GSI GROUP INC
Form 10-K
March 18, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2012

Or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File No. 001-35083

GSI Group Inc.

(Exact name of registrant as specified in its charter)

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

(781) 266-5700

(Registrant s telephone number, including area code)

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

Title of Each Class	Name of Exchange on Which Registered
Common Shares, no par value	**The NASDAQ Stock Market LLC**

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No þ

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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ 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. þ

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

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

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

The aggregate market value of the Registrant s outstanding common shares held by non-affiliates of the Registrant, based on the closing price of the common shares on the NASDAQ Global Select Market on the last business day of the Registrant s most recently completed second fiscal quarter (June 29, 2012) was $301,953,688. For purposes of this disclosure, common shares held by officers and directors of the Registrant and by persons who hold more than 5% of the Registrant s outstanding common shares have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily conclusive.

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

As of February 28, 2013, there were 33,820,825 of the Registrant s common shares, no par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s Definitive Proxy Statement for the Registrant s Annual Meeting of Shareholders scheduled to be held on May 15, 2013 to be filed with the Securities and Exchange Commission are incorporated by reference in answer to Part III of this Annual Report on Form 10-K.

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GSI GROUP INC.

FORM 10-K

YEAR ENDED DECEMBER 31, 2012

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As used in this report, the terms we, us, our, GSI Group , GSI , GSIG and the Company mean GSI Group Inc. and its subsidiaries, unles context indicates another meaning.

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

The following brand and trade names of GSI Group are used in this report: GSI WaferMark, GSI WaferRepair, GSI WaferTrim, GSI CircuitTrim, MicroE Systems, Westwind Air Bearings, Synrad, JK Lasers, Continuum, Quantronix, Cambridge Technology, ExoTec Precision, General Scanning Thermal Printers, Photo Research, JK Fiber Lasers, Spectron Lasers and NDSsi.

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PART I

Cautionary Note Regarding Forward-Looking Statements

Except for historical information, the matters discussed in this Annual Report on Form 10-K are forward looking statements that involve risks, uncertainties and assumptions that, if they never materialize or if they prove incorrect, could cause our consolidated results to differ materially from those expressed or implied by such forward-looking statements. The Company makes such forward-looking statements under the provision of the Safe Harbor section of the Private Securities Litigation Reform Act of 1995. Actual future results may vary materially from those projected, anticipated, or indicated in any forward-looking statements as a result of various factors, including those set forth in Item 1A of this Annual Report on Form 10-K under the heading Risk Factors. Readers should also carefully review the risk factors described in the other documents that we file from time to time with the SEC. In this Annual Report on Form 10-K, the words anticipates, believes, expects, intends, future, could, estimates, plans, , would, should, potential, continues and similar words or expressions (as well as other words or expr referencing future events, conditions or circumstances) identify forward-looking statements. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. The forward-looking statements contained in this Annual Report include, but are not limited to, statements related to: anticipated financial performance; expected liquidity and capitalization; drivers of revenue growth; management s plans and objectives for future operations, expenditures and product development, and investments in research and development; business prospects; potential of future product releases; anticipated sales performance; industry trends; market conditions; changes in accounting principles; changes in actual or assumed tax liabilities; expectations regarding tax exposures; anticipated reinvestment of future earnings; anticipated expenditures in regard to the Company s benefit plans; future acquisitions and dispositions and anticipated benefits from such acquisitions; anticipated outcomes of the legal proceedings and litigation matters; anticipated use of currency hedges; timing, scope and expected savings and charges related to realignment and restructuring initiatives; ability to repay our indebtedness; our intentions regarding the use of cash; expectations regarding the Company s ability to leverage its medical original equipment manufacturer (OEM) sales channels and the NDS acquisition; the expected opportunities for growth as a result of the NDS acquisition; and other statements that are not historical facts. All forward-looking statements included in this document are based on information available to us on the date hereof. We will not undertake and specifically decline any obligation to update any forward looking statements.

Item 1. *Business*

OVERVIEW

GSI Group Inc. and its subsidiaries (collectively referred to as the Company , we , us , ours) design, develop, manufacture and sell laser-based solutions, optical control devices, and associated precision technologies. Our technology is incorporated into customer products or manufacturing processes for a wide range of applications in a variety of markets, including: electronics, industrial, medical, and scientific. Our products enable customers to make advances in materials and processing technology and to meet extremely precise manufacturing specifications.

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

- driving more consistent, profitable growth by improving our business mix to increase medical sales and reduce microelectronics sales as a percentage of total revenue;
- strengthening our strategic position in medical components, scanning solutions, and fiber lasers through continual investment in differentiated new products and solutions;
- expanding our market access and reach, particularly in higher growth and emerging regions, through investment in internal sales channels as well as external channel partners;

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broadening our product and service offerings through the acquisition of innovative and complementary technologies and solutions;

streamlining our existing operations through site consolidations and strategic divestitures and expanding our business through strategic acquisitions;

expanding operating margins by establishing a continuous improvement culture through formalized productivity programs and initiatives; and

attracting, retaining, and developing talented and motivated employees.

GSI Group Inc. was founded and initially incorporated in Massachusetts in 1968 as General Scanning, Inc. (General Scanning). General Scanning developed, manufactured and sold components and subsystems used for high-speed micro positioning of laser beams. In 1999, General Scanning merged with Lumonics Inc., a Canadian company that developed, manufactured and sold laser-based, advanced manufacturing systems for electronics, semiconductor, and general industrial applications. The post-merger entity, GSI Lumonics Inc., continued under the laws of the Province of New Brunswick, Canada. In 2005, we changed our name to GSI Group Inc. In August 2008, we acquired Excel Technology, Inc. (Excel), a designer, manufacturer and marketer of photonics-based solutions consisting of lasers, laser-based systems, precision motion devices, and electro-optical components primarily used in industrial and scientific applications.

Beginning in 2011, we initiated a strategic review of our businesses to focus our growth priorities and simplify our business model. In June 2012, we committed to a plan for the sale of the Semiconductor Systems operating segment, sold under the GSI brand name, and the Laser Systems product lines, sold under the Control Laser and Baublys brand names. We began accounting for these businesses as discontinued operations in the second quarter of 2012. In October 2012, we sold certain assets and liabilities of the Lasers Systems business for $7.0 million, subject to working capital adjustments, and recorded a $2.3 million gain.

