

GSI LUMONICS INC  
Form 10-K/A  
May 21, 2003

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 10-K/A**

Amendment No. 2

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2002

Commission File No. 333-71449

**GSI Lumonics Inc.**

*(Exact name of registrant as specified in its charter)*

**New Brunswick, Canada**  
*(State or other jurisdiction  
of incorporation or organization)*

**39 Manning Road**  
**Billerica, Massachusetts, USA**  
*(Address of principal executive offices)*

**98-0110412**  
*(I.R.S. Employer  
Identification No.)*

**01821**  
*(Zip Code)*

**(978) 439-5511**

*(Registrant's telephone number, including area code)*

**Securities Registered Pursuant to Section 12(b) of the Act:**

**None**

**Securities Registered Pursuant to Section 12(g) of the Act:**

**Common Stock, no par value**

*(Title of class)*

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of the Registrant's common shares held by non-affiliates of the Registrant, based on the closing price of the common shares on The NASDAQ Stock Market® on the last business day of the Registrant's most recently completed second fiscal quarter (June 28, 2002) was approximately \$261,848,010 (assumes officers, directors, and all shareholders beneficially owning 5% or more of the outstanding common shares are affiliates).

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There were approximately 40,790,130 of the Registrant's common shares, no par value, issued and outstanding on May 9, 2003.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12-b-2 of the Securities Exchange Act of 1934). YES  NO

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As used in this report, the terms we, us, our, GSI Lumonics and the company mean GSI Lumonics Inc. and its subsidiaries, unless the context indicates another meaning.

Unless otherwise noted, all dollar amounts in this report are expressed in United States dollars.

The following trademarks and trade names of GSI Lumonics are used in this report: WaferMark®, Super SoftMark®, DrillStar®, WavePrecision™, M430™, GMAX™, TrimSmart™, CSP300™, JK Series™ and Sigma Series™.

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**EXPLANATORY NOTE**

In accordance with Rule 12b-5 under the Securities Exchange Act of 1934, as amended, we are filing this amendment on Form 10-K/A to reflect comments to our original annual report on Form 10-K that we received from the Securities and Exchange Commission in connection with their review of our proxy circular-prospectus contained in the registration statement on Form S-4 of GSLI Corp. The original Form 10-K was filed on March 31, 2003 and we filed this amended and restated Form 10-K responding to the Staff's comments and updating certain information on May 21, 2003.

We have specifically amended and restated Items 1, 2, 3, 6, 7, 8, 12 and 15 (to reflect recently filed reports on Form 8-K) in response to the Staff's comments. For convenience, we have restated our entire disclosure contained in this amendment. Please note that we have not been requested to, and we are not, restating our financial results.

This report speaks as of the original filing date of our annual report on Form 10-K and, except as indicated, has not been updated to reflect events occurring subsequent to that date.

**PART I**

**Item 1. *Business of GSI Lumonics Inc.***

**Overview**

We design, develop, manufacture and market components, lasers and laser-based advanced manufacturing systems as enabling tools for a wide range of applications. Our products allow customers to meet demanding manufacturing specifications, including device complexity and miniaturization, as well as advances in materials and process technology. Major markets for our products include the medical, automotive, semiconductor and electronics industries. In addition, we sell our products and services to other markets such as light industrial and aerospace.

**Recent Developments**

On March 31, 2003, we filed with the Securities and Exchange Commission a registration statement on Form S-4, which contained a proxy circular-prospectus in connection with the annual and special meeting of the company's shareholders originally scheduled for June 24, 2003. Among the proposals to have been considered at the meeting was the approval of a plan of arrangement, the principal effect of which will be to restructure the company as a publicly traded United States domiciled corporation. On May 16, 2003, we filed with the Securities and Exchange Commission an amendment to the Form S-4 in response to comments we received from the Securities and Exchange Commission relating to our initial filing.

In order to allow for adequate time to (i) have our registration statement declared effective by the Securities and Exchange Commission, (ii) effectively solicit the support of our shareholders for the plan of arrangement, and (iii) hold our annual meeting by the end of June (a requirement of Canadian law), we are bifurcating our annual and special meeting into two meetings. Our annual meeting will still be held on Tuesday, June 24, 2003. At that meeting shareholders will be asked to vote on the election of directors and the reappointment of our auditors. Today we filed definitive proxy materials relating to our annual meeting with the Securities and Exchange Commission.

We anticipate holding a special meeting to vote on the plan of arrangement in late July or early August of this year. We cannot, however, give you any assurances that we will hold the special meeting within that time frame or at all, or that the matters presented at the meeting will be approved.

**The foregoing discussion is qualified by and subject to, the more detailed information on the plan of arrangement, including the applicable reasons, mechanics, effects and risks associated with the plan of arrangement, contained in the registration statement on Form S-4 that we filed with the Securities and Exchange Commission.**

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### **Corporate History**

GSI Lumonics Inc., a New Brunswick corporation, is the product of a merger of equals between General Scanning, Inc. and Lumonics Inc. that was completed on March 22, 1999. Our shares trade on The NASDAQ Stock Market® under the symbol GSLI and on the Toronto Stock Exchange under the symbol LSI. Immediately following the merger, the General Scanning shareholders and the Lumonics shareholders each, as a group, owned approximately half of the combined company's common shares.

General Scanning, Inc. was incorporated in 1968 in Massachusetts. In its early years, General Scanning developed, manufactured and sold components and subsystems for high-speed micro positioning of laser beams. Starting in 1989, General Scanning began manufacturing complete laser-based advanced manufacturing systems for the semiconductor and electronics markets.

Lumonics Inc., incorporated in 1970 under the laws of the Province of Ontario, Canada, initially produced lasers for scientific and research applications. By the 1980s, the company was developing, manufacturing and selling laser-based, advanced manufacturing systems for electronics, semiconductor, and general industrial applications.

During the past two years, we have consolidated facilities and operations with the purpose of more tightly focusing activities on our three major business segments: Components, Lasers, and Laser Systems. We manage the company within these three major business segments. All of these segments share some common characteristics and incorporate similar core technologies and competencies. There are important distinguishing factors, however, such as products and services, distribution channels, customers, production processes and operational economics, that we believe require different perspectives.

#### ***Components Group***

The company's component products are designed and manufactured at our facilities in Billerica, Massachusetts, Nepean, Ontario and Moorpark, California and are sold directly, or, in some territories, through distributors, to original equipment manufacturers, or OEMs. Products include optical scanners and subsystems used by OEMs for applications in materials processing, test and measurement, alignment, inspection, displays, imaging, graphics, vision, rapid prototyping, and medical use such as dermatology and ophthalmology. The Components Group also manufactures printers for certain medical end products such as defibrillators, patient care monitors and cardiac pacemaker programmers, as well as film imaging subsystems for use in medical imaging systems. Under the trade name, WavePrecision, we also manufacture precision optics supplied to OEM customers for applications in aerospace and semiconductor. Typical selling prices for Components products range from \$200 to \$4,000. Major markets are medical, semiconductor and electronics, light industrial and aerospace.

#### ***Laser Group***

The company designs and manufactures a wide range of lasers at our Rugby, United Kingdom facility for sale in the merchant market to end-users, OEMs and systems integrators. We also use some of these products in the company's own laser systems. The Laser Group also derives significant revenues from providing parts and technical support for lasers in its installed base at customer locations. These lasers are primarily used in material processing applications (cutting, welding and drilling) in light automotive, electronics, aerospace, medical and light industrial markets. The lasers are sold worldwide directly in North America and Europe, and through distributors in Japan, Asia Pacific and China. Sumitomo Heavy Industries (a significant shareholder of the company) is our distributor in Japan. Specifically, our pulsed and continuous wave Nd:YAG lasers are used in a variety of medical, light automotive and industrial settings. Typical selling prices for lasers range from \$40,000 to \$180,000.

#### ***Laser Systems Group***

The company's laser systems are designed and manufactured at our Wilmington, Massachusetts facility and are sold directly, or, in some territories, through distributors, to end users, usually semiconductor

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integrated device manufacturers and electronic component and assembly manufacturers. The Laser Systems Group also derives significant revenues from servicing systems in its installed base at customer locations. System applications include laser repair to improve yields in the production of dynamic random access memory chips, or DRAMs, permanent marking systems for silicon wafers and individual dies for traceability and quality control, circuit processing systems for linear and mixed signal devices, as well as for certain passive electronic components, and printed circuit boards manufacturing systems for via hole drilling, solder paste inspection and component placement inspection. Typical selling prices for such laser systems range from \$100,000 to \$1.5 million.

### **Industry Overview**

Lasers are generally used in a growing number of applications in industries, such as medical, automotive, consumer products and aerospace, as well as in semiconductor and electronics industries. In the long term, subject to market cycles, we expect capital equipment expenditures for laser processing to increase as the result of the advantages offered by lasers over other more traditional technologies. First, the laser is an enabling technology, which allows processing of materials for applications not otherwise possible, such as hermetically sealing implantable defibrillators. In many cases the laser affords higher speed, greater throughput and increased flexibility.

We see the principal market drivers for our businesses to be:

advances in materials and process technology that are creating new opportunities for laser processing as the enabling technology;

the continuing development of medical devices, automotive components, consumer products, semiconductor, and electronic components that require new manufacturing technology; and

the replacement of older, less flexible mechanical and electrical manufacturing tools by laser technology.

### ***Components Group***

The Components Group benefits from having a broad product portfolio serving many different markets and customers. This has enabled sales to be less cyclical than the overall laser equipment market. The scanning components and multi-axis scan heads service many varied laser OEM applications. Strategies Unlimited, a research unit of PennWell, has forecast that these laser equipment market applications (medical, material processing and instrumentation) are projected to increase for 2003 by 5% to 12% over 2002 levels. Our printer products service the critical care medical equipment market. Most medical OEM programs run multiple years and help maintain stability of this product line. Our precision optics products are used by OEMs in aerospace and semiconductor industries. Sales of precision optics to telecommunication applications fell significantly in 2001 and 2002 due to overcapacity in that industry resulting from over-investment in telecom infrastructure in prior years.

The components business benefits from being less cyclical, primarily by serving several diverse markets, and as well as lower operating costs for distribution and product support required by OEM customers.

### ***Laser Group***

Although the overall laser market is growing, the rate varies according to laser type, end user industry and geography. For individual sub-segments, growth projections range from single digits to midteens. For our served market sectors, we project overall market growth in 2003 of about 5%. Additionally, we expect our recently introduced new products in the third quarter of 2002 will improve our penetration into new and existing customers.

The laser market we serve is expanding in line with the growth of overall industrial capital equipment. Our broad range of customers reduces the cyclical impact of individual industry cycles. Major markets served include automotive components, electronics, aerospace, medical and light industrial.



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We have seen increased activity recently in areas such as Japan, Asia-Pacific and China. Developing infrastructure in China for economic growth is leading to increased demand for lasers as new manufacturing businesses are created.

### ***Laser Systems Group***

Our laser systems are sold primarily into the semiconductor and electronic markets. The semiconductor and electronics industries are characterized by ever increasing demands on throughput, reduced device size and increased device complexity, performance, traceability and quality. Semiconductor and electronic devices are used in a variety of products including electronics, consumer products, personal computers, communications products, appliances and medical instruments.

These markets have historically been subject to economic fluctuations due to the substantial capital investment required in those industries. In the past, this has led to significant short-term over- or under-capacity. The current downturn in demand, which began in mid 2001, for capital equipment in our major markets is due to the downturn in general economic conditions, combined with our customers' current excess of manufacturing capacity and their customers' excess inventories of components. Historically, when the economy improves, excess inventories are consumed and excess capacity is absorbed, eventually leading to renewed orders for capital equipment.

During the current business down cycle, both the semiconductor and electronics industries have undergone significant restructuring which may affect the historical cycle. Four major factors have combined to radically alter both industries:

the number of producers in each has reduced;

absence of capacity increases;

equipment throughput has increased; and

pressure for lower prices due to more competition.

The number of active producers of DRAMs has declined in the past three years due to consolidation caused by the economics of the marketplace. In Japan alone, which led the world in DRAM production through the last business cycle, the number of manufacturers has declined from six to one. Presently, after the consolidations, the capacity utilization in the industry is still low. Similarly, the electronics manufacturing services sector has consolidated with excess capacity. As a result, capital equipment purchasing in the industries has declined dramatically since 2000 due to this overcapacity situation.

Currently, equipment is procured primarily for technology changeover, as opposed to increasing capacity. In the past, upcycles were fueled by additions of capacity to meet increased demand for chips. The absence of demand for more capacity in semiconductors is due, in large part, to the saturation in the end markets for products such as computers, mobile telephones and other wireless devices. Production of printed circuit boards is similarly affected.

Equipment now being provided has higher throughput at relatively the same or lower price than the prior generation. Further, the transition from 200 millimeter to 300 millimeter wafers in the production of DRAMs produces twice as many chips on a single wafer. Combined, these two factors reduce the number of systems required and, hence, the overall available market.

Based on these factors, we have not been planning for a strong recovery in this business sector, but have restructured our Laser Systems business to become profitable at a lower revenue level and continue to focus on new technology and applications to improve opportunities for growth and profitability.

### **Corporate Strategy**

We believe our product lines are complementary and share the same underlying core competencies. Broadly, our strategy is to exploit our expertise in precision control of laser power and micro-positioning, in

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optimizing laser/material interaction and in developing new lasers for high precision processing. Accordingly, the key elements of our overall corporate strategy include:

invest in laser-based technologies, products and capabilities which position us as one of the leading companies in markets that offer strong profitable growth opportunities;

increase market penetration through expanded product offerings of the Components and Laser businesses;

explore opportunities in emerging markets and industries that would benefit from our technology;

continue to develop new laser systems for our leading customers; and

acquire complementary products and technologies.

Consistent with our strategy, in 1999-2001 we divested certain product lines that were not strategic, thereby allowing us to redirect resources to opportunities in our strategic markets.

In 2002, we took specific actions to strengthen our position in each of our three business segments.

### ***Components Group***

We increased market share in medical printing products with a design win with a major medical device OEM. We re-designed and introduced, in concert with a leading OEM, our GMAX multi-axis scan head. We also developed and commenced implementation of a new strategy to leverage our engineering developments in laser systems by introducing to the OEM market some of the key modules of our Laser Systems business. We have redirected our precision optics business away from its primary focus in telecommunications into new opportunities in laser, scientific, aerospace and other opportunities for custom optics.

### ***Laser Group***

We focused our activity into a number of market segments where the clear benefits of laser processing match with the segments' attributes of process speed, consistency, cost of application and value added by the laser process. We have developed a number of new products, which offer competitive price and processing performance in current and near future industrial markets. Our lasers produce high quality, repeatable cuts, welds or holes in products where laser processing is the key value-adding step. We released four new models of our continuous wave JK Series lasers which feature our patented super-modulation capability, which allows for dramatically improved processing at reduced power levels while reducing heat input and operating costs by giving process engineers control of key factors. In addition, four JK700TR pulsed lasers were introduced into the market in the fourth quarter of 2002.

We work extensively with major customers to qualify our products into their production processes. Combining this with our service, technical and spares support ensures a longer-term business partnership with our customers.

### ***Laser Systems Group***

We became a qualified vendor at six major DRAM manufacturers for the M430, our new technology platform for memory yield enhancement, which was introduced in the latter part of 2001. We completed the 300 millimeter SECS GEM (Semiconductor Equipment Communication Standard Generic Equipment Model) factory automation interface for wafer and die marking products, and we are in alpha test for memory yield improvement. We introduced the CSP 300, the industry's first production system for die marking chip-scale packages, or CSP, on 300 millimeter wafers. Marking of CSPs is critical for both manufacturing process traceability and product identification. We believe the use of CSPs, which are small (down to sub-1mm in size), packageless IC devices, in next-generation end-user products, such as smart phones and advanced PDAs, is expected to grow as functionality increases and product form factors shrink in size. We also released the TrimSmart EP1000 laser trimmer for adjusting embedded passive components within the inner layers of multi-layer PCBs. This process change is in the early stages of development by leading-edge manufacturers of PCBs. This will allow for greater functionality to be attained within a smaller PCB size—a key market driver for the next-generation of personal, portable electronic devices.



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Our revenues in 2002 were derived from the following business segments, in millions of United States dollars:

Segment	Revenue
Components group	\$ 70.5
Laser group	23.7
Laser Systems group	65.9
Other and intra-segment eliminations	(1.0)
	<hr/>
Total	\$ 159.1
	<hr/>

**Components Group**

*Precision Motion Control Components and Subsystems.* We produce optical scanners and scanner subsystems, which include optics, software and control systems. These are used by the company in some of its laser systems and by our customers in a variety of applications including materials processing, test and measurement, alignment, inspection, displays, imaging, graphics, vision, rapid prototyping, and medical applications such as dermatology and ophthalmology.

*Printer Products.* We produce a variety of printing products, primarily for medical applications. These printers are used in end products such as defibrillators, patient care monitors, and cardiac pacemaker programmers. They provide a permanent record of a patient's condition during critical medical care.

*Film Imaging Systems.* We produce laser imaging and digitizing subsystems to process data sets from computer-assisted tomography, magnetic resonance imaging or nuclear medicine equipment. This application of lasers for imaging directly on film requires precise micro-positioning for pixel placement and adjustable contrast range. This process replaces traditional chemical development of photographic films.

*Precision Optical Components.* Our specialty and precision optical components are sold under the trade name WavePrecision. We specialize in complex, tight tolerance optical components and subassemblies for aerospace and semiconductor. Unique product features include polishing to sub-nanometer tolerances and proprietary coating techniques.

**Laser Group**

We manufacture lasers for the light automotive, electronics, aerospace, medical and light industrial markets for advanced manufacturing applications. Our lasers can be controlled and directed with precision and used in a wide spectrum of applications. Lasers offer lower production costs, fast solutions and flexibility on the production line. Our JK Series laser systems incorporate advanced solid-state laser technology to produce efficient, reliable, dependable and accurate production systems. These systems operate at uniform energy density, offer improved process efficiency and require less energy. These systems use our patented power supply, allowing a wide range of applications, including drilling cooling holes in jet engine turbo fans. They also permit high speed, repetitive processing which maximizes production rates. Our JK Series can be readily linked with robotics systems to provide manufacturers with a flexible production tool.

*JK Series continuous wave Nd:YAG lasers.* We produce a range of 400W-2000W average power continuous wave Nd:YAG lasers for welding, cutting, and drilling. Applications range from high speed welding of fuel injectors and sensors to cutting car and truck chassis members.

*Pulsed Nd:YAG lasers.* We produce a range of 50W-100W pulsed Nd:YAG spot and seam welding lasers and the JK Series of pulsed Nd:YAG lasers for welding, cutting, and drilling in the 150W to 600W range. Applications include disc drives, cardiac pacemakers and mobile telephone batteries.

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*Sigma Series Nd:YLF.* We produce a range of continuous wave lasers up to 7W for silicon processing and electronic PCB manufacturing applications.

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*Excimer Lasers for materials processing.* We produce high repetition rate and high energy industrial Excimer lasers with power ranges from 10W-80W with integrated cryogenic gas processing for extended gas lifetimes. Applications include marking, remote sensing, surface structuring and polymer processing.

*CO2 Lasers for marking and coding.* We produce a laser marking/ coding system in addition to a 45-75W range of pulsed CO2 lasers for high precision machining of non-metallic workpieces and a 200W high power pulsed CO2 laser for large area ablative machining.

### ***Laser Systems Group***

Our laser systems are used in several production process steps within the semiconductor industry and in the production of electronic components and assemblies.

*Laser Trim and Test Systems.* These systems enable production of electronic circuits by precisely tuning, with a laser, the performance of linear and mixed signal devices. Tuning is accomplished by adjusting various component parameters with selective laser cuts, while the circuit is under test, thereby achieving the desired electrical performance. These systems combine material handling, test stimulus, temperature control and laser trim subsystems to form turnkey production process packages. Applications include power management, data conversion, sensors, RF, precision analog devices used in the mobile communication market, as well as automotive electronics.

*Permanent Marking Systems.* We provide products to support the product marking requirements of the semiconductor industry. WaferMark laser systems are used for the marking of silicon wafers at the front end of the semiconductor manufacturing process, aiding process control and device traceability. These systems incorporate advanced robotics and proprietary Super SoftMark process control technology to provide debris free marking of high-density silicon wafers along automated production lines. We also supply systems for marking the individual dies on wafers. Our automated wafer marking system supports individual bare die traceability marks. The system incorporates a tightly coupled vision system for automated wafer identification and mark alignment on each die. Complete system operation is managed with software for intuitive process monitoring and automated wafer map downloading through a single graphical user interface. Our systems are used in the silicon foundry, the wafer fab and in the back-end die marking process.

*Memory Repair Systems.* DRAMs are critical components in the active memory portion of computers and a broad range of other digital electronic products. First-pass manufacturing yields are typically low at the start of production of a new generation of higher capacity memory devices. Laser processing is used to raise production yields to acceptable economic levels. Our memory repair laser systems allow semiconductor manufacturers to effectively disconnect defective or redundant circuits in a memory chip with accurately positioned and power modulated laser pulses. Shrinking DRAM die-density to tight circuit pitches below two microns requires systems, such as ours, to operate with exceptional accuracy of less than 0.2 micron while processing at a rate of 30,000 circuits per second. As a point of reference, the diameter of a human hair is greater than 100 microns.

The producers of electronic components and assemblies, particularly surface mount technology assemblies, have a number of our laser systems available to support their process requirements. Features of these systems include precision laser spot size, laser power control, high-speed parts handling, and applications adaptability.

Our laser systems are used in various process steps in the production of printed circuit boards and flex circuits.

*Via drilling.* Our DrillStar products, which are capable of drilling micro vias at very high speeds in every type of material commonly used for printed circuit board fabrication, supports the miniaturization trend within the industry.

*Surface Mount Measurement Systems.* Our surface mount measurement products are also used in the manufacture of printed circuit board assemblies. In the manufacture process, surface-mount solder, in paste form, is stenciled onto the circuit board with a screen printer, and components are then placed in their

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respective positions on the board by automated equipment. Our systems use our patented three-dimensional scanning laser data acquisition technology to inspect either solder paste depositions or component placement accuracy.

*Thick Film Laser Processing Systems.* Our laser systems are used in the production of thick film resistive components for surface mount technology electronic circuits, known as chip resistors, as well as more general-purpose hybrid thick film electronic circuits. These systems optimize the operating parameters of RF devices, sensors, resistor networks and other devices.

## **Customers**

Many of our customers are among the largest global participants in their industries. Many of our customers participate in several market segments. During 2002, our largest customer accounted for 8.5% of our total sales and our top 28 customers accounted for 50% of our total sales. During 2001, our largest customer accounted for 6% of our total sales and the top 36 customers accounted for 50% of our total sales. The increase in concentration from 2001 to 2002 is due in part to the decline in sales volume in the end-user systems business relative to the OEM based components business.

## **Marketing, Sales and Distribution**

We believe that our marketing, sales and customer support organizations are important to our long-term growth and give us the ability to respond rapidly to the needs of our customers. Our product line managers have worldwide responsibility for determining product strategy based on their knowledge of the industry, customer requirements and product performance. These managers have direct contact with customers and, working with the sales and customer service organizations, develop and implement strategic and tactical plans aimed at serving the needs of existing customers as well as identifying new opportunities based on the market's medium-to-long term requirements.

*Components* are sold worldwide, mostly through direct sales, as well as through distributors to OEMs. There are direct application engineering centers located in Billerica, Massachusetts, Munich, Germany and Tokyo, Japan to support pre- and post-sales of our products. The Components Group does not field service/ repair its products, but relies, instead, on return-and-repair, given the relatively small physical size of the products sold and fundamental nature of the products.

*Lasers* are sold worldwide, either directly or through distributors to end-users, OEMs and systems integrators in North America and Europe, and through distributors in Japan, Asia-Pacific and China. Sumitomo Heavy Industries Ltd. (a significant shareholder of the company) is our distributor in Japan. Our worldwide network of integrators are also an active sales channel offering complete turn key solutions to customers demanding single point responsibility. Significant revenues are derived from providing parts and technical support for lasers in our installed base.

*Laser Systems* are sold directly, or, in some territories, through distributors, to end users, usually semiconductor integrated device manufacturers and electronic component and assembly manufacturers. Our worldwide advanced manufacturing systems sales activities are directed from the product business unit sites in North America, Europe, Japan and Asia Pacific. Field offices are located close to key customers manufacturing sites to maximize sales and support effectiveness. Significant revenues are provided from servicing systems in our installed base at customer locations. In Europe, we maintain offices in the United Kingdom, Germany, France and Italy, and in the Asia-Pacific region, in Hong Kong, Japan, Korea, Malaysia, the Philippines, Singapore and Taiwan.

## **Competition**

We face substantial competition in each of our markets from both established competitors and potential new market entrants. Significant competitive factors include product functionality, performance, size, flexibility, price, market presence, customer satisfaction, customer support capabilities, breadth of product

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line, technology and intellectual property. We believe that we compete favorably on the basis of each of these factors. Competition for our products is concentrated in certain markets and fragmented in others.

We expect our competitors to continue to improve the design and performance of their products. There is a risk that our competitors will develop enhancements to, or future generations of, competitive products that will offer superior price or performance features, or that new processes or technologies will emerge that render our products less competitive or obsolete. Increased competitive pressure could lead to lower prices for our products, adversely affecting our sales and profitability.

### ***Components Group***

In component markets, we compete primarily with Cambridge Technology, Inc., a unit of Excel Technology, in scanning components, and Scanlabs GmbH for scanning subsystems. Most of our competition for printer products comes from make/buy decisions by the medical OEMs. Competition in precision optics is rather fragmented among numerous suppliers.

### ***Laser Group***

In the laser markets which we serve, we compete primarily with Trumpf-Haas, Rofin-Sinar, NEC, Coherent, Spectra Physics, LambdaPhysik, Unitek-Miyachi and Lasag.

### ***Laser Systems Group***

In laser-based processing systems for the semiconductor and electronics markets, we compete primarily with companies such as NEC, Electro Scientific Industries, Hitachi, Rofin-Sinar, EO Technics, CyberOptics and Innolas.

## **Manufacturing**

We perform internally those manufacturing functions that enable us to add value and to maintain control over critical portions of the production process. To the extent practical, we outsource other portions of the production process. During the last year, we continued to redirect attention from the management of internal production processes to the management of supplier quality and production. The retained internal activity is focused on module integration and testing, with particular emphasis on our customers' applications. We believe we achieve a number of competitive advantages from this integration, including the ability to achieve lower costs and higher quality, bring new products and product enhancements more quickly and reliably to market, and produce sophisticated component parts not available from other sources.

We manufacture our components at facilities in Billerica, Massachusetts, Nepean, Ontario and Moorpark, California, our lasers in Rugby, United Kingdom and laser systems in Wilmington, Massachusetts. Each of our manufacturing facilities has co-located manufacturing, manufacturing engineering, marketing and product design personnel. We believe that this organizational proximity greatly accelerates development and entry into production of new products and aids economical manufacturing. Most of our products are manufactured under ISO 9001 certification.

We are subject to a variety of governmental regulations related to the discharge or disposal of toxic, volatile, or otherwise hazardous chemicals used on our premises. We believe we are in material compliance with these regulations and have obtained all necessary environmental permits to conduct our business.

## **Research and Development**

We continue to make a strong commitment to research and development for core technology programs directed at creating new products, product enhancements and new applications for existing products, as well as funding research into future market opportunities. Each of the markets we serve is generally characterized by rapid technological change and product innovation. We believe that continued timely development of new products and product enhancements to serve both existing and new markets is necessary to remain competitive.



## **Table of Contents**

We carry out our research and development activities at the manufacturing locations cited above. We also maintain links with leading industrial, government and university research laboratories worldwide. We work closely with customers and institutions to develop new or extended applications of our technology.

We maintain significant expertise and continue to advance our capabilities in the core technologies listed below.

### ***Components Group***

*Optical Components:* high precision servomechanisms and optical scanners, typically associated with a broad spectrum of laser systems.

*Precision Subsystems:* OEM laser and thermal imaging subsystems for medical and industrial applications.

*Precision Optics:* design and manufacturing process capability for production of laser quality lenses, mirrors of high dynamic rigidity, high performance mirrors and lens coatings.

### ***Laser Group***

*Lasers:* both gas and solid-state, designed to produce efficient, reliable and accurate lasers in a broad range of configurations for material processing applications.

*Laser Beam Deliveries:* design and manufacture of fiber optic beam deliveries and focus heads for integration into complex manufacturing systems either by integrators or end-users.

*Laser Control Software and Systems Interfaces:* development of laser control systems and interfaces for integrating our lasers into customers manufacturing systems.

### ***Laser Systems Group***

*Electronics:* design of wide bandwidth power amplifiers and high signal-to-noise ratio and low thermal drift signal detection circuits; design and manufacture of analog servo controllers with low electromagnetic interference circuitry.

*Software:* development of real-time control of servomechanisms, process system control and machine interfaces.

*Inspection:* design of non-contact measurement probes, systems and related software.

*Systems Design and Integration:* creation of highly efficient and effective application-specific manufacturing solutions typically based on lasers and their interaction with materials including integration with robotics systems.

## **Sources of Supply**

We depend on limited source suppliers that could cause substantial manufacturing delays and additional cost if a disruption of supply occurs. We obtain some components from a single source. We also rely on a limited number of independent contractors to manufacture subassemblies for some of our products. If suppliers or subcontractors experience difficulties that result in a reduction or interruption in supply to us, or fail to meet any of our manufacturing requirements, our business would be harmed until we are able to secure alternative sources. These components and manufacturing services may not continue to be available to us at favorable prices, if at all.

### ***Components Group***

We manufacture some of our own machined parts. We purchase fully-functional electronics as well as certain key components, such as laser diodes, from external sources.

**Table of Contents*****Laser Group***

We design and assemble our lasers. Supply of our proprietary parts comes from both internal sources, as well as a network of specialist, qualified suppliers predominantly located in North America and the United Kingdom. We purchase certain critical parts from single sources to ensure quality and consistency.

***Laser Systems Group***

We purchase certain major subsystems, such as lasers, motion stages, certain vision systems, fully-functional electronics and frames and racks, from the merchant market. Our optics components are sourced both internally by manufacture and externally by purchase in the merchant market. In some cases, upper level assemblies and, in some cases, entire systems are outsourced to electronic manufacturing services companies.

