

GSI GROUP INC
Form 10-Q
November 13, 2006

**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 29, 2006

OR

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

Commission File Number 333-43089

The GSI Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

37-0856587

(I.R.S. Employer
Identification No.)

**1004 E. Illinois Street, Assumption,
Illinois**

(Address of principal executive offices)

62510

(Zip Code)

(217) 226-4421

(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 for 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer Accelerated filer Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common stock, par value \$0.01 per share, 826,948 shares outstanding as of November 13, 2006.

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* No response to this item is included herein for the reason that it is inapplicable.

Forward-Looking Statements

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 concerning, among other things, the prospects and developments of The GSI Group, Inc. (the "Company") and business strategies for our operations, all of which are subject to risks and uncertainties. Among these forward-looking statements and among those risks and uncertainties, are obtaining suitable financing to support our growth in operations; possible acquisition or divestiture transactions; managing our growth to achieve operating efficiencies; successfully competing in our markets; adequately protecting our proprietary information and technology from competitors; assuring that our products are not rendered obsolete by products or technologies of competitors; successfully managing product liability risks; and avoiding problems with third parties, including key personnel, upon whom we may be dependent. These forward-looking statements are included in various sections of this report. These statements are identified as "forward-looking statements" or by their use of terms (and variations thereof) such as "will," "may," "can," "anticipate," "intend," "continue," "estimate," "expect," "plan," "should," "outlook," "believe," and "seek" and similar terms (and variations thereof) and phrases.

When a forward-looking statement includes a statement of the assumptions or bases underlying the forward-looking statement, we caution that, while we believe such assumptions or bases to be reasonable and make them in good faith, assumed facts or bases almost always vary from actual results, and the differences between assumed facts or bases and actual results can be material, depending upon the circumstances. Where, in any forward-looking statement, we or our management express an expectation or belief as to future results, we express that expectation or belief in good faith and believe it has a reasonable basis, but we can give no assurance that the statement of expectation or belief will result or be achieved or accomplished. The Company expressly disclaims any obligation to update forward-looking information for future events and changes in existing events and circumstances.

Our actual results may differ significantly from the results discussed in the forward-looking statements.

PART I - FINANCIAL INFORMATION<TABLE><CAPTION>
ITEM 1 - FINANCIAL STATEMENTS
THE GSI GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

| <BTB> | (Unaudited) | |
|---|--------------------|-----------------|
| Assets | Sept 29, | December |
| | 2006 | 31, |
| | | 2005 |
| Current Assets: | | |
| Cash and cash equivalents | \$ 6,544 | \$ 2,522 |
| Accounts receivable, net | 47,951 | 35,801 |
| Inventories, net | 55,424 | 46,746 |
| Prepays | 1,906 | 2,961 |
| Income tax receivable | -- | 1,499 |
| Deferred taxes | 5,497 | 4,645 |
| Other | 2,052 | 3,165 |
| Total current assets | 119,374 | 97,339 |
| Property, Plant and Equipment, net | 39,155 | 33,933 |
| Other Assets: | | |
| Goodwill | 39,162 | 39,162 |
| Other intangible assets, net | 48,455 | 51,684 |
| Deferred taxes | 4,245 | 323 |
| Deferred financing costs, net | 4,083 | 5,105 |
| Other | 120 | 102 |
| Total other assets | 96,065 | 96,376 |
| Total assets | \$ 254,594 | \$ 227,648 |
| Liabilities and Stockholder's Equity | | |
| Current Liabilities: | | |
| Accounts payable | \$ 28,016 | \$ 20,989 |
| Accrued interest | 4,459 | 1,722 |
| Payroll and payroll related expenses | 9,711 | 6,683 |
| Accrued warranty | 2,284 | 2,335 |
| Accrued workers compensation | 4,883 | 4,539 |
| Other accrued expenses | 7,011 | 3,449 |
| Customer deposits | 8,320 | 5,256 |
| Current maturities of long-term debt | 95 | 876 |
| Total current liabilities | 64,779 | 45,849 |
| Long-Term Debt, less current maturities | 111,720 | 119,306 |
| Minority Interest | 2,994 | 2,654 |
| Stockholder's Equity: | | |
| Common stock, \$.01 par value voting (authorized 6,900,000 shares; issued 6,633,652 shares; outstanding 626,948 shares) | 16 | 16 |

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| | | |
|--|------------|------------|
| Common stock, \$.01 par value, nonvoting (authorized 1,100,000 shares; issued 1,059,316 shares; outstanding 200,000 shares) | 2 | 2 |
| Additional paid-in capital | 97,881 | 97,881 |
| Accumulated other comprehensive income | 1,424 | 762 |
| Retained earnings | 17,337 | 2,737 |
| Treasury stock, at cost, voting (6,006,704 shares) | (41,550) | (41,550) |
| Treasury stock, at cost, nonvoting (859,316 shares) | (9) | (9) |
| Total stockholder's equity | 75,101 | 59,839 |
| Total liabilities and stockholder's equity | \$ 254,594 | \$ 227,648 |

</TABLE>The accompanying notes to condensed consolidated financial statements are an integral part of these statements.

<TABLE><CAPTION>

THE GSI GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)
(Unaudited)

| <S> | Three Months Ended Successor | | Nine Months Ended Successor | | Predecessor |
|---|---------------------------------|------------------|--------------------------------|-----------------------------|-----------------------------|
| | Sept 29, 2006 | Sept 30, 2005 | Sept 29, 2006 | May 17- Sept 30, 2005 | Jan. 1 - May 16, 2005 |
| Sales | \$127,564 | \$ 107,723 | \$ 333,364 | \$ 155,901 | \$ 114,635 |
| Cost of sales | 97,430 | 78,394 | 254,157 | 118,676 | 83,733 |
| Warranty expense | 248 | 280 | 638 | 622 | 519 |
| Total cost of sales..... | 97,678 | 78,674 | 254,795 | 119,298 | 83,214 |
| Gross profit | 29,886 | 29,049 | 78,569 | 36,603 | 31,421 |
| Selling, general and administrative expenses | 14,026 | 14,110 | 38,238 | 20,653 | 25,568 |
| Amortization expense | 1,052 | 1,950 | 3,228 | 2,912 | 166 |
| Total operating expenses | 15,078 | 16,060 | 41,466 | 23,565 | 25,734 |
| Operating income | 14,808 | 12,989 | 37,103 | 13,038 | 5,687 |
| Other income (expense): | | | | | |
| Interest expense | (3,632) | (3,705) | (11,147) | (5,680) | (5,238) |
| Interest income..... | 148 | 145 | 418 | 199 | 134 |
| Other, net | (813) | 137 | (786) | 170 | 573 |
| Income from continuing operations before income tax | | | | | |
| expense and minority interest | 10,511 | 9,566 | 25,588 | 7,727 | 1,156 |
| Minority interest in net income of subsidiary | (20) | (119) | (149) | (174) | (105) |
| Income tax expense | 4,353 | 4,075 | 10,839 | 2,503 | 1,115 |
| Net income (loss) | \$ 6,138 | \$ 5,372 | \$ 14,600 | \$ 5,050 | \$ (64) |
| Basic and diluted earnings per share | \$ 7.42 | \$ 6.50 | \$ 17.66 | \$ 6.11 | \$ (0.08) |