In January 2013, we acquired NDS Surgical Imaging (NDS) for $82.5 million in cash, subject to customary closing working capital adjustments. NDS, based in San Jose, California, designs, manufactures, and markets high definition visualization solutions and imaging informatics products for the surgical and radiology end-markets. NDS serves the medical sector, with a focus in surgery, radiology, neurosurgery, and other medical imaging disciplines. This business sells products both directly to original equipment manufacturers (OEMs) through a technical sales force and indirectly through distributors. We expect the addition of NDS will help us leverage our existing medical OEM sales channels and our expertise in color measurement technology. In addition, the medical applications that NDS serves with its products are adjacent to several of our existing medical applications. There are also a number of common customers with some of our existing businesses, which we expect will strengthen our key OEM customer relationships.

In 2013, the Company will evaluate our reportable segments in light of the acquisition of NDS. As of December 31, 2012, we operated in two reportable segments: Laser Products and Precision Motion and Technologies. The prior period information stated herein has been restated to conform to the new segment presentation as a result of classifying our Semiconductor Systems and Laser Systems businesses as discontinued operations beginning in June 2012. The following table shows the revenues and gross profit margin for each of the segments for the year ended December 31, 2012 (dollars in thousands):

	Sales	Gross Profit Margin
Laser Products	$ 108,186	33.8%
Precision Motion and Technologies	163,312	48.3%
Total	$ 271,498	42.2%

See Note 17 to Consolidated Financial Statements for additional financial information about our reportable segments.

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Laser Products Segment

The Laser Products segment designs, manufactures, and markets photonics-based solutions to customers worldwide. The segment serves highly demanding photonics-based applications such as cutting, welding, marking, and scientific research. The segment sells these products both directly utilizing a highly technical sales force and indirectly through resellers and distributors.

The Laser Products segment is comprised of three major product lines:

Product Line	Key End Market	Brand Names	Description
Sealed CO^2 Lasers	Industrial and Medical	Synrad	Applications include engraving and cutting of non-metals
Fiber Lasers	Industrial	JK Lasers	Applications include metal cutting, welding and drilling
Specialty Lasers	Scientific and Industrial	Continuum, Quantronix	Applications include scientific research, micro-machining, material processing and laser diagnostics

Precision Motion and Technologies Segment

The Precision Motion and Technologies segment designs, manufactures, and markets air bearing spindles, optical encoders, thermal printers, laser scanning devices, optics, and light and color measurement instrumentation to customers worldwide. The vast majority of the segment s product offerings in precision motion and optical control technologies are sold to OEMs. The segment sells these products both directly utilizing a highly technical sales force and indirectly through resellers and distributors.

The Precision Motion and Technologies segment has five major product lines:

Product Line	Key End Market	Brand Names	Description
Spindles	Electronics	Westwind Air Bearings	High-speed air bearing spindles used to drill very small and precise holes in printed circuit boards (PCB)
Optical Encoders	Electronics, Industrial, Scientific and Medical	MicroE Systems	Linear and rotary electro-optical tracking devices that measure movement with sub-micron accuracy. Applications include motion control of semiconductor and electronic manufacturing equipment, confocal microscopes, positioning magnetic rings on hard drives, precision manufacturing, coordinate measuring systems, and robotic surgery equipment
Light and Color Measurement	Industrial, Medical, and Electronics	Photo Research, Inc.	Color metrology devices are used by a wide variety of industries for research, quality control and on-line testing, including portable battery operated spectroradiometers, photometers, and video photometers
Thermal Printers	Medical	General Scanning Thermal Printers	Rugged paper tape printers for the medical instruments and defibrillator markets

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Product Line	Key End Market	Brand Names	Description
Laser Scanners	Industrial, Medical, Electronics, and Scientific	Cambridge Technology and ExoTec Precision	High precision motors that, when coupled with a mirror, can direct a laser beam with a high degree of accuracy. Applications include laser marking and coding, laser machining and welding, high density via hole drilling of printed circuit boards, scanning microscopy, retinal scanning, laser-based vision correction, Optical Coherence Tomography imaging for laser-based biomedical diagnostics, high resolution printing, holographic imaging and storage, semiconductor wafer inspection and processing, 2D or 3D imaging, and laser projection and entertainment

Customers

We have a diverse group of customers that include companies that are global leaders in their industries. Many of our customers participate in several market segments. There were no customers of our continuing operations with greater than 10% of our sales in 2012, 2011 or 2010.

Customers of our Precision Motion and Technologies and Laser Products segments include a large number of OEMs who integrate our products into their systems for sale to end users. We also sell directly to end users. The customers of our Precision Motion and Technologies and Laser Products segments include leaders in the industrial systems, microelectronics, automotive, data storage, and medical equipment markets. A typical OEM customer will usually evaluate a product and our ability to provide application support and customization before deciding to incorporate our product into their product or system. Customers generally choose suppliers based on a number of factors, including product performance, reliability, application support, price, breadth of the supplier s product offering, the financial condition of the supplier and the geographical coverage offered by the supplier. Once certain products of our Precision Motion and Technologies segment and Laser Products segment have been designed into a given OEM customer s product or system, there are generally significant barriers to subsequent supplier changes.

Customers of NDS include a number of OEMs who integrate our products into their systems for sale to end users. NDS has one customer which has historically accounted for over 10% of its revenues.

Seasonality

While our sales are not highly seasonal on a consolidated basis, the sales of some of our individual product lines, particularly our specialty laser business, is attributable to orders received from governmental entities or research institutions whose budgeting and funding cycles may be different from those of our commercial and industrial customers.

Backlog

As of December 31, 2012, our consolidated backlog was approximately $70.7 million. The majority of orders included in backlog represent open orders for products and services that management has concluded have a reasonable probability of being delivered over the subsequent twelve month period. Orders included in backlog

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may be canceled or rescheduled by customers without significant penalty. Management believes that backlog is not a meaningful indicator of future business prospects for any of our business segments due to the wide range of lead times required by our various types of customers and the ability of our customers to reschedule or cancel orders. Therefore, backlog as of any particular date should not be relied upon as indicative of our revenues for any future period.

Manufacturing

Manufacturing functions are performed internally when management chooses to maintain control over critical portions of the production process or for cost related reasons. To the extent it makes financial sense, we will consider outsourcing additional portions of the production process.

Products offered by our Laser Products segment are manufactured at facilities in Santa Clara, California; Rugby, United Kingdom; Mukilteo, Washington; and Suzhou, China.

Products offered by our Precision Motion and Technologies segment are primarily manufactured at facilities in Bedford, Massachusetts; Poole and Taunton, United Kingdom; Chatsworth, California; and Suzhou, China.

Many of our products are manufactured under ISO 9001 certification and our encoders and medical printers are manufactured under ISO 13485 certification.

Research and Development and Engineering

We incur research and development and engineering expenses as part of our ongoing operations. The following table shows total research and development and engineering expenses and as a percent of total sales for the years ended December 31, 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Research and development and engineering expenses	$ 22,393	$ 23,454	$ 22,297
As a percentage of sales	8.2%	7.7%	7.8%

We are strongly committed 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. Our markets have experienced rapid technological changes and product innovations. We believe that continued timely development of new products and product enhancements to serve existing and new markets is necessary for us to remain competitive.