**Patents and Intellectual Property**

Our intellectual property includes copyrights, patents, proprietary software, technical know-how and expertise, designs, process techniques and inventions. As of December 31, 2002, we held 113 United States and 73 foreign patents; in addition, applications were pending for 59 United States and 122 foreign patents. We have also obtained licenses under a number of patents in the United States and foreign countries and may require licenses under additional patents. There can be no assurance as to the degree of protection offered by these patents or as to the likelihood that patents will be issued for pending applications.

We also rely on a combination of copyrights and trade secret laws and restrictions on access to protect our trade secrets and proprietary rights. We routinely enter into confidentiality agreements with our employees and consultants. There is a risk that these agreements will not provide meaningful protection of our proprietary information in the event of misappropriation or disclosure.

**Human Resources**

At December 31, 2002, we had 793 employees in the following areas:

	<b>Number of Employees</b>	<b>Percentage</b>
Production and operations	316	40%
Customer service	154	19%
Sales, marketing and distribution	119	15%
Research and development	102	13%
Administration	102	13%
	<hr/>	<hr/>
Total	793	100%
	<hr/>	<hr/>

The loss of key personnel could negatively impact our operations. Our business and future operating results depend in part upon our ability to attract and retain qualified management, technical, sales and support personnel for our operations on a worldwide basis. Competition for qualified personnel is intense, and we cannot guarantee that we will be able to continue to attract and retain qualified personnel. Our operations could be negatively affected if we lose key executives or employees or are unable to attract and retain skilled executives and employees as needed.

**Government Regulation**

We are subject to the laser radiation safety regulations of the Radiation Control for Health and Safety Act administered by the National Center for Devices and Radiological Health, a branch of the United States Food and Drug Administration. Among other things, these regulations require a laser manufacturer to file new product and annual reports, to maintain quality control and sales records, to perform product testing, to distribute appropriate operating manuals, to incorporate design and operating features in lasers sold to end-users and to certify and label each laser sold to end-users as one of four classes (based on the level of radiation



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from the laser that is accessible to users). Various warning labels must be affixed and certain protective devices installed depending on the class of product. The National Center for Devices and Radiological Health is empowered to seek fines and other remedies for violations of the regulatory requirements. We are subject to similar regulatory oversight, including comparable enforcement remedies, in the European markets we serve.

## **Other**

Information concerning product lines, backlog, working capital and research and development expenses may be found in Item 7, Management Discussion and Analysis. Information about geographic segments may be found in note 14 to the financial statements.

## **Website and Access to Financial Filings**

We maintain an Internet website at <http://www.gsilumonics.com>. We are not including the information contained on our website as a part of, or incorporating it by reference into, this Form 10-K/A. We make available free of charge through our website our proxy statements, registration statements, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission. Our SEC filings are also available over the Internet at the SEC's website at <http://www.sec.gov>. You may also read and copy any document we have filed by visiting the SEC's public reference rooms in Washington, D.C. and Chicago, Illinois. Please call the SEC at 1-800-SEC-0330 for further information about the public reference rooms. You may also inspect our SEC reports and other information at the offices of the National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C. 20006. In addition, our reports and other information are filed with securities commissions or other similar authorities in Canada, and are available over the Internet at <http://www.sedar.com>.

## **Special Note Regarding Forward-Looking Statements**

Certain statements in this Form 10-K/A constitute forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995, Section 27A of the United States Securities Act of 1933, as amended, and Section 21E of the United States Securities Exchange Act of 1934, as amended. These forward-looking statements relate to anticipated financial performance, management's plans and objectives for future operations, business prospects, outcome of regulatory proceedings, market conditions, tax issues and other matters. All statements contained in this Form 10-K/A that do not relate to matters of historical fact should be considered forward-looking statements, and are generally identified by words such as anticipate, believe, estimate, expect, intend, plan and objective and other similar expressions. You should not place undue reliance on the forward-looking statements contained in this document. Such statements are based on management's beliefs and assumptions and on information currently available to management and are subject to risks, uncertainties and changes in condition, significance, value and effect, including risks discussed in reports and documents filed by the company with the United States Securities and Exchange Commission and with securities regulatory authorities in Canada. Such risks, uncertainties and changes in condition, significance, value and effect, many of which are beyond our control, could cause our actual results and other future events to differ materially from those anticipated. We do not assume any obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

**Table of Contents****Item 2. Properties**

The principal owned and leased properties of the company and its subsidiaries are listed in the table below.

<u>Location</u>	<u>Principal Use</u>	<u>Current Segment</u>	<u>Approximate Square Feet</u>	<u>Owned/Leased</u>
<b>Facilities Used in Current Operations</b>				
Billerica, Massachusetts, USA	Manufacturing, R&D, Marketing, Sales, Corporate	1,4	90,000 (two sites)	Leased; one expires in 2008 with two 5-year renewal options; one expires in 2006
Ottawa (Nepean), Ontario, Canada	Manufacturing, R&D, Marketing, Sales	1	24,000	Owned
Moorpark, California, USA	Manufacturing, R&D, Marketing, Sales	1	49,000 (three sites)	Leased; two leases expire in 2005 with one 5-year renewal option; one lease expires in 2004
Rugby, United Kingdom	Manufacturing, R&D, Marketing, Sales	2	113,000	Owned; approximately 10% of the space is subleased through 2012
Wilmington, Massachusetts, USA	Manufacturing, R&D, Marketing, Sales	3	78,000	Leased; expires in 2007 with two 5-year renewal options
Farmington Hills, Michigan, USA	Partially occupied by Customer Support and Sales	2,3	56,000	Leased; expires in 2003
Munich, Germany	Partially occupied Customer Support, Logistics, Sales and Applications Engineering	1,2,3	29,000	Leased; expires in 2013 with option to renew
<b>Excess or Unoccupied Facilities</b>				
Ottawa (Kanata), Ontario, Canada	Currently unoccupied and offered for sale	4	75,000	Owned
Ottawa (Nepean), Ontario, Canada	Subleased effective March 2002	4	10,000	Leased; expires in 2006
Maple Grove, Minnesota, USA	Currently unoccupied	4	104,000	Leased; expires in 2003

The facilities house the segments as indicated by the numbers below. Facilities are not dedicated to just one segment:

- 1 Components Group
- 2 Laser Group
- 3 Laser Systems Group
- 4 Corporate

Additional sales, service and logistics sites are located in France, Italy, Hong Kong, Japan, Korea, Malaysia, the Philippines, Singapore, Taiwan and Shanghai. These additional offices are in leased facilities occupying approximately 26,000 square feet in the aggregate. We reduced the amount of space occupied by these worldwide sales, service and logistic sites from 44,000 square feet at the end of 2001.

Because of the exit activities described in note 11 to the consolidated financial statements during fiscal 2002, we no longer operate out of our former sites in Kanata, Ontario and one of our sites in Nepean, Ontario.

We believe the productive capacity of the remaining facilities to be both suitable and adequate for the requirements of our business.

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**Item 3. Legal Proceedings**

*Electro Scientific Industries, Inc. v. GSI Lumonics Inc. et al.* On March 16, 2000, Electro Scientific Industries, Inc. filed an action for patent infringement in the United States District Court for the Central District of California against the company and Dynamic Details Inc., an unrelated party that is one of the company's customers. Electro Scientific alleged that the company offered to sell and import into the United States the GS-600 high speed laser drilling system and that Dynamic Details possessed and used a GS-600 System. It further alleged that Dynamic Details' use of the GS-600 laser system infringed Electro Scientific's United States patent 5,847,960 and that the company had actively induced the infringement of, and contributorily infringed, the patent. Electro Scientific sought an injunction, unspecified damages, trebling of those damages, and attorney fees. The company indemnified Dynamic Details with respect to these allegations. On August 14, 2001, the United States District Court for the Central District of California granted the company's motion for summary judgment of non-infringement and denied Electro Scientific's motion for summary judgment of infringement. In the ruling, the court concluded that the GS-600 system did not literally infringe the asserted claims of the alleged Electro Scientific patent, nor did it infringe under the doctrine of equivalents. On September 7, 2001, Electro Scientific appealed the District Court's decision on the summary judgment motions and oral arguments were heard on May 7, 2002. On October 7, 2002, the Court of Appeals vacated the summary judgment ruling of non-infringement of the District Court and remanded the matter back to the District Court for additional claim construction. In November 2002, the company reached an agreement with Electro Scientific Industries Inc. and Dynamic Details pursuant to which the case was dismissed without prejudice. In connection with the agreement, the company paid Electro Scientific Industries an amount that was not material to the company's results of operations or financial position.

*Other.* As the company has disclosed since 1994, a party has commenced legal proceedings in the United States against a number of United States manufacturing companies, including companies that have purchased systems from us. The plaintiff in the proceedings has alleged that certain equipment used by these manufacturers infringes patents claimed to be held by the plaintiff. While we are not a defendant in any of the proceedings, several of our customers have notified us that, if the party successfully pursues infringement claims against them, they may require us to indemnify them to the extent that any of their losses can be attributed to systems sold to them by us. Due to (i) the relatively small number of systems sold to any one of the company's customers involved in this litigation, (ii) the low probability of success by the plaintiff in securing judgment(s) against the company's customers and (iii) the existence of a countersuit that seeks to invalidate the patents that are the basis for this litigation, we do not believe that the outcome of any these claims individually would have a material adverse effect upon our financial condition or results of operations. No assurances can be given, however, that these or similar claims, if successful and taken in the aggregate, would not have a material adverse effect upon our financial condition or results of operations.

We are also subject to various legal proceedings and claims which arise in the ordinary course of business. We do not believe that the outcome of these claims will have a material adverse effect upon our financial condition or results of operations but there can be no assurance that any such claims, or any similar claims, would not have a material adverse effect upon our financial condition or results of operations.

**Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of security holders during the quarter ended December 31, 2002.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Stock and Related Stockholder Matters**  
**Market Information**

Our common shares, no par value, trade on The NASDAQ Stock Market® under the symbol GSLI and on the Toronto Stock Exchange under the symbol LSI. From September 29, 1995 until the 1999 merger between General Scanning, Inc. and Lumonics Inc., Lumonics Inc.'s common shares were traded on the Toronto Stock Exchange under the symbol LUM.

The following table sets forth, for the periods indicated, the high and low closing prices per share of our common shares as reported by The NASDAQ Stock Market® in United States dollars and the Toronto Stock Exchange in Canadian dollars.

	NASDAQ Stock Market® Price Range US\$		Toronto Stock Exchange Price Range Cdn\$	
	High	Low	High	Low
<b>Fiscal year 2002:</b>				
First Quarter	\$ 10.78	\$ 7.80	\$ 17.20	\$ 12.50
Second Quarter	11.22	6.88	17.80	10.49
Third Quarter	8.46	4.71	13.06	7.50
Fourth Quarter	6.89	3.65	10.90	5.90
<b>Fiscal year 2001:</b>				
First Quarter	\$ 13.31	\$ 7.28	\$ 20.00	\$ 11.59
Second Quarter	11.01	6.69	16.75	10.68
Third Quarter	9.25	6.18	14.40	9.77
Fourth Quarter	8.90	6.58	14.16	10.28

**Holders**

As of the close of business on Thursday, May 8, 2003, there were approximately 154 holders of record of our common shares. Since many of the common shares are registered in nominee or street names, we estimate that the total number of beneficial owners is considerably higher. As of the close of business on Thursday, May 8, 2003, there were approximately 158 holders of record of options to acquire our common shares.

**Dividends**

We have never paid cash dividends on our common shares. We currently intend to reinvest our earnings for use in our business and do not expect to pay cash dividends in the foreseeable future. Subject to the provisions of the Canada-United States Income Tax Convention, Canadian withholding tax at a rate of 25% would be payable on dividends paid or credited, or deemed to be paid or credited, by the company to a United States holder on its common shares. The withholding tax rate is reduced to 15%, or if the United States holder is a corporation that owns 10% or more of our voting shares, to 5%.

**Item 6. Selected Financial Data**

The following selected consolidated financial data as of and for the five years ended December 31, 2002 are derived from our audited consolidated financial statements. This information should be read together with consolidated financial statements of GSI Lumonics Inc., including the related notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations. The selected



consolidated financial data in this section is not intended to replace the consolidated financial statements.

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On March 22, 1999, Lumonics Inc. and General Scanning, Inc. completed a merger of equals. GSI Lumonics Inc. (the combined entity) recorded this transaction as a purchase for accounting purposes. Accordingly, the consolidated financial statements exclude the results of General Scanning, Inc. before the merger date and therefore do not provide meaningful year-to-year comparative information. Results for 1999 reflect \$34.5 million of restructuring and acquired in-process research and development expenses related to the merger. Commencing in the first quarter of 2002, we classified service sales support and service management costs as selling, general and administrative expenses. In prior years, we classified these costs as cost of goods sold and such costs have been reclassified in the comparative statement of operations for each year except 1998. The data was not available to make the reclassification for 1998, because this was pre-merger, as noted above, and information was not kept in the same manner or on the same systems; therefore 1998 is not comparable to the other years.

	Years Ended December 31,				
	2002	2001	2000	1999	1998
(In thousands except per share amounts)					
<b>Condensed Consolidated Statement of Operations:</b>					
Sales	\$ 159,070	\$ 247,904	\$ 373,864	\$ 274,550	\$ 144,192
Gross profit	49,194	85,782	131,471	99,957	40,673
Operating expenses:					
Research and development	20,444	25,634	33,931	28,700	12,985
Selling, general and administrative	55,483	73,815	87,459	68,833	38,191
Amortization of purchased intangibles	5,135	5,226	4,851	4,070	861
Acquired in-process research and development				14,830	
Restructuring (note 11)	6,448	2,930	10,141	19,631	2,022
Other (note 11)	(1,021)	(148)	(2,945)		
Loss from operations	(37,295)	(21,675)	(1,966)	(36,107)	(13,386)
Other income (expense)	590	(797)	77,009	(1,223)	2,210
Income (loss) before income taxes	(36,705)	(22,472)	75,043	(37,330)	(11,176)
Income tax provision (benefit)	(8,981)	(7,774)	29,666	(2,556)	(3,260)
Net income (loss)	\$ (27,724)	\$ (14,698)	\$ 45,377	\$ (34,774)	\$ (7,916)
Net income (loss) per common share:					
Basic	\$ (0.68)	\$ (0.36)	\$ 1.19	\$ (1.14)	\$ (0.46)
Diluted	\$ (0.68)	\$ (0.36)	\$ 1.13	\$ (1.14)	\$ (0.46)
Weighted average common shares outstanding (000s)	40,663	40,351	38,187	30,442	17,079
Weighted average common shares outstanding and dilutive potential common shares (000s)	40,663	40,351	40,000	30,442	17,079

	December 31,				
	2002	2001	2000	1999	1998
(In thousands)					
<b>Balance Sheet Data:</b>					
Working capital	\$ 172,135	\$ 224,787	\$ 190,935	\$ 103,727	\$ 85,977
Total assets	297,088	336,687	434,949	289,722	159,642
Long-term liabilities, including current portion	6,004	4,736	8,524	9,898	7,082
Total stockholders' equity	254,481	282,330	289,267	171,730	120,757

**Table of Contents****Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

You should read this discussion together with the consolidated financial statements and other financial information included in this report. This report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those indicated in the forward-looking statements. Please see the *Special Note Regarding Forward Looking Statements* elsewhere in this report.

**Overview**

We design, develop, manufacture and market components, lasers and laser-based advanced manufacturing systems as enabling tools for a wide range of applications. Our products allow customers to meet demanding manufacturing specifications, including device complexity and miniaturization, as well as advances in materials and process technology. Major markets for our products include the medical, automotive, semiconductor and electronics industries. In addition, we sell our products and services to other markets such as light industrial and aerospace.

We completed a merger of equals with General Scanning, Inc. on March 22, 1999. The merger transaction has been accounted for as a purchase for accounting purposes and, accordingly, the operations of General Scanning, Inc. have been included in the consolidated financial statements from the date of merger.

Results of Operations. The following table sets forth items in the consolidated statement of operations as a percentage of sales for the periods indicated:

	Year Ended December 31,		
	2002	2001	2000
Sales	100.0%	100.0%	100.0%
Cost of goods sold	69.1	65.4	64.8
Gross profit	30.9	34.6	35.2
Operating expenses:			
Research and development	12.9	10.3	9.1
Selling, general and administrative	34.9	29.8	23.5
Amortization of purchased intangibles	3.2	2.1	1.3
Restructuring	4.0	1.2	2.7
Other	(0.6)	(0.1)	(0.8)
Operating expenses	54.4	43.3	35.8
Loss from operations	(23.5)	(8.7)	(0.6)
Gain (loss) on sale of assets and investments		(1.9)	20.5
Other income (expense)	(0.3)		
Interest income, net	1.3	1.7	0.9
Foreign exchange transaction gains (losses)	(0.5)	(0.1)	(0.8)
Income (loss) before income taxes	(23.0)	(9.0)	20.0
Income tax provision (benefit)	(5.6)	(3.1)	7.9
Net income (loss)	(17.4)%	(5.9)%	12.1%

Commencing in the first quarter of 2002, we classified service sales support and service management costs as selling, general and administrative expenses. The change was made to properly classify costs that we believed should be classified as selling, general and administrative costs rather than cost of sales. The primary components of the costs reclassified were the general management of the company's service organization, which included the vice president of that organization and management employees worldwide who report to him, sales and

marketing activities for service products, training development and order entry support. The company continues to reflect all direct field costs for services as well as technical support costs in cost of sales.

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**Business Environment and Restructurings**

Several significant markets for our products have been in severe decline for the past two years. Our sales of systems for semiconductor and electronics applications and precision optics for telecommunications have declined. The continued downturn in demand for capital equipment in our major markets, which commenced in mid 2001 and continues to the present, is due to the downturn in general economic conditions, combined with our customers' current excess of manufacturing capacity and their customers' excess inventories of semiconductor and electronic components. In response to the business environment, we have taken the following measures.

During fiscal 2000 and through the first quarter of 2003, we accomplished the major portion of a strategic repositioning of the company through a series of steps, including divestitures and one acquisition and the restructurings described below.

From 2000 through 2002, the company faced a 57% decline in revenues and responded by streamlining operations to reduce fixed costs. This was done in stages under different restructuring plans that focused on different areas of the company over time.

*2000*

During 2000, the company took total restructuring charges of \$15.1 million and reversed a provision of \$5 million primarily for plant consolidation costs originally recorded in 1999 that were for restructuring actions not taken. As part of our strategic repositioning, during the fourth quarter of fiscal 2000, the executive team approved a plan to restructure our Rugby, United Kingdom operations and our manufacturing capacity worldwide. In connection with that restructuring, the company recorded a charge of \$12.5 million, consisting of \$1 million to accrue employee severance for approximately 50 employees; other exit costs of \$3.8 million for the company's United Kingdom operation and worldwide distribution system related to high-power laser systems for certain automotive applications; and \$7.7 million associated with restructuring for excess capacity at three leased facilities in the United States and Germany. The company also recorded a non-cash write-down of land and building in the United Kingdom of \$2 million. Compensation expense of \$0.6 million from the acceleration of options upon the sale of businesses during the year was also charged to restructuring. In addition, an inventory write-down to net realizable value of \$8.5 million was recorded in cost of goods sold related to the high-power laser system product line. The company recorded a reversal of \$0.5 million in the fourth quarter of 2001 for costs that will not be incurred. The provisions for lease costs in the United States and Germany primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that the company cannot terminate. The Rugby, United Kingdom land and building write down reflects the net realizable value based on market assessments for the facility. The other exit costs were based primarily on purchase commitments of the company at the time of the restructuring that the company could not terminate.

Cumulative cash draw-downs of \$6 million, reversal of \$0.5 million for restructuring costs that will not be incurred and non-cash draw-down of \$2.6 million have been applied against the total \$15.1 provision, resulting in a remaining balance of \$6 million as at December 31, 2002. All actions relating to the 2000 restructuring charge have been completed except for the balance accrued for the Farmington Hills, Michigan and the Maple Grove, Minnesota facilities, which is expected to be completed during 2003 at the end of the lease terms.

*2001*

During the fourth quarter of fiscal 2001, as a response to declining sales, the executive team approved a plan to further reduce capacity, and the company recorded a charge of \$3.4 million to accrue employee severance of \$0.9 million for approximately 35 employees at our Farmington Hills, Michigan and Oxnard, California locations, leased facilities costs of \$1.8 million associated with restructuring for excess capacity at five leased locations in the United States, Canada, and Germany and write-down of leasehold improvements and certain equipment of \$0.7 million associated with the exiting of leased facilities. The lease costs primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that

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the company cannot terminate. The expected effects of the 2001 restructuring were to better align our ongoing expenses and cash flows in light of reduced revenues.

Cumulative cash draw-downs of approximately \$2.4 million and non-cash draw-downs of \$0.7 million have been applied against the provision, resulting in a remaining provision balance of \$0.3 million as at December 31, 2002. The restructuring was completed, except for costs that are expected to be paid on the leased facilities in Munich, Germany (lease expiration January 2013), Oxnard, California (expected payment March 2003) and Nepean, Ontario (lease expiration January 2006).

*2002*

Two major restructuring plans were initiated in 2002. In the first quarter of 2002, the company made a determination to reduce fixed costs by transferring the manufacturing operations of the Kanata, Ontario facility to other manufacturing facilities. Associated with this decision, the company incurred restructuring costs in the first, second, and fourth quarters of 2002. At this time, the company believes that all cost associated with the closure of this facility have been recorded, as noted below.

During the first quarter of 2002, the company consolidated its electronics systems business from its facility in Kanata, Ontario into the company's existing systems manufacturing facility in Wilmington, Massachusetts and transferred its laser business from the company's Kanata, Ontario facility to its existing facility in Rugby, United Kingdom. The company then closed its Kanata, Ontario facility. Restructuring provisions totaling \$2.7 million in the first quarter of 2002, relate to severance and benefits of \$2.2 million for the termination of approximately 90 employees, \$0.3 million for the write-off of furniture, equipment and system software, and \$0.2 million for plant closure and other related costs. Future expense and cash outflow associated with the termination of the 90 employees will be avoided, improving income before tax and cash flow by approximately \$1.2 million per quarter.

During the second quarter of fiscal 2002, the company recorded additional restructuring charges of \$1.4 million related to cancellation fees on contractual obligations of \$0.3 million and an aggregate write-down of land and building in Kanata, Ontario and Rugby, United Kingdom of \$0.8 million, and leased facility costs of \$0.3 million at the Farmington Hills, Michigan and Oxnard, California locations. The lease costs primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that the company cannot terminate. The write-downs of the land and building brings the buildings offered for sale in line with market values and has no effect on cash.

The second restructuring plan in 2002 related to the refocusing of our Nepean, Ontario operations on its custom optics business, as a result of the telecom industry's severe downturn. The executive team approved a plan to reduce capacity and the company recorded a pre-tax restructuring charge of \$2.3 million in the fourth quarter of 2002. The company downsized manufacturing operations in its Nepean, Ontario facility, and we incurred \$0.6 million of expense for severance and benefits for the termination of approximately 41 employees. Future expense and cash outflow associated with the 41 terminated employees will be avoided, improving quarterly income before tax and cash flow by approximately \$0.5 million per quarter. The company also wrote-off approximately \$0.2 million of excess fixed assets and wrote-down one of the Nepean, Ontario buildings by \$0.2 million to its estimated fair market value. Additionally, we continued to evaluate accruals made in prior restructuring and we recorded charges of approximately \$0.8 million for an adjustment to earlier provisions for the leased facilities in Munich, Germany, Maple Grove, Minnesota and Farmington Hills, Michigan. The company also took a further write-down of \$0.3 million on the buildings in Kanata, Ontario and Rugby, United Kingdom and a \$0.1 million write-off for fixed assets in Kanata and a \$0.1 million for the Maple Grove, Minnesota and Farmington Hills, Michigan facilities.

At December 31, 2002, the net book value of two facilities, one in Kanata, Ontario and the other in Nepean, Ontario, was reclassified as held for sale and included in other assets.

Cumulative cash draw-downs of approximately \$2.1 million and non-cash draw-downs of \$1.8 million have been applied against the provisions taken in 2002, resulting in a remaining provision balance of \$2.5 million at December 31, 2002. For severance related costs associated with these two restructuring actions,

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the company does not anticipate taking additional restructuring charges and expects to finalize payment in 2003. The company will continue to evaluate the fair value of the buildings and fixed assets that were written down. The restructuring is expected to be complete during January 2013 at the end of the lease term for the Munich facility.

The result of this restructuring activity was the establishment of our three new primary business segments: Components, Lasers and Laser Systems. In addition, improved working capital management provided substantially reduced investment in receivables and inventories.

**2002 Compared to 2001**

*Sales by Segment.* The following table sets forth sales in millions of dollars by our business segments for 2002 and 2001. The information was not available and impracticable to obtain to reclassify 2000 results into these new segments. In 2000, there were other businesses and product lines that were subsequently divested or discontinued that do not conform to the new segments, as such the information would not be comparable. Information for 2000 by segment is not presented.

	<b>2002</b>	<b>2001</b>
	<b>Sales</b>	<b>Sales</b>
Components	\$ 70.5	\$ 88.7
Lasers	23.7	39.1
Laser Systems	65.9	124.0
Other and intra-segment eliminations	(1.0)	(3.9)
	<b>_____</b>	<b>_____</b>
Total	\$ 159.1	\$ 247.9
	<b>_____</b>	<b>_____</b>

Sales for 2002 decreased by \$88.8 million or 36% compared to 2001. The divestiture and discontinuation of product lines accounted for \$12 million of this reduction. But, the primary reason for the decline remains the deep recession in the market for semiconductor and electronic capital equipment and optical telecommunications components, which began midway through 2001. Sales have now stabilized at a level of approximately \$40 million per quarter since the third quarter of 2001.

Sales in the Components segment decreased in 2002 by \$18.2 million compared to 2001. The weakness in the telecommunications market sector was the primary cause for the decline. Sales from the product lines linked to that sector accounted for a combined \$9.6 million in sales reduction. Other factors were a \$6.1 million reduction in the Optical Scanning product line affected by the downturn of the semiconductor industry and the market for laser ophthalmology equipment and \$1.8 million decline in our GMAX product line affected by a slow down in Europe and North America. Discontinued product lines contributed another \$0.7 million in sales decrease against 2001.

Sales in the Lasers segment declined by \$15.4 million or 39% below 2001 results. The decline was due to a combination of repositioning the business out of high power automotive lasers into lower power lasers for medical and other markets, as well as the introduction of a new family of products. Our JK series and Excimer laser product lines accounted for \$10.8 million or 70% of the sales decline in this segment against 2001. Excimer laser sales declined as a result of the collapse of the telecommunications market. Discontinued product lines accounted for \$1.4 million of the 2002 sales decline.

The sales of Laser Systems have suffered the most with a \$58.1 million or 47% decline from 2001. Our Trim & Test, WaferMark and DrillStar product line sales decreased by a combined \$57.9 million primarily due to lower volume reflecting the downturn in the global semiconductor, electronics and telecom industries. These factors were partially offset by market acceptance of our Memory Repair product line, sales of which increased by \$10.9 million in 2002 from 2001. Discontinued and divested product lines accounted for \$10 million of the 2002 sales decline.

*Sales by Region.* We distribute our systems and services via our global sales and service network and through third-party distributors and agents. Our sales territories are divided into the following regions: the

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United States; Canada; Latin and South America; Europe, consisting of Europe, the Middle East and Africa; Japan; and Asia-Pacific, consisting of ASEAN countries, China and other Asia-Pacific countries. Sales are attributed to these geographic areas on the basis of the bill to customer location. Not infrequently, equipment is sold to large international companies, which may be headquartered in Asia-Pacific, but the sales of our systems are billed and shipped to locations in the United States. These sales are therefore reflected in United States totals in the table below. The following table shows sales in millions of dollars to each geographic region for 2002, 2001 and 2000.

	2002		2001		2000	
	Sales	% of total	Sales	% of total	Sales	% of total
United States	\$ 94.7	59%	\$ 119.3	48%	\$ 177.8	48%
Canada	1.9	1	11.4	5	20.2	5
Latin and South America	1.2	1	0.9		5.5	1
Europe	25.8	16	50.7	20	72.0	19
Japan	23.5	15	41.0	17	58.2	16
Asia-Pacific, other	12.0	8	24.6	10	40.2	11
<b>Total</b>	<b>\$ 159.1</b>	<b>100%</b>	<b>\$ 247.9</b>	<b>100%</b>	<b>\$ 373.9</b>	<b>100%</b>

The significant downturn in economic conditions that commenced in 2001, especially in the global semiconductor, electronics and telecom industries, continues to impact sales in all of our geographic regions. The 2002 sales decline of 20.6% in the United States was not as marked as the percent decline in other regions, because there was a relatively moderate sales decline of 23% in the Components sales segment, which is predominately in the United States, and there was a \$6.4 million sales increase in the United States in Memory Repair over 2001. Sales from the Components segment and Memory Repair accounted for respectively \$52.7 million or 56%, and \$12.5 or 13% of the sales recorded in the United States in 2002. Other products sold in the United States recorded a combined 40% decline in 2002. The decline in Canada in 2002 compared to 2001 relate primarily to the downturn of the optics and telecommunication market sectors. Europe, Japan and Asia Pacific all suffered from the downturn in the semiconductor and electronics markets. In 2000, all geographic regions had relatively strong sales. This was especially true for Japan and Asia Pacific, which experienced recovery in 2000 after the financial crisis and economic downturn of the 1990s.

*Backlog.* We define backlog as unconditional purchase orders or other contractual agreements for products for which customers have requested delivery within the next twelve months. Backlog was \$42 million at December 31, 2002, compared to \$50 million at December 31, 2001 and \$119 million at December 31, 2000.

*Gross Profit.* Gross profit was 30.9% in 2002 and 34.6% in 2001. Gross profit as a percentage of sales in 2002 decreased compared to 2001 primarily as a result of fixed costs representing a larger percentage of cost of sales in 2002 as compared to 2001. Fixed costs for manufacturing and service were 18.1% of sales in 2002 versus 14.6% in 2001. While fixed costs of sales decreased by \$7.4 million, or 20%, from 2001 to 2002, sales in the same period decreased by 36%. Favorable fluctuations in cost of materials (3%) and other costs of sales (1%) were offset by unfavorable fluctuations in direct service cost (3%) and inventory provision (1%).

