GSI GROUP INC
Form 10-Q
October 01, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended July 3, 2009

Or

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

For the transition period from to

Commission File No. 000-25705

GSI Group Inc.

(Exact name of registrant as specified in its charter)

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

(781) 266-5700

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ¨ No x

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

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

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

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

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EXPLANATORY NOTE

In August 2008, GSI Group Inc. (the Company) closed its acquisition of Excel Technology, Inc. (Excel). Delays in the integration of the financial accounting systems of the Company and Excel following the acquisition initially led to a delay of several weeks in the preparation of the Company s Quarterly Report on Form 10-Q for the quarterly period ended September 26, 2008 (the 2008 Q3 Report). Shortly thereafter and prior to filing the 2008 Q3 Report, the Company initiated an internal review of certain potential errors in the recognition of revenue related to sales to a customer in the first and second fiscal quarters of 2008 in the Company s Semiconductor Systems segment, which were brought to the attention of the Audit Committee of the Company s Board of Directors (the Audit Committee) by Company management. Following this initial internal review, the Audit Committee, in consultation with the Company s outside legal counsel determined that it was appropriate to undertake an independent review of the potential revenue recognition issues brought to its attention.

On or about November 25, 2008, the Audit Committee initiated a broader independent review of sales transactions in the Semiconductor Systems segment that contain arrangements with multiple deliverables for fiscal years 2007 and 2008. The review was subsequently expanded to include sales transactions in the Semiconductor Systems segment, along with certain other sales transactions for fiscal years 2006, 2007 and 2008. To assist in its review, the Audit Committee retained independent legal counsel and forensic accounting experts.

On December 4, 2008, the Company announced that it identified errors in the recognition of revenue related to sales to a customer in the first and second fiscal quarters of 2008 in the Semiconductor Systems segment and that the previously issued financial statements contained in the Company s Quarterly Reports on Form 10-Q for the periods ended March 28, 2008 and June 27, 2008 should no longer be relied upon.

Subsequently, the Company announced that it had identified additional revenue recognition errors related to the timing of revenue recognition from sales to certain Semiconductor Systems segment customers during fiscal year 2007. The Audit Committee concluded, upon the recommendation of Company management, that the range of potential adjustments resulting from the identified errors is material to the financial statements of the Company for the periods indicated and as a result, the Audit Committee determined that the previously issued interim and annual historical financial statements for 2007 should no longer be relied upon. The Audit Committee thereafter expanded the scope of its investigation to include fiscal year 2006.

On March 30, 2009, the Company announced that it had identified additional revenue recognition errors related to the timing of revenue recognition from sales to certain Semiconductor Systems segment customers during fiscal year 2006. The Audit Committee concluded, upon the recommendation of Company management, that the range of potential adjustments resulting from the identified errors is material to the financial statements of the Company for the periods indicated and as a result, the Audit Committee determined that the previously issued interim and annual historical financial statements for 2006 should no longer be relied upon.

The Audit Committee s advisors reported the results of the investigation to the Audit Committee on April 24, 2009. The Company voluntarily reported the investigation results to the Securities and Exchange Commission (SEC) on April 30, 2009. The Company later announced in May 2009 that it was reviewing sales transactions of its Semiconductor Systems segment during fiscal years 2004 and 2005 to determine if adjustments needed to be made to those periods. Thereafter, on June 30, 2009, the Company announced that it was undertaking a preliminary review of the timing of revenue recognized in connection with multiple element arrangements in its Precision Technology segment from 2004 through 2008 to determine if adjustments need to be made to those periods (collectively with the Audit Committee s review of transactions in the Semiconductor Systems segment and any other related Company reviews of transactions in the Semiconductor Systems segment and Precision Technology segment, the Revenue Review). As is further explained in Note 2 to Consolidated Financial Statements, in connection with the Revenue Review, the Company concluded that there were a number of adjustments required that primarily relate to revenue recognition and the corresponding adjustments to deferred revenue, cost of goods sold and other assets. Adjustments to revenue resulted in revenue and their related costs being deferred and recognized in subsequent periods once all revenue recognition criteria have been met. In addition, these adjustments did not affect the Company s cash balances. The transactions that are being restated as a result of the Revenue Review include transactions for which the complete facts required to make the appropriate assessment with respect to the timing of the revenue recognition were not communicated to the finance department at the time the initial revenue was booked. As of September 26, 2008, a substantial portion of the revenue deferred through the restatement remains deferred, pending the finalization of all deliverables under the terms of the arrangements with customers. The revenue adjustments, in aggregate for both the Semiconductor Systems and the Precision Technology segments, primarily relate to:

multiple-element arrangements for which objective and reliable evidence of fair value does not exist for one or more of the undelivered elements;

for those arrangements whereby it was determined that customer acceptance was required in order to record revenue in accordance with the Company s policy, the correction of the timing of revenue for instances where customer acceptance could not be demonstrated until a period subsequent to the period of original revenue recognition;

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- contractual terms that resulted in arrangements being deemed to not be fixed or determinable at the outset of the arrangement (including extended payment terms and contracts whereby product quantity mix was subject to adjustment during the term of the arrangement); and

- certain other revenue adjustments which were not individually, or in the aggregate, significant. These adjustments have been reflected in the restated consolidated financial statements and primarily relate to the accounting for separately priced extended warranty contracts.

In addition to adjustments from the Revenue Review, the Company has also identified and recorded the impact of certain adjustments which, due to their materiality, were not previously recorded. Certain of these adjustments affect revenue, cost of goods sold and operating expenses, as well as offsetting balance sheet accounts. These adjustments have been reflected in the accompanying consolidated financial statements.

In connection with its restatement, the Company and Ernst & Young LLP, its independent auditors, identified and reported to the Company s Audit Committee significant internal control matters that collectively constitute material weaknesses . Please see Item 4. Controls and Procedures below for a description of these matters, and of certain of the measures that have been implemented to date, as well as additional steps the Company plans to take to strengthen its controls.