Marketing, Sales and Distribution

We sell our products worldwide through our direct sales force and through distributors, including manufacturers representatives. Our local sales, applications and service teams and our distributors work closely with our customers to ensure customer satisfaction with our products. Our Laser Products and Precision Motion and Technologies products are sold worldwide through our direct sales force and through distributors, including manufacturer s representatives. We have sales and service centers located in North America, Europe, Asia Pacific, and Japan.

Competition

The markets in which we compete are dynamic and highly competitive. Due to the wide range of our products, we face many different types of competition and competitors. This affects our ability to sell our products and the prices at which these products are sold. Our competitors range from large foreign and domestic organizations, which produce a comprehensive array of goods and services and may have greater financial and

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other resources than we do, to small firms producing a limited number of goods or services for specialized market segments. We expect the proportion of large competitors to increase through the continued consolidation of competitors.

Competitive factors in our Precision Motion and Technologies and Laser Products segments include product performance, price, quality and reliability, features, flexibility, compatibility of products with existing systems, technical support, product breadth, market presence, on-time delivery and our overall reputation. We believe that our products offer a number of competitive advantages; however, some of our competitors are substantially larger and have greater financial and other resources.

Raw Materials, Components and Supplies

Each of our businesses uses a wide variety of raw materials, key components and supplies that are generally available from alternative sources of supply and in adequate quantities from domestic and foreign sources. In some instances, we design and/or re-engineer the parts and components used in our products. For certain critical raw materials, key components and supplies used in the production of some of our principal products, we have identified only a limited number of suppliers or, in some instances, a single source of supply. We also rely on a limited number of independent contractors to manufacture subassemblies for some of our products.

In the Laser Products segment, we rely upon unaffiliated suppliers for the material components and parts used to assemble our products. Most parts and components purchased from suppliers are available from multiple sources.

Our Precision Motion and Technologies segment sources most of its parts externally while some critical parts are manufactured internally, particularly in the air bearing spindles product line. Fully functional electronics as well as certain key components are purchased from external sources.

For a further discussion of the importance and risks associated with our supply chain, see applicable risk factors under Item 1A of this Annual Report on Form 10-K.

Patents and Intellectual Property

We rely upon a combination of copyrights, patents, trademarks, trade secret laws and restrictions on disclosure to protect our intellectual property rights. We hold a number of registered and pending patents in the United States and other countries. The issued patents cover various products in many of our key product categories, particularly laser scanning products, optical encoders, spindles, and lasers. In addition, we also have trademarks registered in the United States and foreign countries. We will continue to actively pursue applications for new patents and trademarks as we deem appropriate. However, there can be no assurance that any other patents will be issued to us or that such patents, if and when issued, will provide any protection or benefit to us.

Although we believe that our patents and pending patent applications are important, we rely upon several additional factors that are essential to our business success, including: market position, technological innovation, know-how, application knowledge and product performance. There can be no assurance that we will realize any of these advantages.

We also protect our proprietary rights by controlling access to our proprietary information and by maintaining confidentiality agreements with our employees, consultants, and certain customers and suppliers. For a further discussion of the importance of risks associated with our intellectual property rights, see applicable risk factors under Item 1A of this Annual Report on Form 10-K.

Human Resources

As of December 31, 2012 and 2011, we employed 1,264 and 1,539 employees, respectively. As of December 31, 2012 and 2011, 86 and 211 employees, respectively, were employees of our discontinued businesses.

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Geographic Information

We are a multinational company with approximately 68% of our 2012 sales outside the United States and approximately 30% of our property, plant and equipment, net, outside the United States at December 31, 2012. Geographic information is discussed in Note 17 to Consolidated Financial Statements. For a further discussion of the risks associated with our foreign operations, see applicable risk factors under Item 1A of this Annual Report on Form 10-K.

Government Regulation

Our current and contemplated activities and the products and processes that will result from such activities are subject to substantial government regulation, both in the United States and internationally.

Radiation Control for Health and Safety Act

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, those regulations require laser manufacturers 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 also subject to certain safety regulations in the United Kingdom related to the manufacturing of beryllium structures. The Control of Substances Hazardous to Health (COSHH) regulations are administered by the Health and Safety Executive and require us to monitor beryllium levels, provide health safety information to our employees and limit exposure to beryllium. Non-compliance with these regulations could result in warnings, penalties or fines. We believe that we are currently in compliance with these regulations. We are subject to similar regulatory oversight, including comparable enforcement remedies, in the European markets we serve.

CE Marking

We are subject to certain regulations in Europe as administered by the European Commission. CE Marking is required for products marketed within the European Economic Area (EEA) and confirms that the manufacturer meets certain safety, health and environmental protection requirements administered by the European Union. Non-compliance with these regulations could result in warnings, penalties or fines. We believe that we are currently in compliance with these regulations.

United States Food and Drug Administration

Certain products manufactured by us are integrated into systems by our customers that are subject to certain regulations administered by the United States Food and Drug Administration. We must comply with certain quality control measurements in order for our products to be effectively used in our customers end products. Non-compliance with quality control measurements could result in loss of business with our customers, fines and penalties.

We are subject to certain medical device regulations. Medical devices are subject to extensive and rigorous regulation by the Food and Drug Administration and by other federal, state and local authorities. The Federal Food, Drug and Cosmetic Act (FDC Act) and related regulations govern the conditions of safety, efficacy, clearance, approval, manufacture, quality system requirements, labeling, packaging, distribution, storage, record keeping, reporting, marketing, advertising, and promotion of products. Non-compliance with applicable requirements can result in, among other things, fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, refusal by the government to grant premarket clearance or approval of products, withdrawal of clearances and approvals, and criminal prosecution.

Other Information

We maintain a website with the address www.gsig.com. We are not including the information contained in our website as part of, or incorporating it by reference into, this Annual Report on Form 10-K. We make available, free of charge through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports as soon as reasonably practicable after we electronically file these materials with, or otherwise furnish them to, the Securities and Exchange Commission (SEC). 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 www.sedar.com.

Item 1A. ***Risk Factors***

The following risk factors could have a material adverse effect on our business, financial position, results of operations and cash flows and could cause the market value of our common shares to fluctuate or decline. These risk factors may not include all of the important factors that could affect our business or that could cause our future financial results to differ materially from historic or expected results or cause the market price of our common shares to fluctuate or decline.

Risks Relating to our Business

Our results of operations could be adversely affected by economic and political conditions and the effects of these conditions on our customers businesses and level of business activity.