Although the number of competitors in our marketplace remained relatively constant, demand for our products, particularly products in the markets served by our Laser Systems segment, decreased in 2002 from 2001. As a result, we faced increased competition for fewer potential sales. In an effort to reduce some of our slower moving inventory, we reduced prices on some of our products, primarily in lines in which the company does not expect to focus significant resources in the future. We anticipate that pricing pressure will continue in the future and that such pressure will continue to affect sales particularly in our Laser Systems segment. To attempt to improve our gross profit as a percentage of sales in the future, we have taken steps to reduce our fixed manufacturing costs and to add technology features to some of our products that, as a result, we believe may command a premium price, although no assurances can be given that we will be successful in improving or preventing a future decline in our gross profit percentage.



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As a policy, we review inventory values, based on expected future usage, to ensure that inventory is recorded at the lower of cost or net realizable values. The company establishes a reserve in the event of excess inventory. In 2002, as sales declined, the company established additional inventory reserves for potential excess and obsolete inventory. The majority of these reserves were in our Laser Systems and Lasers segments. The company has initiated programs to try to sell this inventory and believes that, based on the stabilization of sales since the third quarter of 2001, the current inventory provisions are adequate, although no assurances can be given that such provisions will be adequate or that the markets that our products serve will not further deteriorate.

Commencing in the first quarter of 2002, we classified service sales support and service management costs as selling, general and administrative expenses. In prior years, we classified these costs as cost of goods sold. As such we have reclassified in the comparative statement of operations \$5.3 million in 2002 and \$5.1 million in 2001 from cost of goods sold to selling, general and administrative expenses. The reclassification was prepared on a consolidated basis only and is not available by segment.

*Research and Development Expenses.* Research and Development (R&D) expenses for 2002 were 12.9% of sales or \$20.4 million, compared to 10.3% of sales or \$25.6 million in 2001.

The R&D expenses in the Components segment were \$4.4 million in 2002 compared to \$6.3 million in 2001. The decrease in R&D expenses of \$1.9 million in 2002 is due primarily to a \$1.3 million reduction in projects related to the telecommunications market.

The R&D expenses in the Lasers segment were \$2.8 million in 2002 compared to \$3 million in 2001. The modest reduction in R&D spending in 2002 in spite of lower sales confirm the company's commitment to grow the equipment sales in this segment.

The R&D expenses in the Laser Systems segment were \$12.4 million in 2002 compared to \$16.4 million in 2001. The decrease of \$4 million in 2002 reflects the completion of major projects and the impact of initiatives undertaken by the company to focus our spending on key potential growth areas.

R&D expenses for \$0.8 million in 2002 compared to none in 2001 were recorded at the corporate level. These expenses are mostly in support of our patent application management. In 2001 similar expenses were recorded at the factory level.

*Selling, General and Administrative Expenses.* Selling, General and Administrative (SG&A) expenses decreased by \$18.3 million to \$55.5 million or 34.9% of sales in 2002 compared to \$73.8 million or 29.8% of sales in 2001. Significant headcount reductions during the year resulted in a reduction for SG&A of 31% from December 31, 2001 to December 31, 2002. SG&A cost reductions, however, did not decline during 2002 proportionately as much as our sales, resulting in an increase in SG&A as a percentage of sales ratio from 2001 to 2002. Of the total decrease in SG&A expenses from 2001 to 2002, \$9 million or 49% of the decrease is attributable to reduced personnel costs, such as salaries and benefits, as a result of the reductions in headcount made during 2002 and mandatory shutdown days. Also, as a result of decreased hiring, recruiting expenses decreased by \$0.5 million. Lower commissions as a result of lower sales accounted for \$1.9 million or 10% of decrease in SG&A expenses from 2001 to 2002. Lower occupancy costs as a result of reductions in operating locations accounted for \$1.3 million or 8% of the decrease in SG&A spending year over year. Reductions in spending on consultants and temporary employees accounted for \$1.2 million or 6% of the decrease in SG&A expenses from 2001 to 2002. Lower spending on travel related expenses accounted for \$1 million or 5% of the decrease in SG&A expenses. Although legal expenses decreased by \$0.9 million from 2001 to 2002, they were still approximately \$2.5 million for the year ended 2002, as a result of expenses associated with the defense of two lawsuits that were settled in 2002. The balance of the decrease in SG&A expenses from 2002 to 2001 of approximately \$2.5 million was in a variety of areas as a result of cost cutting measures that were implemented.

As noted above, in 2002 service sales support and service management costs were reclassified to selling, general and administrative expenses from cost of goods sold. As this was done on a consolidated basis, it is not possible to breakdown SG&A expenses by segment.

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*Amortization of Purchased Intangibles.* Amortization of purchased intangibles was \$5.1 million in 2002 compared to \$5.2 million in 2001. This slight decrease in the amortization in 2002 as compared to 2001 is due to the write-down of certain intangibles that occurred at the end of 2001.

*Restructuring.* As described above and in note 11 to the audited consolidated financial statements for the year ended December 31, 2002, we recorded restructuring charges of \$6.4 million in the year then ended, and of \$2.9 million in the year ended December 31, 2001.

*Other.* Other includes a net benefit of \$0.7 million from settlement of two lawsuits during 2002 and royalty income of \$0.3 million. As more fully described in note 11 to the audited consolidated financial statements for the year ended December 31, 2002, during the fourth quarter of 2001, the company recorded a reduction of purchased intangibles related to technologies no longer a part of the business in the amount of \$1.8 million. Also, during 2001, the company recorded a benefit of \$0.3 million related to royalties earned on the divested OLT precision alignment system product line. The company also adjusted a \$19 million provision originally recorded the first quarter of fiscal 1999 related to litigation and recorded a benefit of \$1.6 million when the litigation was settled.

*Loss from Operations.* The following table sets forth loss from operations in thousands of dollars by our business segments for the years ended December 31, 2002 and 2001.

	<b>Year Ended December 31,</b>	
	<b>2002</b>	<b>2001</b>
<b>Profit (loss) from operations before income taxes</b>		
Components	\$ 16,763	\$ 18,603
Lasers	(5,010)	4,425
Laser Systems	(18,732)	(23,712)
<b>Total by segment</b>	<b>(6,979)</b>	<b>(684)</b>
Unallocated amounts:		
Corporate expenses	19,754	12,983
Amortization of purchased intangibles	5,135	5,226
Restructuring and other	5,427	2,782
<b>Loss from operations</b>	<b>\$ (37,295)</b>	<b>\$ (21,675)</b>

*Gain (loss) on Sale of Assets and Investments.* During 2001, we sold our investment in shares of PerkinElmer, Inc. for a loss of \$4.8 million. There were no such items in 2002.

*Interest Income.* Interest income was \$2.7 million in 2002 compared to \$5.1 million in 2001. The decrease in interest income in 2002 was due to continuous declines in interest rates.

*Interest Expense.* Interest expense was \$0.7 million in 2002 compared to \$0.9 million in 2001. The decrease in interest expense in 2002 was due to lower balances of debt in 2002 than 2001. By the end of December 2002, the company had no bank debt.

*Other Expense.* In 2002, we recorded a write-down of approximately \$0.6 million related to an investment in OpNet Partners, L.P. See note 10 to the audited consolidated financial statements.

*Income Taxes.* The effective tax rate for 2002 was 24.5% of income before taxes, compared to an effective tax rate of 34.6% for 2001. Our tax rates in 2002 and 2001 reflect the fact that we do not recognize the tax benefit from losses in certain countries where future use of the losses is uncertain and other non-deductible costs. The company believes it is more likely than not that the remaining deferred tax assets will be realized principally through future taxable income and carry backs to taxable income in prior years. If the company does not return to profitability, we may be at risk to take further write-downs in our deferred tax assets.

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*Net Income (Loss).* As a result of the forgoing factors, net loss during 2002 was \$27.7 million, compared with a net loss of \$14.7 million in 2001.

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**2001 Compared to 2000**

*Sales.* The total sales in 2001 of \$247.9 million were \$126 million or 34% below the total sales in 2000. The divestitures of the LaserDyne, Custom Systems, Life Sciences, Metrology and Xymark product lines accounted for \$42.8 million or 34% of the decline. The discontinuation of the AM Series and other product lines accounted for \$35.2 million or 28% of the decline. We expect that sales from these divested and discontinued product lines will be negligible going forward. The balance of the 2001 sales decline as compared to the prior year was primarily due to the significant downturn in the markets we serve, especially in the semiconductor and electronics markets.

*Gross Profit.* Gross profit was 34.6% in 2001 and 35.2% in 2000. Gross profit in 2001 decreased compared to 2000 as a result of the economic downturn, and fixed manufacturing and service overhead costs, which were not reflective of the lower sales volumes during the period. This was partially offset by lower inventory loss provisions in 2001 compared to 2000. In the fourth quarter of 2000, the company wrote off \$8.5 million of AM series inventory related to high power lasers for the auto industry that we discontinued and evaluated other inventory that resulted in a \$10.5 million increase in inventory provision.

*Research and Development Expenses.* Research and Development (R&D) expenses were 10.3% of sales or \$25.6 million in 2001 and 9.1% of sales or \$33.9 million in 2000. During 2001 and 2000, R&D activities focused on products targeted at the electronics, semiconductor and telecommunications markets. The spending reduction in 2001 compared to 2000 is due primarily to a decision to focus R&D spending on core technologies combined with the divestitures of certain product lines in the second half of 2000 as well as Laserdyne and Custom Systems in 2001.

*Selling, General and Administrative Expenses.* Selling, General and Administrative (SG&A) expenses decreased to \$73.8 million or 29.8% of sales in 2001 compared to \$87.5 million or 23.5% of sales in 2000. The quarterly spending rate in 2001 was \$3.5 million lower in the fourth quarter of 2001 compared to the first quarter due to the impact of lower sales, discontinued product lines, cost reduction measures and mandatory factory shut down days.

*Amortization of Purchased Intangibles.* Amortization of purchased intangibles increased to \$5.2 million in 2001 from \$4.9 million in 2000. The increase in amortization from 2000 to 2001 is a result of amortizing intangible assets acquired from the acquisition of General Optics, which was partially offset by a reduction in amortization due to the sale of Life Sciences in October 2000.

*Restructuring.* As described above and in note 11 to the audited consolidated financial statements for the year ended December 31, 2002, we recorded restructuring charges of \$2.9 million in the year ended December 31, 2001 and \$10.1 million in the year ended December 31, 2000.

*Gain (loss) on Sale of Assets and Investments.* During 2001, we sold our investment in shares of PerkinElmer, Inc. for a loss of \$4.8 million. During 2000, we sold the net assets of the Life Sciences business for a non-operating gain of \$73.1 million and the operating assets of other product lines including View Engineering metrology product line, fiber-optics operations in Phoenix, Arizona and package coding product line in Hull, United Kingdom for a net gain of \$1.3 million. We also sold two facilities in the United States for a net gain of \$2.4 million.

*Interest Income.* Interest income was \$5.1 million in 2001 and \$4.8 million in 2000. The increase in interest income in 2001 was due to an increased average cash and investment balance compared to 2000 and due to the sale of the company's holding of PerkinElmer, Inc. stock and reinvestment of proceeds into short-term investments.

*Interest Expense.* Interest expense was \$0.9 million in 2001 compared to \$1.5 million in 2000. The decrease in interest expense in 2001 was due to lower balances of debt in 2001 as compared to 2000.

*Income Taxes.* The effective tax rate for 2001 was 34.6% of income before taxes, compared to an effective tax rate of 39.5% for 2000. Our tax rates in 2001 and 2000 reflect the fact that we do not recognize the tax benefit from losses in certain countries where future use of the losses is uncertain and other non-deductible costs.

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*Net Income (Loss).* As a result of the forgoing factors, net loss during 2001 was \$14.7 million, compared with a net income of \$45.4 million in 2000.

### **Critical Accounting Policies and Estimates**

Our consolidated financial statements are based on the selection and application of significant accounting policies, which require management to make significant estimates and assumptions. We believe that the following are some of the more critical judgment areas in the application of our accounting policies that currently affect our financial condition and results of operations.

*Revenue Recognition.* We recognize product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, risk of loss has passed to the customer and collection of the resulting receivable is probable. We design, market and sell our products as standard configurations. Accordingly, customer acceptance provisions for standard configurations are generally based on seller-specified criteria, which we demonstrate prior to shipment. Revenue on new products is deferred until we have established a track record of customer acceptance on these new products. When customer-specified objective criteria exist, revenue is deferred until customer acceptance if we cannot demonstrate the system meets these specifications prior to shipment. Should management determine that these customer acceptance provisions are not met for certain future transactions, revenue recognized for any reporting period could be affected.

*Stock Based Compensation.* We recognize compensation expense for stock options under the intrinsic value method, as allowed in APB 25. At this time, the company does not intend to include stock based compensation expense directly in the results of operations, except as required under APB 25, but to disclose the pro-forma effects of stock based compensation in the notes to the financial statements. If the accounting rules change to require the expensing of all stock based compensation, then our results of operations would be lower. See note 7 to the financial statements for the disclosure of the effects of stock based compensation.

*Allowance for Doubtful Accounts.* We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

*Inventory.* We write down inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. Sales volumes have been adversely impacted by the general economic downturn, and the semiconductor, electronics, and telecommunication industries downturn in particular, and inventory has been affected accordingly. We have been implementing a program to reduce our inventory to desired levels. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

*Warranties.* We provide for the estimated costs of product warranties at the time revenue is recognized. Our estimate of costs to service the warranty obligations is based on historical experience and expectation of future conditions. To the extent we experience increased warranty claim activity or increased costs associated with servicing those claims, revisions to the estimated warranty liability would be required.

*Restructuring.* During fiscal year 2002, 2001 and 2000, we recorded significant reserves in connection with our restructuring program. These reserves include estimates pertaining to employee separation costs and the settlements of contractual obligations resulting from our actions. Some of these accruals relate to costs of excess leased facilities that are under long-term leases. Our estimate of the reserve is based on estimates of market value of leased buildings, where we have made residual value guarantees, or of office rental rates in the future in various markets and the time required to sublease the space, both of which are subject to many variables, such as economic conditions and amount of space available in the market. Additionally, our restructuring reserve includes estimates to reduce owned buildings to market value. We are trying to sell these buildings, but there are many factors that could affect the fair market value or final value that we receive in

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any sale, as such there may be adjustments to our reserves. Although we do not anticipate significant changes, the actual costs may differ from these estimates.

*Deferred Taxes.* As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets totaling \$17.2 million within our December 31, 2002 consolidated balance sheet, after providing a valuation allowance of \$22.6 million, as presented in note 9 to the consolidated financial statements.

We assess the likelihood that our deferred tax assets will be recovered. To the extent that we believe that future recovery is not likely, we must establish a valuation allowance. To the extent we establish or increase a valuation allowance, we must include an expense within the tax provision in the statement of operations.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. The company has provided a valuation allowance against losses in the parent company and subsidiaries with an inconsistent history of taxable income and loss due to the uncertainty of their realization. In addition, the company has provided a valuation allowance on foreign tax credits, due to the uncertainty of generating foreign earned income to claim the tax credits. In the event that actual results differ from our estimates of future taxable income, or we adjust these estimates in future periods, we may need to establish an additional valuation allowance, which could impact our financial position and results of operations.

*Intangible Assets.* In assessing the recoverability of our intangible assets, we must make assumptions regarding estimated future operating results, cash flows, planned uses of technology and other factors to determine the fair value of the respective assets. During the fourth quarter of 2002, we reviewed the intangible assets for potential impairment, and determined that there was no adjustment needed. During the fourth quarter of 2001, we determined that the carrying value of our intangible assets was no longer fully recoverable based on these factors. As a result, we recognized an impairment charge of \$1.8 million in 2001. If our estimates or their related assumptions change in the future, we may require adjustments to the carrying value of the remaining assets.

*Pension Plan.* The company's United Kingdom subsidiary maintains a defined benefit pension plan, whose membership was closed effective 1997. At year-end 2002, because of significant declines in the stock market and low interest rates, the market value of the plan assets was approximately \$5 million less than the projected benefit obligation.

The accounting rules applicable to our pension plan require amounts recognized in financial statements be determined on an actuarial basis, rather than as contributions are made to the plan. A significant element in determining our pension income or pension expense is the expected return on plan assets. We have assumed, based on the type of securities in which the plan assets are invested and the long-term historical returns of these investments, that the long-term expected return on pension assets will be 7% and its assumed discount rate will be 6%. Given our pension plan's current under-funded status, absent improved market conditions, we will be required to increase cash contributions to our pension plan in future years. Further declines in the stock market and lower rates of return could increase our required contributions.

Since the market value of our pension assets at year-end 2002 was less than the accumulated pension benefit obligation, the company recorded a \$3.9 million non-cash charge to other comprehensive income in stockholders' equity and an accrued long-term pension liability. This charge to equity did not affect net loss. The charge will only be reversed when the value of the pension assets exceed the accumulated pension benefit obligation as of a future measurement date.

In December 2002, the company notified plan participants that it intended to cease sponsoring the pension plan. Statutorily required consultations with the plan participants are being held, during which benefits continue to accrue. No final decision has been made by the pension plan trustees. The company, however, cannot currently quantify its liability in connection with the curtailment of the pension plan, which

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will depend on the timing and details of the curtailment and the actual settlements with the plan participants, if any.

**Liquidity and Capital Resources**

*Lines of Credit*

At December 31, 2002, the company had lines of credit denominated in United States and Canadian dollars with Fleet National Bank, or Fleet, Bank One and Canadian Imperial Bank of Commerce, or CIBC, and letters of credit with National Westminster Bank, or NatWest, for a total amount of available credit of \$12.1 million versus \$32.4 million at December 31, 2001. The company's agreement with Fleet provides for an \$8 million line of credit. At December 31, 2002, the company had a \$4 million line of credit with CIBC. NatWest provides a \$0.1 million bank guarantee for letters of credit used for VAT purposes in the United Kingdom. At December 31, 2002, marketable securities totaling \$14.5 million had been pledged as collateral for the Fleet and CIBC credit facilities under security agreements. The line of credit with Fleet expires on June 28, 2003. In addition to the customary representations, warranties and reporting covenants, the borrowings under the Fleet credit facility require the company to maintain a quarterly minimum tangible net worth of \$200 million. The line of credit with CIBC was reviewed by the company and a decision to cancel the line of credit was conveyed to CIBC prior to December 31, 2002. By giving CIBC appropriate advance notice, the company initiated its right to cancel the line of credit at any time at no cost, excluding breakage fees relating to the used and outstanding amounts under fixed loan instruments, which we do not expect to be material. The \$0.4 million remaining under the CIBC credit facility at March 28, 2003 should be cancelled by the end of the second quarter of 2003. The company also cancelled a credit facility with Bank One on December 20, 2002 without paying any breakage fees. North American inventories and receivables were pledged as collateral for the Bank One credit facility. Bank One continues to work on the release of all liens and obligations associated with the facility.

The company had approximately \$12.1 million denominated in Canadian dollars and United States dollars that are available for general purposes, under the credit facilities discussed above, at December 31, 2002. Of the available \$12.1 million at December 31, 2002, \$7.7 million was in use; consisting of \$3.8 million committed at Fleet Bank for use in foreign exchange transactions, \$2.9 million in Rugby, United Kingdom under the CIBC credit facilities and approximately \$0.8 million of bank guarantees and outstanding letters of credit under the CIBC credit facility and \$0.1 million with NatWest. Though the Fleet Bank amount of \$3.8 million is committed for support of foreign currency hedging contracts and not, therefore, available, it is not considered used for purposes of calculating interest payments. The aggregate unused portion of credit available under the credit facilities amounted to \$4.4 million at December 31, 2002. The Fleet line of credit is due on demand and bears interest based on either prime or LIBOR depending on the borrowing notification period. This resulted in an effective average rate of 1.79% for fiscal 2002.

*Cash Flows for the Years Ended December 31, 2002, 2001, 2000*

The company used \$19.3 million in cash during 2002 to close the year on December 31, 2002 with cash and cash equivalents of \$83.6 million compared to \$103 million at December 31, 2001 and \$113.9 million at December 31, 2000. In addition, short-term investments were \$29 million at December 31, 2002 a decrease of \$14.5 million compared to December 31, 2001. Long-term investments totaled \$37.4 million at December 31, 2002. Short-term, long-term and other investments consist principally of commercial paper, governments, short-term corporate debt, and bankers' acceptances with original maturities greater than three months. The total of cash, cash equivalents and investments at December 31, 2002 was \$150 million.

We generated \$11.7 million in cash from operating activities during 2002. The net loss, after adjustments for non-cash items, resulted in a use of cash of \$10 million in 2002. Accounts receivable, inventories and other current assets generated a further \$29.8 million during 2002, which was offset by current liabilities using \$8.1 million. Accounts receivables contributed \$9.4 million due to a 17-day improvement in the average time of collection offset by the impact on receivables of a \$2.7 million sales increase in the fourth quarter of 2002 over the fourth quarter of 2001. Inventories contributed \$19.6 million due to a reduction in manufacturing

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activities caused by lower demand in 2002, and management's focus on disposing of slow moving inventory. These efforts resulted in inventory turns increasing to 3.0 at the end of 2002 from 2.3 at the end of 2001. The reduction in current liabilities is due to a lower manufacturing activities and lower spending due to a reduction in workforce. During 2001, we used \$17.5 million in operating activities. Net income, after adjustment for non-cash items, generated cash of \$12.8 million in 2001. Accounts receivable, inventories and other current assets generated a further \$57.4 million, which was more than offset by current liabilities using \$87.7 million. Accounts receivable contributed \$47.1 million as the 2001 balance dropped sharply as a result of a 56% decline in sales from the fourth quarter of 2000 to the fourth quarter of 2001, offset by a 5-day increase in the average time of collection. Inventories contributed \$8.9 million due to a reduction in manufacturing activities. However the reduction in inventory did not match the sales decline resulting in a decrease in inventory turns to 2.3 from 4.3 in December 2000. The usage in current liabilities reflects the downturn in manufacturing activities and the reduction in workforce. During 2000, we used \$10.2 million in operating activities. The net loss, after adjustment for non-cash items, resulted in the use of cash of \$19.9 million in 2000. Accounts receivable, inventories and other current assets used a further \$28.4 million, which was more than offset by current liabilities providing \$38.1 million. The usage of cash in accounts receivable is due to higher sales in 2000 partially offset by a 2-day improvement in the average time of collection. The usage in inventory reflects the increase in inventory to support higher demand. The increase in current liabilities is also due to higher spending associated with higher sales.

We used \$23.8 million in investing activities, including \$132.9 million of purchases of short-term and long-term investments and \$110 million of maturities of short and long-term investments during 2002. Investment in property, plant and equipment, net of disposals, used \$3 million and in cash and other assets generated \$2 million in 2002. During 2001, investing activities provided \$12.4 million, including \$109.4 million of purchases and \$85.8 million of maturities of short-term investments. During 2001, we generated \$38.5 million from the sale of our investment in PerkinElmer Inc. and \$7.3 million from the sale of our Laserdyne and Custom Systems product lines to Laserdyne Prima (see note 2 to the audited consolidated financial statements for details of both transactions). Investment in property, plant and equipment used \$8.6 million in cash and other assets used \$1.2 million. During 2000, investing activities provided \$35.8 million, including \$57.7 million of purchases and \$45 million of maturities of short-term investments. During 2000, we generated \$65 million from the sale of business assets and invested \$10.1 million in property, plant and equipment. The acquisition of General Optics used \$7.1 million in cash in 2000.

Cash flow used in financing activities was \$8.2 million for the year ended December 31, 2002 compared to \$6.3 million for the year ended December 31, 2001 and \$62.7 million that was provided by financing activities for the year ended December 31, 2000. We made net repayments of bank indebtedness during 2002 of \$6.4 million compared to \$4.1 million in 2001, and a scheduled payment of \$3 million on long-term debt in 2002 as compared to \$4 million on long-term debt in 2001. These were partially offset by \$1.2 million received in 2002 and \$1.8 million received in 2001 from the exercise of stock options and issuance of shares under the employee stock purchase plan. The net increase in cash in 2000 relates primarily to \$68.3 million net proceeds received from a public offering of 4.3 million common shares, \$8.7 million raised from the exercise of stock options and decrease in bank indebtedness and long-term debt of \$14.2 million.

*Other Liquidity Matters*

The company's final salary defined benefit pension plan in the United Kingdom had an excess of projected benefit obligation over the fair market value of plan assets of approximately \$5 million at December 31, 2002. The company's funding policy is to fund pensions and other benefits based on widely used actuarial methods as permitted by regulatory authorities. These factors are subject to many changes, including the performance of investments of the plan assets. Because of the current underfunding and potential changes in the future, the company may have to increase payments to fund the pension plan.



**Table of Contents****Contractual Obligations**

The following summarizes our contractual obligations at December 31, 2002, and the effect such obligations are expected to have on liquidity and cash flow in future years in thousands.

<b>Contractual Obligations</b>	<b>Total</b>	<b>1st Year</b>	<b>2 - 3 Years</b>	<b>4 - 5 Years</b>	<b>After 5 Years</b>
Operating leases(1)	\$ 13,814	\$ 3,549	\$ 4,625	\$ 3,146	\$ 2,494
Unconditional purchase obligations	10,518	10,168	350		
Other long-term obligations(2)	2,318	189	376	374	1,379
<b>Total Contractual Cash Obligations</b>	<b>\$ 26,650</b>	<b>\$ 13,906</b>	<b>\$ 5,351</b>	<b>\$ 3,520</b>	<b>\$ 3,873</b>

(1) See note 12 to the audited consolidated financial statements.

(2) See note 6 to the audited consolidated financial statements.

We lease certain equipment and facilities under operating lease agreements that expire through 2013. The company leases two facilities (Maple Grove, Minnesota and Farmington Hills, Michigan) under operating lease agreements that expire in 2003, where at the end of the initial lease term, these leases require the company to renew the lease for a defined number of years at the fair market rental rate or purchase the property at the fair market value. The lessor may sell the facilities to a third party but the leases provide for a residual value guarantee of the first 85% of any loss the lessor may incur on its \$19.1 million investment in the buildings, which may become payable by the company upon the termination of the transaction, or the company may exercise its option to purchase the facilities for approximately \$19 million. As of December 31, 2002, residual value guarantees in connection with these leases totaled approximately \$16 million. Upon termination of the leases, the company expects to purchase the buildings for approximately \$19 million cash and then sell them for the combined estimated market value of the two buildings of approximately \$12.5 million to \$13.3 million. During the fourth quarter of fiscal 2000, the company took a charge of \$6 million associated with restructuring for excess capacity at the two leased facility locations, including the estimated residual value guarantees. In the fourth quarter of 2002, the company took an additional restructuring charge of \$0.1 million to increase the reserve for the decline in the estimated market values of the underlying buildings. The total expected value of the buildings at the end of the leases may vary, depending on whether or not the buildings are leased at time of sale and whether the buildings are sold to a buyer/owner or to an investor. The company will incur other costs such as lease and sales commissions. If market values for the two facilities were to decrease by 10%, our required provision would change by approximately \$1 million. The lease agreement requires, among other things, the company to maintain specified quarterly financial ratios and conditions. As of March 29, 2002, the company was in breach of the fixed charge coverage ratio, but on April 30, 2002, the company entered into a Security Agreement with the Bank of Montreal, or BMO pursuant to which the company deposited with BMO and pledged approximately \$18.9 million as security in connection with the operating leases discussed above in exchange for a written waiver from BMO and BMO Global Capital Solutions for any company defaults of or obligations to satisfy the specified financial covenants relating to the operating lease agreements until June 30, 2003. This item is included on the balance sheet in long-term investments.

The company only uses derivatives for hedging purposes. The following is a summary of the company's risk management strategies and the effect of these strategies on the company's consolidated financial statements.

The company has instituted a foreign currency cash flow hedging program to manage exposures to changes in foreign currency exchange rates associated with forecasted sales transactions. Currency forwards and swaps are used to fix the cash flow variable of local currency costs or selling prices denominated in currencies other than the functional currency. For hedged forecasted transactions, hedge accounting is discontinued if the forecasted transaction is no longer intended or expected to occur and any previously unrealized hedging gains or losses recorded in other comprehensive income are immediately recorded to earnings. Earnings impacts for all designated hedges are recorded in the consolidated statement of operations

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generally on the same line item as the gain or loss on the item being hedged. The company records all derivatives at fair value as assets or liabilities in the consolidated balance sheet, with classification as current or long-term depending on the duration of the instrument.

At December 31, 2002, the company had eleven foreign exchange forward contracts to purchase \$16.9 million dollars and one currency swap contract valued at \$8.7 million dollars with an aggregate fair value loss of \$0.5 million after-tax recorded in accumulated other comprehensive income and maturing at various dates in 2003. At December 31, 2001, the company had eight foreign exchange forward contracts to purchase \$17.8 million dollars and one foreign exchange option contract to purchase \$6.5 million dollars with an aggregate fair value gain of \$0.8 million dollars and maturing at various dates in 2002. At December 31, 2000, the company had four foreign exchange contracts to purchase \$6.5 million with a fair value loss of \$164,000 that matured and was recognized in earnings during the first quarter of 2001.

On March 31, 2003, the company completed the sale to a third party of its excess facility in Nepean, Ontario for a price of Cdn \$1.3 million (or approximately U.S.\$0.9 million based on March 2003 exchange rates). At March 28, 2003, the net book value of this facility of U.S.\$0.8 million is included in other assets. The estimated gain on the sale of this facility of approximately U.S.\$0.1 million will be recorded in our second quarter.

On April 21, 2003, the company announced that it has entered into a definitive agreement for the acquisition of the principal assets of Spectron Laser Systems, a subsidiary of Lumenis Ltd., located in Rugby, United Kingdom. The Spectron assets are being acquired for \$6.3 million in cash, subject to adjustment, and the assumption of certain liabilities. This transaction closed on May 7, 2003. The integration of Spectron into the company's Laser Group in Rugby United Kingdom is scheduled for completion by the end of August, 2003. The company expects to account for this transaction as a business combination under SFAS No. 141 *Business Combinations*.

On May 2, 2003, the company announced that it had acquired the principal assets of the Encoder division of Dynamics Research Corporation, located in Wilmington, Massachusetts. The Encoder division assets were acquired for \$3.3 million in cash, subject to adjustment, and the assumption of certain liabilities. The integration of the Encoder division into the company's Components Group in Billerica, Massachusetts is currently scheduled for completion by the end of August, 2003. The company expects to account for this transaction as a business combination under SFAS No. 141 *Business Combinations*.

Our future liquidity and cash requirements will depend on numerous factors, including, but not limited to, the level of sales we will be able to achieve in the future, the introduction of new products and potential acquisitions of related businesses or technology. We believe that existing cash balances, together with cash generated from operations and available bank lines of credit, will be sufficient to satisfy anticipated cash needs to fund working capital and investments in facilities and equipment for the next two years. We are not aware of any events that could trigger a significant cash payment, except for items already accrued in the financial statements or noted above.