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| | | | | | |
|--|----------|----------|-----------|----------|---------|
| Weighted average common shares outstanding | 826,948 | 826,948 | 826,948 | 826,948 | 826,948 |
| Comprehensive Income | | | | | |
| Net income | \$ 6,138 | \$ 5,372 | \$ 14,600 | \$ 5,050 | \$ (64) |
| Cumulative currency translation adjustment | (228) | 1,061 | 662 | 1,645 | 536 |
| Comprehensive income | \$ 5,910 | \$ 6,433 | \$ 15,262 | \$ 6,695 | \$ 472 |

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

<TABLE><CAPTION>

THE GSI GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

<BTB>

| | Successor | Predecessor | |
|---|-----------|-------------|-------------|
| | Nine | | |
| | Months | May 17 - | January 1 - |
| | Ended | Sept 30, | May 16, |
| | Sept 29, | 2005 | 2005 |
| | 2006 | | |
| Cash Flows From Operating Activities: | | | |
| Net income | \$ 14,600 | \$ 5,050 | \$ (64) |
| Adjustments to reconcile net income to cash provided by operating activities: | | | |
| Depreciation and amortization | 7,653 | 4,190 | 2,070 |
| Amortization of deferred financing costs | 513 | 279 | 572 |
| Gain on sale of property and equipment | (37) | (20) | (84) |
| Non-cash charges related to inventory fair value adjustment | -- | 661 | -- |
| Deferred taxes | (4,774) | (196) | (69) |
| Minority interest in net income of subsidiaries | 149 | 174 | 105 |
| Minority interest compensation expense | 191 | 463 | 779 |
| Loss on bond repurchase..... | 933 | -- | -- |
| Stock-based compensation | -- | -- | 2,842 |
| Changes in: | | | |
| Accounts receivable, net | (12,150) | (10,492) | (11,388) |
| Inventories, net | (8,678) | 18,188 | (6,968) |
| Other current assets | 3,667 | (668) | 5,159 |
| Accounts payable | 7,027 | (528) | 5,388 |
| Accrued expenses and payroll related expenses | 9,620 | 10,066 | 3,130 |
| Customer deposits | 3,064 | (1,548) | (1,449) |
| Net cash flows provided by operating activities | 21,778 | 25,619 | 23 |
| Cash Flows From Investing Activities: | | | |
| Capital expenditures | (9,369) | (2,569) | (2,046) |
| Proceeds from sale of property and equipment | 151 | 80 | 268 |
| Other | 42 | (68) | (48) |
| Net cash flows used in investing activities | (9,176) | (2,557) | (1,826) |
| Cash Flows From Financing Activities: | | | |
| Payments on long-term debt | (13,481) | (100,035) | (90) |
| Proceeds from stockholder loan | -- | -- | 12 |
| Payments on stockholder loan | -- | (5,012) | -- |
| Proceeds from issuance of long-term debt | -- | 110,000 | -- |
| | 4,690 | (37,705) | 10,369 |

| | | | |
|---|----------|----------|----------|
| Net borrowing (repayments) under line of credit agreement | | | |
| Net proceeds of equity contributed | -- | 15,326 | -- |
| Payment of deferred financing costs | -- | (5,568) | (485) |
| Dividends paid | -- | -- | (7,913) |
| Other | 165 | 1,477 | 50 |
| Net cash flows provided by (used in) financing activities | (8,626) | (21,517) | 1,943 |
| Effect of Exchange Rate Changes on Cash | 46 | (69) | (7) |
| Increase In Cash and Cash Equivalents | \$ 4,022 | \$1,476 | \$ 133 |
| Cash and Cash Equivalents, beginning of period | 2,522 | 2,437 | 2,304 |
| Cash and Cash Equivalents, end of period | \$ 6,544 | \$ 3,913 | \$ 2,437 |

</TABLE>

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

THE GSI GROUP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

The financial statements have been prepared by The GSI Group, Inc. (the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information not misleading. The condensed consolidated balance sheet of the Company as of December 31, 2005 has been derived from the audited consolidated balance sheet of the Company as of that date. Certain information and note disclosures normally included in the Company's annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes contained in the Company's December 31, 2005 Form 10-K as filed with the Securities and Exchange Commission. Other than as indicated herein, there have been no significant changes from the data presented in the Company's 2005 Form 10-K.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of the Company as of September 29, 2006 and the results of operations and cash flows for the successor period of nine months ended September 29, 2006 and May 17-September 30, 2005 and the predecessor period ended May 16, 2005. Those adjustments consist only of normal recurring adjustments.

The results of operations for the successor period of nine months ended September 29, 2006 and May 17 - September 30, 2005 and the predecessor period ended May 16, 2005 are not necessarily indicative of the operating results for the full year.

Sales of agricultural equipment are seasonal, with farmers traditionally purchasing grain storage bins and grain drying and handling equipment in the summer and fall in conjunction with the harvesting season, and swine and poultry producers purchasing equipment during prime construction periods in the spring, summer and fall. The Company's sales and net income have historically been lower during the first and fourth fiscal quarters as compared to the second and third quarters.

The financial statements are presented under two different ("Predecessor" and "Successor") bases of accounting. The predecessor and successor financial statements are consolidated and include all of the accounts of GSI Group, Inc. and its subsidiaries. All intercompany transactions and balances have been eliminated.

During the period ended September 29, 2006 the Company began reporting research and development expenses as part of selling, general and administrative expenses. All periods shown have been presented with this change for comparability. There was no effect on net income.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP"), and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurement where the FASB has previously determined that under those pronouncements fair value is the appropriate measurement. This statement does not require any new fair value

measurements, but may require companies to change current practice. This statement is effective for fiscal years beginning after November 15, 2007 and to the interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of SFAS No. 157.

In June 2006, the FASB issued Interpretation (“FIN”) No. 48, “*Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109.*” This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of this Interpretation on its financial position and results of operations.