A large portion of our product sales are dependent on the need for increased capacity or replacement of inefficient manufacturing processes. These sales also tend to lag behind other businesses in an economic recovery. There was a rapid decline of the economy and tightening of the financial markets in the second half of 2008 that continued into the first half of 2009. This slowing of the economy reduced the financial capacity of our customers, thereby slowing spending on the products and services we provide. While business conditions improved during the second half of 2009 and throughout 2010, economic conditions softened again since the third quarter of 2011 and continued throughout 2012, particularly in the microelectronics markets. If such weak economic conditions continue or worsen, we may not be able to meet anticipated revenue levels on a quarterly or annual basis. A severe and/or prolonged economic downturn or a negative or uncertain political climate could adversely affect our customers financial condition and the timing or levels of business activity of our customers and the industries we serve. In particular, the growing European financial crisis could have an impact on our customers financial condition and ability to maintain product orders in the future. This may reduce the demand for our products or depress pricing for our products and have a material adverse effect on our results of operations. Changes in global economic conditions could also shift demand to products or services for which we do not have competitive advantages, and this could negatively affect the amount of business that we are able to obtain. In addition, if we are unable to successfully anticipate changing economic and political conditions, we may be unable to effectively plan for and respond to those changes, and our business could be negatively affected.

Our business depends significantly upon our customers capital expenditures, which are subject to cyclical market fluctuations.

The microelectronics and electronics materials processing industries are cyclical and have historically experienced periods of oversupply, resulting in downturns in demand for capital equipment, including the products that we manufacture. The timing, length and severity of these cycles, and their impact on our business, are difficult to predict. Further, our order levels or results of operations for a given period may not be indicative

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of order levels or results of operations for subsequent periods. We cannot assure investors that demand for our products will increase or that demand will not decrease. For the foreseeable future, our operations will continue to depend upon industries that are subject to market cycles which, in turn, could adversely affect the market for our products.

Cyclical variations have historically had the most pronounced effect on our spindles product line, which resides in our Precision Motion and Technologies segment and concentrates in the electronics industries. In past economic slowdowns, we have experienced significant cyclical fluctuations, and we cannot assure you that such slowdowns will not recur or that the impact of such slowdowns will be more or less significant compared to historical fluctuations.

Our business success depends upon our ability to respond to fluctuations in product demand, but doing so may require us to incur costs despite limited visibility toward future business declines.

In periods of weak demand, like we have experienced since the third quarter of 2011, we may be required to reduce costs while at the same time maintaining the ability to motivate and retain key employees. Additionally, to remain competitive, we must also continually invest in research and development, which may inhibit our ability to reduce costs in a down cycle. Long product lead-times create a risk that we may purchase or manufacture inventories of products that we are unable to sell.

During a period of increasing demand and rapid growth, we must be able to increase manufacturing capacity quickly. Our inability to quickly increase production in response to a surge in demand could prompt customers to look for alternative sources of supply or leave our customers without a supply, both of which events could harm our reputation and make it difficult for us to retain our existing customers or to obtain new customers.

The success of our business requires that we continually innovate.

Technology requirements in our markets are consistently advancing. We must continually introduce new products that meet evolving customer needs. Our ability to grow depends on the successful development, introduction and market acceptance of new or enhanced products that address our customer s requirements. Developing new technology is a complex and uncertain process requiring us to accurately anticipate technological and market trends and meet those trends with responsive products. Additionally, this requires that we manage the transition from older products to minimize disruption in customer ordering patterns, avoid excess inventory and ensure adequate supplies of new products. Failure to develop new products, failed market acceptance of new products or problems associated with new product transitions could harm our business.

Delays in delivery of new products could have a negative impact on our business. If we do not introduce new products in a timely manner, we may lose market share and be unable to achieve revenue growth targets.

Our research and development efforts may not lead to the successful introduction of products within the time period our customers demand. Our competitors may introduce new or improved products, processes or technologies that make our current or proposed products obsolete or less competitive. 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;
- inability to manufacture products in a cost efficient manner;
- 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 have higher costs than initially estimated. There may be delays in starting volume production of new products and/or new products may not be commercially successful. There may also be difficulty in sourcing components for new products. Any of these developments could harm our business, including our results of operations.

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Our reliance upon third party distribution channels subjects us to credit, inventory, business concentration, and business failure risks beyond our control.

We sell many of our products through resellers, distributors, and system integrators. As these third parties tend to have more limited financial resources than OEMs and end-user customers, they generally represent sources of increased credit risk. Any downturn in the business of our resellers, distributors, and systems integrators would in turn harm our results of operations or financial condition.

Our sales also depend 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 influencing these OEM customers could have a substantial impact upon our financial results. We cannot assure investors 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.

Our quarterly results of operations may fluctuate significantly from period to period. As a result, we may fail to meet or exceed our expected financial performance, which could cause our stock price to decline.

We sell a relatively small number of high value semiconductor systems, which are included in our discontinued operations, within any period. These systems are complex and may have multiple elements for customer delivery including overall systems, spare parts, extended warranties, installation and training and may be subject to customer acceptance criteria. In certain transactions, we recognize all or a portion of revenue upon shipment provided that title and risk of loss have passed to the customer, evidence of an arrangement exists, fees are contractually fixed or determinable, collectability is reasonably assured through historical collection results and regular credit evaluations, and there are no uncertainties regarding the receipt or timing of customer acceptance. As a result, it is often difficult to project the timing of product revenue recognition. Consequently, our revenue and financial results could vary significantly from expectations in a particular quarter if anticipated orders from even a few customers are not received and fulfilled in time to satisfy customer obligations to the extent necessary to permit revenue to be recognized under generally accepted accounting principles.

Changes in customer order timing and other factors beyond our control may cause our operating results to fluctuate from period to period.

Changes in customer order timing and the existence of certain other factors beyond our control may cause our operating results to fluctuate from period to period. Such factors 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 parts from our suppliers and the manufacturing capacity of our subcontractors;
- changes in the prices of our products or of our competitors products; and
- fluctuations in exchange rates of foreign currencies.

Certain of our sales come from products with high selling prices and significant lead times. We may receive several 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.

A delay in a shipment or failure to meet our revenue recognition criteria near the end of a reporting period due, for example, to rescheduling or cancellations by customers or to unexpected difficulties experienced by us, may cause sales in the period to decline significantly and may have a material adverse effect on our operations for that period. Our inability to quickly adjust could magnify the adverse effect of that revenue shortfall on our results of operations.

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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 to fluctuate, perhaps substantially.

Revenues in our medical components market are largely dependent on one customer, which may reduce its purchases of our products in the future.