**Related Party Transactions**

The company had the following transactions with related parties. The company recorded \$2.3 million as sales revenue from Sumitomo Heavy Industries Ltd., a significant shareholder in the year ended December 31, 2002 (2001 - \$4.2 million; 2000 - \$10.2 million) at amounts and terms approximately equivalent to third party transactions. Transactions with Sumitomo Heavy Industries Ltd. are at normal trade terms. Receivables from Sumitomo Heavy Industries Ltd. of \$0.5 million and \$0.6 million as at December 31, 2002 and 2001, respectively, are included in accounts receivable on the balance sheet.

On February 23, 2000, the company entered into an agreement with V2Air LLC relating to the use of the LLC aircraft for company purposes. The V2Air LLC is owned by the company's President and Chief Executive Officer, Charles D. Winston. Pursuant to the terms of the Agreement, the company is required to reimburse the V2Air LLC for certain expenses associated with the use of the aircraft for company business

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travel. During the most recently completed fiscal year, the company reimbursed V2Air LLC approximately \$145,000 (2001 - \$150,000) under the terms of this agreement.

In January of 2001, the company made an investment of \$2 million in a technology fund managed by OpNet Partners, L.P. During 2002, the company received a cash distribution (return of capital) from OpNet Partners in the amount of \$1.4 million. In the second quarter of 2002, the company wrote-down the investment by \$0.2 million to its estimated fair market value and wrote-off the remainder of the investment (\$0.4 million) in the fourth quarter of 2002. Richard B. Black, a member of the company's board of directors, is a general partner for OpNet Partners, L.P.

On April 26, 2002, the company entered into an agreement with Photoniko, Inc, a private photonics company in which one of the company's directors, Richard B. Black, was a director and stock option holder. As of August 16, 2002, Mr. Black was no longer a director or stock option holder of Photoniko, Inc. Under the agreement, the company provided a non-interest bearing unsecured loan of \$75,000 to Photoniko, Inc. to fund designated business activities at Photoniko, Inc. in exchange for an exclusive 90 day period to evaluate potential strategic alliances. In accordance with the terms of the agreement and the promissory note which was signed by Photoniko, Inc. on April 26, 2002, the loan was to be repaid in full to the company no later than August 28, 2002, but still remains outstanding. The company has provided a full reserve for this receivable.

## **Recent Pronouncements**

### ***Business Combinations***

On January 1, 2002, the company implemented, on a prospective basis, Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* (SFAS 141). As a result, all business combinations initiated in the future will be accounted for under the purchase method. Also, SFAS 141 does not permit the company to recognize an assembled workforce asset. Therefore, the company reallocated its assembled workforce asset with a cost of \$2.8 million and a net carrying value of \$2 million at January 1, 2002 to other remaining long-lived assets arising from the merger with General Scanning, Inc. in 1999, including \$1.4 million to developed technology, \$0.5 million to property, plant and equipment and \$0.1 million to trademarks and trade names. The adoption of SFAS 141 did not have any other material impact on the company's financial position or cash flows. It will accelerate amortization by \$0.6 million per year for 2002 and 2003 and reduce amortization thereafter.

### ***Intangible Assets***

On January 1, 2002, the company implemented, on a prospective basis, SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). As a result, intangible assets with finite useful lives must now be amortized over their estimated lives to their estimated residual values and be reviewed for impairment according to SFAS 144. Goodwill and intangible assets with indefinite lives will not be amortized, but will rather be tested at least annually for impairment. The adoption of SFAS 142 did not have a material impact on the company's financial position, as it does not possess goodwill or intangible assets with indefinite lives. It also did not have a material impact on the company's results of operations or cash flows.

### ***Impairment or Disposal of Long-Lived Assets***

On January 1, 2002, the company adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). SFAS 144 applies to all long-lived assets, including discontinued operations, and develops one accounting model for long-lived assets to be disposed of by sale. SFAS 144 supersedes SFAS 121, and the accounting and reporting provisions of APB No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions (APB 30)*, for the disposal of a segment of a business. The adoption of SFAS 144 did not have a material impact on the company's financial position, results of operations or cash flows. During 2002 as a result of restructuring actions, the company wrote-down fixed assets by approximately \$1.1 million (see note 11 to the financial statements).

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### ***Costs Associated with Exit or Disposal Activities***

In July 2002, SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146) was issued. SFAS 146 requires that a liability for costs associated with exit or disposal activities be recognized and measured initially at fair value only when the liability is incurred. SFAS 146 will be effective for exit or disposal activities initiated after December 31, 2002, and had no impact on the company's financial statements in 2002, but will impact the accounting treatment of future exit or disposal activities should they occur.

### ***Guarantor's Accounting for Guarantees***

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (the Interpretation). The Interpretation will significantly change current practice in the accounting for, and disclosure of, guarantees. Guarantees meeting the characteristics described in the Interpretation, which are not included in a long list of exceptions, are required to be initially recorded at fair value, which is different from the general current practice of recording a liability only when a loss is probable and reasonably estimable, as those terms are defined in FASB Statement No. 5, *Accounting for Contingencies*. The Interpretation also requires a guarantor to make significant new disclosures for virtually all guarantees even if the likelihood of the guarantor's having to make payments under the guarantee is remote. The initial recognition and initial measurement provisions of the Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. Accounting for guarantees issued prior to December 31, 2002 should not be revised or restated. As discussed in Note 12 to the consolidated financial statements, the company has two existing operating lease agreements with terms that include residual value guarantees totaling approximately \$16 million.

### ***Stock Based Compensation Transition and Disclosure***

In December 2002, SFAS No. 148 (SFAS 148), *Accounting for Stock-Based Compensation-Transition and Disclosure* was issued to amend SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of SFAS 148 will not have a material impact on our financial position, results of operations, or cash flows, because the company will continue to follow the guidance of APB 25 in recognizing stock compensation expense. The company will comply with the new disclosure requirements in its financial statements for the first quarter of 2003.

## **Risk Factors**

The risks presented below may not be all of the risks that we may face. These are the factors that we believe could cause actual results to be different from expected and historical results. Other sections of this report include additional factors that could have an effect on our business and financial performance. The industry in which we compete is very competitive and changes rapidly. Sometimes new risks emerge and management may not be able to predict all of them, or be able to predict how they may cause actual results to be different from those contained in any forward-looking statements. You should not rely upon forward-looking statements as a prediction of future results.

*A prolonged economic slowdown will continue to put pressure on our ability to meet anticipated revenue levels.* We are in a broad-based economic slowdown affecting most technology sectors and semiconductors and electronics in particular. As a result, many of our customers continue to order low quantities. A large portion of our sales is dependent on the need for increased capacity or replacement of inefficient manufactur-

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ing processes, because of the capital-intensive nature of our customers' businesses. These also tend to lag behind in an economic recovery longer than other businesses. Because it is difficult to predict how long this slowdown will continue, we may not be able to meet anticipated revenue levels on a quarterly or annual basis.

*We have experienced operating losses and may not return to profitability.* We have incurred operating losses since 1998. For the years ended December 31, 2002 and 2001, we reported net losses of approximately \$27.7 million and \$14.7 million, respectively. For the year ended December 31, 2000, we did achieve overall profitability, even though we experienced operating losses of approximately \$2 million, primarily as a result of the sale of assets of company's Life Science business which resulted in a non-operating gain of \$73.1 million. Our operating losses in fiscal 2000 were attributable primarily to restructuring activities relating to the discontinuance of product lines in our high power laser business. No assurances can be given that we will not continue to sustain losses in the future and the market price of our common shares may decline as a result.

*Our inability to return to profitability may result in the loss of significant deferred tax assets.* In determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets requires subjective judgment and analysis. Our ability to utilize the full deferred tax assets that are recorded on our balance sheet is dependent on our achieving our planned profitability goals. If actual results differ from our plans or we do not achieve profitability, we may be required to increase the valuation allowance on our tax assets by increasing expenses, which may have a negative result on our operations.

*Our business depends significantly upon capital expenditures, particularly by manufacturers in the semiconductor, electronics, machine tool and automotive industries, each of which are subject to cyclical fluctuations.* These industries are cyclical and have historically experienced periods of oversupply, resulting in significantly reduced demand for capital equipment, including the products that we manufacture and market. The timing, length and severity of these cycles are difficult to predict. For the foreseeable future, our operations will continue to depend upon capital expenditures in these industries, which, in turn, depend upon the market demand for their products. Our net sales and results of operations may be materially adversely affected if downturns or slowdowns in the semiconductor, electronics, machine tool and automotive industries occur in the future.

*The success of our business is dependant upon our ability to respond to fluctuations in demand for our products.* During a period of declining demand, we must be able to quickly and effectively reduce expenses while continuing to motivate and retain key employees. Our ability to reduce expenses in response to any downturn is limited by our need for continued investment in engineering and research and development and extensive ongoing customer service and support requirements. In addition, the long lead-time for production and delivery of some of our products creates a risk that we may incur expenditures or purchase inventories for products which we cannot sell. During a period of increasing demand and rapid growth, we must be able to quickly increase manufacturing capacity to meet customer demand and hire and assimilate a sufficient number of qualified personnel. Our inability to ramp up in times of increased demand could harm our reputation and cause some of our existing or potential customers to place orders with our competitors rather than us.

*Fluctuations in our customers' businesses, timing and recognition of revenues from customer orders and other factors beyond our control may cause our results of operations quarter over quarter to fluctuate, perhaps substantially.* Our revenues and net income, if any, in any particular period may be lower than revenues and net income, if any, in a preceding or comparable period. Factors contributing to these fluctuations, some of which are beyond our control, include:

fluctuations in our customers' businesses;

timing and recognition of revenues from customer orders;

timing and market acceptance of new products or enhancements introduced by us or our competitors;

availability of components from our suppliers and the manufacturing capacity of our subcontractors;

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timing and level of expenditures for sales, marketing and product development; and

changes in the prices of our products or of our competitors' products.

We derive a substantial portion of our sales from products that have a high average selling price and significant lead times between the initial order and delivery of the product, which, on average, can range from ten to fourteen weeks. We may receive one or more large orders in one quarter from a customer and then receive no orders from that customer in the next quarter. As a result, the timing and recognition of sales from customer orders can cause significant fluctuations in our operating results from quarter to quarter. If our quarterly revenue or operating results fall below the expectations of investors or public market analysts, our common share price may decline as a result.

Gross profits realized on product sales vary depending upon a variety of factors, including production volumes, the mix of products sold during a particular period, negotiated selling prices, the timing of new product introductions and enhancements and manufacturing costs.

A delay in a shipment, or failure to meet our revenue recognition criteria, near the end of a fiscal quarter or year, due, for example, to rescheduling or cancellations by customers or to unexpected difficulties experienced by us, may cause sales in a particular period to fall significantly below our expectations and may materially adversely affect our operations for that period. Our inability to adjust spending quickly enough to compensate for any sales shortfall would magnify the adverse impact of that sales shortfall on our results of operations.

As a result of these factors, our results of operations for any quarter are not necessarily indicative of results to be expected in future periods. We believe that fluctuations in quarterly results may cause the market prices of our common shares, on The NASDAQ Stock Market® and the Toronto Stock Exchange, to fluctuate, perhaps substantially.

*Our reliance upon third party distribution channels subjects us to credit, inventory, business concentration and business failure risks beyond our control.* The company sells approximately 55% of its products through resellers (which include OEMs, systems integrators and distributors). Reliance upon third party distribution sources subjects us to risks of business failure by these individual resellers, distributors and OEMs, and credit, inventory and business concentration risks. In addition, our net sales depend in part upon the ability of our OEM customers to develop and sell systems that incorporate our products. Adverse economic conditions, large inventory positions, limited marketing resources and other factors affecting these OEM customers could have a substantial impact upon our financial results. No assurances can be given that our OEM customers will not experience financial or other difficulties that could adversely affect their operations and, in turn, our financial condition or results of operations.

*The steps we take to protect our intellectual property may not be adequate to prevent misappropriation or the development of competitive technologies or products by others that could harm our competitive position and materially adversely affect our results of operations.* Our future success depends in part upon our intellectual property rights, including trade secrets, know-how and continuing technological innovation. There can be no assurance that the steps we take to protect our intellectual property rights will be adequate to prevent misappropriation or that others will not develop competitive technologies or products. As of December 31, 2002, we held 113 United States and 73 foreign patents, and had filed 59 United States and 122 foreign patent applications, which are under review by the patent authorities. There can be no assurance that other companies are not investigating or developing other technologies that are similar to ours, that any patents will issue from any application filed by us or that, if patents do issue, the claims allowed will be sufficiently broad to deter or prohibit others from marketing similar products. In addition, there can be no assurance that any patents issued to us will not be challenged, invalidated or circumvented, or that the rights thereunder will provide a competitive advantage to us.

*Our success depends upon our ability to protect our intellectual property and to successfully defend against claims of infringement by third parties.* From time to time we receive notices from third parties alleging infringement of such parties' patent or other proprietary rights by our products. While these notices are common in the laser industry and we have in the past been able to develop non-infringing technology or

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license necessary patents or technology on commercially reasonable terms, there can be no assurance that we would in the future prevail in any litigation seeking damages or expenses from us or to enjoin us from selling our products on the basis of such alleged infringement, or that we would be able to develop any non-infringing technology or license any valid and infringed patents on commercially reasonable terms. In the event any third party made a valid claim against us or our customers for which a license was not available to us on commercially reasonable terms, we would be adversely affected. Our failure to avoid litigation for infringement or misappropriation of propriety rights of third parties or to protect our propriety technology could result in a loss of revenues and profits.

*The industries in which we operate are highly competitive and competition in our markets could intensify, or our technological advantages may be reduced or lost, as a result of technological advances by our competitors.* The industries in which we operate are highly competitive. We face substantial competition from established competitors, some of which have greater financial, engineering, manufacturing and marketing resources than we do. Our competitors can be expected to continue to improve the design and performance of their products and to introduce new products. There can be no assurance that we will successfully differentiate our current and proposed products from the products of our competitors or that the market place will consider our products to be superior to competing products. Because many of the components required to develop and produce a laser-based marking system are commercially available, barriers to entry into this market are relatively low, and we expect new competitive product entries in this market. To maintain our competitive position in this market, we believe that we will be required to continue a high level of investment in engineering, research and development, marketing and customer service and support. There can be no assurance that we will have sufficient resources to continue to make these investments, that we will be able to make the technological advances necessary to maintain our competitive position, or that our products will receive market acceptance. We may not be able to compete successfully in the future, and increased competition may result in price reductions, reduced profit margins, loss of market share, and an inability to generate cash flows that are sufficient to maintain or expand our development of new products.

*Our operations could be negatively affected if we lose key executives or employees or are unable to attract and retain skilled executives and employees as needed.* Our business and future operating results depend in part upon our ability to attract and retain qualified management, technical, sales and support personnel for our operations on a worldwide basis. The loss of key personnel could negatively impact our operations. Competition for qualified personnel is intense, and we cannot guarantee that we will be able to continue to attract and retain qualified personnel.

*We may not develop, introduce or manage the transition to new products as successfully as our competitors.* The markets for our products experience rapidly changing technologies, evolving industry standards, frequent new product introductions, changes in customer requirements and short product life cycles. To compete effectively we must continually introduce new products that achieve market acceptance. Our future performance will depend on the successful development, introduction and market acceptance of new and enhanced products that address technological changes as well as current and potential customer requirements. Developing new technology is a complex and uncertain process requiring us to be innovative and to accurately anticipate technological and market trends. We may have to manage the transition from older products to minimize disruption in customer ordering patterns, avoid excess inventory and ensure adequate supplies of new products. The introduction by us or by our competitors of new and enhanced products may cause our customers to defer or cancel orders for our existing products, which may harm our operating results. Failed market acceptance of new products or problems associated with new product transitions could harm our business.

*Delays or deficiencies in research, development, manufacturing, delivery of or demand for new products or of higher cost targets could have a negative affect on our business, operating results or financial condition.* We are active in the research and development of new products and technologies. Our research and development efforts may not lead to the successful introduction of new or improved products. The development by others of new or improved products, processes or technologies may make our current or proposed products obsolete or less competitive. Our ability to control costs is limited by our need to invest in research and development. Because of intense competition in the industries in which we compete, if we were

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to fail to invest sufficiently in research and development, our products could become less attractive to potential customers, and our business and financial condition could be materially and adversely affected. As a result of our need to maintain our spending levels in this area, our operating results could be materially harmed if our net sales fall below expectations. In addition, as a result of our emphasis on research and development and technological innovation, our operating costs may increase further in the future, and research and development expenses may increase as a percentage of total operating expenses and as a percentage of net sales.

In addition, we may encounter delays or problems in connection with our research and development efforts. Product development delays may result from numerous factors, including:

changing product specifications and customer requirements;

difficulties in hiring and retaining necessary technical personnel;

difficulties in reallocating engineering resources and overcoming resource limitations;

changing market or competitive product requirements; and

unanticipated engineering complexities.

New products often take longer to develop, have fewer features than originally considered desirable and achieve higher cost targets than initially estimated. There may be delays in starting volume production of new products and new products may not be commercially successful. Products under development are often announced before introduction and these announcements may cause customers to delay purchases of existing products until the new or improved versions of those products are available.

*We may not be able to find suitable targets or consummate acquisitions in the future, and there can be no assurance that the acquisitions we have made and do in the future make will provide expected benefits.* We intend to pursue strategic acquisitions. Our identification of suitable acquisition candidates involves risks inherent in assessing the values, strengths, weaknesses, risks and profitability of acquisition candidates, including the effects of the possible acquisition on our business, diversion of our management's attention and risks associated with unanticipated problems or liabilities. Should we acquire another business, the process of integrating acquired operations into our existing operations may result in unforeseen operating difficulties and may require significant financial resources that would otherwise be available for the ongoing development or expansion of our existing business. Other difficulties might include the diversion of management's attention from our core business and risks associated with the potential entrance into markets in which we have limited or no prior experience and the potential loss of key employees, particularly those of the acquired business.

*We could in the future be considered a passive foreign investment company under United States tax laws, which may have adverse tax consequences for United States holders of our shares.* Under United States tax laws, United States investors who hold stock in a passive foreign investment company, referred to in this report as a PFIC, may be subject to adverse tax consequences. Any non-United States corporation may be classified as a PFIC if 75% or more of its gross income in any year is considered passive income for United States tax purposes. For this purpose, passive income generally includes interest, dividends and gains from the sale of assets that produce these types of income. In addition, a non-United States corporation may be classified as a PFIC if the average percentage of the fair market value of its gross total assets during any year that produced passive income (based on the average of such values as at each quarter end of that year), or that were held to produce passive income, is at least 50% of the fair market value of its gross total assets.

The determination of whether a corporation is a PFIC is a fact-sensitive inquiry that depends, among other things, on the fair market value of its assets (and such value is subject to change from time to time). We believe that the company is not a PFIC. However, it currently holds a relatively large amount of cash and investments that are passive assets and produce passive income. In addition, the fair market valuation of its non-passive assets is uncertain because it depends, in part, on the valuation of its goodwill or going concern value. One indicator of the amount of goodwill is our share price, which at times during the preceding six months has traded near historic lows. We cannot provide you with any assurances that the company will not be classified as a PFIC at the end of 2003 or a subsequent year.



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All gains recognized on the disposition of PFIC shares by a United States shareholder are taxable as ordinary income. Additionally, at the time of disposition, the United States shareholder incurs an interest charge. The interest is computed at the rate for underpayments of tax, generally as though the gain had been included in the United States shareholder's gross income ratably over the period the United States shareholder held the PFIC's stock, but payment of the resulting tax had been delayed until the sale or distribution. Similar rules apply to excess distributions. An excess distribution is a current year distribution received by a United States shareholder on PFIC stock, to the extent the distribution exceeds his or her ratable portion of 125% of the average amount so received during the three preceding years. The portion of an actual distribution that is not an excess distribution is not taxed under the excess distribution rules, but rather is treated as a distribution subject to the normal tax rules. Moreover, in general, the rules allowing for nonrecognition of gain or loss on dispositions of stock in corporate reorganizations do not apply to stock of a PFIC. However, under proposed regulations issued by the Internal Revenue Service, a transfer of PFIC stock by a United States holder that otherwise would qualify for nonrecognition of gain will continue to qualify if:

the basis of the stock that is the subject of the disposition, in the hands of its actual owner immediately after the transfer, is no greater than the basis of such stock in the hands of its actual owner immediately before the transfer;

the United States transferee's holding period for the transferred stock is at least as long as the holding period of the shareholder immediately before the transfer; and

the aggregate ownership of the shareholder and the United States transferee immediately after the transfer (determined without regard to stock held by the United States transferee prior to the transfer) is the same as or greater than the shareholder's proportionate ownership immediately before the transfer.

A United States shareholder may avoid the effect of the forgoing rules if he or she makes a qualified electing fund election or a mark-to-market election, but then becomes subject to the special rules that apply to such elections.

*Our classification as a controlled foreign corporation could have adverse tax consequences for significant United States shareholders.* A non-United States corporation, such as we are, will constitute a controlled foreign corporation, or CFC, for United States federal income tax purposes if United States shareholders owning (directly, indirectly, or constructively) 10% or more of the foreign corporation's total combined voting power collectively own (directly, indirectly, or constructively) more than 50% of the total combined voting power or total value of the foreign corporation's stock.

If we are treated as a CFC, this status should have no adverse effect on any shareholder who does not own (directly, indirectly, or constructively) 10% or more of the total combined voting power of all classes of our shares. If, however, we are treated as a CFC for an uninterrupted period of thirty (30) days or more during any taxable year, any United States shareholder who owns (directly, indirectly, or constructively) 10% or more of the total combined voting power of all classes of our shares on any day during the taxable year, and who directly or indirectly owns any shares on the last day of the year in which we are a CFC, will have to include in its gross income for United States federal income tax purposes its pro rata share of the company's subpart F income (primarily consisting of investment income such as dividends, interest and capital gains on the sale of assets producing such income) relating to the period during which we are or were a CFC.

In addition, if we were treated as a CFC, any gain realized on the sale of our shares by such a shareholder would be treated as ordinary income to the extent of the shareholder's proportionate share of the undistributed earnings and profits of the company accumulated during the shareholder's holding period while we are a CFC. If the United States shareholder is a corporation, however, it may be eligible to credit against its United States tax liability with respect to these potential inclusions foreign taxes paid on the earnings and profits associated with the included income.

We do not believe that we are currently, or have ever been, a CFC. However, no assurances can be given that we will not become a CFC in the future.

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*We depend on limited source suppliers that could cause substantial manufacturing delays and additional cost if a disruption in supply occurs.* We obtain some components from a single source. We also rely on a limited number of independent contractors to manufacture subassemblies for some of our products. There can be no assurance that, in the future, our current or alternative sources will be able to meet all of our demands on a timely basis. If suppliers or subcontractors experience difficulties that result in a reduction or interruption in supply to us, or fail to meet any of our manufacturing requirements, our business would be harmed until we are able to secure alternative sources, if any, on commercially reasonable terms. Unavailability of necessary parts or components could require us to reengineer our products to accommodate available substitutions which would increase our costs and/or have a material adverse effect on manufacturing schedules, product performance and market acceptance.

*Production difficulties and product delivery delays could materially adversely affect our business, operating results or financial condition.* We assemble our products at our facilities in the United States, Canada and the United Kingdom. If use of any of our manufacturing facilities were interrupted by natural disaster or otherwise, our operations could be negatively affected until we could establish alternative production and service operations. In addition, we may experience production difficulties and product delivery delays in the future as a result of:

changing process technologies;

ramping production;

installing new equipment at our manufacturing facilities; and

shortage of key components.

*Our operations in foreign countries subject us to risks not faced by companies operating exclusively in the United States.* In addition to operating in the United States, Canada and the United Kingdom, we have sales and service offices in France, Germany, Italy, Japan, Singapore, Hong Kong, Korea, Taiwan, Malaysia and the Philippines. We may in the future expand into other international regions. During 2002 and 2001, approximately 41% and 52% of our revenue, respectively, were derived from our international operations.

Because of the scope of our international operations, we are subject to risks, which could materially impact our results of operations, including:

foreign exchange rate fluctuations;

longer payment cycles;

greater difficulty in collecting accounts receivable;

use of different systems and equipment;

difficulties in staffing and managing foreign operations and diverse cultures;

protective tariffs;

trade barriers and export/import controls;

transportation delays and interruptions;

reduced protection for intellectual property rights in some countries; and

the impact of recessionary foreign economies.

We cannot predict whether the United States or any other country will impose new quotas, tariffs, taxes or other trade barriers upon the importation of our products or supplies or gauge the effect that new barriers would have on our financial position or results of operations.

We do not believe that travel advisories or health concerns have had a material effect on our business to date. However, no assurances can be given that future travel advisories or health concerns will not have an impact on our business.

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*If the economic and political conditions in United States and globally do not improve or if the economic slowdown continues, we may continue to experience material adverse impacts on our business, operating results and financial condition.* Our business is subject to the effects of general economic and political conditions globally. Our revenues and operating results have declined partially due to continuing unfavorable economic conditions as well as uncertainties arising out of the threatened terrorist attacks on the United States, including the potential worsening or extension of the current global economic slowdown, the economic consequences of protracted military action or additional terrorist activities and associated political instability, and the impact of heightened security concerns on domestic and international travel and commerce. In particular, due to these uncertainties we are subject to:

the risk that future tightening of immigration controls may adversely affect the residence status of non-United States engineers and other key technical employees in our United States facilities or our ability to hire new non-United States employees in such facilities; and

the risk of more frequent instances of shipping delays.

*Increased governmental regulation of our business could materially adversely affect our business, operating results and financial condition.* We are subject to the laser radiation safety regulations of the Radiation Control for Health and Safety Act administered by the National Center for Devices and Radiological Health, a branch of the United States Food and Drug Administration. Among other things, these regulations require a laser manufacturer to file new product and annual reports, to maintain quality control and sales records, to perform product testing, to distribute appropriate operating manuals, to incorporate design and operating features in lasers sold to end-users and to certify and label each laser sold to end-users as one of four classes (based on the level of radiation from the laser that is accessible to users). Various warning labels must be affixed and certain protective devices installed depending on the class of product. The National Center for Devices and Radiological Health is empowered to seek fines and other remedies for violations of the regulatory requirements. We are subject to similar regulatory oversight, including comparable enforcement remedies, in the European markets we serve.

Changes in governmental regulations may reduce demand for our products or increase our expenses. We compete in many markets in which we and our customers must comply with federal, state, local, and international regulations, such as environmental, health and safety, and food and drug regulations. We develop, configure, and market our products to meet customer needs created by those regulations. Any significant change in regulations could reduce demand for our products, which in turn could materially adversely affect our business, operating results and financial condition.

*Defects in our products or problems arising from the use of our products together with other vendors' products may seriously harm our business and reputation.* Products as complex as ours may contain known and undetected errors or performance problems. Defects are frequently found during the period immediately following introduction and initial implementation of new products or enhancements to existing products. Although we attempt to resolve all errors that we believe would be considered serious by our customers before implementation, our products are not error-free. These errors or performance problems could result in lost revenues or customer relationships and could be detrimental to our business and reputation generally. In addition, our customers generally use our products together with their own products and products from other vendors. As a result, when problems occur in a combined environment, it may be difficult to identify the source of the problem. These problems may cause us to incur significant warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations problems. To date, defects in our products or those of other vendors' products with which ours are used by our customers have not had a material negative effect on our business. However, we cannot be certain that a material negative effect will not occur in the future.

**Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

*Interest Rate Risk.* Our exposure to market risk associated with changes in interest rates relates primarily to our cash equivalents, short-term investments and debt obligations. As described in note 13 to the audited consolidated financial statements, at December 31, 2002, the company had \$53.3 million invested in

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cash equivalents and \$66.4 million invested in short-term and other investments. At December 31, 2001, the company had \$79.8 million invested in cash equivalents and \$43.5 million invested in short-term to investments. Due to the average maturities and the nature of the investment portfolio, a change in interest rates is not expected to have a material effect on the value of the portfolio. We do not use derivative financial instruments in our investment portfolio. We do not actively trade derivative financial instruments but may use them to manage interest rate positions associated with our debt instruments. We currently do not hold interest rate derivative contracts.

*Foreign Currency Risk.* To reduce the company's exposure to exchange gains and losses, we generally transact sales and costs and related assets and liabilities in the functional currencies of the operations. We have a foreign currency hedging program using currency forwards, currency swaps and currency options to hedge exposure to foreign currencies. These financial instruments are used to fix the cash flow variable of local currency costs or selling prices denominated in currencies other than the functional currency. We do not currently use currency forwards or currency options for trading purposes. As of December 31, 2002, we had eleven foreign exchange forward contracts to purchase \$16.9 million United States dollars and one currency swap contract valued at \$8.7 million compared to December 31, 2001, where the company had eight foreign exchange forward contracts to purchase \$17.8 million United States dollars and one foreign exchange option contract to purchase \$6.5 million United States dollars. For December 31, 2002, we recorded an aggregate fair value loss of \$0.5 million in accumulated other comprehensive income and maturing at varying dates in 2003.

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**Item 8. *Financial Statements and Supplementary Data***

**GSI LUMONICS INC.**

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**AUDITORS REPORT**

To the Stockholders of

GSI Lumonics Inc.

We have audited the consolidated balance sheets of GSI Lumonics Inc. as of December 31, 2002 and 2001 and the consolidated statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2002. Our audits also included the financial statement schedule listed at Item 15 of this Form 10-K Annual Report. These financial statements and the schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2002 and 2001 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2002 in accordance with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

The Company changed its method of accounting for business combinations, goodwill and other intangible assets and impairment or disposal of long-lived assets in 2002, as described in note 1.

On February 21, 2003, we reported without reservation to the shareholders on the Company's consolidated financial statements prepared in accordance with Canadian generally accepted accounting principles.