2. Detail of Certain Assets and Liabilities

<TABLE><CAPTION>

<BTB>

| | (Unaudited) Sept 29, 2006 | December 31, 2005 |
|--------------------------------------|---------------------------------|----------------------|
| | (In thousands) | |
| <i>Accounts Receivable</i> | | |
| Trade receivables | \$ 50,986 | \$ 37,747 |
| Allowance for doubtful accounts | (3,035) | (1,946) |
| Total | \$ 47,951 | \$ 35,801 |
| <i>Inventories</i> | | |
| Raw materials | \$ 20,409 | \$ 16,039 |
| Work-in-process | 9,337 | 8,758 |
| Finished goods | 25,678 | 21,949 |
| Total..... | \$ 55,424 | \$ 46,746 |
| <i>Property, Plant and Equipment</i> | | |
| Land | \$ 599 | \$ 594 |
| Buildings and improvements | 14,076 | 12,817 |
| Machinery and equipment | 29,021 | 24,279 |
| Office equipment and furniture | 3,583 | 2,523 |
| Construction-in-progress | 3,605 | 868 |
| | 50,884 | 41,081 |
| Accumulated depreciation | (11,729) | (7,148) |
| Property, plant and equipment, net | \$ 39,155 | \$ 33,933 |
| <i>Intangible Assets</i> | | |
| Goodwill | \$ 39,162 | \$ 39,162 |
| Non-compete agreements | \$ 2,890 | \$ 2,890 |
| Technology | 5,700 | 5,700 |
| Trade names | 14,300 | 14,300 |
| Customer relations | 31,400 | 31,400 |
| Backlog | 3,490 | 3,490 |
| | 57,780 | 57,780 |
| Accumulated amortization | (9,325) | (6,096) |
| Total | \$ 48,455 | \$ 51,684 |
| <i>Deferred Financing Costs</i> | | |
| Deferred financing costs | \$ 4,978 | \$ 5,570 |

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| | | | |
|-------------------------|--------------------------|----------|----------|
| | Accumulated amortization | (895) | (465) |
| | Total | \$ 4,083 | \$ 5,105 |
| <i>Accrued Warranty</i> | | | |
| | Beginning balance | \$ 2,335 | \$ 2,764 |
| | Increase to expense | 638 | 1,630 |
| | Charge to reserve | (689) | (2,059) |
| | Ending balance | \$ 2,284 | \$ 2,335 |

3. Supplemental Cash Flow Information

The Company paid \$7.5 million, \$0.5 million and \$6.0 million in interest during the successor period of nine months ended September 29, 2006 and May 17 - September 30, 2005 and the predecessor period ended May 16, 2005, respectively. The Company paid \$9.9 million, \$1.9 million and \$0.2 million in income taxes during the successor period of nine months ended September 29, 2006 and May 17 - September 30, 2005 and the predecessor period ended May 16, 2005, respectively.

4. Debt

Revolving Credit Facility

On May 16, 2005, concurrently with the issuance of \$110,000,000 of 12% Senior Notes due 2013 and the closing of the acquisition of The GSI Group, Inc. (the "Company") by GSI Holdings Corp. ("GSI Holdings"), an affiliate of Charlesbank Equity Fund V, Limited Partnership, the Company refinanced its existing credit facility with a five-year asset-backed revolving credit facility provided by lenders led by Wachovia Capital Finance Corporation (Central) ("Wachovia"), as the agent. The maximum amount of revolving credit available under the Company's refinanced credit facility (the "Credit Facility") is \$60.0 million and the Company has the option to increase the facility in increments of \$5.0 million up to a maximum of \$75.0 million (subject to compliance with the covenants in the indenture). Up to \$15 million of the facility is available for issuances of letters of credit.

The Credit Facility provides floating rate revolving loans bearing interest at a rate equal to 0.0% to 0.5% over Wachovia's prime rate or 1.50% to 2.00% over LIBOR, in each case based on the excess availability under the borrowing base from time to time.

The Company's obligations under its Credit Facility are secured by a first priority lien on, and pledge of, substantially all of its and any subsidiary guarantors' current and future assets. In addition, GSI Holdings pledged all of its shares of the Company's common stock, as well as any rights that it may have under the stock purchase agreement with the Company's selling stockholders, as additional collateral security.

The Credit Facility contains a number of covenants that, among other things, restrict our ability to dispose of assets, incur additional indebtedness, pay or make dividends or distributions to the Company's stockholders, create liens on assets, enter into sale and leaseback transactions and otherwise restrict our general corporate activities. The Company is also required to comply with specified financial ratios and tests including a fixed charge coverage ratio.

As of September 29, 2006 the Company had \$13.9 million of revolving loans outstanding and \$5.9 million of standby letters of credit which reduced the overall availability under the credit facility to \$45.0 million. As of September 29, 2006 the Company had expensed as Cost of Sales \$1.2 million related to the standby letters of credit under the credit facility.

Senior Notes due 2013

On May 16, 2005, concurrently with the refinancing of its existing revolving credit facility with Wachovia Capital Finance Corporation and the closing of the acquisition of The GSI Group, Inc. (the "Company") by GSI Holdings Corp. ("GSI Holdings"), an affiliate of Charlesbank Equity Fund V, Limited Partnership, the Company issued and sold \$110,000,000 aggregate principal amount of Senior Notes due 2013 (the "Notes"). Payment on the Notes is guaranteed on an unsecured basis by GSI Holdings and by all of the Company's domestic material subsidiaries. None

of the Company's domestic subsidiaries are currently material subsidiaries. The Notes were issued under an Indenture among the Company, the Guarantors and U.S. Bank National Association, as trustee (the "Indenture").

The Notes have a fixed annual interest rate of 12%, which will be paid semiannually in arrears on May 15 and November 15, commencing on November 15, 2005.

Prior to May 15, 2008, the Company may redeem up to 35% of the Notes at a redemption price of 112.000% of the principal amount, plus accrued and unpaid interest from the proceeds of certain equity offerings; *provided* that: (i) at least 65% of the aggregate principal amount of Notes originally issued under the Indenture (excluding Notes held by the Company and its subsidiaries) remains outstanding immediately after the occurrence of such redemption and (ii) the redemption occurs within 90 days of the date of the closing of such equity offering. Except pursuant to the preceding sentence, the Notes will not be redeemable at the Company's option prior to May 15, 2009.