Greater than 10% of NDS revenues in 2012 were derived from one customer within the surgical display business. There is a risk that this customer may reduce its purchases of NDS products in the future. Although GSI did not have any revenues related to this customer in 2012 because the acquisition of NDS occurred in January 2013, the loss of a significant portion of purchases by this customer would significantly impact our results of operations in the future. If the customer reduces its purchases of NDS products, there is no assurance that we will be able to compensate for the shortfall in revenue and profitability through other means. Changes in technologies or solutions, consolidation of customers, changes in products manufactured by this customer or its selection of other suppliers could result in a further loss of future revenues and could materially impact our financial condition and results of operations in the future.

If we experience a significant disruption in, or breach in security of, our information technology systems, our business may be adversely affected.

We rely on information technology systems throughout our company to manage orders, process shipments to customers, manage inventory levels and maintain financial information. Events could result in the disruption of our systems, including power outages, computer attacks by hackers, viruses, catastrophes, hardware and software failures and other unforeseen events. If we were to experience a significant period of system disruption in information technology systems that involve our interactions with customers or suppliers, it could result in the loss of sales and customers and significant incremental costs, which could adversely affect our business. In addition, security breaches of our information technology systems could result in the misappropriation or unauthorized disclosure of confidential information belonging to us or to our employees, partners, customers or suppliers, which could result in significant financial or reputational damage to us.

We transact a significant portion of our sales, and maintain significant cash balances, in foreign currencies and in the past we have maintained and may in the future maintain foreign currency exchange contracts. As a result, changes in interest rates, credit ratings or foreign currency rates could have a material effect on our operations, financial position, results of operations and cash flows.

A significant portion of our sales are derived from our European and Asian operations and transacted primarily in Euros and Japanese yen, respectively, while our products are mainly manufactured in the United States and the United Kingdom. In the event of a decline in the value of the Euro or yen, we would typically experience a decline in our revenues. In addition, because our products are mainly manufactured in the United States, we may be required to increase the sale prices on our products sold in Europe and Japan in order to maintain sales margins and recover costs . This may have a materially adverse impact on our sales, profitability, financial position and cash flows.

Additionally, balances we maintain in foreign currencies create additional financial exposure to changing interest and currency rates. We have in the past, and may in the future, attempt to mitigate these risks by purchasing foreign currency exchange contracts, and by investing in United States government issued treasury bills. However, if long term interest rates or foreign currency rates were to change rapidly, we could incur material losses. Further, if management chooses to invest in less risk adverse investment vehicles, the risk of losing principal and/or interest could increase.

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International operations are an expanding part of our business and our operations in foreign countries subject us to risks not faced by companies operating exclusively in the United States.

During the year ended December 31, 2012, 68% of our revenues from continuing operations were derived from operations outside of the United States. The scope of our international operations subjects us to risks which could materially impact our results of operations, including:

- foreign exchange rate fluctuations;
- social and political unrest in countries where we operate;
- increases in shipping costs or increases in fuel costs;
- longer payment cycles;
- acts of terrorism;
- greater difficulty in collecting accounts receivable;
- use of incompatible systems and equipment;
- problems with staffing and managing foreign operations in diverse cultures;
- protective tariffs;
- trade barriers and export/import controls;
- transportation delays and interruptions;
- increased vulnerability to the theft of, and reduced protection for intellectual property rights;
- government currency control and restrictions, delays, penalties or required withholdings on repatriation of earnings; 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 or exportation of our products or supplies or gauge the effect that new barriers would have on our financial position or results of operations.

We also are subject to risks that our operations outside the United States could be conducted by our employees, contractors, service providers, representatives or agents in ways that violate the Foreign Corrupt Practices Act or other similar anti-bribery laws. Any such violations could have a negative impact on our business and could result in government investigations and/or injunctive, monetary or other penalties. Moreover, we face additional risks that our anti-bribery policy and procedures may be violated by third-party sales representatives or other agents that help sell our products or provide other services, because such representatives or agents are not our employees and it may be more difficult to oversee their conduct.

The increased use of outsourcing in foreign countries exposes us to additional risks which could negatively impact our business.

We are increasingly outsourcing the manufacture of subassemblies to suppliers based in China and elsewhere overseas. Economic, political or trade problems with foreign countries could substantially impact our ability to obtain critical parts needed in the timely manufacture of our products. Additionally, this practice increases our vulnerability to the theft of, and reduced protection for, our intellectual property.

Our global operations are subject to extensive and complex import and export rules that vary among the legal jurisdictions in which we operate. Failure to comply with these rules could result in substantial penalties.

Due to the international scope of our operations, we are subject to a complex system of import and export related laws and regulations, including U.S. export control and customs regulations and customs regulations of other countries. These regulations are complex and vary among the legal jurisdictions in which we operate. Any alleged or actual failure to comply with such regulations may subject us to government scrutiny, investigation and civil and criminal penalties, and may limit our ability to import or export our products or to provide services outside the United States. Any of these penalties could have a material impact on our financial position, results of operations and cash flows.

We have a history of operating losses and we may not be able to sustain our profitability.

We incurred operating losses in each of the years from 1998 through 2003 and again in 2008 and 2009. Although we reported an operating profit for the years ended December 31, 2012, 2011 and 2010, no assurances can be given that we will be able to sustain or increase the level of profitability in the future based on extrinsic market forces.

We are exposed to the credit risk of some of our customers and to credit exposures in weakened markets, which could adversely affect our results of operations.

Customers with liquidity issues may lead to additional bad debt expense. There can be no assurance that our open credit customers will pay the amounts they owe to us or that the reserves we maintain will be adequate to cover such credit exposure. Our customers failure to pay and/or our failure to maintain sufficient reserves could have a material adverse effect on our operating results and financial condition.

In addition, to the extent that the ongoing turmoil in the credit markets makes it more difficult for some customers to obtain financing, those customers ability to pay may be adversely impacted, which in turn could have a material adverse effect on our business, operating results, and financial condition.

Others may violate our intellectual property rights and cause us to incur significant costs to protect our rights.

Our future success depends in part upon our intellectual property rights, including trade secrets, know-how and continuing technological innovation. We do not have personnel dedicated to the oversight, organization and management of our intellectual property. There can be no assurance that the steps we take to protect our intellectual property rights will be adequate to prevent misappropriation or disclosure, or that others will not develop competitive technologies or products outside of our patented intellectual property. It is possible that, despite our efforts, other parties may use, obtain or try to copy our technology and products. There can be no assurance that other companies are not investigating or developing other technologies that are similar to ours, that any patents will be issued from any application filed by us or that, if patents are issued, the claims allowed will be sufficient to deter or prohibit others from marketing similar products. In addition, our patents may be challenged, invalidated or circumvented in a legal or administrative proceeding. Our patents and know-how may not provide a competitive advantage to us. Policing unauthorized use of our intellectual property rights is difficult and time consuming and may involve initiating claims or litigation against third parties for infringement of our proprietary rights, which could be costly.