ERNST & YOUNG LLP  
Chartered Accountants

Ottawa, Canada,  
February 21, 2003  
(except with respect to  
note 15, which is  
as at May 16, 2003)

**Table of Contents****GSI LUMONICS INC.****CONSOLIDATED BALANCE SHEETS**

(United States GAAP and in thousands of United States dollars, except share amounts)

	As of December 31,	
	2002	2001
<b>ASSETS</b>		
Current		
Cash and cash equivalents (note 13)	\$ 83,633	\$ 102,959
Short-term investments (note 13)	28,999	43,541
Accounts receivable, less allowance of \$2,681 (2001 \$3,034) (notes 4 and 10)	33,793	39,919
Income taxes receivable	8,431	9,224
Inventories (note 3)	39,671	57,794
Deferred tax assets (note 9)	9,763	15,097
Other current assets (note 3)	4,448	8,528
	<u>208,738</u>	<u>277,062</u>
Total current assets	208,738	277,062
Property, plant and equipment, net of accumulated depreciation of \$21,453 (2001 \$20,575) (note 3)	26,675	32,482
Deferred tax assets (note 9)	7,443	6,537
Other assets (note 3)	3,360	1,539
Long-term investments (note 13)	37,405	
Intangible assets, net of amortization of \$16,217 (2001 \$11,857) (note 3)	13,467	19,067
	<u>\$ 297,088</u>	<u>\$ 336,687</u>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current		
Bank indebtedness (note 4)	\$	\$ 6,171
Accounts payable	9,235	10,839
Accrued compensation and benefits	6,523	7,515
Other accrued expenses (note 3)	20,845	25,096
Current portion of long-term debt (note 5)		2,654
	<u>36,603</u>	<u>52,275</u>
Total current liabilities	36,603	52,275
Deferred compensation (note 6)	2,129	2,082
Accrued minimum pension liability (note 8)	3,875	
	<u>42,607</u>	<u>54,357</u>
Total liabilities	42,607	54,357
Commitments and contingencies (note 12)		
Stockholders' equity (note 7)		
Common shares, no par value; Authorized shares: unlimited; Issued and outstanding: 40,785,922 (2001 40,556,130)	304,713	303,504
Additional paid-in capital	2,592	2,592
Accumulated deficit	(41,270)	(13,546)
Accumulated other comprehensive loss	(11,554)	(10,220)
	<u>254,481</u>	<u>282,330</u>
Total stockholders' equity	254,481	282,330
	<u>\$ 297,088</u>	<u>\$ 336,687</u>



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

**Table of Contents****GSI LUMONICS INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(United States GAAP and in thousands of United States dollars, except share amounts)

	Capital Stock		Additional Paid-In- Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive	Total	Comprehensive
	# Shares	Amount			Income (Loss)		Income (Loss)
	(000 s)						
<b>Balance, December 31, 1999</b>	34,299	\$ 222,865	\$	\$(44,225)	\$ (6,910)	\$ 171,730	
Net income				45,377		45,377	\$ 45,377
Issuance of capital stock							
public offering	4,300	70,137				70,137	
stock options	1,564	8,665				8,665	
Unrealized loss on equity securities, net of tax of \$2,905					(5,395)	(5,395)	(5,395)
Compensation expense			759			759	
Foreign currency translation adjustments					(2,006)	(2,006)	(2,006)
<b>Balance, December 31, 2000</b>	40,163	301,667	759	1,152	(14,311)	289,267	37,976
Net loss				(14,698)		(14,698)	(14,698)
Issuance of capital stock							
stock options	344	1,503				1,503	
employee stock purchase plan	51	334				334	
Other	(2)						
Tax benefit associated with stock options			1,433			1,433	
Cumulative effect of change in accounting policy for cash flow hedges					(164)	(164)	(164)
Realized loss on derivative instruments designated and qualifying as foreign currency cash flow hedging instruments, net of tax of \$0					164	164	164
Unrealized gain on cash flow hedging instruments, net of tax of \$567					793	793	793
Unrealized gain on equity securities, net of tax of \$1,221					2,269	2,269	2,269
Reclassification adjustment for loss on sale of equity securities, net of tax of \$1,683					3,126	3,126	3,126
Translation loss on liquidation of a subsidiary, net of tax of \$0.					723	723	723

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Stock-based compensation			400			400	
Foreign currency translation adjustments					(2,820)	(2,820)	(2,820)
<b>Balance, December 31, 2001</b>	40,556	303,504	2,592	(13,546)	(10,220)	282,330	(10,607)
Net loss				(27,724)		(27,724)	(27,724)
Issuance of capital stock							
stock options	133	648				648	
employee stock purchase plan	97	561				561	
Unrealized gain on investments, net of tax of \$0					312	312	312
Realized gain on cash flow hedging instruments, net of tax of \$567					(793)	(793)	(793)
Unrealized loss on cash flow hedging instruments, net of tax of \$0					(521)	(521)	(521)
Additional minimum pension liability, net of tax of \$0					(3,875)	(3,875)	(3,875)
Foreign currency translation adjustments					3,543	3,543	3,543
<b>Balance, December 31, 2002</b>	40,786	\$304,713	\$2,592	\$(41,270)	\$(11,554)	\$254,481	\$(29,058)

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

**Table of Contents****GSI LUMONICS INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(United States GAAP and in thousands of United States dollars, except per share amounts)**

	<b>Year Ended December 31,</b>		
	<b>2002</b>	<b>2001</b>	<b>2000</b>
Sales	\$ 159,070	\$ 247,904	\$ 373,864
Cost of goods sold (note 11)	109,876	162,122	242,393
Gross profit	49,194	85,782	131,471
Operating expenses:			
Research and development	20,444	25,634	33,931
Selling, general and administrative	55,483	73,815	87,459
Amortization of purchased intangibles	5,135	5,226	4,851
Restructuring (note 11)	6,448	2,930	10,141
Other (note 11)	(1,021)	(148)	(2,945)
Total operating expenses	86,489	107,457	133,437
Loss from operations	(37,295)	(21,675)	(1,966)
Gain (loss) on sale of assets and investments (note 2)		(4,809)	76,786
Interest income	2,744	5,084	4,802
Interest expense	(701)	(897)	(1,457)
Foreign exchange transaction losses	(825)	(175)	(3,122)
Other expense (note 10)	(628)		
Income (loss) before income taxes	(36,705)	(22,472)	75,043
Income tax provision (benefit) (note 9)	(8,981)	(7,774)	29,666
Net income (loss)	\$ (27,724)	\$ (14,698)	\$ 45,377
Net income (loss) per common share:			
Basic	\$ (0.68)	\$ (0.36)	\$ 1.19
Diluted	\$ (0.68)	\$ (0.36)	\$ 1.13
Weighted average common shares outstanding (000 s)	40,663	40,351	38,187
Weighted average common shares outstanding and dilutive potential common shares (000 s)	40,663	40,351	40,000

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

**Table of Contents****GSI LUMONICS INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(United States GAAP and in thousands of United States dollars)**

	Year Ended December 31,		
	2002	2001	2000
<b>Cash flows from operating activities:</b>			
Net income (loss) for the year	\$ (27,724)	\$ (14,698)	\$ 45,377
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Loss (gain) on sale of assets and investments	62	5,267	(76,786)
Translation loss on liquidation of a subsidiary		723	
Stock-based compensation		400	759
Reduction of long-lived assets	2,510	2,483	2,137
Depreciation and amortization	10,919	11,918	12,172
Deferred income taxes	4,267	6,688	(3,613)
Changes in current assets and liabilities:			
Accounts receivable	9,356	47,083	(14,061)
Inventories	19,632	8,917	(13,506)
Other current assets	840	1,403	(844)
Accounts payable, accruals, and taxes (receivable) payable	(8,145)	(87,662)	38,145
Cash provided by (used in) operating activities	11,717	(17,478)	(10,220)
<b>Cash flows from investing activities:</b>			
Acquisition of businesses, net of cash acquired (note 2)			(7,138)
Sale of assets and investments		45,822	64,962
Additions to property, plant and equipment, net	(2,952)	(8,639)	(10,142)
Proceeds from the sale and maturity of short-term and other investments	110,014	85,834	45,031
Purchase of short-term and other investments	(132,877)	(109,355)	(57,710)
Decrease (increase) in other assets	1,979	(1,219)	838
Cash provided by (used in) investing activities	(23,836)	12,443	35,841
<b>Cash flows from financing activities:</b>			
Payments of bank indebtedness	(6,441)	(4,117)	(10,131)
Repayment of long-term debt	(3,000)	(4,000)	(4,114)
Issue of share capital (net of issue costs)	1,209	1,837	76,986
Cash provided by (used in) financing activities	(8,232)	(6,280)	62,741
Effect of exchange rates on cash and cash equivalents	1,025	416	224
Increase (decrease) in cash and cash equivalents	(19,326)	(10,899)	88,586
Cash and cash equivalents, beginning of year	102,959	113,858	25,272
Cash and cash equivalents, end of year	\$ 83,633	\$ 102,959	\$ 113,858

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



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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**As of December 31, 2002**

**(United States GAAP and tabular amounts in thousands of United States dollars except share amounts)**

**1. Significant Accounting Policies**

***Nature of operations***

We design, develop, manufacture and market components, lasers and laser-based advanced manufacturing systems as enabling tools for a wide range of applications. Our products allow customers to meet demanding manufacturing specifications, including device complexity and miniaturization, as well as advances in materials and process technology. Major markets for our products include the medical, automotive, semiconductor, and electronics industries. In addition, we sell our products and services to other markets such as light industrial and aerospace. The Company's principal markets are in North America, Europe, Japan and Asia-Pacific.

***Basis of presentation***

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

***Basis of consolidation***

The consolidated financial statements include the accounts of GSI Lumonics Inc. and its wholly owned subsidiaries (the Company). Intercompany accounts and transactions are eliminated.

***Comparative amounts***

Certain prior year amounts have been reclassified to conform to the current year presentation in the financial statements for the year ended December 31, 2002. These reclassifications had no effect on the previously reported results of operations or financial position.

***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. Actual results could differ from those estimates.

***Cash equivalents***

Cash equivalents are investments held to maturity with original maturities of three months or less. Cash equivalents, consisting principally of commercial paper, short-term corporate debt, and banker's acceptances, are stated at amortized cost, which approximates fair value. The Company does not believe it is exposed to any significant credit risk on its cash equivalents.

***Investments***

Short-term, long-term and other investments consist principally of commercial paper, governments, short-term corporate debt, and banker's acceptances with original maturities greater than three months for short-term investments and greater than twelve months for long-term investments. The Company has classified these investments as available-for-sale securities that are stated at estimated fair value based upon

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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

market quotes. Unrealized holding gains and losses on available-for-sale securities are excluded from earnings and reported as a component of accumulated other comprehensive income until realized.

***Inventories***

Inventories, which include materials and conversion costs, are stated at the lower of cost (primarily first-in, first-out) or market. Market is defined as replacement cost for raw materials and net realizable value for other inventories.

***Property, plant and equipment***

Property, plant and equipment are stated at cost and the declining-balance and straight-line methods are used to determine depreciation and amortization over estimated useful lives. Estimated useful lives for buildings and improvements range from 5 to 39 years and for machinery and equipment from 3 to 15 years. Leasehold improvements are amortized over the lesser of their useful lives or the lease term, including option periods expected to be utilized.

***Intangible assets***

Intangibles assets include purchased trademarks and trade names, which are amortized on a straight-line basis over periods from three to ten years from the date of acquisition. Patents and purchased technology are stated at cost and are amortized on a straight-line basis over the expected life of the asset, up to 19 years.

***Impairment of long-lived assets***

When events and circumstances warrant a review, the Company evaluates the carrying values of long-lived assets and purchased intangibles in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144). The carrying value of a long-lived asset and purchased intangible is considered impaired when the anticipated undiscounted cash flow from such asset is less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value. Fair value is determined using anticipated discounted cash flows.

***Revenue recognition***

We recognize product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, risk of loss has passed to the customer and collection of the resulting receivable is probable. We design, market and sell our products as standard configurations. Accordingly, customer acceptance provisions for standard configurations are generally based on seller-specified criteria, which we demonstrate prior to shipment. Revenue on new products is deferred until we have established a track record of customer acceptance on these new products. When customer-specified objective criteria exist, revenue is deferred until customer acceptance if we cannot demonstrate the system meets these specifications prior to shipment. The Company recognizes installation revenue when installation has been completed.

Revenue associated with service or maintenance contracts is recognized ratably over the life of the contract, which is generally one year.

***Product Warranty***

We generally warrant our products for a period of up to 12 months for material and labor to repair and service the system. A provision for the estimated cost related to warranty is recorded at the time revenue is recognized.



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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Our estimate of costs to service the warranty obligations is based on historical experience and expectation of future conditions. To the extent we experience increased warranty claims or increased costs associated with servicing those claims, revisions to the estimated warranty liability would be made.

***Stock based compensation***

The Company uses the intrinsic value method for accounting for its stock option plans as proscribed in APB 25.

***Foreign currency translation***

The financial statements of the parent corporation and its subsidiaries outside the United States have been translated into United States dollars in accordance with the Financial Accounting Standards Board Statement No. 52, *Foreign Currency Translation*. Assets and liabilities of foreign operations are translated from foreign currencies into United States dollars at the exchange rates in effect on the balance sheet date. Revenues and expenses are translated at the average exchange rate in effect for the period. Accordingly, gains and losses resulting from translating foreign currency financial statements are reported as a separate component of other comprehensive income in stockholders equity. Foreign currency transaction gains and losses are included in net income.

***Derivative financial instruments***

As of January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), which was issued in June 1998 and its amendments, Statements 137 and 138, issued in June 1999 and June 2000, respectively.

As a result, the Company recognizes all derivative financial instruments, such as interest rate swap contracts and foreign exchange contracts, in the consolidated financial statements at fair value regardless of the purpose or intent for holding the instrument. Changes in the fair value of derivative financial instruments are either recognized periodically in income or in stockholders equity as a component of comprehensive income depending on whether the derivative financial instrument qualifies for hedge accounting and, if so, whether it qualifies as a fair value hedge or cash flow hedge. Generally, changes in fair value of derivatives accounted for as fair value hedges are recorded in income along with the portions of the changes in fair values of the hedged items that relate to the hedged risk(s). Changes in fair values of derivatives accounted for as cash flow hedges, to the extent they are effective as hedges, are recorded in other comprehensive income net of deferred taxes. Changes in fair value of derivatives used as hedges of the net investment in foreign operations are reported in other comprehensive income as part of the cumulative translation adjustment. Changes in fair values of derivatives not qualifying as hedges are reported in income.

The Company accounted for the accounting change as a cumulative effect of a change in accounting principle. The Company recorded a transition adjustment loss of \$164 thousand in other comprehensive income as a result of adopting SFAS 133. The loss was recognized in earnings during the period ended March 30, 2001, and at that time the underlying hedged transactions were realized.

Prior to January 1, 2001, the Company used foreign exchange contracts and interest rate swap contracts for hedging purposes. For foreign currency forward contracts hedging firm commitments, the effects of movements in currency exchange rates on those instruments were recognized when the related operating revenue was recognized. The discounts or premiums on the instruments were amortized to income over the lives of the contracts using the straight-line method. Realized gains and losses were included in other assets and liabilities and recognized in income when the future transaction occurred or at the time the transaction was no longer expected to occur. For interest rate swap contracts, payments and receipts under such contracts were recognized as adjustments to interest expense on a basis that matched them with the fluctuations in the

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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

interest receipts and payments under floating rate financial assets and liabilities. Unrealized gains or losses on interest rate swap contracts were not recognized in income.

***Income taxes***

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

***Recent accounting pronouncements***

***Business Combinations***

On January 1, 2002, the Company implemented, on a prospective basis, Statement of Financial Accounting Standards ( SFAS ) No. 141, *Business Combinations* ( SFAS 141 ). As a result, all business combinations initiated in the future will be accounted for under the purchase method. Also, SFAS 141 does not permit the Company to recognize an assembled workforce asset. Therefore, the Company reallocated its assembled workforce asset with a cost of \$2.8 million and a net carrying value of \$2 million at January 1, 2002 to other remaining long-lived assets arising from the merger with General Scanning Inc. in 1999, including \$1.4 million to developed technology, \$0.5 million to property, plant and equipment and \$0.1 million to trademarks and trade names. The adoption of SFAS 141 did not have any other material impact on the Company's financial position or cash flows. It will accelerate amortization by \$0.6 million per year for 2002 and 2003 and reduce amortization thereafter.

***Intangible Assets***

On January 1, 2002, the Company implemented, on a prospective basis, SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS 142 ). As a result, intangible assets with finite useful lives must now be amortized over their estimated lives to their estimated residual values and be reviewed for impairment according to SFAS 144. Goodwill and intangible assets with indefinite lives will not be amortized, but will rather be tested at least annually for impairment. The adoption of SFAS 142 did not have a material impact on the Company's financial position, as it does not possess goodwill or intangible assets with indefinite lives. It also did not have a material impact on the Company's results of operations or cash flows.

***Impairment or Disposal of Long-Lived Assets***

On January 1, 2002, the Company adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS 144 ). SFAS 144 applies to all long-lived assets, including discontinued operations, and develops one accounting model for long-lived assets to be disposed of by sale. SFAS 144 supersedes SFAS 121, and the accounting and reporting provisions of APB No. 30, *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* ( APB 30 ), for the disposal of a segment of a business. The adoption of SFAS 144 did not have a material impact on the Company's financial position, results of operations or cash flows. During 2002 as a result of restructuring actions, the Company wrote-down fixed assets by approximately \$1.1 million (see note 11).

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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Costs Associated with Exit or Disposal Activities*

In July 2002, SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities* ( SFAS 146 ) was issued. SFAS 146 requires that a liability for costs associated with exit or disposal activities be recognized and measured initially at fair value only when the liability is incurred. SFAS 146 will be effective for exit or disposal activities initiated after December 31, 2002, and had no impact on the Company's financial statements in 2002, but will impact the accounting treatment of future exit or disposal activities should they occur.

*Guarantor's Accounting for Guarantees*

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (the Interpretation). The Interpretation will significantly change current practice in the accounting for, and disclosure of, guarantees. Guarantees meeting the characteristics described in the Interpretation which are not included in a long list of exceptions are required to be initially recorded at fair value, which is different from the general current practice of recording a liability only when a loss is probable and reasonably estimable, as those terms are defined in FASB Statement No. 5, *Accounting for Contingencies*. The Interpretation also requires a guarantor to make significant new disclosures for virtually all guarantees even if the likelihood of the guarantor's having to make payments under the guarantee is remote. The initial recognition and initial measurement provisions of the Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. Accounting for guarantees issued prior to December 31, 2002 should not be revised or restated. As discussed in Note 12 to the consolidated financial statements, the Company has two existing operating lease agreements with terms that include residual value guarantees totaling approximately \$16 million, both entered into before December 31, 2002, and, therefore, not required to be revised or restated.

*Stock Based Compensation Transition and Disclosure*

In December 2002, SFAS No. 148 ( SFAS 148 ), *Accounting for Stock-Based Compensation-Transition and Disclosure* was issued to amend SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of SFAS 148 will not have a material impact on our financial position, results of operations, or cash flows, because the Company will continue to follow the guidance of APB 25 in recognizing stock compensation expense. The Company will comply with the new disclosure requirements in the financial statement for the first quarter of 2003.

**2. Business Combinations and Divestitures**

*Purchases*

On September 21, 2000, the Company acquired all outstanding shares of General Optics, Inc. ( General Optics ), a privately held precision optics company located in Moorpark, California. The purchase price of \$13.5 million was comprised of cash of \$6.9 million paid on closing, note payable valued at \$6.4 million, discounted at an imputed interest rate of 6.23%, and costs of acquisition of \$0.2 million. The note payable was settled in two installments, due September 21, 2001 and 2002. The transaction has been accounted for as a purchase and, accordingly, the operations of General Optics have been included in the consolidated financial statements from the date of acquisition. The excess of the purchase price over the fair value of net identifiable

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

tangible assets acquired was recorded as acquired technology to be amortized over its estimated useful life of 10 years.

***Divestitures***

On April 2, 2001, the Company completed the sale of operating assets of the Laserdyne and Custom Systems product lines for cash proceeds of approximately \$7.3 million. Sales for these product lines were \$3 million and \$24.3 million for the years ended December 31, 2001 and December 31, 2000, respectively.

On October 1, 2000, the Company sold the net assets of its Life Sciences business to Packard BioScience Company ( Packard ) for \$39.3 million in cash and approximately 4.5 million shares of unregistered Packard common stock valued at \$43.3 million by management. To determine the fair value of the stock, a number of factors were considered, including a valuation. The value of the stock reflected a discount from the quoted market value of Packard's registered common stock that was traded on the NASDAQ National Market. The Life Sciences business comprised working capital of approximately \$3.5 million and fixed and other intangible assets of approximately \$1.2 million. The Company recorded a non-operating gain of \$73.1 million (\$47.3 million after tax), or \$1.24 per share, as a result of this transaction. Sales for the Life Sciences business for the nine months ended September 30, 2000 were \$13.1 million and for the year ended December 31, 1999 were \$13.8 million. On November 13, 2001, Packard was acquired by PerkinElmer, Inc. As a result, the shares of Packard owned by the Company were converted into the right to receive 0.311 of a share of PerkinElmer, Inc. at the quoted market value of \$27.285 per share. The Company sold these shares on November 19, 2001 for proceeds of \$38.5 million and recorded a loss of \$4.8 million.

During the third quarter of 2000, the Company sold two facilities in the United States for \$12.5 million cash and recorded a net gain of \$2.4 million.

During the second quarter of 2000, the Company sold operating assets of its View Engineering metrology product line, fiber-optics operations in Phoenix, Arizona and package coding product line in Hull, United Kingdom for an aggregate of \$13 million cash and recorded a net gain of \$1.3 million.

**3. Supplementary Balance Sheet Information**

The following tables provide the details of selected balance sheet items as at December 31:

***Inventories***

	<u>2002</u>	<u>2001</u>
Raw materials	\$ 16,380	\$ 29,779
Work-in-process	7,468	8,028
Finished goods	11,114	12,918
Demo inventory	4,709	7,069
	<u>          </u>	<u>          </u>
Total inventories	<u>\$ 39,671</u>	<u>\$ 57,794</u>

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Property, Plant and Equipment, net***

	<u>2002</u>	<u>2001</u>
Cost:		
Land, buildings and improvements	\$ 12,102	\$ 18,167
Machinery and equipment	36,026	34,890
	<u>          </u>	<u>          </u>
Total cost	48,128	53,057
Accumulated depreciation	(21,453)	(20,575)
	<u>          </u>	<u>          </u>
Net property, plant and equipment	<u>\$ 26,675</u>	<u>\$ 32,482</u>

***Other Assets***

	<u>2002</u>	<u>2001</u>
Short term other assets:		
Note receivable	\$ 563	\$ 1,125
Investment (note 10)		1,500
Prepaid expenses and other	3,885	5,903
	<u>          </u>	<u>          </u>
Total	<u>\$4,448</u>	<u>\$8,528</u>
Long term other assets:		
Investment (note 10)	\$	\$ 500
Note receivable		563
Deposits and other	425	476
Facilities available for sale (note 11)	2,935	
	<u>          </u>	<u>          </u>
Total	<u>\$3,360</u>	<u>\$1,539</u>

The note receivable bears interest at the prime rate and will be received in quarterly installments of \$0.3 million, ending in June 2003.

At December 31, 2002, the Company had two facilities that were classified as available for sale. One is a 75,000 square foot facility in Kanata, Ontario and the other is a 17,000 square foot facility in Nepean, Ontario. Both of these facilities became available for sale in 2002, as a result of restructuring actions that occurred (Note 11). These buildings are recorded at their estimated fair market value (approximately \$2.2 million for the Kanata, Ontario property and \$0.7 million for Nepean, Ontario).

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Intangible assets consist of the following:

	December 31, 2002		December 31, 2001	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Patents and acquired technology	\$ 28,660	\$(15,850)	\$ 27,174	\$(10,809)
Assembled workforce			2,814	(786)
Trademarks and trade names	1,024	(367)	936	(262)
Total cost	29,684	\$(16,217)	30,924	\$(11,857)
Accumulated amortization	(16,217)		(11,857)	
Net intangible assets	\$ 13,467		\$ 19,067	

Amortization of intangible asset expense subsequent to December 31, 2002 is:

2003	\$ 5,135
2004	1,970
2005	1,137
2006	1,137
2007	1,137
Thereafter	2,951
Total amortization expense	\$13,467

**Other Accrued Expenses**

	2002	2001
Accrued warranty	\$ 3,383	\$ 4,027
Deferred revenue	3,404	2,148
Accrued restructuring (note 11)	8,790	8,827
Other	5,268	10,094
Total	\$20,845	\$25,096

**Accrued Warranty**

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	Year Ended December 31,	
	2002	2001
Balance at the beginning of the period	\$ 4,027	\$ 7,107
Charged to costs and expenses	5,624	9,551
Use of provision	(6,358)	(12,507)
Foreign currency exchange rate changes	90	(124)
	<u>          </u>	<u>          </u>
Balance at the end of the period	\$ 3,383	\$ 4,027
	<u>          </u>	<u>          </u>

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. Bank Indebtedness**

At December 31, 2002, the Company had lines of credit denominated in US and Canadian dollars with Fleet National Bank ( Fleet ), Bank One and Canadian Imperial Bank of Commerce ( CIBC ) and letters of credit ( LC ) with National Westminster Bank ( NatWest ), for a total amount of available credit of \$12.1 million versus \$32.4 million at December 31, 2001. The Company's agreement with Fleet provides for an \$8 million line of credit and its agreement with CIBC provides for a \$4 million line of credit. The previous \$13 million line of credit with CIBC expired on June 28, 2002, and the new CIBC credit facility eliminated the Company's requirement to meet certain financial covenants which were required under the previous credit facility. NatWest provides a \$0.1 million bank guarantee for LC used for VAT purposes in the United Kingdom. Marketable securities totaling \$14.5 million have been pledged as collateral for the Fleet and CIBC credit facilities under security agreements. The line of credit with Fleet expires on June 28, 2003. In addition to the customary representations, warranties and reporting covenants, the borrowings under the Fleet credit facility require the Company to maintain a quarterly minimum tangible net worth of \$200 million. The line of credit with CIBC was reviewed by the Company and a decision to cancel the line of credit was conveyed to CIBC prior to December 31, 2002. By giving CIBC appropriate advance notice, the Company initiated its right to cancel the line of credit at any time at no cost, excluding breakage fees relating to the used and outstanding amounts under fixed loan instruments, which we do not expect to be material. The line of credit with CIBC should be eliminated by the end of the second quarter in 2003. The Company also cancelled its credit facility with Bank One on December 20, 2002 without paying any breakage fees. North American inventories and receivables were pledged as collateral for the Bank One credit facility. Bank One continues to work on the release of all liens and obligations associated with the facility.

At December 31, 2002, the Company has approximately \$12.1 million denominated in Canadian dollars and US dollars that are available for general purposes, under the credit facilities discussed above. Of the available \$12.1 million, \$7.7 million was in use at December 31, 2002, consisting of \$3.8 million committed at Fleet Bank for use in foreign exchange transactions, \$2.9 million in Rugby, U.K. under the CIBC credit facilities and approximately \$0.8 million of bank guarantees and outstanding letters of credit under the CIBC credit facility and \$0.1 million with NatWest. Though the Fleet Bank amount of \$3.8 million is committed for support of foreign currency hedging contracts and not available, it is not considered used for the purpose of calculating interest payments. At December 31, 2002, the aggregate unused portion of credit available under the credit facilities amounts to \$4.4 million. The CIBC credit facility is currently a demand facility with interest based on the prime rate. The Fleet line of credit is due on demand and bears interest based on either prime or LIBOR depending on the borrowing notification period. This resulted in an effective average rate of 1.79% for fiscal 2002.

The Company had a line of credit at December 31, 2001 of approximately \$32.4 million that was denominated in Canadian dollars, US dollars, British Sterling and Japanese Yen. The line of credit available for general purposes was \$32.4 million. As at December 31, 2001, there was an outstanding balance of approximately \$6.2 million under the line of credit and outstanding letters of credit and other discretionary lines of \$4.9 million. The line of credit was due on demand and bore interest based on prime, which resulted in an effective average rate of 1.68% for fiscal 2001. Borrowings were limited to the sum of eligible accounts receivable under 90 days and North American inventories. Accounts receivable and inventories were pledged as collateral for the bank indebtedness under general security agreements. As of December 31, 2001, the Company was in breach of one of the financial covenants, the interest coverage ratio, for which no borrowings were made under the facility. The bank issued a waiver of this non-compliance, which would have allowed the Company to draw on the line of credit if needed.



**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Long-term Debt**

There was no long-term debt at December 31, 2002. In 2001, long-term debt includes a note payable with a face value of \$3 million (2000 \$7 million), non-interest bearing, to the former shareholders of General Optics. The note payable was discounted at an imputed interest rate of 6.23% and was settled on September 21, 2002.

Total cash interest paid on all long-term debt during the year ended December 31, 2002 was \$0.3 million (2001 \$0.5 million; 2000 \$1.2 million).

**6. Deferred Compensation**

Certain officers and employees have deferred payment of a portion of their compensation until termination of employment or later. Interest on the outstanding balance is credited quarterly at the prime rate, which averaged 4.7% during the year ended December 31, 2002 (2001 6.9%). The portion of deferred compensation estimated to be due within one year is included in accrued compensation and benefits.

**7. Stockholders Equity*****Capital stock***

The authorized capital of the Company consists of an unlimited number of common shares without nominal or par value. During 2001, the Company reduced its common shares outstanding for 2,309 shares that were not claimed since the merger.

***Accumulated other comprehensive loss***

The following table provides the details of accumulated other comprehensive loss at December 31;

	<b>2002</b>	<b>2001</b>
Unrealized gain on investments (net of tax of \$0)	\$ 312	\$
Unrealized gain (loss) on cash flow hedging (net of tax of \$0 for 2002 and \$567 for 2001)	(521)	793
Accumulated foreign currency translations	(7,470)	(11,013)
Additional minimum pension liability (net of tax of \$0)	(3,875)	
<b>Total</b>	<b>\$ (11,554)</b>	<b>\$ (10,220)</b>

***Net income (loss) per common share***

Basic income (loss) per common share was computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the year. For diluted income per common share, the denominator also includes dilutive outstanding stock options and warrants determined using the treasury stock method. As a result of the net losses for the years ended December 31, 2002 and 2001, the effect of converting options and warrants was antidilutive.

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Common and common equivalent share disclosures are:

	Year Ended December 31,		
	2002	2001	2000
	(In thousands)		
Weighted average common shares outstanding	40,663	40,351	38,187
Dilutive potential common shares			1,813
Diluted common shares	40,663	40,351	40,000
Options and warrants excluded from diluted income per common share as their effect would be antidilutive	3,676	3,633	252

**Shareholder rights plan**

On April 12, 1999, the Board of Directors adopted a Shareholders Rights Plan (the "Plan"). Under this Plan one Right has been issued in respect of each common share outstanding as of that date and one Right has been and will be issued in respect of each common share issued thereafter. Under the Plan, each Right, when exercisable, entitles the holder to purchase from the Company one common share at the exercise price of Cdn\$200, subject to adjustment and certain anti-dilution provisions (the "Exercise Price"). At the annual meeting of the shareholders held on May 9, 2002, the shareholders adopted a resolution to approve the continued existence of the Plan.