On or after May 15, 2009, the Company may redeem all or a part of the Notes upon not less than 30 nor more than 60 days' notice, at the redemption prices (expressed as percentages of principal amount) listed below plus accrued and unpaid interest and liquidated damages, if any, on the Notes redeemed, to the applicable redemption date, if redeemed during the twelve-month period beginning on May 15 of the years indicated below, subject to the rights of holders of Notes on the relevant record date to receive interest on the relevant interest payment date: 2009 at a redemption price of 106.000%; 2010 at a redemption price of 103.000%; and 2011 and thereafter at a redemption price of 100.000%.

Upon a change of control, as defined in the Indenture, the Company is required to offer to purchase all of the Notes then outstanding for cash at 101% of the aggregate principal amount thereof plus accrued and unpaid interest and liquidated damages, if any, on the Notes repurchased to the date of purchase, subject to the rights of holders of Notes on the relevant record date to receive interest due on the relevant interest payment date.

The Company purchased \$7.4 million of its outstanding bonds from Charlesbank, an affiliate of its parent, on May 12, 2006 and immediately retired them. The bonds were purchased at a 1% premium. The Company purchased \$5.0 million of its outstanding bonds on August 25, 2006 and immediately retired them. The bonds were purchased at fair market value.

5. Income Taxes

The following table represents the unaudited successor and predecessor income taxes for the first nine months of 2006 and 2005.

<TABLE><CAPTION>

| <BTB> | Successor | | | | Predecessor | |
|-----------------------|---|--|---|--|---|--|
| | Nine Months as of Sept 29, 2006 | | May 17, 2005 - Sept 30, 2005 | | Jan 1, 2005 - May 16, 2005 | |
| | Income/(Loss) Before Income Taxes | Income Tax Expense/ (Benefit) | Income/(Loss) Before Income Taxes | Income Tax Expense/ (Benefit) | Income/(Loss) Before Income Taxes | Income Tax Expense/ (Benefit) |
| <S> | | | | | | |
| U.S. | \$ 21,348 | \$ 10,281 | \$ 4,952 | \$ 2,148 | \$ (564) | \$ 495 |
| Brazil | 1,475 | 481 | 1,541 | 393 | 1,051 | 336 |
| Malaysia | 889 | 77 | 503 | 2 | (317) | (10) |
| Mexico | 1,181 | -- | 389 | (3) | 432 | 256 |
| China | (100) | -- | (8) | -- | 242 | -- |
| Poland | (168) | -- | (30) | -- | (2) | -- |
| South Africa | 814 | -- | 206 | (37) | 209 | 38 |
| Total | \$ 25,439 | \$ 10,839 | \$ 7,553 | \$ 2,503 | \$ 1,051 | \$ 1,115 |
| Current income taxes | | \$ 15,613 | | \$ 2,699 | | \$ 1,184 |
| Deferred income taxes | | (4,774) | | (196) | | (69) |
| Total | | \$ 10,839 | | \$ 2,503 | | \$ 1,115 |

| | Successor | | Predecessor | |
|---|------------------------------------|--|---------------------------------|-----------------|
| | Nine Months as of Sept 29, 2006 | | May 17, 2005 - Sept 30, 2005 | |
| | | | | |
| Income taxes at U.S. statutory rate | \$ 8,907 | | \$ 2,644 | \$ 368 |
| Effect of conversion to "C" corporation | -- | | (990) | -- |
| State income taxes | 1,858 | | 551 | 77 |
| Foreign tax rate differential-federal | 558 | | 977 | 620 |
| Other | (484) | | (679) | 50 |
| Total | \$ 10,839 | | \$ 2,503 | \$ 1,115 |

</TABLE>

The following table represents the successor and predecessor income taxes for the third quarter of 2006 and 2005.
<TABLE><CAPTION>

| <BTB> | Successor | | | |
|-----------------------|---|--|---|-------------------------------------|
| | Three Months as of Sept 29, 2006 | | Three Months as of Sept 30, 2005 | |
| | Income/(Loss) Before Income Taxes | Income Tax Expense/ (Benefit) | Income/(Loss) Before Income Taxes | Income Tax Expense/ (Benefit) |
| <S> | | | | |
| U.S. | \$ 9,322 | \$ 4,262 | \$ 7,763 | \$ 3,827 |
| Brazil | 197 | 63 | 1,048 | 250 |
| Malaysia | 289 | 28 | 371 | 1 |
| Mexico | 515 | -- | 171 | (3) |
| China | (4) | -- | (27) | -- |
| Poland | (28) | -- | (18) | -- |
| South Africa | 200 | -- | 139 | -- |
| Total | \$ 10,491 | \$ 4,353 | \$ 9,447 | \$ 4,075 |
| Current income taxes | | \$ 8,095 | | \$ 2,199 |
| Deferred income taxes | | (3,742) | | 1,876 |
| Total | | \$ 4,353 | | \$ 4,075 |

| | Successor | |
|---------------------------------------|-------------------------------------|-------------------------------------|
| | Three Months as of Sept 29, 2006 | Three Months as of Sept 30, 2005 |
| Income taxes at U.S. statutory rate | \$ 3,675 | \$ 3,306 |
| State income taxes | 767 | 690 |
| Foreign tax rate differential-federal | 91 | 870 |
| Other | (180) | (791) |
| Total | \$ 4,353 | \$ 4,075 |

The Company was an "S" Corporation for federal income tax purposes for the period ended May 16, 2005. Income taxes for the period were an obligation of its stockholders.

6. Business Segment

The Company has no separately reportable segments in accordance with Statement of Financial Accounting Standard ("SFAS") No. 131, "Disclosure About Segments of an Enterprise and Related Information." Under the enterprise wide disclosure requirements of SFAS 131, the Company reports sales by each product line. Amounts for the first nine months of 2006 and 2005, based on the aggregation of historical and successor accounting, are as shown in the table below (in thousands).

<TABLE><CAPTION>

| | Successor | Predecessor |
|----------------------|------------------|--------------------|
| | May 17 - | January 1- |
| | Sept 29, | May 16, |
| | 2006 | 2005 |
| <S> | | |
| Grain product line | \$ 202,256 | \$ 93,125 |
| Swine product line | 71,491 | 29,590 |
| Poultry product line | 59,617 | 33,186 |
| Sales | \$ 333,364 | \$ 155,901 |
| | | \$ 114,635 |

</TABLE>

For the first nine months of 2006 and 2005, sales in Brazil were \$30.6 million and \$27.4 million, respectively. Long-lived assets in Brazil were \$6.7 million at September 29, 2006.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the Consolidated Financial Statements and the notes included in Item 1 hereof.