Our success depends upon our ability to protect our intellectual property and to successfully defend against claims of infringement by third parties.

We have received in the past, and could receive in the future, notices from third parties alleging that our products infringe patent or other proprietary rights. We believe that our products are non-infringing or that we have the patents and/or licenses to allow us to lawfully sell our products throughout the world. However, we may be sued for infringement. In the event any third party makes a valid claim against us or our customers for which a license was not available to us on commercially reasonable terms, our operating results would be adversely affected. Adverse consequences may also apply to our failure to avoid litigation for infringement or misappropriation of proprietary rights of third parties.

Our efforts to protect our intellectual property rights may not be effective in some foreign countries where we operate or sell our products. Many U.S. companies have encountered substantial problems in protecting their intellectual property rights against infringement in foreign countries. If we fail to adequately protect our intellectual property in these countries, we may lose significant business to our competitors.

We operate in highly competitive industries and, if we lose competitive advantages, our business would suffer adverse consequences.

Some of our competition comes from established competitors, some of which have greater financial, engineering, manufacturing and marketing resources than we do. Our competitors will continue to improve the design and performance of their products and introduce new products. It is possible that we may not successfully differentiate our current and proposed products from the products of our competitors, or that the marketplace will not consider our products to be superior to competing products. To remain competitive, we will be required to invest heavily in research and development, marketing and customer service and support. It is also possible that we may not be able to make the technological advances necessary to maintain our competitive position, or our products will not receive market acceptance. We may not be able to compete successfully in the future. 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 business strategy may include making strategic divestitures. There can be no assurance that any divestitures will provide business benefit.

Our business strategy has included divesting certain non-core businesses. During the second quarter ended June 29, 2012, we committed to a plan to sell our Semiconductor Systems operating segment and Laser Systems businesses. We sold certain assets and liabilities of our Laser Systems businesses in October 2012 and expect to sell our Semiconductor Systems business by the end of the second quarter of 2013. The divestiture of an existing business could reduce our future operating cash flows and revenues, make our financial results more volatile, and/or cause a decline in revenues and profits. A divestiture could also cause a decline in the price of our common shares and increased reliance on other elements of our core business operations. If we do not successfully manage the risks associated with a divestiture, our business, financial condition, and results of operations could be adversely affected. In addition, there could be other negative unforeseen effects from a divestiture. We also may not find suitable purchasers for the Semiconductor Systems business and would continue to pay operating costs associated with this business.

We have made, and expect to continue to make, acquisitions, and we may fail to successfully integrate future acquisitions into our business.

As part of our business strategy, we expect to broaden our product and service offerings through acquiring businesses, technologies, assets and product lines that we believe complement or expand our existing businesses. In January 2013, we acquired NDS, which designs, manufactures, and markets high definition visualization solutions and imaging informatics products for the surgical and radiology end-markets. It is likely that we will continue to make acquisitions in the future.

We may face challenges as a result of these acquisition activities. For example, we may fail to successfully integrate acquisitions, including the operations of NDS and future acquisitions, into our business and, as a result, may fail to realize the synergies, cost savings and other benefits expected from the acquisitions. We may not find suitable acquisition candidates in the future or succeed in executing acquisitions that are accretive to earnings. We must also achieve these objectives without adversely affecting our revenues. If we are not able to successfully achieve these objectives, the anticipated benefits of such acquisitions may not be realized fully or at all, and our results of operations could be adversely affected.

Further, our ability to maintain and increase profitability of an acquired business will depend on our ability to manage and control operating expenses and to generate and sustain increased levels of revenue. Our expectations to achieve more consistent and predictable levels of revenue and to increase profitability as a result of any acquisitions may not be realized. Such revenues and profitability may even decline as we integrate operations into our business. If revenues of acquired businesses grow more slowly than we anticipate, or if their operating expenses are higher than we expect, we may not be able to sustain or increase their profitability, in which case our financial condition will suffer and our stock price could decline. Moreover, our acquisition activities may divert management s attention from our regular operations and managing a larger and more geographically dispersed operation and product portfolio could pose challenges for our management.

If we do not attract and retain our key personnel, our ability to execute our business strategy will be limited.

Our success depends, to a significant extent, upon the continued service of our executive officers and key management and technical personnel, particularly our experienced engineers, and upon our ability to continue to attract, retain, and motivate qualified personnel. The competition for these employees is intense. The loss of the services of one or more of our key personnel could have a material adverse effect on our operating results. In addition, there could be a material adverse effect on us should the turnover rates for engineers and other key personnel increase significantly or if we are unable to continue to attract qualified personnel.

Our success also depends on our ability to execute leadership succession plans. The inability to successfully transition key management roles could have a material adverse effect on our operating results.

We have undertaken restructuring and realignment activities in the past, and we will continue to assess our operating structure in the future. These actions may not improve our financial position, and may ultimately prove detrimental to our operations and sales.

Our ability to reduce operating expenses is dependent upon the nature of the actions we take to reduce expenses and our subsequent ability to implement those actions and realize expected cost savings. If global conditions continue to deteriorate and unfavorably impact our business, we may need to take additional restructuring actions. There can be no assurance that these actions will improve our financial position, results of operations or cash flows. Further, there is a risk that these actions may ultimately prove detrimental to our operations and sales, or to our intellectual property protections.

Product defects or problems with integrating our products with other vendors products may seriously harm our business and reputation.

We produce complex products that can contain latent errors or performance problems. This could happen to both existing and new products. Such defects or performance problems could be detrimental to our business and reputation.

In addition, customers frequently integrate our products with other vendors products. 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 relationship issues. These issues may also complicate our determination of the timing and amount of revenue recognition and could have a material negative impact on our business.

Disruptions in the supply of or defects in raw materials, certain key components and other goods from our suppliers, including limited or single source suppliers, could have an adverse effect on the results of our business operations, and could damage our relationships with customers.

The production of our products requires a wide variety of raw materials, key components and other goods that are generally available from alternate sources of supply. However, certain critical raw materials, key components and other goods required for the production and sale of some of our principal products are available from limited or single sources of supply. Many of our products are manufactured with high precision parts and components designed and/or manufactured by outside suppliers, which subjects us to an increased risk of defects. Any such parts or components that have latent or known defects may materially impact our relationship with customers if they cause us to miss our scheduled shipment deadlines. If latent defects are incorporated into our products and discovered later, there could be a material impact on our operations, financial position, results of operations and cash flow.