The Rights are not exercisable and cannot be transferred separately from the common shares until the "Separation Time", which is defined as the eighth business day (subject to extension by the Board) after the earlier of (a) the "Stock Acquisition Date" which is generally the first date of public announcement that a person or group of affiliated or associated persons (excluding certain persons and groups) has acquired beneficial ownership of 20% or more of the outstanding common shares, or (b) the date of commencement of, or first public announcement of the intent of any person or group of affiliated or associated persons to commence, a Take-over Bid. At such time as any person or group of affiliated or associated persons becomes an "Acquiring Person" (a "Flip-In Event"), each Right shall constitute the right to purchase from the Company that number of common shares having an aggregate Market Price on the date of the Flip-In Event equal to twice the Exercise Price, for the Exercise Price (such Right being subject to anti-dilution adjustments).

So long as the Rights are not transferable separately from the common shares, the Company will issue one Right with each new common share issued. The Rights could have certain anti-takeover effects, in that they would cause substantial dilution to a person or group that attempts to acquire the Company on terms not approved by the Board of Directors.

**Stock options**

In conjunction with the merger with General Scanning, Inc., the Company adopted outstanding options held by employees under nonqualified and incentive stock options plans of General Scanning and issued 2,051,903 stock options of the Company in exchange. At December 31, 2002, options to purchase 630,677 shares of common stock remained outstanding under the assumed General Scanning, Inc. stock option plans. In addition, the Company adopted outstanding warrants for the purchase of common stock issued to non-employee members of the General Scanning, Inc. Board of Directors. The warrants are subject to vesting as determined by a committee of the Board of Directors at the date of grant and expire ten years from the date of grant. During the year ended December 31, 2002, none were granted, cancelled or exercised. At December 31, 2002, 51,186 warrants, of which all are exercisable, remain outstanding at prices ranging from \$9.65 to \$15.41 per share. The warrants are included in the stock option activity table in this note.



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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Lumonics Inc. had three (3) stock option plans in existence for key employees and for directors prior to the merger with General Scanning, Inc., known as the May 1994 Executive Management Plan ( May 1994 Plan ), the September 1994 Key Employee and Director Plan ( September 1994 Plan ) and the 1995 Stock Option Plan ( 1995 Option Plan ). Outstanding options under these three plans vest over periods of one to four years beginning on the date of grant. The options expire over a period of two to ten years beginning at the date of grant. With respect to the May 1994 Plan, a total of 700,000 options were authorized for issuance under the plan and at December 31, 2000, there were no options outstanding under the plan. With respect to the September 1994 Plan, a total of 1,094,000 options were authorized for issuance under the plan and at December 31, 2000, there were no options outstanding under the plan. All outstanding options under the May 1994 Plan and the September 1994 Plan expired on September 14, 2001. No additional options will be granted under the May 1994 Plan or the September 1994 Plan. With respect to the 1995 Option Plan, a total of 4,906,000 options have been authorized for issuance under the plan.

The 1995 Option Plan referenced above, which was established in September 1995 by Lumonics Inc. for the benefit of employees (including contract employees), consultants, and directors of the Company, remained in place following the merger with General Scanning, Inc. in 1999 and as of the date of this Form 10-K, is the only Company stock option plan under which new options may be granted. Subject to the requirements of the 1995 Option Plan, the Compensation Committee or in lieu thereof, the Board of Directors, has the authority to select those directors, consultants, and employees to whom options will be granted, date of the grant, the number of options to be granted and other terms and conditions of the Options. The exercise price of options granted under the 1995 Option Plan must be equal to the closing price of the Company's common shares on The Toronto Stock Exchange, or in lieu thereof, The NASDAQ Stock Market®, on the day immediately preceding the date of grant. The exercise period of each option is determined by the Compensation Committee but may not exceed 10 years from the date of grant. The 1995 Option Plan initially authorized the issuance of a maximum of 406,000 options to purchase common shares. This authorization was increased to: 1,906,000 on May 6, 1997, 2,906,000 on May 11, 1999, and 4,906,000 on May 8, 2000; with all such increases being approved by the shareholders. Currently, a maximum of 4,906,000 options to purchase common shares are permitted to be issued under the 1995 Option Plan. The Compensation Committee has the power to amend, modify, or terminate the 1995 Option Plan provided that optionee's rights are not materially adversely affected and subject to any approvals required under the applicable regulatory requirements. At December 31, 2002, 424,801 (2001 626,113) options were available for grant under the 1995 Option Plan.

In July 1999, the Company offered employee option holders an exchange of one option for each two options outstanding with exercise prices over US\$9.00 or Cdn\$13.32. Under this exchange 243,597 options with exercise price of US\$4.63 or Cdn\$6.95 per share, the then-current market price of the stock, were granted with a new vesting schedule, and 487,194 options were cancelled. The Company is accounting for the replacement options as variable from July 1, 2000, in accordance with Financial Accounting Standard Board Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation - an Interpretation of APB Opinion No. 25*, until the options are exercised, forfeited or expire unexercised. Because the market price of the Company's stock has decreased since July 1, 2000, there was no material impact on its financial position and results of operations.

During 2001, the Company accelerated vesting of certain options and recorded compensation expense of \$0.2 million (2000 \$0.6 million) in results of operations.

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Stock option activity for the years ended December 31, 2002, 2001 and 2000 is presented below.

	<b>Options (thousands)</b>	<b>Weighted Avg. Exercise Price</b>
Outstanding at December 31, 1999	3,978	\$ 6.71
Granted	1,037	18.99
Exercised	(1,564)	5.54
Forfeited	(366)	8.30
	<hr/>	<hr/>
Outstanding at December 31, 2000	3,085	11.20
Granted	1,835	9.37
Exercised	(344)	4.38
Forfeited	(943)	12.61
	<hr/>	<hr/>
Outstanding at December 31, 2001	3,633	10.45
Granted	736	8.58
Exercised	(133)	4.78
Forfeited	(560)	11.81
	<hr/>	<hr/>
Outstanding at December 31, 2002	3,676	\$10.11
	<hr/>	<hr/>
Exercisable at December 31, 2002	1,686	\$10.22
	<hr/>	<hr/>

The following summarizes outstanding and exercisable options outstanding on December 31, 2002:

<b>Range of Exercise Prices</b>	<b>Options Outstanding</b>			<b>Exercisable Options</b>	
	<b>Number of Options (000 s)</b>	<b>Weighted Average Remaining Life</b>	<b>Weighted Average Exercise Price</b>	<b>Number of Options Exercisable (000 s)</b>	<b>Weighted Average Exercise Price</b>
\$ 1.75 to \$ 4.63	667	3.5 years	\$ 4.41	571	\$ 4.41
\$ 4.68 to \$ 8.27	222	4.3 years	\$ 7.31	95	\$ 6.39
\$ 8.35 to \$ 8.90	505	5.1 years	\$ 8.41	16	\$ 8.81
\$ 8.93 to \$ 8.93	886	4.3 years	\$ 8.93	223	\$ 8.93
\$ 8.98 to \$14.66	799	4.9 years	\$11.65	446	\$13.05
\$14.85 to \$20.31	597	3.9 years	\$18.65	335	\$18.37
	<hr/>			<hr/>	
	3,676			1,686	
	<hr/>			<hr/>	

Options outstanding include 221,771 options denominated in Canadian dollars with a weighted average exercise price of \$16.09 Canadian.

***Employee Stock Purchase Plan***

At the Annual General Meeting of Stockholders on May 8, 2001, the Stockholders approved the adoption of the Employee Stock Purchase Plan (the Purchase Plan ). A total of 300,000 common shares have been reserved for issuance under the Purchase Plan. The Company will make open market purchases and/or issue treasury common shares to satisfy employee subscriptions under the Purchase Plan. Under the terms of the Purchase Plan, employees can choose to have up to 7% of their base earnings withheld to purchase the Company's common stock. The Purchase Plan provides for consecutive offering periods during which payroll deductions may be accumulated for the purchase of common shares. The initial offering period commenced on July 1, 2001 and ended on December 31, 2001. Thereafter, each offering period will continue for a period of

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six months following commencement, as determined by the Compensation Committee. The purchase price per share at which shares will be sold in an offering period under the Purchase Plan is the lower of 85% of the Fair Market Value of a common share at the beginning of the offering period or 85% of the Fair Market Value of a common share at the end of the offering period. Fair Market Value, as defined by the Purchase Plan, is the weighted average sale price of the shares for the five (5) day period preceding the grant date and the exercise date. During the two offerings in the period ended December 31, 2002, 95,269 shares were issued under the Purchase Plan at an average cost of \$5.89 per share (2001 51,529 with average cost of \$6.48).

***Pro forma stock based compensation***

Had compensation cost for the Company's stock option plans and employee stock purchase plan been determined consistent with SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts below.

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Net income (loss):			
As reported	\$ (27,724)	\$ (14,698)	\$ 45,377
Pro forma	\$ (31,336)	\$ (17,832)	\$ 42,520
Basic net income (loss) per share:			
As reported	\$ (0.68)	\$ (0.36)	\$ 1.19
Pro forma	\$ (0.77)	\$ (0.44)	\$ 1.11
Diluted income (loss) per share:			
As reported	\$ (0.68)	\$ (0.36)	\$ 1.13
Pro forma	\$ (0.77)	\$ (0.44)	\$ 1.07

The fair value of options was estimated at the date of grant using a Black-Scholes option-pricing model with the following assumptions:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Risk-free interest rate	3.1%	4.1%	5.1%
Expected dividend yield			
Expected lives upon vesting	1.0 years	1.0 years	1.0 years
Expected volatility	67%	70%	100%
Weighted average fair value per share	\$ 5.27	\$ 4.82	\$ 12.48

The fair value of the employees' purchase rights under the employee stock purchase plan was estimated using the Black-Scholes option-model with the following assumptions: dividend yield of nil (2001 nil); an expected life of 6 months (2001 6 months); expected volatility of 67% (2001 70%); and risk-free interest rate of 1.75% (2001 3.45%). The weighted-average fair value of those purchase rights granted in 2002 was \$3.71 (2001 \$2.98).

**8. Employee Benefit Plans*****Defined Benefit Pension Plan***

The Company's subsidiary in the United Kingdom maintains a pension plan, known as the GSI Lumonics Ltd. United Kingdom Pension Scheme Retirement Savings Plan. The plan has two components: the Final Salary Plan, which is a defined benefit plan, and the Retirement Savings Plan, which is a defined contribution plan. Effective April 1997, membership to the Final Salary Plan was closed. Benefits under this plan are based on the employees' years of service and compensation. GSI Lumonics' funding policy is to fund





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pensions and other benefits based on widely used actuarial methods as permitted by regulatory authorities. The funded amounts reflect actuarial assumptions regarding compensation, interest and other projections. The assets of this plan consist primarily of equity and fixed income securities of U.K. and foreign issuers.

In December 2002, the Company notified plan participants that it no longer wants to sponsor the final salary plan. Consultations are underway and the final outcome of these matters has not yet been determined.

Pension and other benefit costs reflected in the consolidated statements of operations are based on the projected benefit method of valuation. Within the consolidated balance sheet, pension plan benefit liabilities are included in accrued compensation and benefits.

The net periodic pension cost for the defined benefit pension plan was determined as follows:

	<b>2002</b>	<b>2001</b>	<b>2000</b>
Service cost benefits earned	\$ 216	\$ 393	\$ 442
Interest cost on projected plan benefits	837	827	847
Premiums and expenses	135	151	149
Expected return on plan assets	(814)	(873)	(945)
<b>Net Periodic Pension Cost</b>	<b>\$ 374</b>	<b>\$ 498</b>	<b>\$ 493</b>

The assumptions used to develop the actuarial present value of the accrued pension benefits (obligations) were as follows:

	<b>2002</b>	<b>2001</b>
Discount Rate	6.0%	7.0%
Rate of Compensation Increase	3.0%	4.0%
Long-Term Rate of Return on Plan Assets	7.0%	7.0%

The estimates are based on actuarially computed best estimates of pension asset long-term rates of return and long-term rate of obligation escalation. Variances between these estimates and actual experience are amortized over the employees' average remaining service life.

The most recent actuarial valuation of the plan was performed as at November 30, 2000. The extrapolation as at December 31 indicates the actuarial present value of the pension benefit obligation; the net assets available to provide for these benefits, at market value; and the funded status of the plan were as follows:

	<b>2002</b>	<b>2001</b>
<b>Change in benefit obligation:</b>		
Projected benefit obligation at beginning of year	\$ 11,633	\$ 12,917
Service cost	216	393
Interest cost	837	827
Plan participants' contributions	158	118
Actuarial changes in assumptions and experience	2,205	(1,345)
Benefits paid	(278)	(922)
Foreign currency exchange rate changes	1,345	(355)

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Projected benefit obligation at end of year	<u>\$ 16,116</u>	<u>\$ 11,633</u>
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	<u>2002</u>	<u>2001</u>
<b>Change in plan assets:</b>		
Market value of plan assets at beginning of year	\$ 11,270	\$ 12,917
Actual return on plan assets	(1,642)	(569)
Employer contributions	625	180
Plan participants contributions	158	118
Benefits paid	(278)	(922)
Foreign currency exchange rate changes	1,029	(358)
Other	(82)	(96)
	<u>          </u>	<u>          </u>
Market value of plan assets at end of year	\$ 11,080	\$ 11,270
	<u>          </u>	<u>          </u>
<b>Funded Status and Net Amounts Recognized:</b>		
Excess of projected benefit obligation over plan assets	\$ 5,036	\$ 363
Unrecognized actuarial gain (loss)	(4,823)	126
	<u>          </u>	<u>          </u>
Net amount recognized	\$ 213	\$ 489
	<u>          </u>	<u>          </u>
Amount recognized in the balance sheet consists of:		
Accrued compensation and benefits	\$ 213	\$
Accrued minimum pension liability	3,875	
Accumulated other comprehensive loss	(3,875)	
	<u>          </u>	<u>          </u>
Net amount recognized	\$ 213	\$ 489
	<u>          </u>	<u>          </u>

**Defined Contribution Plans**

The Company has defined contribution employee savings plans in Canada, the United Kingdom, and the United States. In the United States, the provisions of Section 401(k) of the Internal Revenue Code under which its United States employees may make contributions govern the plan. The Company matches the contributions of participating employees on the basis of percentages specified in each plan. Company matching contributions to the plans were \$1.9 million in 2002 (2001 \$2.4 million; 2000 \$2.7 million).

**9. Income Taxes**

Details of the income tax provision (benefit) are as follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>Current</b>			
Canadian	\$ (2,676)	\$ (1,575)	\$ 2,197
International	(10,572)	(12,887)	31,082
	<u>          </u>	<u>          </u>	<u>          </u>
	(13,248)	(14,462)	33,279
<b>Deferred</b>			
Canadian	1,942	(1,123)	4,089

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International	2,325	7,811	(7,702)
	<u>4,267</u>	<u>6,688</u>	<u>(3,613)</u>
Income tax provision (benefit)	\$ (8,981)	\$ (7,774)	\$29,666

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The income tax provision (benefit) reported differs from the amounts computed by applying the Canadian rate to income (loss) before income taxes. The reasons for this difference and the related tax effects are as follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Expected Canadian tax rate	38.6%	41.7%	44.0%
Expected income tax provision (benefit)	\$(14,168)	\$(9,370)	\$33,019
Non-deductible expenses	195	2,782	2,885
International tax rate differences	(141)	(788)	(3,632)
Losses and temporary differences the benefit of which has not been recognized	6,176	1,222	3,554
Previously unrecognized losses and temporary differences	(873)	(2,162)	(6,549)
Other items	(170)	542	389
	<u>          </u>	<u>          </u>	<u>          </u>
Reported income tax provision (benefit)	\$ (8,981)	\$(7,774)	\$29,666
	<u>          </u>	<u>          </u>	<u>          </u>

Deferred income taxes result principally from temporary differences in the recognition of certain revenue and expense items for financial and tax reporting purposes. Significant components of the Company's deferred tax assets and liabilities as at December 31 are as follows:

	<u>2002</u>	<u>2001</u>
<b>Deferred tax assets</b>		
Operating tax loss carryforwards	\$ 18,943	\$ 11,556
Compensation related deductions	1,769	1,690
Tax credits	4,990	4,525
Restructuring and other accrued liabilities	5,092	5,916
Deferred revenue	543	690
Inventory	4,397	8,918
Tax effect of UK pension liability	1,162	
Book and tax differences on fixed assets	488	1,103
Intangibles	1,811	286
Share issue costs	575	962
	<u>          </u>	<u>          </u>
Total deferred tax assets	39,770	35,646
Valuation allowance for deferred tax assets	(22,564)	(13,445)
	<u>          </u>	<u>          </u>
Net deferred tax assets	17,206	22,201
	<u>          </u>	<u>          </u>
<b>Deferred tax liabilities</b>		
Unrealized gain on hedging activities		567
Intangibles		
	<u>          </u>	<u>          </u>
Net deferred income tax asset	\$ 17,206	\$ 21,634
	<u>          </u>	<u>          </u>
<b>Allocated as follows:</b>		
Net deferred income tax asset short-term	9,763	15,097
Net deferred income tax asset long-term	7,443	6,537
	<u>          </u>	<u>          </u>

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Net deferred income tax asset	\$ 17,206	\$ 21,634
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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company has provided a valuation allowance of \$22.6 million against losses in the parent company and subsidiaries with an inconsistent history of taxable income and loss due to the uncertainty of their realization. In addition, the Company has provided a valuation allowance on foreign tax credits, due to the uncertainty of generating foreign earned income to claim the tax credits. The Company believes it is more likely than not that the remaining deferred tax assets will be realized principally through future taxable income and carry backs to taxable income in prior years. If actual results differ from those expected, or if we do not achieve profitability, we may be required to increase the valuation allowance on our tax assets by taking a charge to the consolidated statements of operations, which may have a material adverse effect on our results of operations.

As at December 31, 2002, the Company had loss carry forwards of approximately \$57.6 million available to reduce future years' income for tax purposes. Of this amount, approximately \$1.7 million expires between 2003 and 2006, \$13.6 million expires in 2007, \$9.4 million expires between 2020 and 2022 and \$32.9 million can be carried forward indefinitely.

Undistributed earnings of the Company's foreign subsidiaries amounted to approximately \$53.6 million at December 31, 2002. The Company has not recorded a provision for withholding tax on undistributed earnings of foreign subsidiaries, as the Company currently has no plans to repatriate those earnings. Determination of the amount of unrecognized deferred tax liabilities is not practicable because of the complexities associated with its hypothetical calculation.

Income taxes paid during 2002 were \$1.7 million (2001 \$33.3 million; 2000 \$4.3 million).

**10. Related Party Transactions**

The Company had the following transactions with related parties. The Company recorded \$2.3 million as sales revenue from Sumitomo Heavy Industries Ltd., a significant shareholder in the year ended December 31, 2002 (2001 \$4.2 million; 2000 \$10.2 million) at amounts and terms approximately equivalent to third party transactions. Transactions with Sumitomo Heavy Industries Ltd. are at normal trade terms. Receivables from Sumitomo Heavy Industries Ltd. of \$0.5 million and \$0.6 million as at December 31, 2002 and 2001, respectively, are included in accounts receivable on the balance sheet.

On February 23, 2000, the Company entered into an Agreement with V2Air LLC relating to the use of the LLC aircraft for Company purposes. The V2Air LLC is owned by the Company's President and Chief Executive Officer, Charles D. Winston. Pursuant to the terms of the Agreement, the Company is required to reimburse the V2Air LLC for certain expenses associated with the use of the aircraft for Company business travel. During the most recently completed fiscal year, the Company reimbursed V2Air LLC approximately \$145,000 (2001 \$150,000) under the terms of such Agreement.

In January of 2001, the Company made an investment of \$2 million in a technology fund managed by OpNet Partners, L.P. During 2002, the Company received a cash distribution (return of capital) from OpNet Partners in the amount of \$1.4 million. In the second quarter of 2002, the Company wrote-down the investment by \$0.2 million to its estimated fair market value and wrote-off the remainder of the investment (\$0.4 million) in the fourth quarter of 2002. Richard B. Black, a member of the Company's Board of Directors, is a General Partner for OpNet Partners, L.P.

On April 26, 2002, the Company entered into an agreement with Photoniko, Inc, a private photonics company in which one of the Company's directors, Richard B. Black, was a director and stock option holder. As of August 16, 2002, Mr. Black was no longer a director or stock option holder of Photoniko, Inc. Under the agreement, the Company provided a non-interest bearing unsecured loan of \$75,000 to Photoniko, Inc. to fund designated business activities at Photoniko, Inc. in exchange for an exclusive 90 day period to evaluate potential strategic alliances. In accordance with the terms of the agreement and the promissory note which

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was signed by Photoniko, Inc. on April 26, 2002, the loan was to be repaid in full to the Company no later than August 28, 2002, but still remains outstanding. The Company has provided a full reserve for this receivable.

**11. Restructuring and other**

	Year Ended December 31,		
	2002	2001	2000
Restructuring charges	\$ 6,448	\$ 3,380	\$ 15,147
Reversal of restructuring charges		(450)	(5,006)
<b>Total restructuring charges</b>	<b>6,448</b>	<b>2,930</b>	<b>10,141</b>
Other reduction of purchased intangibles		1,759	
Other royalties	(276)	(348)	(275)
Other legal settlements	(745)	(1,559)	(2,670)
<b>Total other</b>	<b>\$(1,021)</b>	<b>\$ (148)</b>	<b>\$ (2,945)</b>

**Restructuring charges**

From 2000 through 2002, the Company faced a 57% decline in revenues and responded by streamlining operations to reduce fixed costs. This was done in stages under different restructuring plans that focused on different areas of the Company over time.

**2000**

During 2000, the Company took a restructuring charge of \$15.1 million and reversed a provision of \$5 million primarily for plant consolidation costs originally recorded in 1999 that were for restructuring actions not taken. As part of our strategic repositioning, during the fourth quarter of fiscal 2000, the executive team approved a plan to restructure our Rugby, United Kingdom operations and our manufacturing capacity world wide. The Company recorded a charge of \$12.5 million consisting of \$1 million to accrue employee severance for approximately 50 employees; other exit costs of \$3.8 million for the Company's United Kingdom operation worldwide distribution system related to high-power laser systems for certain automotive applications; and costs of \$7.7 million associated with restructuring for excess of capacity at three leased facility locations in the United States and Germany were also accrued. The Company also recorded a non-cash write-down of land and building in the United Kingdom of \$2 million. Compensation expense of \$0.6 million arising on the acceleration of options upon the sale of businesses during the year was also charged to restructuring. In addition, an inventory write-down to net realizable value of \$8.5 million was recorded in cost of goods sold related to the high-power laser system product line. The Company recorded reversal of \$0.5 million in the fourth quarter of 2001 for costs that will not be incurred. The provisions for lease costs in the United States and Germany primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that the Company cannot terminate. The Rugby, United Kingdom, land and building write down reflects the net realizable value based on market assessments for the facility. The other exit costs were based primarily on purchase commitments of the Company as the time of the restructuring that the Company could not terminate.

Cumulative cash draw-downs of \$6 million, reversal of \$0.5 million for restructuring costs that will not be incurred and non-cash draw-down of \$2.6 million have been applied against the provision, resulting in a remaining balance of \$6 million as at December 31, 2002. The actions have all been completed except for the balance accrued for the Farmington Hills, Michigan and the Maple Grove, Minnesota facilities, which is expected to be completed during 2003 at the end of the lease term.





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**GSI LUMONICS INC.**

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*2001*

During the fourth quarter of fiscal 2001, as a response to declining sales, the executive team approved a plan to further reduce capacity and the Company recorded a charge of \$3.4 million to accrue employee severance of \$0.9 million for approximately 35 employees at our Farmington Hills, Michigan and Oxnard, California locations, leased facilities costs of \$1.8 million associated with restructuring for excess capacity at five leased locations in the United States, Canada, and Germany and write-down of leasehold improvements and certain equipment of \$0.7 million associated with the existing of leased facilities. The lease costs primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that the Company cannot terminate. The expected effects of the restructuring were to better align our ongoing expenses and cash flows in light of reduced revenues.

Cumulative cash draw-downs of approximately \$2.4 million and non-cash draw-downs of \$0.7 million have been applied against the provision, resulting in a remaining provision balance of \$0.3 million as at December 31, 2002. The restructuring was completed, except for costs that are expected to be paid on the leased facilities in Munich, Germany (lease expiration January 2013), Oxnard, California (expected payment March 2003) and Nepean, Ontario (lease expiration January 2006).

*2002*

The Company continued to adapt to the lower level of sales. Two major restructuring plans were initiated in 2002. In the first quarter of 2002, the Company made a determination to reduce fixed costs by transferring the manufacturing operations of the Kanata, Ontario facility to other manufacturing facilities. Associated with this decision, the Company incurred restructuring costs in the first, second, and fourth quarters of 2002. At this time, the Company believes that all costs associated with the closure of this facility have been recorded, as noted below.

During the first quarter of 2002, the Company consolidated its electronics systems business from its facility in Kanata, Ontario into the Company's existing systems manufacturing facility in Wilmington, Massachusetts and transferred its laser business from the Company's Kanata, Ontario facility to its existing facility in Rugby, United Kingdom. In addition, the Company closed its Kanata, Ontario facility. Restructuring provisions totaling \$2.7 million in the first quarter of 2002, relate to severance and benefits of \$2.2 million for the termination of approximately 90 employees, \$0.3 million for the write-off of furniture, equipment and system software, and \$0.2 million for plant closure and other related costs.

During the second quarter of fiscal 2002, the Company recorded additional restructuring charges of \$1.4 million related to cancellation fees on contractual obligations of \$0.3 million and a write-down of land and building in Kanata, Ontario and Rugby, United Kingdom of \$0.8 million, and also leased facility costs of \$0.3 million at the Farmington Hills, Michigan and Oxnard, California locations. The lease costs primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that the Company cannot terminate. The write-downs of the building brings the buildings offered for sale in line with market values and has no effect on cash.

The second restructuring plan in 2002 related to our refocusing of our Nepean, Ontario operations on its custom optics business, as a result of the telecom industry's severe downturn. The executive team approved a plan to reduce capacity and the Company recorded a pre-tax restructuring charge of \$2.3 million in the fourth quarter of 2002. The Company downsized manufacturing operations in its Nepean, Ontario facility and we incurred \$0.6 million of expense for severance and benefits for the termination of approximately 41 employees. The Company also wrote-off approximately \$0.2 million of excess fixed assets and wrote-down one of the Nepean buildings by \$0.2 million to its estimated fair market value. Additionally, we continued to evaluate accruals made in prior restructuring and we recorded charges of approximately \$0.8 million for an adjustment to earlier provisions for the leased facilities in Munich, Germany, Maple Grove, Minnesota and Farmington

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Hills, Michigan. The Company also took a further write-down of \$0.3 million on the buildings in Kanata, Ontario and Rugby, United Kingdom and a \$0.1 million write-off for fixed assets in Kanata, Ontario and a \$0.1 million for the Maple Grove, Minnesota and Farmington Hills, Michigan facilities.

At December 31, 2002, the net book value of two facilities, one in Kanata, Ontario and the other in Nepean, Ontario, were reclassified as held for sale and included in other assets (note 3).

Cumulative cash draw-downs of approximately \$2.1 million and non-cash draw-downs of \$1.8 million have been applied against the provisions taken in 2002, resulting in a remaining provision balance of \$2.5 million at December 31, 2002. For severance related costs associated with these two restructuring actions, the Company does not anticipate taking additional restructuring charges, and expects to finalize payment in 2003. The Company will continue to evaluate the fair value of the buildings and fixed assets that were written down. The restructuring is expected to be complete during January 2013 at the end of the lease term for the Munich, Germany facility.

The following table summarizes changes in the restructuring provision.

	<u>Severance</u>	<u>Facilities</u>	<u>Other</u>	<u>Total</u>
	(In millions)			
Provision at December 31, 1999	\$ 2.8	\$ 3.9	\$ 3.4	\$ 10.1
Charges during 2000.	1.6	9.7	3.8	15.1
Cash draw-downs 2000.	(1.8)	(1.0)	(1.5)	(4.3)
Reversals during 2000.	(0.8)	(2.3)	(1.9)	(5.0)
Non-cash draw-down 2000.	(0.6)	(2.0)		(2.6)
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
Provision at December 31, 2000	1.2	8.3	3.8	13.3
Charges during 2001.	0.9	2.5		3.4
Cash draw-downs 2001.	(1.2)	(1.6)	(3.8)	(6.6)
Reversals during 2001.		(0.5)		(0.5)
Non-cash draw-down 2001.		(0.7)		(0.7)
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
Provision at December 31, 2001	0.9	8.0		8.9
Charges during 2002.	2.8	3.1	0.5	6.4
Cash draw-downs 2002.	(2.5)	(1.6)	(0.5)	(4.6)
Non-cash draw-down 2002.		(1.9)		(1.9)
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
Provision at December 31, 2002	\$ 1.2	\$ 7.6	\$	\$ 8.8
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>

**Other**

During 2002, the Company recorded a net benefit of \$0.7 million related to two litigation settlements. During 2002, the Company earned \$0.3 million in royalties related to OLT precision alignment product line that was divested.

During the fourth quarter of 2001, the Company recorded a reduction of purchased intangibles related to technologies no longer a part of the business in the amount of \$1.8 million in accordance with the policy described in note 1. The Company performed an assessment of the carrying values of intangible assets, including trademark and trade names, assembled workforce and developed technology, recorded in connection with its merger of equals with General Scanning, Inc. in 1999. The assessment was performed in light of the abandonment of certain technologies in 2001 that had been in development or production since the date of the merger and also the significant economic downturn. As a result of the assessment, it was determined that a portion of the intangible assets no longer had value and should be written-down to reflect the lower carrying

value. The Company has determined that the remaining intangible asset balances at that time would continue

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

to be amortized on a straight-line basis over the remaining useful lives established at the time of the related acquisition, as the remaining useful lives of these intangible assets has not changed.