General

The Company is a major worldwide manufacturer of agricultural equipment. The Company's grain, swine and poultry products are used by producers and purchasers of grain, and by producers of swine and poultry. Demand for our agricultural equipment is driven by the overall level of grain, swine and poultry production, the level of net farm income, agricultural real estate values and producers' increasing focus on improving productivity in their operations. In addition, fluctuations in grain and feed prices affect our sales, with sustained increases in grain and feed prices increasing demand for our grain equipment and decreasing demand for our swine and poultry equipment. We believe that our diversified product offerings mitigate the effects of fluctuations in the price of grain. Sales of our swine and poultry equipment are also affected by long-term trends in consumer demand for pork and poultry both domestically and internationally.

Sales of agricultural equipment are seasonal, with farmers traditionally purchasing grain storage bins and grain conditioning and handling equipment in the summer and fall in conjunction with the harvesting season, and swine and poultry producers purchasing equipment during prime construction periods in the spring, summer and fall. The Company's sales, operating income and net income have historically been lower during the first and fourth fiscal quarters as compared to the second and third quarters. Traditionally, this has caused the Company to have increased working capital needs during the second and third quarters as material is purchased and converted to inventory during the year.

Although the Company's sales are primarily denominated in U.S. dollars and are not generally affected by currency fluctuations (except for transactions from the Company's Brazilian operation), the production costs, profit margins and competitive position are affected by the strength of the U.S. dollar relative to the strength of the currencies in countries where its products are sold.

The Company's international sales have historically comprised a significant portion of our total sales. In the first nine months of 2006 and 2005, the Company's international sales accounted for 30.9% and 30.8%, of total sales, respectively. International operations generally are subject to various risks that are not present in domestic operations, including restrictions on dividends, restrictions on repatriation of funds, unexpected changes in tariffs and other trade barriers, difficulties in staffing and managing foreign operations, political instability, fluctuations in currency exchange rates, reduced protection for intellectual property rights in some countries, seasonal reductions in business activity and potentially adverse tax consequences, any of which could adversely impact our international operations.

The primary raw materials we use to manufacture our products are steel and polymers. Fluctuations in the prices of steel and, to a lesser extent, polymer materials can impact our cost of sales.

Items Affecting Comparability

On April 6, 2005, all of the Company's stockholders entered into a stock purchase agreement with GSI Holdings, Inc. (GSI Holdings), a newly formed holding company owned primarily by an affiliate of Charlesbank Equity Fund V, Limited Partnership, pursuant to which GSI Holdings purchased for cash all of the issued and outstanding shares of the Company's common stock. On May 16, 2005, under the "successor" basis of accounting, the closing of the

Acquisition occurred. Consequently, our financial statements shown in Item 1 of this Form 10Q have been presented under two different bases of accounting, with all historical Company activity up to and including May 16, 2005 under the predecessor basis, and all Company activity from May 17, 2005 to present under the successor basis. The following discussion and analysis is based upon these two bases of accounting for the nine months ended September 29, 2006, and our review of the business and operations during such periods as compared to the same periods of 2005.

As a result of the Acquisition, our assets and liabilities have been adjusted to their fair value as of the closing date. Depreciation and amortization expenses are higher in successor accounting due to the fair value assessments resulting in increases to the carrying value of our property, plant and equipment and intangible assets.

We believe the discussion and analysis of The GSI Group, Inc.'s financial condition and combined results of operations set forth below are not indicative, nor should they be relied upon as an indicator, of our future performance. Please refer to the footnotes to the Financial Statements included in Item 1 of this report, including "Summary of Significant Accounting Policies" for important additional information concerning the basis of presentation of financial information included in this report.

Historical Performance

Results of Operations

The following table sets forth a summary of the Company's operations and their percentages of total revenue for the periods indicated based on the aggregation of historical predecessor and successor accounting (dollars in thousands):

<TABLE><CAPTION>

| | Three months ended | | | |
|--|-------------------------------|-------|------------------------------|-------|
| | Sept 29 , 2006 (Unaudited) | | Sept 30, 2005 (Unaudited) | |
| | Amount | % | Amount | % |
| Sales | \$ 127,564 | 100.0 | \$ 107,723 | 100.0 |
| Cost of sales | 97,430 | 76.4 | 78,394 | 72.8 |
| Warranty expense | 248 | 0.2 | 280 | 0.3 |
| Total cost of sales | 97,678 | 76.6 | 78,674 | 73.0 |
| Gross profit | 29,886 | 23.4 | 29,049 | 27.0 |
| Selling, general and administrative expenses | 14,026 | 11.0 | 14,110 | 12.3 |
| Amortization expense | 1,052 | 0.8 | 1,950 | 1.8 |
| Total operating expenses | 15,078 | 11.8 | 16,060 | 14.9 |
| Operating income | 14,808 | 11.6 | 12,989 | 12.1 |
| Other income (expense): | | | | |
| Interest expense | (3,632) | (2.8) | (3,705) | (3.4) |
| Interest income | 148 | 0.1 | 145 | 0.1 |
| Other, net | (813) | (0.6) | 137 | (0.1) |
| Income before income tax expense and minority interest | 10,511 | 8.2 | 9,566 | 8.9 |
| Minority interest in net income of subsidiary | (20) | 0.0 | (119) | (0.1) |
| Income tax provision | 4,353 | 3.4 | 4,075 | 3.8 |

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| | | | | |
|--|----------|-----|----------|-----|
| Net income | \$ 6,138 | 4.8 | \$ 5,372 | 5.0 |
| Basic and diluted earnings per share | \$ 7.42 | | \$ 6.50 | |
| Weighted average common shares outstanding | 826,948 | | 826,948 | |

</TABLE>

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The following table sets forth a summary of the Company's operations and their percentages of total revenue for the nine month periods indicated based on the aggregation of historical predecessor and successor accounting (dollars in thousands):

<TABLE><CAPTION>

| | Nine months ended | | | |
|--|--------------------------|----------|----------------------|----------|
| | Sept 29, 2006 | | Sept 30, 2005 | |
| | (Unaudited) | | (Unaudited) | |
| | Amount | % | Amount | % |
| Sales | \$ 333,364 | 100.0 | \$ 270,536 | 100.0 |
| Cost of sales | 254,157 | 76.2 | 202,409 | 74.8 |
| Warranty expense | 638 | 0.2 | 103 | 0.0 |
| Total cost of sales | 254,795 | 76.4 | 202,512 | 74.9 |
| Gross profit | 78,569 | 23.6 | 68,024 | 25.1 |
| Selling, general and administrative expenses | 38,238 | 11.5 | 46,221 | 17.1 |
| Amortization expense | 3,228 | 1.0 | 3,078 | 1.1 |
| Total operating expenses | 41,466 | 12.4 | 49,299 | 18.2 |
| Operating income | 37,103 | 11.1 | 18,725 | 6.9 |
| Other income (expense): | | | | |
| Interest expense | (11,147) | (3.3) | (10,918) | (4.0) |
| Interest income | 418 | 0.1 | 333 | 0.1 |
| Other, net | (786) | (0.2) | 743 | 0.3 |
| Income before income tax expense and minority interest | 25,588 | 7.7 | 8,883 | 3.3 |
| Minority interest in net income of subsidiary | (149) | (0.0) | (279) | (0.1) |
| Income tax provision | 10,839 | 3.3 | 3,618 | 1.3 |
| Net income | \$ 14,600 | 4.4 | \$ 4,986 | 1.8 |
| Basic and diluted earnings per share | \$ 17.66 | | \$ 6.03 | |
| Weighted average common shares outstanding | 826,948 | | 826,948 | |