Certain of our businesses buy components, including limited or sole source items, from competitors of our other businesses, and certain of our businesses sell products to customers that compete with certain other segments of our business. This dynamic may adversely impact our relationship with these suppliers and customers. For example, these suppliers could increase the price of those components or reduce their supply of those components to us. Similarly, these customers could elect to manufacture products to meet their own requirements rather than purchasing products from us. Our businesses may be adversely affected by our other business relationships with customers and suppliers. Our current or alternative sources may not be able to continue to meet all of our demands on a timely basis. If suppliers or subcontractors experience difficulties, 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. A prolonged inability to obtain certain raw materials, key components or other goods is possible and could have an adverse effect on our business operations, and could damage our relationships with customers.

Production difficulties and product delivery delays or disruptions could have a material adverse effect on our business.

We assemble our products at our facilities in the United States, the United Kingdom and China. Each of our products is typically manufactured in a single manufacturing location. If the use of any of our manufacturing facilities were interrupted by a natural disaster or otherwise, our operations would be negatively impacted until we could establish alternative production and service operations. Significant production difficulties could be the result of:

- mistakes made while transferring manufacturing processes between locations;
- changing process technologies;
- ramping production;
- installing new equipment at our manufacturing facilities;
- shortage of key components; and
- loss of electricity or employees access to the manufacturing facilities due to natural disasters.

In addition, we may experience product delivery delays in the future. We ship a significant portion of our products to our customers through independent package delivery and import/export companies. We also ship our products through national trucking firms, overnight carrier services and local delivery practices. If one or more of the package delivery or import/export providers experiences a significant disruption in services or institutes a significant price increase, the delivery of our products could be prevented or delayed. Such events could cause us to incur increased shipping costs that could not be passed on to our customers, negatively impacting our profitability and our relationships with certain customers.

We are subject to regulation by various federal, state and foreign agencies that require us to comply with a wide variety of regulations, including those regarding the manufacture of products, the shipping of our products.

Medical devices manufactured by NDS are subject to regulations by the U.S. Food and Drug Administration and similar international agencies. These regulations govern a wide variety of product activities, from design and development to labeling, manufacturing, promotion, sales and distribution. If we fail to comply with the U.S. Food and Drug Administration s regulations or those of similar international agencies, we may have to recall products and cease their manufacture and distribution, which would increase our costs and reduce our revenues.

In recent years, the medical industry has undergone significant changes in order to reduce healthcare costs. This includes cuts in Medicare, consolidation of healthcare distribution companies and collective purchasing arrangements by office-based healthcare practitioners. Foreign and domestic governments have also undertaken efforts to control healthcare costs through legislation and regulation. In March 2010, President Obama signed into law health care reform legislation in the form of the U.S. Patient Protection and Affordable Care Act (PPACA). One of the components of the PPACA is a 2.3% excise tax on the sales of most medical devices, starting in 2013. This tax may put increased pressure on our NDS business and may lead our customers to reduce their orders for products we produce or to request that we reduce the prices we charge for our products in order to offset the tax. Many of the impacts of the law will not be known until those regulations are enacted over the next several years. The implementation of health care reform and medical cost containment measures in the U.S. and in foreign countries in which we operate could:

- decrease the price we might establish for our products and products that we may develop, which would result in lower product revenues to us;

- require additional safety monitoring, labeling changes, restrictions on product distribution or use, or other measures after the introduction of our products to market, which could increase our costs of doing business, or otherwise adversely affect the market for our products; and

- create new laws, regulations and judicial decisions affecting pricing or marketing practices.

Changes in governmental regulation of our business or our products could reduce demand for our products or increase our expenses.

We are subject to many governmental regulations, including but not limited 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, and certain health regulations related to the manufacture of products using beryllium, an element used in some of our products. Among other things, these regulations require us to file annual reports, to maintain quality control and sales records, to perform product testing, to distribute appropriate operating manuals, to conduct safety reviews, to incorporate design and operating features in products sold to end-users and to certify and label our products. Various warning labels must be affixed and certain protective devices installed depending on the class of product. We are also subject to regulatory oversight, including comparable enforcement remedies, in the markets we serve, and 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 these regulations could reduce demand for our products or increase our expenses, which in turn could adversely affect our business, financial condition, results of operations and cash flows.

The SEC has recently issued rules requiring disclosure regarding the use of certain conflict minerals mined from the Democratic Republic of Congo and adjoining countries and procedures regarding a manufacturer s efforts to prevent the sourcing of such minerals from these countries. The implementation of these rules may require significant additional expense, particularly in the event that only a limited pool of suppliers are available to certify that products are free from conflict minerals.

If we fail to implement new information technology systems successfully, our business could be adversely affected.

We rely on various centralized information systems throughout our company to keep financial records, process orders, manage inventory, process shipments to customers, and operate other critical functions. Some of our existing systems are no longer supported by the software system providers and need to be upgraded or replaced. If we are unable to successfully implement new systems or upgrade the existing systems, particularly those that record, process or manage financial information, we may experience disruption in our operations and may be unable to recognize the expected benefits associated with new systems.

Our results of operations will be adversely affected if we fail to realize the full value of our intangible assets.

As of December 31, 2012, our total assets included $84.6 million of net intangible assets, including goodwill. Net intangible assets consist principally of goodwill, patents, trademarks, customer relationships, core

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technology and technology licenses. Goodwill and indefinite-lived intangible assets are tested for impairment at least on an annual basis. All other intangible assets are evaluated for impairment should discrete events occur that call into question the recoverability of the intangible assets.

Adverse changes in our business, adverse changes in the assumptions used to determine the fair value of our reporting units, or the failure to grow our segments may result in impairment of our intangible assets, which could adversely affect our results of operations.

Risks Relating to Taxes

Our ability to utilize our net operating loss carryforwards and other tax attributes is dependent on our ability to generate sufficient future taxable income.

Section 382 of the Internal Revenue Code of 1986, as amended, limits a corporation s ability to utilize net operating loss carryforwards (NOLs) and other tax attributes following a section 382 ownership change. Our ability to use future tax deductions is dependent on our ability to generate sufficient future taxable income in tax jurisdictions in which we operate. In determining our provision for income taxes, our tax attributes and liabilities and any valuation allowance recorded against our net tax attributes requires judgment and analysis. We consistently evaluate our tax attributes based on taxes recoverable in the carryback period, existing deferred tax liabilities, tax planning strategies and projected future taxable income. Our ability to recover all of our tax attributes in certain jurisdictions depends upon our ability to continue to generate future profits. If actual results differ from our plans or we do not achieve the desired level of profitability in a given jurisdiction, we may be required to increase the valuation allowance on our tax attributes by taking a charge to the statement of operations.

Our effective tax rates are subject to fluctuation, which could impact our financial position.