The Company did not amend its previously filed annual reports on Form 10-K or any quarterly reports on Form 10-Q. The consolidated financial statements and related consolidated financial information contained in previously filed reports, including for the years ended December 31, 2007 and 2006 and for the first two quarterly reports during 2008 and the first three quarters of 2007, should no longer be relied upon.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

GSI GROUP INC.

CONSOLIDATED BALANCE SHEETS

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

	July 3, 2009 (Unaudited)	December 31, 2008
ASSETS		
Current Assets		
Cash and cash equivalents	$ 61,035	$ 69,001
Accounts receivable, net of allowance of $1,719 and $1,687, respectively	38,988	50,494
Income taxes receivable	24,944	30,038
Inventories	74,816	78,508
Deferred tax assets	11,126	11,106
Deferred cost of goods sold	31,768	20,507
Deferred debt financing costs	5,345	5,999
Prepaid expenses and other current assets	7,511	9,569
Total current assets	255,533	275,222
Property, plant and equipment, net of accumulated depreciation and amortization of $48,067 and $45,309, respectively	52,275	54,439
Deferred tax assets	23,937	23,802
Deferred cost of goods sold		23,133
Investments in auction rate securities	14,316	25,065
Other assets	4,378	2,133
Intangible assets, net	66,690	71,460
Goodwill	45,063	45,063
Total Assets	$ 462,192	$ 520,317
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Debt (Note 8)	$ 187,030	$ 185,115
Accounts payable	12,484	20,286
Accrued compensation and benefits (Note 3)	6,877	8,452
Deferred revenue	59,171	45,061
Deferred tax liabilities	486	486
Other accrued expenses (Note 3)	20,773	23,892
Total current liabilities	286,821	283,292
Deferred revenue		39,164
Deferred tax liabilities	30,109	30,131
Accrued restructuring, net of current portion	868	1,072
Income taxes payable	5,298	5,166
Accrued pension liability (Note 3)	4,131	4,026
Other liabilities (Note 3)	5,593	4,569

Total liabilities	332,820	367,420
Commitments and contingencies (Note 14)		
Stockholders Equity:		
Common shares, no par value; Authorized shares: unlimited; Issued and outstanding: 47,733,255 and 47,567,874, respectively	330,896	330,896
Additional paid-in capital	12,059	10,733
Accumulated deficit	(211,316)	(184,716)
Accumulated other comprehensive loss	(2,482)	(4,236)
Total GSI Group Inc. stockholders equity	129,157	152,677
Noncontrolling interest	215	220
Total stockholders equity	129,372	152,897
Total Liabilities and Stockholders Equity	$ 462,192	$ 520,317

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, except per share amounts)

	Three Months Ended		Six Months Ended	
	July 3, 2009 (Unaudited)	June 27, 2008 (Unaudited, as Restated)	July 3, 2009 (Unaudited)	June 27, 2008 (Unaudited, as Restated)
Sales	$ 62,904	$ 59,469	$ 126,812	$ 120,694
Cost of goods sold	38,451	36,861	78,760	75,529
Gross profit	24,453	22,608	48,052	45,165
Operating expenses:				
Research and development and engineering	6,870	7,167	15,001	14,955
Selling, general and administrative	14,601	14,363	29,439	30,237
Amortization of purchased intangible assets	1,600	551	3,220	1,103
Restructuring, restatement related costs and other	3,090	1,456	11,390	1,133
Pre-petition professional fees	1,280		1,950	
Total operating expenses	27,441	23,537	61,000	47,428
Loss from operations	(2,988)	(929)	(12,948)	(2,263)
Interest income	89	1,002	229	2,168
Interest expense	(7,055)	(18)	(14,231)	(35)
Foreign exchange transaction gains (losses)	(1,382)	133	(1,341)	271
Other income	889	21	162	142
Income (loss) from continuing operations before income taxes	(10,447)	209	(28,129)	283
Income tax provision (benefit)	(734)	259	(1,656)	519
Loss from continuing operations	(9,713)	(50)	(26,473)	(236)
Income (loss) from discontinued operations, net of tax	(132)	110	(132)	329
Consolidated net income (loss)	(9,845)	60	(26,605)	93
Less: Net (income) loss attributable to noncontrolling interest	(14)		5	
Net income (loss) attributable to GSI Group Inc.	(9,859)	60	(26,600)	93
Loss from continuing operations attributable to GSI Group Inc. per common share:				
Basic	$ (0.20)	$	$ (0.56)	$ (0.01)
Diluted	$ (0.20)	$	$ (0.56)	$ (0.01)
Income (loss) from discontinued operations attributable to GSI Group, Inc. per common share:				
Basic	$	$	$	$ 0.01
Diluted	$	$	$	$ 0.01
Net income (loss) attributable to GSI Group Inc. per common share:				
Basic	$ (0.21)	$	$ (0.56)	$
Diluted	$ (0.21)	$	$ (0.56)	$

Weighted average common shares outstanding basic	47,733	41,736	47,662	41,831
Weighted average common shares outstanding diluted	47,733	41,853	47,662	42,112
Amounts attributable to GSI Group Inc.:				
Loss from continuing operations	(9,727)	(50)	(26,468)	(236)
Income (loss) from discontinued operations	(132)	110	(132)	329
Net income (loss)	$ (9,859)	$ 60	(26,600)	$ 93

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

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GSI GROUP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