</TABLE>

Three Months Ended September 29, 2006 Compared to Three Months Ended September 30, 2005

Sales increased 18.4% or \$19.8 million to \$127.6 million in the third quarter of 2006 compared to \$107.7 million in the third quarter of 2005. Grain equipment sales increased \$18.3 million or 28.5% to \$82.4 million during the third quarter of 2006 compared to the \$64.1 million in the third quarter 2005, due to higher volume. Expectations for a positive harvest, a movement to increase farm storage and higher international sales contribute to this growth. Swine equipment sales increased 33.2% to \$26.9 million in the third quarter of 2006 compared to \$20.2 million in the third quarter of 2005 due to an improved swine production market that allows producers to upgrade equipment. Swine commodity prices remain positive. Poultry equipment sales decreased 22.2 % to \$18.2 million in the third quarter of 2006 compared to \$23.4 million in the third quarter of 2005. Declining poultry meat prices contributed to this market decline.

Cost of goods sold increased 24.2% or \$19.0 million to \$97.7 million or 76.6% of sales in the third quarter of 2006 compared to \$78.7 million or 73.0% of sales in the third quarter of 2005. Cost of goods sold after extraordinary and non-recurring expenses related to the inventory fair value step up of \$2.0 million in the third quarter of 2005, resulted in a year over year increase of 27.4% or \$21.0 million. This increase is primarily due to higher volume including some associated premium costs (e.g. overtime, outsourcing of components, and additional labor costs.), material cost increases and higher cost relative to international sales.

Gross profit increased to \$29.9 million in the third quarter of 2006 or 23.4% of sales from \$29.0 million or 27.0% of sales in the same period of 2005. This increase was primarily due to the reasons cited above.

Operating expenses decreased 6.1% or \$1.0 million to \$15.1 million in the third quarter of 2006 from \$16.1 million in the same period of 2005. Amortization expense decreased by \$0.9 million for the period. Operating expenses in the third quarter 2005 included extraordinary and non-recurring expenses of \$1.9 million related primarily to the change in ownership of the Company. In the three months ended September 29, 2006, excluding the extraordinary costs in 2005, operating expenses increased \$1.8 million. This included: higher distribution expenses incurred due to higher volume, additional costs associated with the establishment of the current management team and higher support costs including legal, consulting, and management fees.

Operating income increased to \$14.8 million in the third quarter of 2006 from \$13.0 million in the third quarter of 2005. Operating income margin decreased to 11.6% of sales in 2006 from 12.1% in 2005.

Interest expense decreased \$0.1 million in the third quarter of 2006 as compared to the third quarter of 2005.

Other, Net increased \$1.0 million primarily due to the cost related to the extinguishment of debt.

Income tax expense increased \$0.3 million to \$4.4 million in the third quarter of 2006 from a tax expense of \$4.1 million in the same period of 2005.

Net income increased by \$0.7 million to \$6.1 million for the third quarter of 2006 from \$5.4 million in the same period of 2005.

Nine Months Ended September 29, 2006 Compared to Nine Months Ended September 30, 2005

Sales increased 23.2% or \$62.8 million to \$333.3 million in the first nine months of 2006 compared to \$270.5 million in the first nine months of 2005. Grain equipment sales increased 26.1% during the first nine months of 2006 to \$202.3 million as compared to \$160.4 the first nine months 2005 due to higher volume. Sales volume was positively influenced by a higher percentage of orders placed under the winter program that were shipped in the first six months. The winter program provided deeper discounts which led to lower net pricing on some product lines year over year in the second quarter. Expectations for a positive harvest, a movement to increase farm storage and higher international sales contribute to the sale growth. Swine equipment sales increased 41.9% to \$71.5 million in the first nine months of 2006 compared to \$50.4 million in the first nine months of 2005 due to an improved swine production market that allows producers to upgrade equipment. Swine commodity prices remain positive and weather conditions were favorable early in the year. Poultry equipment sales remained flat at \$59.6 million in the first nine months of 2006 compared to \$59.8 million in the first nine months of 2005.

Cost of goods sold increased 25.8% or \$52.3 million to \$254.8 million or 76.4% of sales in the first nine months of 2006 compared to \$202.5 million or 74.9% of sales in the first nine months of 2005. Cost of goods sold after extraordinary and non-recurring expenses related to the inventory fair value step up of \$4.6 million in the first nine months of 2005, resulted in a year over year increase of 26.8% or \$53.9 million. This increase is primarily due to higher volume including associated premium costs (e.g. overtime, outsourcing of components, and additional labor costs.), material cost increases and higher cost relative to international sales.

Gross profit increased to \$78.6 million in the first nine months of 2006, or 23.6% of sales, from \$68.0 million, or 25.1% of sales, in the same period of 2005. This increase was primarily due to the reasons cited above.

Operating expenses decreased 15.9% or \$7.8 million to \$41.5 million in the first nine months of 2006 from \$49.3 million in the same period of 2005. In 2005, operating expenses included extraordinary and non-recurring expenses of \$13.4 million related primarily to the change in ownership of the Company. In 2006, excluding the extraordinary costs

in 2005, operating expenses increased by \$5.6 million which included: higher distribution expenses related to higher sales volume, additional costs associated with the establishment of the current management team and higher support costs including legal, consulting, and management fees.

Operating income increased to \$37.1 million in the first nine months of 2006 from \$18.7 million in the first nine months of 2005. Operating income margins increased to 11.1% of sales in 2006 from 6.9% in 2005.

Interest expense increased \$0.2 million in the first nine months of 2006 as compared to the first nine months of 2005 due to higher borrowing costs, offset by less debt.

Other, Net increased 1.5 million primarily due to the cost related to the extinguishment of debt.