During 2001, the Company recorded a benefit of \$0.3 million related to royalties earned on the sale of the OLT precision alignment system product line. During the three months ended April 2, 1999, the Company recorded a provision of \$19 million to accrue damages and legal fees, through to appeal, relating to the action against General Scanning, Inc., which was reflected as a reduction in net assets acquired at the time of the March 22, 1999 merger. The Court of Appeals affirmed the judgment on April 18, 2001 and the Company paid approximately \$15.3 million in May 2001 in satisfaction of the judgment and adjusted its accrual related to this litigation and recorded a benefit of \$1.6 million when the litigation was settled.

During 2000, the Company recorded a benefit of \$0.2 million related to royalties earned on the sale of the OLT precision alignment system product line and \$2.7 million received for licensing some of the Company's technology.

**12. Commitments and Contingencies**

***Operating leases***

The Company leases certain equipment and facilities under operating lease agreements that expire through 2013. The facility leases require the Company to pay real estate taxes and other operating costs. For the year ended December 31, 2002, lease expense was approximately \$3.5 million (2001 \$5.6 million, 2000 \$4.7 million).

The Company leases two facilities under operating lease agreements that expire in 2003. At the end of the initial lease term, these leases require the Company to renew the lease for a defined number of years at the fair market rental rate or purchase the property at the fair market value. The lessor may sell the facilities to a third party but the leases provide for a residual value guarantee of the first 85% of any loss the lessor may incur on its \$19.1 million investment in the buildings, which may become payable by the Company upon the termination of the transaction, or the Company may exercise its option to purchase the facilities for approximately \$19 million. As of December 31, 2002, residual value guarantees in connection with these leases totaled approximately \$16 million. Upon termination of the leases, the Company expects to purchase the buildings for approximately \$19 million in cash and then to sell them for the combined estimated market value of the two buildings of approximately \$12.5 to \$13.3 million. During the fourth quarter of fiscal 2000, the Company took a charge of \$6 million associated with restructuring for excess capacity at the two leased facility locations, including the estimated residual value guarantees. In the fourth quarter of 2002, the Company took an additional restructuring charge of \$0.1 million to increase the reserve for the decline in the estimated market values of the underlying buildings. The total expected value of the buildings at the end of the leases may vary, depending on whether or not the buildings are leased at time of sale and whether the buildings are sold to a buyer/owner or to an investor. The Company will incur other costs such as lease and sales commissions. The lease agreement requires, among other things, the Company to maintain specified quarterly financial ratios and conditions. As of March 29, 2002, the Company was in breach of the fixed charge coverage ratio, but on April 30, 2002, the Company entered into a Security Agreement with the Bank of Montreal ( BMO ) pursuant to which the Company deposited with BMO and pledged approximately \$18.9 million as security in connection with the operating leases discussed above in exchange for a written waiver from BMO and BMO Global Capital Solutions for any Company defaults of or obligations to satisfy the specified financial covenants relating to the operating lease agreements until June 30, 2003. This item is included on the balance sheet in long-term investments. The table of future minimum operating lease payments below excludes any payments relating to these guarantees.

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Minimum lease payments under operating leases expiring subsequent to December 31, 2002 are:

2003	\$ 3,549
2004	2,474
2005	2,151
2006	1,608
2007	1,538
Thereafter	2,494
	<hr/>
Total minimum lease payments	\$ 13,814
	<hr/>

The Company has sublease agreements on certain leased facilities and will receive \$1.4 million from 2003 to 2012.

***Recourse receivables***

In Japan, where it is customary to do so, the Company discounts certain customer notes receivable at a bank with recourse. The Company's maximum exposure was \$1.4 million at December 31, 2002 (2001 \$0.6 million). The book value of the recourse receivables approximates fair value. During 2002, the Company received cash proceeds relating to the discounted receivables of \$5.7 million (2001 \$9.8 million). Recourse receivables are included in accounts receivable on the balance sheet.

***Legal proceedings and disputes***

*Electro Scientific Industries, Inc. v. GSI Lumonics, Inc. et al.* On March 16, 2000, Electro Scientific Industries, Inc. filed an action for patent infringement in the United States District Court for the Central District of California against the Company and Dynamic Details Inc., an unrelated party that is one of the Company's customers. Electro Scientific alleged that the Company offered to sell and import into the United States the GS-600 high speed laser drilling system and that Dynamic Details possessed and used a GS-600 System. It further alleged that Dynamic Details' use of the GS-600 laser system infringed Electro Scientific's United States patent 5,847,960 and that the Company had actively induced the infringement of, and contributorily infringed, the patent. Electro Scientific sought an injunction, unspecified damages, trebling of those damages, and attorney fees. The Company indemnified Dynamic Details with respect to these allegations. On August 14, 2001, the United States District Court for the Central District of California granted the Company's motion for summary judgment of non-infringement and denied Electro Scientific's motion for summary judgment of infringement. In the ruling, the Court concluded that the GS-600 system did not literally infringe the asserted claims of the alleged Electro Scientific patent, nor did it infringe under the doctrine of equivalents. On September 7, 2001, Electro Scientific appealed the District Court's decision on the summary judgment motions and oral arguments were heard on May 7, 2002. On October 7, 2002, the Court of Appeals vacated the summary judgment ruling of non-infringement of the District Court and remanded the matter back to the District Court for additional claim construction. In November 2002, the Company reached an agreement with Electro Scientific Industries Inc. and Dynamic Details pursuant to which the case was dismissed without prejudice. In connection with the agreement, the Company paid Electro Scientific Industries an amount that was not material to the Company's results of operations or financial position.

*Other.* As the Company has disclosed since 1994, a party has commenced legal proceedings in the United States against a number of United States manufacturing companies, including companies that have purchased systems from the Company. The plaintiff in the proceedings has alleged that certain equipment used by these manufacturers infringes patents claimed to be held by the plaintiff. While the Company is not a defendant in any of the proceedings, several of the Company's customers have notified the Company that, if the party successfully pursues infringement claims against them, they may require the Company to indemnify

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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

them to the extent that any of their losses can be attributed to systems sold to them by the Company. Due to (i) the relatively small number of systems sold to any one of the Company's customers involved in this litigation, (ii) the low probability of success by the plaintiff in securing judgment(s) against the Company's customers and (iii) the existence of a countersuit that seeks to invalidate the patents that are the basis for the litigation, the Company does not believe that the outcome of any of these claims individually will have a material adverse effect upon the Company's financial condition or results of operations. No assurances can be given, however, that these or similar claims, if successful and taken in the aggregate would not have a material adverse effect upon the Company's financial condition or results of operations.

The Company is also subject to various legal proceedings and claims, which arise in the ordinary course of business. The Company does not believe that the outcome of these claims will have a material adverse effect upon the Company's financial conditions or result of operations but there can be no assurance that any such claims, or any similar claims, would not have a material adverse effect upon the Company's financial condition or results of operations.

***Risks and uncertainties***

The Company uses financial instruments that potentially subject it to concentrations of credit risk. Such instruments include cash equivalents, securities available-for-sale, trade receivables and financial instruments used in hedging activities. The Company does not believe it is exposed to any significant credit risk on these instruments.

Certain of the components and materials included in the Company's laser systems and optical products are currently obtained from single source suppliers. There can be no assurance that a disruption of this outside supply would not create substantial manufacturing delays and additional cost to the Company.

There is no concentration of credit risk related to the Company's position in trade accounts receivable. Credit risk, with respect to trade receivables, is minimized because of the diversification of the Company's operations, as well as its large customer base and its geographical dispersion.

The Company's operations involve a number of other risks and uncertainties including, but not limited to, the cyclical nature of the semiconductor and electronics markets, rapidly changing technology, and international operations.

**13. Financial instruments**

***Cash equivalents, short-term and long-term investments***

At December 31, 2002, the Company had \$53.3 million invested in cash equivalents denominated in United States dollars with average maturity dates between January 2, 2003 and March 24, 2003. At December 31, 2001, the Company had \$79.8 million cash equivalents denominated in United States dollars with average maturities between January 7, 2002 and March 01, 2002.

At December 31, 2002 the Company had \$29 million in short-term investments and \$37.4 million in long-term investments invested in United States dollars with maturity dates between January 6, 2003 and November 23, 2004. As discussed in Note 4 to the financial statements, \$14.5 million of short-term investments are pledged as collateral for the Fleet and CIBC credit facilities at December 31, 2002 and \$18.9 million of the long-term investments is pledged as security for the lease agreements with BMO as described in Note 12 above. At December 31, 2001 the Company had \$43.5 million invested in short-term investments denominated in United States dollars with maturity dates between January 24, 2002 and May 6, 2002.

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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Derivative financial instruments***

The Company only uses derivatives for hedging purposes. The following is a summary of the Company's risk management strategies and the effect of these strategies on the Company's consolidated financial statements.

The Company has instituted a foreign currency cash flow hedging program to manage exposures to changes in foreign currency exchange rates associated with forecasted sales transactions. Currency forwards and swaps are used to fix the cash flow variable of local currency costs or selling prices denominated in currencies other than the functional currency. For hedged forecasted transactions, hedge accounting is discontinued if the forecasted transaction is no longer intended or expected to occur, and any previously unrealized hedging gains or losses recorded in other comprehensive income are recorded to earnings immediately. Earnings impacts for all designated hedges are recorded in the consolidated statement of operations generally on the same line item as the gain or loss on the item being hedged. The Company records all derivatives at fair value as assets or liabilities in the consolidated balance sheet, with classification as current or long-term depending on the duration of the instrument.

At December 31, 2002, the Company had eleven foreign exchange forward contracts to purchase \$16.9 million U.S. dollars and one currency swap contract fair valued at \$8.7 million U.S. dollars with an aggregate fair value loss of \$0.5 million after-tax recorded in accumulated other comprehensive income and maturing at varying dates in 2003. The ineffective portion of the derivative instruments totalled a combined loss of \$0.3 million and is recorded in the consolidated statements of operations in foreign exchange gain (loss). The Company expects an estimated \$0.5 million to be reclassified into earnings in the next 12 months. At December 31, 2001, the Company had eight foreign exchange forward contracts to purchase \$17.8 million U.S. dollars and one foreign exchange option contract to purchase \$6.5 million U.S. dollars and an aggregate fair value gain of \$0.8 million and maturing at various dates in 2002. At December 31, 2000, the Company had four foreign exchange contracts to purchase \$6.5 million with a fair value loss of \$164 thousand that matured and was recognized in earnings during the first quarter of 2001.

**14. Segment Information**

***General description***

During 2002, the Company changed the way it manages its business to reflect a growing focus on its three core businesses: components, lasers and laser systems. In classifying operational entities into a particular segment, the Company aggregated businesses with similar economic characteristics, products and services, production processes, customers and methods of distribution. Segment information for the 2001 year has been restated to conform to the current year's presentation. Segment information for the 2000 year has not been restated because it is impracticable to do so. In 2000, there were other businesses and product lines that have been subsequently divested or discontinued that do not conform to the new segments, as such the information would not be comparable.

The Executive Committee ( EC ) has been identified as the chief operating decision maker in assessing the performance of the segments and the allocation of resources to the segments. The EC evaluates financial performance based on measures of profit or loss from operations before income taxes excluding the impact of amortization of purchased intangibles, acquired in-process research and development, restructuring and other, gain (loss) on sale of assets and investments, interest income, interest expense, and foreign exchange transaction losses. Certain corporate-level operating expenses, including corporate marketing, finance, and administrative expenses, are not allocated to operating segments. Intersegment sales are based on fair market values. All intersegment profit, including any unrealized profit on ending inventories, is eliminated on consolidation. The accounting policies of the segments are the same as those described in note 1.



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**GSI LUMONICS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

GSI Lumonics operations include three reportable operating segments: the Components segment (Components); the Laser segment (Laser Group); and the Laser Systems segment (Laser Systems).

**Components** The Company's component products are designed and manufactured at our facilities in Billerica, Massachusetts, Nepean, Ontario and Moorpark, California and are sold directly, or, in some territories, through distributors, to original equipment manufacturers (OEMs). Products include optical scanners and subsystems used by OEMs for applications in materials processing, test and measurement, alignment, inspection, displays, imaging, graphics, vision, rapid prototyping, and medical use such as dermatology and ophthalmology. The Components Group also manufactures printers for certain medical end products such as defibrillators, patient care monitors and cardiac pacemaker programmers, as well as film imaging subsystems for use in CAT scans and magnetic resonance imaging systems. Under the trade name, WavePrecision, we also manufacture precision optics supplied to OEM customers for applications in aerospace and semiconductor. Major markets are medical, semiconductor, and electronics, light industrial and aerospace.

**Laser Group** The Company designs and manufactures a wide range of lasers at our Rugby, United Kingdom facility for sale in the merchant market to end-users, OEMs and systems integrators. We also use some of these products in the Company's own laser systems. The Laser Group also derives significant revenues from providing parts and technical support for lasers in its installed base at customer locations. These lasers are primarily used in material processing applications (cutting, welding and drilling) in light automotive, electronics, aerospace, medical and light industrial markets. The lasers are sold worldwide directly in North America and Europe, and through distributors in Japan, Asia Pacific and China. Sumitomo Heavy Industries Ltd. (a significant shareholder of the Company) is our distributor in Japan. Specifically, our pulsed and continuous wave Nd:YAG lasers are used in a variety of medical, light automotive and industrial settings.

**Laser Systems** The Company's laser systems are designed and manufactured at our Wilmington, Massachusetts facility and are sold directly, or, in some territories, through distributors, to end users, usually semiconductor integrated device manufacturers and electronic component and assembly manufacturers. The Laser Systems Group also derives significant revenues from servicing systems in its installed base at customer locations. System applications include laser repair to improve yields in the production of dynamic random access memory chips (DRAMs), permanent marking systems for silicon wafers and individual dies for traceability and quality control, circuit processing systems for linear and mixed signal devices, as well as for certain passive electronic components, and printed circuit boards (PCB) manufacturing systems for via hole drilling, solder paste inspection and component placement inspection.

In 2001, the Company had reported its WavePrecision division as a separate business segment. During 2002, with restructuring actions taken as a result of the collapse of the telecom market sector, the Company has placed this group in its Components segment. At the end of 2002, WavePrecision did not meet the criteria of a business segment, as defined in SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Segments**

Information on reportable segments is as follows:

	Year Ended December 31,	
	2002	2001
<b>Sales</b>		
Components	\$ 70,436	\$ 88,689
Laser Group	23,748	39,119
Laser Systems	65,906	123,969
Intersegment sales elimination	(1,020)	(3,873)
<b>Total</b>	<b>\$ 159,070</b>	<b>\$ 247,904</b>
<b>Profit (loss) from operations before income taxes</b>		
Components	\$ 16,763	\$ 18,603
Laser Group	(5,010)	4,425
Laser Systems	(18,732)	(23,712)
<b>Total by segment</b>	<b>(6,979)</b>	<b>(684)</b>
Unallocated amounts:		
Corporate expenses	19,754	12,983
Amortization of purchased intangibles	5,135	5,226
Restructuring and other	5,427	2,782
<b>Loss from operations</b>	<b>\$ (37,295)</b>	<b>\$ (21,675)</b>

The EC does not review asset information on a segmented basis and the Company does not maintain assets on a segmented basis, therefore a breakdown of assets by segments is not included.

**Geographic segment information**

The Company attributes revenues to geographic areas on the basis of the customer location. Long-lived assets include property, plant and equipment and intangibles, but exclude other assets, long-term investments and deferred tax assets are attributed to geographic areas in which Company assets reside.

	Year Ended December 31,					
	2002		2001		2000	
Revenues from external customers:						
USA	\$ 94,654	59%	\$ 119,321	48%	\$ 177,813	48%

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Canada	1,883	1%	11,410	5%	20,159	5%
Europe	25,804	16%	50,745	20%	71,973	19%
Japan	23,460	15%	40,956	17%	58,173	16%
Latin and South America	1,249	1%	852	0%	5,563	1%
Asia-Pacific, other	12,020	8%	24,620	10%	40,183	11%
	<u>          </u>	<u>      </u>	<u>          </u>	<u>      </u>	<u>          </u>	<u>      </u>
Total	\$ 159,070	100%	\$ 247,904	100%	\$ 373,864	100%
	<u>          </u>	<u>      </u>	<u>          </u>	<u>      </u>	<u>          </u>	<u>      </u>

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	As at December 31,	
	2002	2001
Long-lived assets and goodwill:		
USA	\$24,158	\$29,754
Canada	6,625	9,404
Europe	11,540	11,484
Japan	618	686
Asia-Pacific, other	136	221
	<u>          </u>	<u>          </u>
Total	\$43,077	\$51,549
	<u>          </u>	<u>          </u>

**15. Subsequent Events**

On March 28, 2003, a registration statement was filed whereby the Company proposed its shareholders consider a Plan of Arrangement which, if approved and effected, would restructure the Company as a publicly traded United States domiciled corporation. On May 16, 2003, the Company filed an amendment to the registration statement in response to comments received from the Securities and Exchange Commission.

On March 31, 2003, the Company completed the sale to a third party of its excess facility in Nepean, Ontario for a price of Cdn \$1.3 million (or approximately U.S.\$0.9 million based on March 2003 exchange rates). At March 28, 2003, the net book value of this facility of U.S.\$0.8 million is included in other assets. The estimated gain on the sale of this facility of approximately U.S.\$0.1 million will be recorded in our second quarter.

On April 21, 2003, the Company announced that it has entered into a definitive agreement for the acquisition of the principal assets of Spectron Laser Systems, a subsidiary of Lumenis Ltd., located in Rugby, United Kingdom. The Spectron assets are being acquired for \$6.3 million in cash, subject to adjustment, and the assumption of certain liabilities. This transaction closed on May 7, 2003. The integration of Spectron into the Company's Laser Group in Rugby United Kingdom is scheduled for completion by the end of August, 2003. The Company expects to account for this transaction as a business combination under SFAS No. 141 *Business Combinations*.

On May 2, 2003, the Company announced that it had acquired the principal assets of the Encoder division of Dynamics Research Corporation, located in Wilmington, Massachusetts. The Encoder division assets were acquired for \$3.3 million in cash, subject to adjustment, and the assumption of certain liabilities. The integration of the Encoder division into the Company's Components Group in Billerica, Massachusetts is currently scheduled for completion by the end of August, 2003. The Company expects to account for this transaction as a business combination under SFAS No. 141 *Business Combinations*.

**Table of Contents****GSI LUMONICS INC.****SUPPLEMENTARY FINANCIAL INFORMATION**

(United States GAAP and in thousands of United States dollars, except share amounts)  
(Unaudited)

	Three Months Ended			
	December 31, 2002	September 27, 2002	June 28, 2002	March 29, 2002
	(Unaudited)			
Sales	\$45,099	\$37,419	\$ 39,664	\$36,888
Gross profit	13,408	11,310	12,203	12,273
Net income	(4,577)	(5,415)	(11,112)	(6,620)
Net income per common share:				
Basic	\$ (0.11)	\$ (0.13)	\$ (0.27)	\$ (0.16)
Diluted	\$ (0.11)	\$ (0.13)	\$ (0.27)	\$ (0.16)

	Three Months Ended			
	December 31, 2001	September 28, 2001	June 29, 2001	March 30, 2001
Sales	\$ 42,378	\$41,277	\$76,542	\$87,707
Gross profit	10,214	10,518	30,917	34,133
Net income	(14,575)	(8,487)	3,585	4,779
Net income per common share:				
Basic	\$ (0.36)	\$ (0.21)	\$ 0.09	\$ 0.12
Diluted	\$ (0.36)	\$ (0.21)	\$ 0.09	\$ 0.12

Subsequent to Q2 2002, the Company made a reclassification of \$0.5 million from cost of goods sold to selling, general and administrative expenses, effective for the period ending June 30, 2002. This reclassification did not effect the net loss presented for Q2 2002.

**Table of Contents****Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure**

None

**PART III****Item 10. Directors and Executive Officers of the Registrant  
Directors**

The articles of the company provide that its board of directors is to be comprised of between five (5) and fifteen (15) directors, as determined from time to time by resolution of the board of directors. Within these minimum and maximum numbers of directors, the board of directors has resolved that the entire board of directors will consist of six (6) directors.

The following table states, with respect to each person currently serving as a director of the company, the name, age, position held with the company (where applicable), the year first elected or appointed as a director, committee memberships and the person's principal occupation and employment during the past five (5) years.

Name, Age, Principal Occupation and Municipality of Residence(6)	Year Became Director
Richard B. Black(1)(2)(4), 69 President and Chief Executive Officer, ECRM, Inc. Moose, Wyoming, U.S.A.	1999
Paul F. Ferrari (4)(5), 72 Independent Consultant Former Vice President & Treasurer Thermo Electron Corporation Hobe Sound, Florida, U.S.A.	1999
Phillip A. Griffiths, Ph.D. (3), 64 Director, Institute for Advanced Study Princeton, New Jersey, U.S.A.	2001
Byron O. Pond (1)(2), 66 Chairman and Chief Executive Officer, Amcast Industrial Corp. Dayton, Ohio, U.S.A.	2000
Benjamin J. Virgilio (1)(2), 63 President & Chief Executive Officer, BKJR, Inc. Toronto, Ontario, Canada	1998
Charles D. Winston (3), 62 President & Chief Executive Officer, GSI Lumonics Inc. Nutting Lake, Massachusetts, U.S.A.	1999

(1) Member, Audit Committee

(2) Member, Compensation Committee

(3) Member, Technology Committee

(4) Member, Pricing Committee

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(5) Chairman of the Board

(6) The mailing address of each of Messrs. Black, Ferrari, Griffiths, Pond, Virgilio and Winston is c/o GSI Lumonics Inc. at 39 Manning Road, Billerica, Massachusetts 01821, Telephone: (978) 439-5511.

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*Richard B. Black* is President and Chief Executive Officer of ECRM, Inc., a manufacturer of laser systems equipment for the printing and publishing industry. He served as Chairman of ECRM until March 2002. Mr. Black also serves as a General Partner for OpNet Partners, L.P., a technology investment fund. He has served as Vice Chairman of Oak Technology, Inc. (Oak) since March 1999 and as President of Oak from January 1998 to March 1999 and has been a director at Oak since 1988. From 1987 to 1997, Mr. Black served as a General Partner for KBA Partners, L.P., a technology venture capital fund. Prior to that time, he served as president and CEO of AM International, Inc., Aluisse of America, Inc. and Maremont Corporation. In addition to ECRM and Oak, he currently serves as a director of the following companies: Altigen Communications Inc., Applied Optoelectronics, Inc., Gabelli Group Capital Partners, Inc., TREX Enterprises and Benedetto Gartland, Inc.

*Paul F. Ferrari* has been an independent consultant since 1991. Previously, he was Vice President of Thermo Electron Corporation from 1988 to 1991 and was Treasurer of Thermo Electron Corporation from 1967 to 1988. He also served as a director of Thermedics Inc. and ThermoTrex Inc.

*Phillip A. Griffiths, Ph.D.* is serving as the Director of the Institute for Advanced Study in Princeton, New Jersey, where he is responsible for managing the various research activities of the Institute. Prior to joining the Institute in 1991, Dr. Griffiths was Provost and James B. Duke Professor of Mathematics at Duke University for eight years. He has also taught at Harvard University, Princeton University and the University of California, Berkeley. He currently serves as a Director of Oppenheimer Funds, Inc.

*Byron O. Pond* has been serving as Chairman and Chief Executive Officer of Amcast Industrial Corp. since April 2002. He joined Amcast in February 2001 as President and CEO. Prior to that time and since 1990, Mr. Pond was a senior executive with Arvin Industries, Inc. serving as its President and Chief Executive Officer from 1993 to 1996 and as its Chairman and Chief Executive Officer from 1996 to 1998. He retired as Chairman of Arvin Industries, Inc. in 1999. He currently serves as a Director of Cooper Tire and Rubber Company and Precision Castparts Corporation.

*Benjamin J. Virgilio* is currently the President and Chief Executive Officer of BKJR, Inc. of Toronto, Canada and was previously, from July 2000 until February 2001, the Chairman of Robotic Technology Systems, Inc. Mr. Virgilio was the President and Chief Executive Officer of Rea International Inc., an automotive fuel systems manufacturer, from May 1995 to July 2000. Prior to May 1995, Mr. Virgilio was a business consultant. Prior to November 1993, he was President and Chief Executive Officer of A.G. Simpson Limited.

*Charles D. Winston* became the President, Chief Executive Officer and a member of the board of directors of the company following the merger of General Scanning, Inc. and Lumonics Inc. in 1999. Mr. Winston served as President and Chief Executive Officer of General Scanning, Inc. beginning in September 1988 and became a member of its board of directors in 1989. Prior to joining General Scanning, Inc., from 1986 to 1988, Mr. Winston was a management consultant. In 1986, Mr. Winston was an officer of Savin Corporation. From 1981 to 1985, he served as a Senior Vice President of Federal Express Corporation.



**Table of Contents****Executive Officers**

The following table sets forth the names, ages and positions of the current executive officers of the company as at May 9, 2003, and the principal occupations held by each person named for at least the past five (5) years.

Name	Age	Position with GSI Lumonics
Charles D. Winston	62	President and Chief Executive Officer
Thomas R. Swain	57	Vice President, Finance and Chief Financial Officer
Linda Palmer	51	Vice President, Human Resources
Kurt A. Pelsue	51	Vice President, Technology and Chief Technology Officer
Felix I. Stukalin	41	Vice President, Business Development

*Charles D. Winston* became the President, Chief Executive Officer and a member of the board of directors of the company following the merger of General Scanning, Inc. and Lumonics Inc. in 1999. Mr. Winston served as President and Chief Executive Officer of General Scanning, Inc. beginning in September 1988 and became a member of its board of directors in 1989. Prior to joining General Scanning, Inc., from 1986 to 1988, Mr. Winston was a management consultant. In 1986, Mr. Winston was an officer of Savin Corporation. From 1981 to 1985, he served as a Senior Vice President of Federal Express Corporation.

*Thomas R. Swain* has held his current position of Vice President, Finance and Chief Financial Officer since September 2000. Prior to that Mr. Swain served as Director of Real Estate Operation from April 1999 to August 2000. He joined General Scanning, Inc. in August 1996 with the acquisition of View Engineering, Inc. and served as Vice President and General Manager, View Engineering Division until December 1997, then served as Vice President of Business Development from January 1998 through March 1999. Prior to its acquisition by General Scanning, Inc., Mr. Swain had served as President and Chief Executive Officer of View Engineering, Inc.

*Linda Palmer* assumed her current role as Vice President, Human Resources in December 1999, having served as Vice President of Integration from March 1999. She had been General Scanning, Inc.'s Vice President of Human Resources beginning in 1996. Prior to that time, Ms. Palmer served as Director of Human Resources for Analog Devices.

*Kurt A. Pelsue* assumed his current position as Vice President, Technology in March 1999. He had served as Vice President, Corporate Engineering for General Scanning, Inc. from 1997 to 1999. Prior to that time, Mr. Pelsue held numerous senior level engineering assignments within General Scanning, Inc. He joined General Scanning, Inc. in 1976.

*Felix I. Stukalin* was appointed to his current position of Vice President, Business Development in April 2002. Mr. Stukalin served as Vice President, WavePrecision since March 2000 and Vice President, Components prior to that. He joined General Scanning, Inc. in 1994 as Director of Engineering for the Components Division and in 1999 was appointed General Manager of that Division.

**Section 16(a) Beneficial Ownership Reporting Compliance**

Section 16(a) of the United States Securities and Exchange Act of 1934, as amended, as well as applicable Canadian securities laws, require directors, executive officers and persons who own more than 10% of the company's common shares to file reports with the United States Securities and Exchange Commission and with Canadian securities regulatory authorities, as applicable, disclosing their ownership of the company's securities and changes in such ownership. Based solely on a review of the copies of such reports furnished to it, or a written representation from certain reporting persons that no Form 5 was required for such person, the company believes that all required filings were timely made during fiscal 2002.

**Table of Contents****Item 11. Executive Compensation**

The following table, presented in accordance with the rules of the United States Securities and Exchange Commission, sets forth information with respect to the compensation earned during the fiscal years ended December 31, 2002, 2001 and 2000 by the company's Chief Executive Officer and the four other most highly compensated executive officers of the company (the Named Executive Officers).

**Summary Compensation Table**

Name and Principal Position	Fiscal Year	Annual Compensation			Long-Term Compensation Awards	
		Salary	Bonus	Other Annual Compensation(1)	Securities Under Options Granted	All Other Compensation(2)
Charles D. Winston(3) President & CEO	2002	\$400,000	\$158,414		200,000	\$ 8,500
	2001	400,000	140,000		250,000	8,500
	2000	392,949	280,000		105,000	8,500
Thomas R. Swain(4) V.P., Finance & CFO	2002	\$200,013	\$ 56,580		100,000	\$ 8,500
	2001	196,167	50,000		100,000	123,405(5)
	2000	178,125	44,549		30,000	8,500
Kurt A. Pelsue(6) V.P., Technology & CTO	2002	\$205,762	\$ 46,505		20,000	\$ 8,500
	2001	196,000			40,000	8,500
	2000	180,712	64,000		20,000	8,500
Linda Palmer(7) V.P., Human Resources	2002	\$174,230	\$ 39,342		20,000	\$ 8,500
	2001	160,000			50,000	8,500
	2000	151,909	48,000		20,000	8,500
Eileen Casal(8) V.P., General Counsel	2002	\$194,230	\$ 43,868		60,000	\$ 8,500
	2001	110,769	36,000		40,000	
	2000					

- (1) Unless otherwise noted, perquisites and personal benefits do not exceed the lesser of \$50,000 or 10% of the total of the annual salary and bonus of the Named Executive Officer.
- (2) Unless otherwise noted, all other compensation consists exclusively of the company's contribution under its retirement and savings plans established pursuant to Section 401(k) of the United States Internal Revenue Code. The terms of the retirement and savings plans permit each participant to defer up to 15% of his annual salary up to an annual maximum amount prescribed by United States Internal Revenue Service regulations (\$11,000 in 2002, plus an additional \$1,000 for those participants who met eligibility requirements for catch up contributions). The company matches such deferrals to the extent of achievement by it of profit goals.
- (3) Mr. Winston became the President, Chief Executive Officer and a member of the board of directors of the company following the merger of General Scanning, Inc. and Lumonics Inc. in 1999. Mr. Winston served as President and Chief Executive Officer of General Scanning, Inc. beginning in September 1988 and became a member of its board of directors in 1989. Prior to joining General Scanning, Inc., from 1986 to 1988, Mr. Winston was a management consultant. In 1986, Mr. Winston was an officer of Savin Corporation. From 1981 to 1985, he served as Senior Vice President of Federal Express Corporation.
- (4) Mr. Swain has held his current position of Vice President, Finance and Chief Financial Officer since September 2000. Prior to that time, Mr. Swain served as Director of Real Estate Operation from April 1999 to August 2000. He joined General Scanning, Inc. in August 1996 with the acquisition of View Engineering, Inc. and served as Vice President and General Manager, View Engineering Division until December 1997, then served as Vice President of Business Development from January 1998 through March 1999. Prior to its acquisition by General Scanning, Inc., Mr. Swain had served as President and Chief Executive Officer of View Engineering, Inc.