	Six Months Ended	
	July 3, 2009 (Unaudited)	June 27, 2008 (Unaudited, as Restated)
Cash flows from operating activities:		
Consolidated net income (loss)	$ (26,605)	$ 93
Adjustments to reconcile net income (loss) to net cash from operating activities:		
(Income) loss from operations of discontinued operations	132	(329)
Depreciation and amortization	9,265	6,739
Provision for uncollectible receivables	240	(40)
Provision for inventory obsolescence	847	2,535
Step-up value of acquired inventory sold	139	
Share based compensation	1,326	1,579
Deferred income taxes	(177)	(30)
Earnings from equity investment	(235)	(142)
Gain on sale of property and assets	(207)	(1,562)
Gain on sale of auction rate securities	(1,749)	
Non-cash interest expense	2,569	
Non-cash restructuring charges	25	
Changes in operating assets and liabilities:		
Accounts receivable	8,721	16,736
Inventories	1,752	1,283
Deferred costs	11,105	(8,559)
Prepaid expenses and other current assets	2,100	431
Deferred revenue	(23,436)	10,923
Deferred rent	(160)	3,217
Accounts payable, accruals and taxes receivable and payable	(5,189)	(3,168)
Changes in other non-current assets and liabilities	(1,555)	(46)
Cash used in operating activities of discontinued operations	(132)	(1,113)
Cash provided by (used in) operating activities	(21,224)	28,547
Cash flows from investing activities:		
Purchases of property, plant and equipment	(536)	(16,097)
Proceeds from the sale of auction rate securities	13,264	
Proceeds from the sale of property, plant and equipment	492	3,211
Cash provided by (used in) investing activities	13,220	(12,886)
Cash flows from financing activities:		
Purchases of the Company s common shares		(6,439)
Net proceeds from the issuance of share capital		38
Excess tax benefit of stock options		23
Cash used in financing activities		(6,378)
Effect of exchange rates on cash and cash equivalents	38	1,601
Increase (decrease) in cash and cash equivalents	(7,966)	10,884
Cash and cash equivalents, beginning of period (1)	69,001	172,387

Cash and cash equivalents, end of period (1)	$ 61,035	183,271
Supplemental disclosure of non cash investing activity:		
Auction rate securities	$ 764	$

(1) The Consolidated Statements of Cash Flows include cash and cash equivalent balances (in thousands) of $0, and $1 of discontinued operations for the six months ended July 3, 2009, and June 27, 2008, respectively.

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

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization, Presentation and Significant Events

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

Acquisition of Excel Technology, Inc.

In August 2008, the Company acquired Excel, a designer, manufacturer and marketer of photonics-based solutions consisting of lasers, laser-based systems, precision motion devices and electro-optical components, primarily for industrial and scientific applications. Excel, which was headquartered in East Setauket, New York, manufactures its products in plants located in the United States and Germany, and sells its products to customers worldwide, both directly and indirectly through resellers and distributors. The Company acquired Excel in exchange for a cash payment of $368.7 million, including transaction costs, a portion of which was financed with proceeds received from the issuance of $210.0 million of 11% Senior Notes due 2013 (the 2008 Senior Notes). This loan is discussed further in Notes 8 and 17 to Consolidated Financial Statements. Subsequent to the acquisition of Excel, the Company established a third segment which was comprised solely of the operations of the newly acquired entity. In 2009, the Company changed the structure of its internal organization in a manner that caused the composition of its reportable segments to change. More specifically, certain portions of a specific product line within the Precision Technology segment were transferred to the Excel segment. The Company s reportable segment financial information has been restated to reflect the updated reportable segment structure for all periods presented. See Note 4 to Consolidated Financial Statements for further details regarding the Excel transaction.

Divestiture of U.S. General Optics Business

On October 8, 2008, the Company completed the sale of its General Optics business (the U.S. Optics Business), located in Moorpark, California, for $21.6 million, which represented a gain of $8.7 million, net of tax. The sale of the U.S. Optics Business is reported as Gain on Disposal of Discontinued Operations in the Company s consolidated statements of operations for the year ended December 31, 2008. This business was part of the Company s Precision Technology segment. The results of operations of the U.S. Optics Business have been reclassified and reported as income from discontinued operations in the Company s consolidated statements of operations. See Note 5 to Consolidated Financial Statements for further details regarding the sale of the U.S. Optics Business.

Chapter 11 Bankruptcy Filing

On December 12, 2008, the Company announced that it had received four letters from certain holders of the 2008 Senior Notes issued in connection with the acquisition of Excel, alleging that the Company had failed to comply with the covenant in the governing Senior Notes Indenture (the 2008 Senior Note Indenture), that required it to file its Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K within the time frames set forth in the SEC s rules and regulations. Specifically, the letters alleged that the Company failed to file its Quarterly Report on Form 10-Q for the quarterly period ended September 26, 2008 (the 2008 Q3 Report) within the time period specified by the rules and regulations of the SEC and that if such failure continued for 60 days from the date that the Company received notices of such failure from holders comprising at least 25% of the aggregate principal amount of the 2008 Senior Notes then outstanding, such failure would constitute an event of default. The Company notified the trustee under the 2008 Senior Note Indenture that the letters did not constitute proper notice as required by the terms of the 2008 Senior Note Indenture, and continued working diligently to complete the review by its Audit Committee and to file its 2008 Q3 Report to avoid any claim of an Event of Default from occurring under the 2008 Senior Note Indenture. Upon receipt of the letters from the note holders, the Company commenced discussions with certain of the noteholders and, on June 30, 2009, announced that the Company had reached an agreement with certain beneficial owners holding greater than 75% of the outstanding aggregate principal amount of the 2008 Senior Notes on a non-binding term sheet to consensually restructure its outstanding obligations under the 2008 Senior Notes.

As discussed below and in further detail in Note 17 to Consolidated Financial Statements, on November 20, 2009 (the Petition Date), GSIG and two of its United States subsidiaries, GSI Group Corporation (GSI US) and MES International, Inc. (MES and, collectively with GSIG and GSI US, the Debtors), filed voluntary petitions for relief (the Chapter 11 Petitions) under Chapter 11 of the United States Bankruptcy Code (the Bankruptcy Code) in the United States Bankruptcy Court for the District of Delaware (the Bankruptcy Court) (the Chapter 11 Cases).