Income tax expense increased \$7.2 million to \$10.8 million in the first nine months of 2006 from \$3.6 million in the same period of 2005. This increase is due to the Company changing from a "C" Corporation on May 16, 2005 from an "S" Corporation.

Net income increased by \$9.6 million to \$14.6 million for the first nine months of 2006 from \$5.0 million in the same period of 2005.

Liquidity and Capital Resources

The Company has historically funded capital expenditures, working capital requirements, debt service, stockholder dividends and stock repurchases from cash flow from its operations, augmented by borrowings made under the Company's credit facility and the sale of the Company's notes.

The Company's working capital requirements for its operations are seasonal, with investments in working capital typically building in the second and third quarters and then declining in the first and fourth quarters. The Company defines working capital as current assets less current liabilities. As of September 29, 2006, the Company had \$54.6 million of working capital, an increase of \$3.1 million from working capital as of December 31, 2005. The increase in working capital was primarily due to increases in cash, accounts receivable, inventory and deferred taxes and decreases in accrued warranty and current maturities of long-term debt of \$26.5 million, partially offset by decreases in prepaids, income tax receivable, other current assets and increases in accounts payable, payroll and payroll related expenses, accrued interest, accrued workers compensation, other accrued expenses and customer deposits of \$23.4 million.

Cash flows from operating activities decreased \$3.9 million in the first nine months of 2006 compared to 2005 and provided \$21.8 million and \$25.6 million, respectively.

Investing activities used \$9.2 million and \$4.4 million in cash flow in the first nine months of 2006 and 2005, respectively. The cash was used primarily for the purchase of property, plant and equipment.

Financing activities used \$8.6 million and used \$19.6 million in cash flow in the first nine months of 2006 and 2005, respectively. The cash was used primarily to pay down debt.

The Company believes that existing cash, cash flow from operations and available borrowings under its refinanced revolving credit facility will be sufficient to support its working capital, capital expenditures and debt service requirements for the foreseeable future. As of September 29, 2006, the Company had approximately \$45.0 million of availability under the credit facility.

Revolving Credit Facility

On May 16, 2005, concurrently with the issuance of \$110,000,000 of 12% Senior Notes due 2013 and the closing of the acquisition of The GSI Group, Inc. (the "Company") by GSI Holdings Corp. ("GSI Holdings"), an affiliate of Charlesbank Equity Fund V, Limited Partnership, the Company refinanced its existing credit facility with a five-year asset-backed revolving credit facility provided by lenders led by Wachovia Capital Finance Corporation (Central) ("Wachovia"), as the agent. The maximum amount of revolving credit available under the Company's refinanced credit facility (the "Credit Facility") is \$60.0 million and the Company has the option to increase the facility in

increments of \$5.0 million up to a maximum of \$75.0 million (subject to compliance with the covenants in the indenture). Up to \$15 million of the facility is available for issuances of letters of credit.

The Credit Facility provides floating rate revolving loans bearing interest at a rate equal to 0.0% to 0.5% over Wachovia's prime rate or 1.50% to 2.00% over LIBOR, in each case based on the excess availability under the borrowing base from time to time.

The Company's obligations under its Credit Facility are secured by a first priority lien on, and pledge of, substantially all of its and any subsidiary guarantors' current and future assets. In addition, GSI Holdings pledged all of its shares of the Company's common stock, as well as any rights that it may have under the stock purchase agreement with the Company's selling stockholders, as additional collateral security.

The Credit Facility contains a number of covenants that, among other things, restrict our ability to dispose of assets, incur additional indebtedness, pay or make dividends or distributions to the Company's stockholders, create liens on assets, enter into sale and leaseback transactions and otherwise restrict our general corporate activities. The Company is also required to comply with specified financial ratios and tests including a fixed charge coverage ratio.

As of September 29, 2006 the Company had \$13.9 million of revolving loans outstanding and \$5.9 million of standby letters of credit which reduced the overall availability under the credit facility to \$45.0 million. As of September 29, 2006 the Company had expensed as Cost of Sales \$1.2 million related to the standby letters of credit under the credit facility.

Senior Notes due 2013

On May 16, 2005, concurrently with the refinancing of its existing revolving credit facility with Wachovia Capital Finance Corporation and the closing of the acquisition of The GSI Group, Inc. (the "Company") by GSI Holdings Corp. ("GSI Holdings"), an affiliate of Charlesbank Equity Fund V, Limited Partnership, the Company issued and sold \$110,000,000 aggregate principal amount of Senior Notes due 2013 (the "Notes"). Payment on the Notes is guaranteed on an unsecured basis by GSI Holdings and by all of the Company's domestic material subsidiaries. None of the Company's domestic subsidiaries are currently material subsidiaries. The Notes were issued under an Indenture among the Company, the Guarantors and U.S. Bank National Association, as trustee (the "Indenture").

The Notes have a fixed annual interest rate of 12%, which will be paid semiannually in arrears on May 15 and November 15, commencing on November 15, 2005.

Prior to May 15, 2008, the Company may redeem up to 35% of the Notes at a redemption price of 112.000% of the principal amount, plus accrued and unpaid interest from the proceeds of certain equity offerings; *provided* that: (i) at least 65% of the aggregate principal amount of Notes originally issued under the Indenture (excluding Notes held by the Company and its subsidiaries) remains outstanding immediately after the occurrence of such redemption and (ii) the redemption occurs within 90 days of the date of the closing of such equity offering. Except pursuant to the preceding sentence, the Notes will not be redeemable at the Company's option prior to May 15, 2009.

On or after May 15, 2009, the Company may redeem all or a part of the Notes upon not less than 30 nor more than 60 days' notice, at the redemption prices (expressed as percentages of principal amount) listed below plus accrued and unpaid interest and liquidated damages, if any, on the Notes redeemed, to the applicable redemption date, if redeemed during the twelve-month period beginning on May 15 of the years indicated below, subject to the rights of holders of Notes on the relevant record date to receive interest on the relevant interest payment date: 2009 at a redemption price of 106.000%; 2010 at a redemption price of 103.000%; and 2011 and thereafter at a redemption price of 100.000%.

Upon a change of control, as defined in the Indenture, the Company is required to offer to purchase all of the Notes then outstanding for cash at 101% of the aggregate principal amount thereof plus accrued and unpaid interest and liquidated damages, if any, on the Notes repurchased to the date of purchase, subject to the rights of holders of Notes on the relevant record date to receive interest due on the relevant interest payment date.

Also on May 16, 2005, the Company issued a call for redemption for all \$100 million principal amount of its existing 10-1/4% senior subordinated notes due 2007 at a price of 101.729% plus accrued interest from May 1, 2005 to the date of redemption.