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- (5) Includes \$114,905 with respect to relocation and related expenses and \$8,500 with respect to 401(k) match.
- (6) Mr. Pelsue assumed his current position as Vice President, Technology and Chief Technology Officer in March 1999. He had served as Vice President, Corporate Engineering for General Scanning, Inc. from 1997 to 1999. Prior to that time, Mr. Pelsue held numerous senior level engineering assignments within General Scanning, Inc. He joined General Scanning, Inc. in 1976.
- (7) Ms. Palmer assumed her current role as Vice President, Human Resources in December 1999, having served as Vice President of Integration from March 1999. She had been General Scanning, Inc.'s Vice President of Human Resources beginning in 1996. Prior to that time, Ms. Palmer served as Director of Human Resources for Analog Devices.
- (8) Ms. Casal served as Vice President, General Counsel from May 2001 until her resignation effective as of January 31, 2003.

**Option Grants During Fiscal 2002**

The following table provides information regarding options granted by the company during the fiscal year ended December 31, 2002 to the Named Executive Officers:

Name	Number of Shares Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year(2)	Exercise or Base Price(\$/SH)	Expiration Date	Potential Realizable Value at Assumed Annual Rate of Share Price Appreciation for Option Term(1)	
					5%(\$)	10%(\$)
Charles D. Winston President & CEO	200,000	27.2%	\$8.35	2/26/08	567,960	1,288,507
Thomas R. Swain V.P., Finance & CFO	100,000	13.6%	\$8.35	2/26/08	283,980	644,253
Kurt A. Pelsue V.P., Technology & CTO	20,000	2.7%	\$8.35	2/26/08	57,796	128,851
Linda Palmer V.P., Human Resources	50,000	6.8%	\$8.35	2/26/08	56,796	128,851
Eileen Casal(3) V.P., General Counsel	60,000	8.2%	\$8.35	2/26/08	170,388	386,552

- (1) This column shows the hypothetical gain of the options granted based on assumed annual share appreciation rates of 5% and 10% above the exercise price over the full term of the option. The 5% and 10% rates of appreciation are mandated by the rules of the United States Securities and Exchange Commission and do not represent the company's estimate of future appreciation of the company's common share prices.
- (2) All options listed above vest as to 25% of the total grant on each of the first, second, third and fourth anniversary of the date of grant.
- (3) Ms. Casal served as V.P., General Counsel until her resignation effective as of January 31, 2003. All outstanding stock options held by Ms. Casal which were not exercised as of March 1, 2003 expired and were subsequently cancelled on that date.

**Table of Contents****Options Exercised During Fiscal 2002 and Year-End Option Values**

The following table provides information, for the Named Executive Officers, concerning the number of shares for which stock options were exercised in the fiscal year ended December 31, 2002, the realized value or spread (the difference between the exercise price and market value on date of exercise), and the number and unrealized spread of unexercised options held by the Named Executive Officers at each fiscal year end.

Name and Principal Position	Securities Acquired on Exercise(#)	Aggregate Value Realized(1)(\$)	Unexercised Options at December 31, 2002		Value of Unexercised In-the-Money Options at December 31, 2002	
			Exercisable/ Unexercisable(#)	Exercisable/ Unexercisable(2)(\$)		
Charles D. Winston President & CEO	0	0	626,075	434,999	383,728	78,373
Thomas R. Swain V.P., Finance & CFO	0	0	83,858	165,000	0	0
Kurt A. Pelsue V.P., Technology & CTO	0	0	147,616	66,250	103,612	18,562
Linda Palmer V.P., Human Resources	0	0	89,240	67,499	50,226	8,248
Eileen Casal V.P., General Counsel	0	0	25,000	75,000	0	0

- (1) Market value of the underlying shares on the date of exercise less the option exercise price. Values are in United States dollars unless otherwise specified.
- (2) Market value of shares covered by in-the-money options on December 31, 2002, less the option exercise price. Options are in-the-money if the market value of the shares covered thereby is greater than the option exercise price. Values are in United States dollars unless otherwise specified.

**Compensation of Directors**

During the most recently completed financial year, directors who were not employees of the company received an annual retainer of \$15,000 and an attendance fee of \$1,500 for attending meetings of shareholders, the board of directors and committees of the board of directors, and \$750 for each meeting conducted by telephone. Upon initial election they receive options to purchase 40,000 common shares and for each annual election after the initial election, they receive options to purchase 10,000 common shares. The options have an exercise price of fair market value of the company's common shares on the day immediately prior to the date of grant, a term of six (6) years, vest as to 25% on each of the first, second, third and fourth anniversary of the date of grant and are otherwise subject to the terms of the 1995 option plan. Directors who are employees of the company receive no remuneration for serving as members of the board of directors. All directors were entitled to reimbursement by the company for all reasonable expenses incurred in attending meetings of shareholders, the board of directors and committees of the board of directors. The chairman of the board of directors, currently Mr. Ferrari, receives an annual salary of \$24,000. No additional compensation is paid to the chairs of the various committees. All payments are made in the currency of the member's residence.

**Employment Contracts and Termination of Employment/ Change-in-Control Arrangements**

The company entered into an employment agreement with Charles D. Winston on January 1, 2000 and an amendment to such agreement on February 26, 2002, pursuant to which the company agreed to employ Mr. Winston as its President and Chief Executive Officer until December 31, 2003 and to pay him certain benefits upon the termination of his employment without cause, prior to such date, which benefits are further detailed in the severance agreement referenced below. In addition, the employment agreement provides for

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Mr. Winston to perform consulting services for the company for a two (2) year period commencing on January 1, 2004, at 50% of his base salary for the last year of his employment agreement. The company and Mr. Winston expect to enter into a second amendment to Mr. Winston's employment agreement which will extend the term of his employment until December 31, 2005 and the time period for providing consulting services to the company to a two (2) year period commencing on January 1, 2006.

In addition, the company has entered into severance agreements with certain members of its executive management team, including the Named Executive Officers. The agreements supercede previously executed severance agreements and all of the agreements provide for a severance payment if employment with the company is terminated without cause or upon or following defined change of control events. The severance agreement with Mr. Winston was entered into on May 24, 2001 and amended on February 26, 2002. The effective date for each of the agreements with Messrs. Swain and Pelsue and Ms. Palmer is May 24, 2001. Ms. Casal's resignation as V.P., General Counsel effective January 31, 2003 did not trigger the terms of a severance agreement, now terminated, entered into between she and the company effective as of May 24, 2001.

The severance agreement entered into with Mr. Winston is coterminous with his employment agreement and is not subject to renewal; while the severance agreements entered into with Messrs. Swain and Pelsue and Ms. Palmer continue for a minimum term of three (3) years from their respective effective dates and will automatically extend for periods of one (1) year after the initial term unless the company or the executive gives notice at least ninety (90) days prior to the expiration of the current period that the agreement will not be extended. Under the severance agreements the payment in the event of termination without cause is equal to a minimum of one (1) year and a maximum of two (2) years of the sum of (a) annual base salary; (b) targeted annual bonus; (c) prorated portion of the annual bonus; and (d) the cost of certain employment benefits, except that with respect to Mr. Winston the payment is equal to a minimum of two (2) years and a maximum of three (3) years of the sum of (a)-(d). If the termination of employment occurs upon or following a defined change of control of the company, the payment is equal to three (3) times the sum of (a)-(d), except that with respect to Mr. Winston the payment is equal to four (4) times the sum of (a)-(d). Also, pursuant to these agreements all unvested options then held shall immediately vest, provided that such options shall expire upon the earlier of (i) three (3) years or the remainder of the option term in the event of a change of control, or (ii) six (6) months or the remainder of the option term in the event of a termination for cause. Most of these agreements provide that a payment would be increased in the event that it would subject the officer to an excise tax as a parachute payment under the Internal Revenue Code of 1986, as amended. The increase would be equal to the additional tax liability imposed on the executive as a result of the payment.

## **Compensation Committee Interlocks and Insider Participation**

The current members of the compensation committee of the board of directors are Messrs. Black, Pond and Virgilio. None of the members of the compensation committee is or has at any time in the past been an officer or employee of the company or any of its subsidiaries. No executive officer of the company served on the compensation committee, or as a director, of another entity, one of whose executive officers served on the company's compensation committee or on its board of directors in fiscal 2002.

## **Report of Compensation Committee on Executive Compensation**

The executive compensation policy of the company has as its goals the following:

to provide executives with compensation that is fair and competitive in the market place;

to incentivize executives to meet and exceed financial and other strategic objectives; and

to raise the perspectives of executives from simply increasing the size of the company to taking a strategic path toward increasing shareholder value.

*Base salary.* Base salaries are determined on an individual basis taking into consideration the individual's position, the individual's ability to contribute to the company's performance and amounts paid by technology companies of similar size for comparable positions.

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*Annual bonus.* Each executive officer has the opportunity to earn an annual bonus. The amount of the bonus is tied to the individual's performance and the achievement of specific goals and objectives which, in some cases, may be difficult to quantify. Cash bonuses may also, at the discretion of the compensation committee, be used to recognize other significant contributions of an executive to the overall success of the company's objectives. All cash bonuses are paid at the discretion and upon the approval of the compensation committee. The amount of the potential bonuses varies based upon the executive officer's position with the company, ability to impact the company's performance and contribute to the company's objectives and degree of responsibility.

*Long term incentives.* Executives may participate in the company's stock option plans, referred to in this report as the plans. The plans are administered by the compensation committee which designates the individuals who are to be granted options, the number of options to be granted and other terms and conditions of the options. The number of stock options granted to executive officers is based upon the same factors as are relevant in setting their salaries and annual bonuses.

*Chief Executive Officer's compensation.* During the year ended December 31, 2002, Charles D. Winston served as the company's Chief Executive Officer. In setting the Chief Executive Officer's salary and target bonus for the year ended December 31, 2002, the compensation committee reviewed salaries and bonuses paid to other chief executive officers of technology companies of similar size and considered his ability to impact the achievement of the company's objectives. For the year ended December 31, 2002, Mr. Winston's target bonus was 70% of his base salary and an option to purchase 200,000 common shares was granted to Mr. Winston in 2002 with an exercise price of \$8.35 per share.

Report submitted by: Richard B. Black, Byron O. Pond and Benjamin J. Virgilio

**Comparison of Cumulative Total Shareholder Return**

The following graph assumes an investment of Cdn \$100 on December 31, 1997 and compares the yearly percentage change in the cumulative total shareholder return on such investment to the cumulative total return of the Toronto Stock Exchange Composite for the five (5) year period which commenced January 1, 1998 and ended on December 31, 2002. The company paid no dividends during the periods shown; the performance of the indices is shown on a total return (dividend reinvestment) basis. The graph lines merely connect the prices on the dates indicated and do not reflect fluctuations between those dates.

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The following graphs assume an investment of \$100 on March 22, 1999 (the date on which the company's common shares commenced trading on The NASDAQ Stock Market®) and compare the percentage change in the cumulative total shareholder return on such investment to the cumulative total return on (1) the NASDAQ Composite Index and (2) the Standard and Poor Small Cap 600 Electronics Equipment Subindex. The company paid no dividends during the periods shown; the performance of the indices is shown on a total return (dividend reinvestment) basis. The graph lines merely connect the prices on the dates indicated and do not reflect fluctuations between those dates.

(1) The NASDAQ Composite Index

(2) Standard and Poor Small Cap 600 Electronics Equipment Subindex



**Table of Contents****Item 12. Security Ownership of Certain Beneficial Owners and Management****Certain Beneficial Owners**

The following sets forth, to the knowledge of the company, certain information concerning the direct and indirect beneficial ownership of common shares, the company's only class of voting securities, as of the close of business on Thursday, May 8, 2003, by each person known by the directors or senior officers of the company to be the beneficial owner of, or to exercise control or direction over 5% or more of the outstanding common shares as of such date. This information is based on the most recent statements on Schedule 13G filed with the United States Securities and Exchange Commission or on other information available to the company.

Shareholder	Shares	Percentage
Sumitomo Heavy Industries Ltd.(1) 9-11, Kita-Shinagawa 5 Chome Shinagawa-Ku, Tokyo, 141-8686, Japan	4,078,238	10.0%
UBS Global Asset Management (Americas) Inc.(2) One North Wacker Drive Chicago, Illinois 60606	3,594,720	8.8%
Franklin Resources, Inc.(3) One Franklin Parkway San Mateo, California 94403	2,121,725	5.2%

- (1) Includes shares held by SHI Canada Inc., a wholly-owned subsidiary of Sumitomo Heavy Industries Ltd. Sumitomo Heavy Industries Ltd. has shared voting and dispositive power with SHI Canada Inc. as to all such shares.
- (2) Consists of shares held by investors whose accounts are managed by UBS Global Asset Management (Americas) Inc. and other subsidiaries of and investment companies managed by UBS AG. UBS Global Asset Management (Americas) Inc. has sole voting and shared dispositive power as to all such shares.
- (3) Consists of shares held by investors whose accounts are managed by Franklin Templeton Investments Corp., Templeton Investment Counsel, LLC, Franklin Templeton Investment Management Limited and Templeton Global Advisors Limited. Franklin Templeton Investments Corp., Templeton Investment Counsel, LLC, Franklin Templeton Investment Management Limited and Templeton Global Advisors Limited have shared voting and dispositive power as to all such shares.

**Directors and Management**

The following table shows the number of common shares, the company's only class of equity securities, beneficially owned by each of the directors, the nominees for election as a director, the Named Executive Officers (see Executive Compensation above), as well as by the directors, the nominees for election as a director and the executive officers of the company as a group, as of the close of business on Thursday, May 8, 2003.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)	Percentage of Common Shares
Richard B. Black, Director	41,735(2)	*
Eileen Casal, Vice President, General Counsel	2,251(3)	*
Paul F. Ferrari, Director, Chairman of the Board	146,435(4)	*
Phillip A. Griffiths, Director	30,880(5)	*



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Name of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)	Percentage of Common Shares
Linda Palmer, Vice President, Human Resources	101,740(6)	*
Kurt A. Pelsue, Vice President, Technology and Chief Technology Officer	190,241(7)	*
Byron O. Pond, Director	39,750(8)	*
Thomas R. Swain, Vice President, Finance and Chief Financial Officer	119,913(9)	*
Benjamin J. Virgilio, Director	39,000(10)	*
Charles D. Winston, President, Chief Executive Officer and Director	697,046(11)	1.7%
All directors, nominees for directors and executive officers as a group (15 persons)	1,675,479(12)	4.1%

\* Less than 1%.

- (1) A person is deemed to be the beneficial owner of securities that can be acquired by such person within sixty (60) days of Thursday, May 8, 2003, whether pursuant to the exercise of options or warrants, the conversion of securities or otherwise. Includes an aggregate of 1,472,135 shares which are fully vested and may be acquired within sixty (60) days of Thursday, May 8, 2003, by exercise of options and warrants. Each beneficial owner's percentage of ownership is determined by assuming that options that are held by such person (but not those held by any other person) and which are fully vested and exercisable (or convertible) within sixty (60) days of Thursday, May 8, 2003 have been exercised. Unless otherwise noted in the footnotes below, the company believes all persons named in the table have sole voting power and investment power with respect to all common shares beneficially owned by them. Statements as to ownership of common shares are based upon information obtained from the directors, nominees and executive officers and from records available to the company.
- (2) Includes 35,000 common shares subject to options and warrants.
- (3) Ms. Casal served as V.P., General Counsel until her resignation effective as of January 31, 2003. All outstanding options held by Ms. Casal which were not exercised as of March 1, 2003 expired and were subsequently cancelled on that date.
- (4) Includes 35,000 common shares subject to options and warrants.
- (5) Includes 25,000 common shares subject to options.
- (6) All common shares subject to options.
- (7) Includes 157,616 common shares subject to options.
- (8) Includes 38,750 common shares subject to options.
- (9) Includes 108,858 common shares subject to options.
- (10) Includes 35,000 common shares subject to options.
- (11) Includes 688,575 common shares subject to options and warrants.
- (12) Includes 1,472,135 common shares subject to options and warrants.



**Table of Contents****Equity Compensation Plans**

The following table gives information about the the company's common shares that may be issued upon the exercise of options, warrants and rights under all of its existing equity compensation plans as of December 31, 2002, the company's most recently completed fiscal year, including the 1995 option plan, the 1981 stock option plan of General Scanning, Inc., the 1992 stock option plan of General Scanning, Inc., the warrants and the company's employee stock purchase plan.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options/Warrants	Weighted-Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in First Column)
Plans approved by shareholders	3,624,741	\$ 10.11	424,801
Plans not approved by shareholders (the warrants)	51,186	\$ 13.36	0
Total	3,675,927		424,801

All of the option plans listed above or described in the table have been approved by the company's shareholders, except the warrants. The outstanding warrants listed in the above table were issued pursuant to the 1995 directors' warrant plan of General Scanning, Inc., referred to in this section as the warrant plan, which was assumed by the company in connection with the March 22, 1999 merger of General Scanning, Inc. and Lumonics Inc. No additional warrants are authorized to be granted under the warrant plan.

**Item 13. Certain Relationships and Related Transactions****Interest of Insiders in Material Transactions**

During the most recently completed fiscal year, the company recorded sales revenue from Sumitomo Heavy Industries Ltd., a significant shareholder, of approximately \$2.3 million. These sales were on terms approximately equivalent to comparable third party transactions.

On April 26, 2002, the company entered into an agreement with Photoniko, Inc., a private photonics company in which one of the company's directors, Richard B. Black, was a director and stock option holder. As of August 16, 2002, Mr. Black ceased to be a director and stock option holder of Photoniko, Inc. Under the agreement, the company provided a non-interest bearing unsecured loan of \$75,000 to Photoniko, Inc. to fund designated business activities at Photoniko, Inc. in exchange for an exclusive ninety (90) day period to evaluate potential strategic alliances. In accordance with the terms of the agreement and promissory note which was signed by Photoniko, Inc. on April 26, 2002, the loan was to be repaid in full to the company no later than August 28, 2002, but still remains outstanding. The company has provided a full reserve for this receivable.

In January of 2001, the company made an investment of \$2 million in a technology fund managed by OpNet Partners L.P. During 2002, the company received a cash distribution (return of capital) from OpNet Partners in the amount of \$1.4 million. In the second quarter of 2002, the company wrote down the investment by \$0.2 million to its estimated fair market value and wrote-off the remainder of the investment (\$0.4 million) in the fourth quarter of 2002. Richard B. Black, a director of the company, is a general partner of OpNet Partners, L.P.

On February 23, 2000 the company entered into an agreement with V2Air LLC relating to the use of the V2Air LLC aircraft for company business purposes. V2Air LLC is owned by the company's President and Chief Executive Officer, Charles D. Winston. Pursuant to the terms of the Agreement, the company is required to reimburse V2Air LLC for certain expenses associated with the use of the aircraft for company-

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related business travel. During the most recently completed financial year, The company reimbursed V2Air LLC approximately \$145,000 under the terms of such agreement.

Except for the foregoing, no director, officer, nominee director, 5% holder of the company's shares, or immediate family member, associate or affiliate thereof, had any material interest, direct or indirect, in any transaction since the commencement of the company's last completed fiscal year or has any material interest, direct or indirect, in any proposed transaction, having a value of \$60,000 or more.

### **Indebtedness of Directors and Officers**

Since the beginning of the fiscal year ended December 31, 2002 there has been no indebtedness to the company by any director or officer or associates of any such person, other than amounts owing for purchases subject to usual trade terms, for ordinary travel and expense advances and for other transactions in the ordinary course of business.

### **Directors and Officers Liability Insurance**

The company maintains directors and officers liability insurance in the aggregate principal amount of \$35,000,000 subject to a \$1,000,000 deductible per loss payable by the company. The premium payable for such insurance is currently \$225,700 per year, which is paid by the company.

### **Item 14. Controls and Procedures**

Within the 90 days prior to the date of this report, the company's management, including the Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of effectiveness of our disclosure controls and procedures pursuant to Rule 13a-14 under the Securities Exchange Act of 1934. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective in ensuring that all material information required to be disclosed in this report has been made known to them in a timely fashion. There have been no significant changes in our internal controls or other factors that could significantly affect internal controls subsequent to the date the Chief Executive Officer and Chief Financial Officer completed their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

## **Part IV**

### **Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K**

#### **List of Financial Statements**

The financial statements required by this item are listed in Item 8, Financial Statements and Supplementary Data herein.

#### **List of Financial Statement Schedules**

See Schedule II-Valuation and Qualifying Accounts. All other schedules are omitted because they are not applicable, not required or the required information is shown in the consolidated financial statements or notes thereto.

**Table of Contents****List of Exhibits**

See the company's SEC filings on Edgar at: <http://www.sec.gov/> for all Exhibits.

Exhibit Number	Description
2.1	Amended and Restated Agreement and Plan of Merger, dated as of October 27, 1998, by and among the Registrant, Grizzly Acquisition Corp., New Grizzly Acquisition Corp. and General Scanning, Inc. Pursuant to Item 601(b)(2) of Regulation S-K, the Schedules referred to in the Merger Agreement are omitted. The Registrant hereby undertakes to furnish a supplemental a copy of any omitted Schedule to the Commission upon request.(4)
2.2	Purchase and Sale Agreement and Joint Escrow Instructions, dated as of February 29, 2000, by and between Alexandria Real Estate Equities, Inc., and General Scanning, Inc., including amendments.(8)
2.3	Asset Purchase Agreement, dated as of August 19, 2000, between GSI Lumonics Life Science Trust, GSI Lumonics Trust, Inc. and Packard BioScience Company.(7)
3.1	Certificate and Articles of Continuance of the Registrant dated March 22, 1999.(4)
3.2	By-Law No.1 of the Registrant.(4)
4.1	Line of Credit Agreement between the Registrant and CIBC dated April 8, 1998 and accepted April 15, 1998.(4)
4.2	Rights Agreement, dated as of April 12, 1999 between GSI Lumonics Inc. and Montreal Trust Company of Canada, as Rights Agent.(12)
4.3	1981 Stock Option Plan of GSI.(1)
4.4	1992 Stock Option Plan of GSI.(1)
4.5	1995 Directors Warrant Plan of GSI.(1)
4.6	1994 Key Employees and Directors Stock Option Plan of the Registrant.(4)
4.7	1995 Stock Option Plan for Employees and Directors of the Registrant.(6)
4.8	GSI Lumonics Inc. Employee Stock Purchase Plan.(11)
4.9	Restatement of the 1995 Stock Option Plan for Employees and Directors of the Registrant.(13)
4.10	Security Agreement between the Registrant and the Bank of Montreal dated April 30, 2002.(14)
4.11	Waiver to Certain of the Operative Agreements between the Registrant and GSI Lumonics Corporation on one part and BMO Global Capital Solutions and the Bank of Montreal on the other part dated April 30, 2002.(14)
4.12	Loan Agreement among General Scanning Inc., GSI Lumonics Corporation and Fleet National Bank dated June 28, 2002.(14)
4.13	Secured Revolving Time Note between General Scanning Inc. and Fleet National Bank dated June 28, 2002.(14)
4.14	Security Agreement between General Scanning Inc. and Fleet National Bank dated June 28, 2002.(14)
4.15	Credit Line Letter Agreement between the Registrant and Canadian Imperial Bank of Commerce dated June 28, 2002.(14)
4.16	Amendment to Credit Line Letter Agreement between the Registrant and Canadian Imperial Bank of Commerce dated June 28, 2002.(14)
10.1	Lease Agreement between JRF II Associates Ltd. Partnership and Lumonics Corporation dated September 24, 1991.(4)
10.2	Industrial Space Lease between Lumonics Corporation and The Travelers Insurance Company dated March 17, 1992.(4)
10.3	Lease Agreement between Lumonics Corporation and Sisilli dated June 1994.(4)
10.4	GSI Lease dated July 31, 1996, as amended to date, between View Engineering, Inc. and Donald J. Devine as Trustee under the Donald J. Devine Trust Agreement.(2)
10.5	Lease dated July 15, 1997, as amended to date, between GSI and The Wilmington Realty Trust.(3)

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Exhibit Number	Description
10.6	Severance Agreement between the Registrant and Patrick D. Austin dated April 13, 1998.(4)
10.7	Split Dollar Compensation Agreement dated September 13, 1997 between GSI and Charles D. Winston.(3)
10.8	Key Employee Retention Agreement between GSI and Victor H. Woolley, dated May 1, 1997.(4)
10.9	Settlement Agreement dated June 12, 1998 between GSI and Robotic Vision Systems, Inc.(4)
10.10	Severance Agreement between the Registrant and Charles D. Winston dated April 21, 1999.(5)
10.11	Severance Agreement between the Registrant and Kurt Pelsue dated April 21, 1999.(5)
10.12	OEM Supply Agreement between the Registrant and Sumitomo Heavy Industries, Ltd. dated August 31, 1999.(5)
10.18	Employment Agreement between the Registrant and Charles D. Winston dated January 1, 2000.(8)
10.19	Severance Agreement between the Registrant and Thomas Swain dated May 24, 2001.(9)
10.20	Severance Agreement between the Registrant and Charles Winston dated May 24, 2001.(9)
10.21	Severance Agreement between the Registrant and Victor Woolley dated May 24, 2001.(9)
10.22	Severance Agreement between the Registrant and Eileen Casal dated May 24, 2001.(9)
10.23	Severance Agreement between the Registrant and Linda Palmer dated May 24, 2001.(9)
10.24	Severance Agreement between the Registrant and Kurt A. Pelsue dated May 24, 2001.(10)
10.25	Severance Agreement between the Registrant and Alfonso DaSilva dated July 9, 2001.(10)
10.26	Separation Agreement and General Release between the Registrant and Patrick D. Austin dated August 21, 2001.(10)
10.29	Amendment to Employment and Severance Agreements between the Registrant and Charles D. Winston dated February 26, 2002.(13)
10.30	Employment Agreement between the Registrant and Victor H. Woolley dated June 25, 2002.(14)
10.31	Termination Amendment to Severance Agreement between the Registrant and Victor H. Woolley dated June 25, 2002.(14)
10.32	Agreement of Purchase and Sale of property between the Registrant and Marcomm Fibre Optics, Inc. dated March 7, 2003.(15)
21.1	Subsidiaries of the Registrant.(15)
23.1	Consent of Independent Chartered Accountants.
99	Selected Consolidated Financial Statements and Notes in U.S. Dollars and in accordance with Canadian Generally Accepted Accounting Principles.
99.1	Management's Discussion and Analysis of Financial Condition and Results of Operations Canadian Supplement.
99.2	Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.3	Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- (1) Incorporated by reference to the Registration Statement of General Scanning, Inc. on Form S-1, filed August 11, 1995.
- (2) Incorporated by reference to the Annual Report on Form 10-K of General Scanning, Inc. for the year ended December 31, 1996.
- (3) Incorporated by reference to the Annual Report on Form 10-K of General Scanning, Inc. for the year ended December 31, 1997.
- (4) Incorporated by reference to the Registration Statement on Form S-4/ A (Amendment No. 2) of Lumonics Inc., filed February 11, 1999.
- (5) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 1999.



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- (6) Incorporated by reference to the Company's Registration Statement on Form S-8 filed August 4, 2000.
- (7) Incorporated by reference to the Company's Current Report on Form 8-K filed October 16, 2000.
- (8) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2000.
- (9) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 29, 2001.
- (10) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 28, 2001.
- (11) Incorporated by reference to the Company's Registration Statement on Form S-8 filed November 16, 2001.
- (12) Incorporated by reference to the Company's Registration Statement on Form 8-A filed January 24, 2002.
- (13) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2001.
- (14) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 28, 2002.
- (15) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

**Reports on Form 8-K**

Form 8-K dated November 12, 2002 Item 9, Regulation FD Disclosure

Disclosed, and included as an exhibit, written communication comprised of slides which were provided and disseminated in both written and oral form to participants in a series of investor presentations delivered in Canada by officers of the company during the week of November 4, 2002.

Form 8-K dated April 22, 2003 Item 5, Other Events

Disclosed, and included as an exhibit, a press release announcing that the company will acquire the principal assets of Spectron Laser Systems, a subsidiary of Lumenis, Ltd., for a purchase price of \$6.3 million in cash.

Form 8-K dated May 6, 2003 Item 5, Other Events

Disclosed, and included as an exhibit, a press release announcing that the company had acquired the principal assets of the Encoder division of Dynamics Research Corporation for a purchase price of \$3.3 million in cash.

Form 8-K dated May 7, 2003 Item 9, Regulation FD Disclosure

Disclosed, and included as an exhibit, written communication comprised of slides which were provided and disseminated in both written and oral form to participants in a series of investor presentations delivered by officers of the company beginning on May 7, 2003.

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**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant, GSI Lumonics Inc., has duly caused this Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized.

GSI LUMONICS INC.

By: /s/ CHARLES D. WINSTON

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Charles D. Winston  
*President and Chief Executive Officer*

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**CERTIFICATIONS PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY  
ACT OF 2002**

I, Charles D. Winston, certify that:

1. I have reviewed this annual report on Form 10-K/A of GSI Lumonics Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures 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 annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the Evaluation Date); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ CHARLES D. WINSTON

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Charles D. Winston  
*President and Chief Executive Officer*

Date: May 21, 2003

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**CERTIFICATIONS PURSUANT TO**

**SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002**

I, Thomas R. Swain, certify that:

1. I have reviewed this annual report on Form 10-K/A of GSI Lumonics Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures 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 annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the Evaluation Date); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ THOMAS R. SWAIN

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Thomas R. Swain  
*Vice President, Finance and Chief Financial Officer*

Date: May 21, 2003

**Table of Contents****GSI LUMONICS INC.****SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS**

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at End of Period
Year ended December 31, 2000					
Allowance for doubtful accounts	\$3,197	\$ 935	\$	\$(1,374)	\$2,758
Year ended December 31, 2001					
Allowance for doubtful accounts	\$2,758	\$1,130	\$	\$ (854)	\$3,034
Year ended December 31, 2002					
Allowance for doubtful accounts	\$3,034	\$ 209	\$	\$ (562)	\$2,681