Following the Petition Date, the Debtors continued to operate their business as debtors-in-possession under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Bankruptcy Court. In late December 2009, the United States Trustee overseeing the Chapter 11 Cases appointed an Official Committee of Equity Security Holders (the Equity Committee) to represent the interests of the Company s equity holders.

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

On May 14, 2010, the Debtors entered into a Restructuring Plan Support Agreement (the May Plan Support Agreement) with the Equity Committee, the individual members of the Equity Committee (the Committee Members) and eight of ten beneficial holders (the Consenting Noteholders) of the 2008 Senior Notes. The Consenting Noteholders held 88.1% of the outstanding principal amount of the 2008 Senior Notes. Pursuant to the May Plan Support Agreement which superseded the previous plan support agreement, the Equity Committee, the Committee Members and the Consenting Noteholders agreed to support a modified plan, in the form of the Fourth Modified Joint Chapter 11 Plan of Reorganization for the Debtors (the May Plan).

On May 24, 2010, the Debtors filed with the Bankruptcy Court a modified joint Chapter 11 plan of reorganization for the Debtors, which was further supplemented on May 27, 2010 to provide for minor modifications to the May Plan (as supplemented, the Final Chapter 11 Plan). On May 27, 2010, the Bankruptcy Court entered an order confirming and approving the Final Chapter 11 Plan and the plan documents.

On July 23, 2010 (the Effective Date) the Debtors consummated their reorganization through a series of transactions contemplated by the Final Chapter 11 Plan, and the Final Chapter 11 Plan became effective pursuant to its terms. Refer to Note 17 to Consolidated Financial Statements for additional information concerning the Chapter 11 Cases including a description of material agreements the Company entered into on the Effective Date pursuant to the terms of the Final Chapter 11 Plan.

NASDAQ Delisting Determination

On November 3, 2009, the NASDAQ Hearing Panel (the Panel) of the NASDAQ Stock Market (NASDAQ) notified the Company that it had determined to delist the Company s common shares from the NASDAQ Global Select Market and to suspend trading in the Company s common shares effective at the open of market on November 5, 2009. The Panel s determination was made in connection with the Company s non-compliance with the filing requirements set forth in Listing Rule 5250(c)(1) due to the delayed filing of certain of the Company s periodic reports. As permitted by NASDAQ rules, the Company timely appealed the Panel s determination to the NASDAQ Listing and Hearing Review Council (the Listing Council). On January 15, 2010, the Listing Council notified the Company that it affirmed the Panel s decision to delist the Company s securities. On March 15, 2010, the Company received notification from the NASDAQ Stock Market, LLC Board of Directors (the NASDAQ Board) that the NASDAQ Board had declined to call for review the January 15, 2010 decision of the Listing Council. Accordingly, pursuant to Listing Rule 5825, the Listing Council s decision represents the final decision of NASDAQ. In accordance with Listing Rule 5830 and Rule 12d2-2 under the Securities Exchange Act of 1934, NASDAQ filed an application on Form 25 with the SEC on April 5, 2010, to delist the Company s securities from NASDAQ. The application became effective on April 15, 2010.

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

Going Concern

On November 20, 2009, GSIG, together with two of its subsidiaries, voluntarily filed petitions for relief under Chapter 11 of the United States Bankruptcy Code. Under the Bankruptcy Code, the Company s status as a bankruptcy debtor automatically accelerated the payment of the debt arising under the 2008 Senior Notes. Accordingly, this debt has been classified as current as of December 31, 2008 and July 3, 2009 in the Company s accompanying consolidated balance sheets. Operating in bankruptcy imposed significant risks and uncertainties on the Company s business.

However, the Company emerged from bankruptcy on July 23, 2010 and in connection therewith completed a rights offering pursuant to which it sold common shares for approximately $85 million (the Rights Offering). The proceeds from the Rights Offering were used to pay down a portion of the obligations due with respect to the 2008 Senior Notes. The remaining obligations due with respect to the 2008 Senior Notes for unpaid principal and accrued interest were satisfied through the issuance of the Company s common shares, the payment of cash and the issuance of new 12.25% Senior Secured PIK Election Notes (the New Notes) which mature in July 2014. As a result of the Company s emergence from bankruptcy and the associated restructuring of its debt obligations, the Company believes it has sufficient liquidity to fund its operations through at least December 31, 2010.

2. Restatement of Previously Issued Financial Statements

In August 2008, the Company completed its acquisition of Excel. Delays in the integration of the financial accounting systems of the Company and Excel following the acquisition initially led to a delay of several weeks in the preparation of the

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Company s Quarterly Report on Form 10-Q for the quarterly period ended September 26, 2008 (the 2008 Q3 Report). Shortly thereafter and prior to filing the 2008 Q3 Report, the Company initiated an internal review of certain potential errors in the recognition of revenue related to sales to a customer in the first and second fiscal quarters of 2008 in the Company s Semiconductor Systems segment, which were brought to the attention of the Audit Committee of the Company s Board of Directors (the Audit Committee) by Company management. Following this initial internal review, the Audit Committee, in consultation with the Company s outside legal counsel, determined that it was appropriate to undertake an independent review of the potential revenue recognition issues brought to its attention.

On or about November 25, 2008, the Audit Committee initiated a broader independent review of sales transactions in the Semiconductor Systems segment, along with certain other sales transactions that contain arrangements with multiple deliverables for fiscal years 2007 and 2008. The review was subsequently expanded to include fiscal year 2006. To assist in its review, the Audit Committee retained independent legal counsel and forensic accounting experts.

On December 4, 2008, the Company announced that it had identified errors in the recognition of revenue related to sales to a customer in the first and second fiscal quarters of 2008 in the Semiconductor Systems segment and that the previously issued financial statements contained in the Company s Quarterly Reports on Form 10-Q for the periods ended March 28, 2008 and June 27, 2008 should no longer be relied upon.