The Company purchased \$7.4 million of its outstanding bonds from Charlesbank, an affiliate of its parent, on May 12, 2006 and immediately retired them. The bonds were purchased at a 1% premium. The Company purchased \$5.0 million of its outstanding bonds on August 25, 2006 and immediately retired them. The bonds were purchased at fair market value.

Inflation

The Company believes that inflation has not had a material effect on its results of operations or financial condition during recent periods.

Critical Accounting Policies

There have been no material changes to the critical accounting policies since December 31, 2005.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is subject to market risk associated with adverse changes in interest rates and foreign currency exchange rates. The Company does not hold any market risk sensitive instruments for trading purposes. At September 29, 2006, principal exposed to interest rate risk was limited to \$14.2 million in variable rate debt. The interest rates on the Company's various debt instruments range from 4.5% to 12.0%. The Company measures its interest rate risk by estimating the net amount by which potential future net earnings would be impacted by hypothetical changes in market interest rates related to all interest rate sensitive assets and liabilities. A 1% change in interest rates would have a \$0.1 million impact on the Company's results of operations.

At September 29, 2006, approximately 13.6% of sales were derived from international operations with exposure to foreign currency exchange rate risk. The Company mitigates its foreign currency exchange rate risk principally by establishing local production facilities in the markets it serves and by invoicing customers in the same currency as the source of the products. The Company also monitors its foreign currency exposure in each country and implements strategies to respond to changing economic and political environments. The Company's exposure to foreign currency exchange rate risk relates primarily to the financial position and the results of operations of its Brazilian subsidiary. The Company's exposure to such exchange rate risk as it relates to the Company's financial position and results of operations would be adversely impacted by devaluation of the Brazilian Real per U.S. dollar. These amounts are difficult to accurately estimate due to factors such as the inherent fluctuation of inter-company account balances, balance sheet accounts and the existing economic uncertainty and future economic conditions in the international marketplace.

ITEM 4. CONTROLS AND PROCEDURES

Overview

In connection with the preparation of its Annual Report on Form 10-K for the fiscal year ended December 31, 2005, the Company's management identified material weaknesses in the Company's internal controls over financial reporting. As defined by the Public Company Accounting Oversight Board ("PCAOB") in Auditing Standard No. 2, a material weakness is a significant deficiency, or combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

The identified material weaknesses in the Company's internal controls over financial reporting have resulted in insufficient controls relating to financial statement preparation and SEC reporting, inventory accounting, accounts payable cut-off, accrued expenses and segregation of duties. The Company's management has discussed the material weaknesses with its independent registered public accounting firm, BKD, LLP, the Audit Committee of the Board of Directors and the Company's Board of Directors. BKD, LLP issued a "material weakness" letter in connection with its audit of the Company's financial statements for the fiscal year ended December 31, 2005. The conclusions of Company management regarding the effectiveness of the Company's disclosure controls and procedures as of September 29, 2006, the end of the period covered by this Quarterly Report on Form 10-Q, are covered in more detail in the following paragraph.

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports it files or submits under the Securities Exchange Act of 1934, as amended, is recorded,

processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding disclosure. The Company's management, with the participation of its Chief Executive Officer and Chief Financial Officer, has performed an evaluation of the Company's disclosure controls and procedures as of September 29, 2006, the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, which included a review of the matters discussed above, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures, while the Company has made some improvements, were not effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

Changes in Internal Controls

In the first nine months of 2006, new accounting staff at the management level were added, others were reassigned, and the CFO became more familiar with the Company, its finances and accounting needs. The Company's management believes, however, that substantial remediation measures are required in order to improve the Company's internal controls. The Company believes that the material weaknesses identified above resulted in part from inadequate staffing and training within the Company's finance and accounting group, and the Company believes that the process of preparing this Quarterly Report on Form 10-Q and the related review of the Company's financial statements for the periods ended September 29, 2006 and September 30, 2005 has resulted in a significant improvement in the finance and accounting staff's familiarity with the accounting and financial treatment of the issues identified above. Although the Company believes that progress has been made in addressing the material weaknesses in its internal controls discussed above, the Company's management intends to continue to work to improve its internal controls.

**PART II
OTHER INFORMATION**

ITEM 1. LEGAL PROCEEDINGS.

There are no legal proceedings pending against the Company, which, in the opinion of management, would have a material adverse effect on the Company's business, financial position or results of operations.

ITEM 6. EXHIBITS.

(a) **Exhibits:**

A list of the exhibits included as part of this Form 10-Q is set forth in the Index to Exhibits that immediately precedes such exhibits, which is incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

The GSI Group, Inc.

By: /s/ John Henderson
Chief Financial Officer

Date: November 13, 2006

Exhibit 31.1

CERTIFICATIONS

I, William Branch, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of The GSI Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) [Paragraph omitted pursuant to SEC Release nos. 33-8392 and 34-49313.]
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2006

/s/ William Branch

Chief Executive Officer and Chairman of the Board

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Exhibit 31.2

CERTIFICATIONS

I, John Henderson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of The GSI Group, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) [Paragraph omitted pursuant to SEC Release nos. 33-8392 and 34-49313.]

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2006

/s/ John Henderson
Chief Financial Officer

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Exhibit 32.1

CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the accompanying Quarterly Report on Form 10-Q of The GSI Group, Inc., a Delaware corporation (the "Company"), for the quarter ended September 29, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), and pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, William Branch, as Interim Chief Executive Officer of the Company and Chairman of the Board, and John Henderson, as Chief Financial Officer of the Company, hereby certify that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 13, 2006

/s/ WILLIAM BRANCH

William Branch
Chief Executive Officer and Chairman of the Board

/s/ JOHN HENDERSON

John Henderson
Chief Financial Officer

This certification shall not be deemed "filed" by the Company for purposes of Section 18 of the Securities Exchange Act of 1934. In addition, this certification shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

INDEX TO EXHIBITS
<TABLE><CAPTION>

<BTB>

Exhibit

No.

Document Description

<S>

3.1* Amended and Restated Articles of Incorporation of The GSI Group, Inc., as amended as of October 23, 1997.

3.2* By-Laws of The GSI Group, Inc, as adopted on September 4, 2001.

31.1 Certification of Chief Executive Officer and Chairman of the Board.

31.2 Certification of Chief Financial Officer.

32.1 Section 906 Certification.

</TABLE>

*Incorporated by reference from the Company's Registration Statement of Form S-4 (Reg. No. 333-43089) filed with the Commission pursuant to the Securities Act of 1933, as amended.

