, foreign currency exchange rates favorably impacted our sales by 0.3% and 0.9% during the three and nine months ended September 26, 2014, respectively.

Excluding the impact of the JADAK acquisition and changes in foreign exchange rates, total sales decreased 0.5% for the three months ended September 26, 2014, versus the prior year comparable period, and increased 0.5% for the nine months ended September 26, 2014, versus the prior year comparable period. Our organic sales growth (decline) is summarized as follows:

	Three Months Ended		Nine Months Ended	
	September 26, 2014		September 26, 2014	
	Percentage Change		Percentage Change	
Reported growth	18.5	%	15.3	%
Less: Change attributable to JADAK acquisition	18.7	%	13.9	%
Less: Change due to foreign currency	0.3	%	0.9	%
Organic growth (decline)	(0.5)%	0.5	%

The organic decline in our sales for the three months ended September 26, 2014 was attributable to a decline in Medical Technologies segment, partially offset by growth in our Laser Products and Precision Motion segments. The decrease in sales in our Medical Technologies segment was primarily driven by a decline in sales in our visualization solutions product line. The increase in sales of our Laser Products segment was primarily attributable to an increase in sales volume of our fiber lasers and CO₂ lasers. The growth in our Precision Motion segment was driven by increases in sales volume of optical encoders products, partially offset by a decline in our air bearing spindles product line.

The organic growth in our sales for the nine months ended September 26, 2014 was attributable to growth in our Laser Products and Precision Motion segments offset by a decline in Medical Technologies. The increase in sales in our Laser Products segment was attributable to an increase in sales volume across our product portfolio. The growth in our Precision Motion segment was driven by similar business dynamics affecting our sales for the three months ended September 26, 2014. These increases were partially offset by a decline in Medical Technologies related to our visualization solutions product line.

Operating income from continuing operations for the three months ended September 26, 2014 increased \$1.0 million, or 17.6%, to \$6.8 million from the prior year comparable period. This increase was primarily attributable to an increase in gross profit of \$5.5 million as a result of higher sales, partially offset by a \$4.5 million increase in operating expenses primarily attributable to the JADAK acquisition. Operating income from continuing operations for the nine months ended September 26, 2014 increased \$4.7 million, or 37.3%, from the prior year comparable period. This increase was primarily due to an increase in gross profit and a decrease in restructuring and acquisition related costs, partially offset by an increase in selling, general and administrative (“SG&A”) and research and development and engineering (“R&D”) expenses as well as amortization of intangibles and acquisition fair value adjustments.

Diluted earnings per share (“Diluted EPS”) from continuing operations of \$0.15 for the three months ended September 26, 2014 increased \$0.08 from the prior year comparable period. This increase was primarily attributable to higher operating income from continuing operations and foreign currency gains in the current period versus foreign currency losses in the prior year comparable period, offset by an increase in interest expense as a result of higher average debt levels during 2014. Diluted EPS from continuing operations of \$0.33 for the nine months ended

September 26, 2014 increased by \$0.18 from the prior year comparable period. Similar business dynamics affected Diluted EPS for the nine months ended September 26, 2014.

Sales

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

	Three Months Ended		Percentage		
	September 26, 2014	September 27, 2013	Increase	Change	
Laser Products	\$45,806	\$ 44,714	\$1,092	2.4	%
Medical Technologies	32,680	19,718	12,962	65.7	%
Precision Motion	16,170	15,426	744	4.8	%
Total	\$94,656	\$ 79,858	\$14,798	18.5	%

	Nine Months Ended		Percentage		
	September 26, 2014	September 27, 2013	Increase	Change	
Laser Products	\$131,494	\$123,311	\$8,183	6.6	%
Medical Technologies	89,838	65,410	24,428	37.3	%
Precision Motion	49,362	45,977	3,385	7.4	%
Total	\$270,694	\$234,698	\$35,996	15.3	%

Laser Products

Laser Products segment sales for the three months ended September 26, 2014 increased by \$1.1 million, or 2.4%, versus the prior year comparable period primarily due to growth in sales of our fiber lasers, driven by new customer wins, and an overall increase in sales of our CO₂ lasers products, driven by new product launches. During the quarter, both product lines were favorably impacted by an increase in capital spending in the advanced industrial technology market. These increases were partially offset by a decline in demand for our scanning technology products used in laser via-hole drilling applications.

Laser Products segment sales for the nine months ended September 26, 2014 increased by \$8.2 million, or 6.6%, versus the prior year comparable period, due to growth in all product lines. The sales growth was primarily due to growth in sales of our fiber lasers, driven by new customer wins, and an overall increase in sales of our CO₂ lasers products, driven by new product launches.

Medical Technologies

Medical Technologies segment sales for the three months ended September 26, 2014 increased by \$13.0 million, or 65.7%, versus the prior year comparable period. The JADAK acquisition accounted for \$14.9 million of the increase in sales year over year, partially offset by a decline in sales in our visualization solutions products as a result of softness in medical equipment spending impacting our customer's demand for our products and delays in new product introductions.

Medical Technologies segment sales for the nine months ended September 26, 2014 increased by \$24.4 million, or 37.3%, versus the prior year comparable period. The JADAK acquisition accounted for \$32.6 million of the increase in sales year over year, partially offset by a decline in sales in our visualization solutions products as a result of softness in medical equipment spending impacting our customer's demand for our products, delays in new product introductions, and dual sourcing at an OEM customer that began in 2013.

Precision Motion

Precision Motion segment sales for the three months ended September 26, 2014 increased by \$0.7 million, or 4.8%, versus the prior year comparable period. This increase was driven by increased sales of our optical encoders products as a result of market share gains with a major OEM customer. This increase was partially offset by a decline in sales of our air bearing spindles products due to lower demand related to mechanical via-hole drilling of printed circuit boards.

Precision Motion segment sales for the nine months ended September 26, 2014 increased by \$3.4 million, or 7.4%, versus the prior year comparable period. This increase was driven by increased sales of our optical encoders products as a result of new customer wins and market share gains with a major OEM customer. This increase was partially offset by a decline in sales of our air bearing spindles products due to lower demand related to mechanical via-hole drilling of printed circuit boards.

Gross Profit and Gross Profit Margin

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

	Three Months Ended		Nine Months Ended	
	September 26,	September 27,	September 26,	September 27,
	2014	2013	2014	2013
Gross profit:				
Laser Products	\$20,269	\$ 19,252	\$54,437	\$ 51,436
Medical Technologies	12,945	7,535	35,672	25,271
Precision Motion	6,776	7,429	21,141	21,487
Corporate	(307)	(55)	(811)	(163)
Total	\$39,683	\$ 34,161	\$110,439	\$ 98,031
Gross profit margin:				
Laser Products	44.2 %	43.1 %	41.4 %	41.7 %
Medical Technologies	39.6 %	38.2 %		