Subsequently, the Company announced that it had identified additional revenue recognition errors related to the timing of revenue recognition from sales to certain Semiconductor Systems segment customers during fiscal year 2007. The Audit Committee concluded, upon the recommendation of Company management, that the range of potential adjustments resulting from the identified errors is material to the financial statements of the Company for the periods indicated and as a result, the Audit Committee determined that the previously issued interim and annual historical financial statements for 2007 should no longer be relied upon. The Audit Committee thereafter expanded the scope of its investigation to include fiscal year 2006.

On March 30, 2009, the Company announced that it had identified additional revenue recognition errors related to the timing of revenue recognition from sales to certain Semiconductor Systems segment customers during fiscal year 2006. The Audit Committee concluded, upon the recommendation of Company management, that the range of potential adjustments resulting from the identified errors is material to the financial statements of the Company for the periods indicated and as a result, the Audit Committee determined that the previously issued interim and annual historical financial statements for 2006 should no longer be relied upon.

The Audit Committee s advisors reported the results of the investigation to the Audit Committee on April 24, 2009. The Company voluntarily reported the investigation results to the SEC on April 30, 2009. Thereafter, on June 30, 2009, the Company announced that it was undertaking a preliminary review of the timing of revenue recognized in connection with multiple element arrangements in its Precision Technology segment from 2004 through 2008 to determine if adjustments need to be made to those periods (collectively with the Audit Committee s review of transactions in the Semiconductor Systems segment and any other related Company reviews of transactions in the Semiconductor Systems segment and Precision Technology segment, the Revenue Review).

As part of its Revenue Review procedures, the Company assessed historic revenue transactions back to 2002. Transactions prior to 2004 were reviewed to the extent that the Company had reason to believe such transactions could materially affect the consolidated financial statements for 2004, or any period after 2004. The restated consolidated financial statements include a number of adjustments primarily related to the timing of revenue recognition which impacts revenue, cost of goods sold, deferred revenue, and deferred cost of goods sold.

Adjustments arising from the Revenue Review resulted in sales and their related costs being deferred and recognized in subsequent periods, once all revenue recognition criteria have been met. In addition, these adjustments did not affect the Company s cash balances. As of July 3, 2009, a substantial portion of the revenue identified in the Revenue Review remains deferred, pending the finalization of all deliverables under the terms of the customer arrangements. The corresponding costs have also been deferred and are included as deferred cost of goods sold as a component of other deferred assets in the accompanying financial statements. All the deferred revenue and the deferred cost of goods sold have been classified as current or long-term, based on the Company s assessment of when each particular transaction is anticipated to be recognized into revenue.

As discussed further below, the majority of adjustments from the Revenue Review were derived from the Company s incorrect accounting for multiple element arrangements, the determination of fixed and determinable consideration, and the determination of customer acceptance. The Company found inconsistent and incorrect application of its policies. The transactions that are being restated as a result of the Revenue Review include transactions for which the complete facts required to make the appropriate assessment with respect to the timing of the revenue recognition were not communicated to the finance department at the time the initial revenue was booked. Refer to Note 3 to Consolidated Financial Statements for discussion of the Company s revenue recognition policy.

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

In addition to adjustments from the Revenue Review, the Company has also recorded the impact of certain adjustments which, due to their materiality, were not previously recorded. Certain of these adjustments affect revenue, cost of goods sold, the provision for income taxes, and, to a lesser extent, operating expenses.

The net effects of all of the restatement adjustments on the statements of operations for the three months ended June 27, 2008 and March 28, 2008 are as follows (in thousands, except per share data):

	Three Month Period Ended June 27, 2008			Three Month Period Ended March 28, 2008		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
Sales	$ 62,772	$ (3,303)	$ 59,469	$ 69,028	$ (7,803)	$ 61,225
Cost of goods sold	38,340	(1,479)	36,861	42,456	(3,788)	38,668
Gross profit	24,432	(1,824)	22,608	26,572	(4,015)	22,557
Operating expenses	24,520	(983)	23,537	24,795	(904)	23,891
Income (loss) from operations	(88)	(841)	(929)	1,777	(3,111)	(1,334)
Interest income (expense), other income (expense), and foreign exchange transaction gains (losses), net	1,138		1,138	1,329	79	1,408
Income (loss) from continuing operations, before income taxes	1,050	(841)	209	3,106	(3,032)	74
Income tax provision (benefit)	94	165	259	997	(737)	260
Income (loss) from continuing operations	956	(1,006)	(50)	2,109	(2,295)	(186)
Income (loss) from discontinued operations, net of tax	138	(28)	110	(2)	221	219
Net income (loss)	$ 1,094	$ (1,034)	$ 60	$ 2,107	$ (2,074)	$ 33
Net income (loss) attributable to GSI Group Inc. per common share basic	$ 0.03	$ (0.02)	$	$ 0.05	$ (0.05)	$
Net income (loss) attributable to GSI Group Inc. per common share diluted	$ 0.03	$ (0.02)	$	$ 0.05	$ (0.05)	$

The net effects of all of the restatement adjustments on the statements of operations for the six months ended June 27, 2008 are as follows (in thousands, except per share data):

	Six Month Period Ended June 27, 2008		
	As Reported	Adjustments	As Restated
Sales	$ 131,800	$ (11,106)	$ 120,694
Cost of goods sold	80,796	(5,267)	75,529

Gross profit		51,004		(5,839)		45,165
Operating expenses		49,315		(1,887)		47,428
Income (loss) from operations		1,689		(3,952)		(2,263)
Interest income (expense), other income (expense), and foreign exchange transaction gains (losses), net		2,467		79		2,546
Income (loss) from continuing operations, before income taxes		4,156		(3,873)		283
Income tax provision (benefit)		1,091		(572)		519
Income (loss) from continuing operations		3,065		(3,301)		(236)
Income (loss) from discontinued operations, net of tax		136		193		329
Net income (loss)	$	3,201	$	(3,108)	$	93
Net income (loss) attributable to GSI Group Inc. per common share basic	$	0.08	$	(0.07)	$	
Net income (loss) attributable to GSI Group Inc. per common share diluted	$	0.08	$	(0.07)	$	

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

The net effects of all of the restatement adjustments on the statement of stockholders equity as of December 31, 2007 are as follows (in thousands):

	Year Ended December 31, 2007		
	As Reported	Adjustments	As Restated
Decrease in stockholders equity	$ 374,118	$ (28,440)	$ 345,678

The following table presents the impact of the restatement adjustments to the Company s beginning retained earnings balance, cumulatively to reflect adjustments booked to all periods prior to January 1, 2008 (in thousands):

	Amount
Retained earnings, December 31, 2007 (as previously reported)	$ 48,329
Adjustments from:	
Semiconductor Systems Segment Revenue Review, before income tax effect	(38,160)
Precision Technology Segment Revenue Review, before income tax effect	(4,226)
All other non-income tax adjustments	(390)
Income tax adjustments	13,578
Total adjustments	(29,198)
Retained earnings, December 31, 2007 (as restated)	$ 19,131

The net effects of all of the restatement adjustments on the condensed cash flow statements for the six months ended June 27, 2008 are as follows (in thousands):

	Six Months Ended June 27, 2008		
	As Reported(1)	Adjustments	As Restated
Consolidated net income (loss)	$ 3,201	$ (3,108)	$ 93
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities	6,304	2,446	8,750
Changes in assets and liabilities	16,753	2,950	19,703
Cash flows provided by operating activities	26,258	2,288	28,546
Cash flows used in investing activities	(9,924)	(2,962)	(12,886)
Cash flows used in financing activities	(6,378)		(6,378)
Effect of exchange rates on cash and cash equivalents	1,602		1,602
Net increase (decrease) to cash and cash equivalents	11,558	(674)	10,884
Cash and cash equivalents, beginning of year (2)	171,713	674	172,387
Cash and cash equivalents, end of year (2)	$ 183,271		$ 183,271

(1) Amounts as reported reflect operating activities associated with discontinued operations as changes in assets and liabilities.

(2) The Consolidated Statements of Cash Flows include cash and cash equivalent balances (in thousands) of $1 and $1 of the discontinued operations for the year ended December 31, 2007 and the six months ended June 27, 2008, respectively.

The following discussion provides additional information regarding the adjustments that were identified during the Revenue Review. Certain transactions may have been restated for multiple reasons but have been included in the most applicable category.

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Semiconductor Systems Segment

The Company s product sales to customers of its Semiconductor Systems segment are typically multiple element arrangements. These arrangements generally include: hardware components, software components, installation services, an initial warranty period and training on the use of the product. Certain of these arrangements may also include other elements including specified product or software upgrades, product performance commitments and may also include separately priced extended warranty services.

Multiple Element Arrangements without Objective and Reliable Evidence of Fair Value for Undelivered Elements

The Revenue Review identified certain arrangements whereby there were undelivered elements for which objective and reliable evidence of fair value did not exist at the time that the revenue was initially recorded. The Company has deferred the revenue under these arrangements, and recognizes the revenue at the point in time when such undelivered elements are resolved. These undelivered elements include undelivered hardware, delivered hardware not functioning to specifications, and undelivered future software features or functionality committed as part of the arrangement. Additionally, the Company evaluated the unit of accounting for certain transactions based on the guidance in AICPA s Technical Practice Aid (TPA) 5100.39, Software Revenue Recognition for Multiple Element Arrangements. As a result, certain multiple customer orders that were originally accounted for as separate transactions are accounted for as one transaction in the restatement.

The Determination of Customer Acceptance

Under the Company s policy, sales to customers in Japan, sales to new customers, and sales of new products to existing customers, as defined in its policy, are required to be recorded upon the customer having installed, tested and accepted the product at the customer s site. Without acceptance for these types of sales, the Company is unable to conclude that the delivery has been achieved in accordance with the criteria in the SEC s Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. The Revenue Review noted instances whereby the criteria required under its policy to record revenue at the time of shipment had not been achieved; therefore revenue was improperly recognized in an earlier period. In such cases, the Company has deferred revenue recognition until the appropriate customer acceptance was received. Additionally, the Company noted instances where there were two documents representing customer acceptance; one form on a format provided by the Company, and another on a customer-specific form. Often these forms were provided from the customer on separate dates. In these cases of dual acceptance , the Company has performed procedures to assess when all deliverables were made, and then reviewed that against the multiple customer acceptance forms. As a result of these procedures, revenue has been generally recorded on the later of the two acceptance forms dates.

Determination that the Fees are not Fixed or Determinable

Under the Company s policy, arrangements with extended payment terms are not considered to be fixed or determinable. Accordingly, revenue is recognized as the payments become due. The Revenue Review noted instances whereby the arrangements with extended payment terms were not properly identified and revenue was improperly recognized in an earlier period. The revenue, as restated, reflects revenue being recorded as the payments have become due.

Other

The Revenue Review also identified certain other revenue adjustments which were not individually, nor in the aggregate, significant. These adjustments have been reflected in the restated consolidated financial statements and primarily relate to the accounting for separately priced extended warranty contracts. In certain arrangements, the amount deferred for extended warranty contracts differed from the stated price of the extended warranty contracts. In such cases, the Company has adjusted the amount of deferred revenue to equal the stated price of the extended warranty contracts, with the recognition of the adjusted amount recorded over the appropriate period of the extended warranty.

Precision Technology Segment

The Company s product sales to customers of its Precision Technology segment generally represent customer orders for a large volume of one or more types of components and occasionally include services such as installation, training and preventative maintenance plans. In order to meet customer production and inventory requirements, these arrangements frequently provide for the delivery of the components over several quarters.

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Multiple Element Arrangements without Objective and Reliable Evidence of Fair Value for Undelivered Elements

The Revenue Review identified certain arrangements whereby there were undelivered elements for which objective and reliable evidence of fair value did not exist at the time that the revenue was initially recorded. Additionally, the Company evaluated the unit of accounting for certain transactions based on the guidance in TPA 5100.39. As a result, certain multiple customer orders that were originally accounted for as separate transactions are accounted for as one transaction in the restatement.

A typical order includes a variety of products shipped over several reporting periods. These transactions were historically recognized based on the invoice price of each product shipped. The restated revenue is recognized under the multiple units shipped methodology, whereby revenue is recognized in each period based upon the lowest common percentage of the products shipped in the period. This approximates a proportional performance model of revenue recognition. This generally results in a partial deferral of revenue to a later reporting period. No revenue is recognized unless one or more units of each product has been delivered.

Determination that the Fees are not Fixed or Determinable

The Revenue Review identified certain customer arrangements that included customer rights to adjust the product quantity mix or otherwise involved uncertainty regarding the terms of the arrangement. In such cases, the Company has determined that the arrangement fees are not fixed or determinable and revenue is recognized when the order is completely fulfilled.

Summary of Sales Adjustments

The following tables reflect the adjustments identified during the Company s Revenue Review, as well as from the recording of previously unrecorded immaterial adjustments. The tables present a reconciliation of sales as previously reported to amounts as restated for the periods indicated (in thousands):

	Three Months Ended		Six Months Ended
	March 28, 2008	**June 27, 2008**	**June 27, 2008**
Sales, as previously reported	$ 69,028	$ 62,772	$ 131,800
Revenue Restatement Adjustments:			
Semiconductor Systems Segment:			
Multiple element arrangements	(5,981)	(6,078)	(12,059)
Customer acceptance not assured	1,108	325	1,433
Price not fixed or determinable	(691)		(691)
Other	(351)	(215)	(566)
Subtotal Semiconductor Systems Segment	(5,915)	(5,968)	(11,883)
Precision Technology Segment:			
Multiple element arrangements	(2,121)	197	(1,924)
Price not fixed or determinable	224	2,388	2,612
Other	9	80	89

Subtotal Precision Technology Segment	(1,888)	2,665	777
Total revenue restatement adjustments	(7,803)	(3,303)	(11,106)
Sales, as restated	$ 61,225	$ 59,469	$ 120,694

Expense Adjustments

In connection with its Revenue Review, the Company has deferred the corresponding direct costs associated with the deferred revenue. These deferred costs have been recorded as deferred cost of goods sold, in the current and long-term sections of the accompanying balance sheets, as appropriate, and are reflected in the statements of operations as cost of goods sold when the related revenue is recognized. These costs represent the direct and incremental costs that are attributable to the product whose revenue is being deferred.

The following tables reflect the adjustments to cost of goods sold and operating expenses that were identified as a result of the Company s Revenue Review, as well as from the recording of previously unrecorded immaterial adjustments. The tables present a reconciliation of previously reported amounts to amounts as restated for the periods indicated (in thousands):

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

	Three Months Ended March 28, 2008	Three Months Ended June 27, 2008	Six Months Ended June 27, 2008
Cost of goods sold, as previously reported	$ 42,456	$ 38,340	$ 80,796
Semiconductor Systems segment adjustments	(3,507)	(3,815)	(7,322)
Precision Technology segment adjustments	(1,155)	1,538	383
Reclassification of amortization of intangible assets (core technology)	874	798	1,672
Cost of goods sold, as restated	$ 38,668	$ 36,861	$ 75,529
Operating expenses, as previously reported	$ 24,795	$ 24,520	$ 49,315
Reclassification of amortization of intangible assets (core technology)	(874)	(798)	(1,672)
All other operating expense adjustments	(30)	(185)	(215)
Operating expenses, as restated	$ 23,891	$ 23,537	$ 47,428

Income Taxes

In connection with its Revenue Review, the Company has reassessed it provision for income taxes. As part of its assessment of its provision for income taxes, the Company has recorded two primary adjustments.

In connection with the Revenue Review, the Company reassessed the probability of realization of deferred tax assets in certain jurisdictions taking into account the effect of the restatement. This assessment, while conducted currently in connection with the restatement activities, was performed using only those facts that were known or expected to be knowable at the time in which each accounting period would have been initially closed. Pursuant to SFAS No. 109 the Company only recognizes a deferred tax asset when it is more likely than not of recovery, considering future reversal of deferred tax liabilities, available taxable income in carryback periods, the probability of future taxable income after a pattern of generating income in the jurisdiction or tax planning strategies that the Company can implement. Accordingly, adjustments have been reflected to the beginning balance sheet to reduce the deferred tax assets, and the corresponding beginning retained earnings balance.

The provision for income taxes has been further adjusted to reflect the statutory rate, adjusted by timing items and other appropriate current period tax credits, as applied against the as adjusted income and loss of the Company in various periods. See Note 12 to Consolidated Financial Statements for further disclosure.

3. Summary of Significant Accounting Policies

Basis of Presentation

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

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission (SEC), and the instructions to Form 10-Q and the provisions of Regulation S-X pertaining to interim financial statements. Accordingly, certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations.

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

Basis of Consolidation

The consolidated financial statements include the accounts of GSI Group Inc. and its wholly owned subsidiaries, including the accounts of Excel since August 20, 2008. The accounts of Excel include its 50% owned joint venture, Excel Laser Technology Private Limited (Excel SouthAsia JV), since it is a variable interest entity and the Company is the primary beneficiary of the joint

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

venture. The accompanying consolidated financial statements of the Company include the assets, liabilities, revenue, and expenses of Excel SouthAsia JV over which the Company exercises control. The Company records noncontrolling interest in its consolidated statements of operations for the ownership interest of the minority owners of Excel SouthAsiaJV. Financial information related to the joint venture is not considered material to the consolidated financial statements. Intercompany accounts and transactions have been eliminated.

Comparative Amounts and Other

Certain prior period amounts have been reclassified to conform to the current period presentation in the financial statements and notes thereto as of and for the three and six months ended July 3, 2009. These reclassifications had no effect on the Company s previously reported results of operations, financial position and cash flows.

Additionally, the Company has corrected the presentation of certain items in the accompanying consolidated balance sheet as of December 31, 2008. These corrections relate to the following: (i) Correction of $0.1 million previously reported within accrued pension liability to other accrued expenses and (ii) Correction of $0.6 million previously reported within other liabilities to accrued compensation and benefits. These corrections had no effect on the Company s previously reported results of operations, financial position and cash flows.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of sales and expenses during the reporting periods. On an ongoing basis, the Company evaluates its estimates, assumptions and judgments, including those related to revenue recognition; allowance for doubtful accounts; inventory costing and reserves; the assessment of warranty reserves; the valuation of goodwill, intangible assets and other long-lived assets; accounting for business combinations; share-based payments; employee benefit plans; accounting for restructuring activities; accounting for income taxes and related valuation allowances; and, accounting for loss contingencies. Actual results could differ significantly from those estimates.

Cash and Cash Equivalents

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

Financial Instruments and Fair Value Measurements

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

Long-Term Investments

As of July 3, 2009, the Company held auction rate securities, recorded at a fair value of $14.3 million, and with a par value of $17.1 million. As of December 31, 2008, the Company held auction rate securities, recorded at a fair value of $25.1 million, and with a par value of $32.3 million. These securities were acquired as part of the Company s purchase of Excel in 2008. These auction rate notes are student loans backed by the federal government and are privately insured. Current capital market conditions have impacted the Company s ability to liquidate certain auction rate securities. Liquidity for these auction rate securities is typically provided by an auction process that resets the applicable interest rate at pre-determined intervals, usually every 7, 28, 35 or 90 days. In the past, the auction process has allowed investors to roll over their holdings or obtain immediate liquidity by selling the securities at par. Due to the current capital market conditions, an investor s ability to sell auction rate securities at par has been adversely affected. Due to the uncertainty in the market as to when these auction rate notes will be refinanced or the auctions will resume, the Company has classified these instruments as long-term assets available for sale. If the credit ratings of the issuer, the bond insurers or the collateral deteriorates further, or if the issuers of these auction rate securities are unable to successfully close further auctions, the Company may further reduce the carrying value of these investments and may in the future be required to record impairment charges against these investments, some of which may be considered other-than-temporary impairment charges. From January 1, 2009 through July 3, 2009, the Company recorded $0.8 million of other comprehensive income attributable to the change in unrealized gains relating to assets still held at July 3, 2009. From the date of the Company s acquisition of Excel through December 31, 2008, the Company recorded $0.1 million of other comprehensive income attributable to the change in unrealized gains relating to assets still held at December 31, 2008.

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(Unaudited)

During the three months ended July 3, 2009, the Company sold $14.9 million in par value of its auction rate securities valued at $11.3 million for $13.0 million in proceeds which resulted in the recognition of realized gains of approximately $1.7 million. During the six months ended July 3, 2009, the Company sold $15.2 million in par value of its auction rate securities valued at $11.5 million for $13.3 million in proceeds which resulted in the recognition of realized gains of approximately $1.8 million related to the sale of these securities. The gains realized upon the sale of the auction rate securities are recorded in other income (expense), net in the accompanying consolidated statements of operations for the three and six months ended July 3, 2009. No losses were realized upon the sale of any auction rate securities during the three or six months ended July 3, 2009. The Company determines the cost of a security sold and the amount to be reclassified out of accumulated other comprehensive income (loss) into earnings based on the specific identification method. During the three and six months ended July 3, 2009, no amounts were reclassified out of accumulated other comprehensive income (loss) into earnings related to the sale of the Company s auction rate securities. See Note 17 to Consolidated Financial Statements for discussion of sales of auction rate securities after July 3, 2009.

At July 3, 2009 and December 31, 2008, the Company had a 25.1% equity investment in a privately held company located in the United Kingdom, valued at $1.2 million and $0.8 million at July 3, 2009 and December 31, 2008, respectively, and included in other assets in the accompanying consolidated balance sheets. The Company uses the equity method to record the results of this entity. In relation to this investment, the Company recognized income of $235,000 and $142,000 for the six months ended July 3, 2009 and June 27, 2008, respectively, which are shown in other income (expense), net in the accompanying consolidated statements of operations. In relation to this investment, the Company recognized income of $163,000 and $36,000 for the three months ended July 3, 2009 and June 27, 2008, respectively, which are shown in other income (expense), net in the accompanying consolidated statements of operations.

Fair Value Measurements

On January 1, 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, with no impact to its consolidated results and financial position. SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and enhances disclosures about fair value measurements. Fair value is defined as the price that would be received for an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. Valuation techniques must maximize the use of observable inputs and minimize the use of unobservable inputs.

SFAS No. 157 establishes a value hierarchy based on three levels of inputs, of which the first two are considered observable and the third is considered unobservable:

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

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

Level 3. Unobservable inputs.

On January 1, 2009, the Company implemented the guidance in SFAS No. 157 related to all nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities in accordance with FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157 . However, no significant nonrecurring fair value measurements were conducted during the six months ended July 3, 2009.

The following table summarizes the Company s assets and liabilities, as of July 3, 2009, that are measured at fair value on a recurring basis (in thousands):

	July 3, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Cash equivalents (1)	$ 5,284	$ 5,284	$	$
Auction rate securities (2)	14,316			14,316
Total	$ 19,600	$ 5,284	$	$ 14,316

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

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

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GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

The following table summarizes the Company s assets and liabilities, as of December 31, 2008, that are measured at fair value on a recurring basis (in thousands):

	December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Cash equivalents (1)	$ 36,324	$ 36,324	$	$
Auction rate securities (2)	25,065			25,065
Total	$ 61,389	$ 36,324		