Our effective tax rates are subject to fluctuation as the income tax rates for each year are a function of (a) taxable income levels in numerous tax jurisdictions, (b) our ability to utilize recorded deferred tax assets, (c) taxes, interest, or penalties resulting from tax audits and (d) credits and deductions as a percentage of total taxable income. Further, tax law changes may cause our effective tax rates to fluctuate between periods.

We may be subject to U.S. federal income taxation even though GSIG is a non-U.S. corporation.

Our holding company, GSIG, is a non-U.S. corporation organized in Canada and is subject to Canadian tax laws. However, our operating company, GSI US, is subject to U.S. tax and files U.S. federal income tax returns. In addition, distributions or payments from entities in one jurisdiction to entities in another jurisdiction may be subject to withholding taxes. Our holding company does not intend to operate in a manner that will cause it to be treated as engaged in a U.S. trade or business or otherwise be subject to U.S. federal income taxes on its net income, but it generally will be subject to U.S. federal withholding tax on certain U.S.-source passive income items, such as dividends and certain types of interest.

Risks Relating to Our Common Shares and Our Capital Structure

We may require additional capital to adequately respond to business challenges or opportunities and repay or refinance our existing indebtedness, and this capital may not be available on acceptable terms or at all.

We may require additional capital to adequately respond to business challenges or opportunities that may arise, including but not limited to the need to develop new products or enhance our existing products, maintaining or expanding research and development projects, the need to build inventory or invest other cash to support business growth and opportunities to acquire complementary businesses and technologies.

The terms of our amended and restated senior secured credit agreement (the Amended and Restated Credit Agreement) provides for a $50.0 million term loan and a $75.0 million revolving credit facility (collectively, the

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Senior Credit Facilities). If we are unable to satisfy those conditions or our needs exceed the amounts available under the facilities, we may need to engage in equity or debt financings to obtain additional funds. If we raise additional funds through further issuances of equity or convertible debt securities, our existing shareholders could suffer significant dilution. Any new equity securities we issue could have rights, preferences and privileges superior to those of the holders of our common shares. Further, our Amended and Restated Credit Agreement restricts our ability to obtain additional debt financing from other sources. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited. In addition, the terms of any additional equity or debt issuances may adversely affect the value and price of our common shares.

Global credit conditions have varied widely over the last several years and could vary significantly in the future. Although these conditions have not affected our current plans, adverse credit conditions in the future could have a negative impact on our ability to execute on future strategic activities.

The market price for our common shares may be volatile.

The market price of our common shares could be subject to wide fluctuations. These fluctuations could be caused by:

- quarterly variations in our results of operations;
- changes in earnings estimates by analysts;
- conditions in the markets we serve; or
- general market or economic conditions.

In addition, in recent years the stock market has experienced extreme price and volume fluctuations. These fluctuations have had a substantial effect on the market prices of many microelectronics and electronics materials processing companies, often unrelated to the operating performance of the specific companies. These market fluctuations could adversely affect the price of our common shares.

To service our indebtedness and fund our operations, we will require a significant amount of cash. Our ability to generate cash depends on many factors beyond our control.

Our ability to make payments on and repay or refinance our indebtedness and to fund planned capital expenditures, acquisitions, and research and development efforts will depend on our ability to generate cash in the future. To a certain extent, this is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

There is no assurance, however, that our business will generate sufficient cash flow from operations; that currently anticipated cost savings and operating improvements will be realized on schedule; that future borrowings will be available to us in an amount sufficient to enable us to make payments on and repay or refinance our indebtedness, or to fund our other liquidity needs. Although we refinanced our Original Senior Credit Facility (as defined below) during 2012, we may need to refinance all or a portion of our indebtedness, before our Senior Credit Facilities mature in 2017. In the event we need to refinance any borrowings under our Amended and Restated Credit Agreement, we may not be able to do so on commercially reasonable terms or at all, which could adversely affect our financial condition.

We may not have access to the cash flow and other assets of our subsidiaries that may be needed to service our indebtedness and fund our operations.

Although much of our business is conducted through our subsidiaries, none of our subsidiaries are obligated to make funds available to us. Accordingly, our ability to make payments on our indebtedness and fund our operations may be dependent on the earnings and the distribution of funds from our subsidiaries. Local laws and

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regulations and/or the terms of our indebtedness may restrict certain of our subsidiaries from paying dividends and otherwise transferring assets to us. We cannot assure you that applicable laws and regulations and/or the terms of our indebtedness will permit our subsidiaries to provide us with sufficient dividends, distributions or loans when necessary.

We have certain significant shareholders, one of whom serves on our Board of Directors. These significant shareholders and their respective affiliates could have substantial influence over our Board of Directors and our outstanding common shares, which could limit our other shareholders ability to influence the outcome of key transactions.

Our largest shareholders and their respective affiliates, in the aggregate, beneficially own a substantial amount of our outstanding common shares. As a result, these shareholders may be able to influence matters requiring approval by our shareholders, including the election of directors and the approval of mergers, acquisitions or other extraordinary transactions. One of these shareholders also serves on our Board of Directors and therefore could have a substantial influence over our Board of Directors. These substantial shareholders may have interests that differ from other shareholders and may vote in a way that may be adverse to the interests of other shareholders.

Certain provisions of our articles of incorporation may delay or prevent a change in control of our company.

Our corporate documents and our existence as a corporation under the laws of New Brunswick subject us to provisions of Canadian law that may enable our Board of Directors to resist a change in control of our company. These provisions include:

- limitations on persons authorized to call a special meeting of shareholders;
- the ability to issue an unlimited number of common shares; and
- advance notice procedures required for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of shareholders.

These antitakeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for shareholders to elect directors of their choosing and cause us to take other corporate actions that shareholders desire. In addition, New Brunswick law provides that cumulative voting is mandatory in director elections which can result in stockholders holding less than a majority of shares being able to elect persons to the Board of Directors and prevent a majority stockholder from controlling the election of all of the directors.

Our existing indebtedness could adversely affect our future business, financial condition and results of operations.

As of December 31, 2012, we had $50.0 million of outstanding debt. In order to fund our NDS acquisition, we borrowed an additional $60.0 million under our Senior Credit Facilities in January 2013. This level of debt could have significant consequences on our future operations, including:

- reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, acquisitions and other general corporate purposes, and limiting our ability to obtain additional financing for these purposes;
- limiting our flexibility in planning for, or reacting to, and increasing our vulnerability to, changes in our business, market changes in the industries in which we operate and the general economy; and
- placing us at a competitive disadvantage compared to our competitors that have less debt or are less leveraged.

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Any of the above-listed factors could have an adverse effect on our business, financial condition and results of operations.

In addition, our Amended and Restated Credit Agreement contains covenants that will limit our ability to engage in activities that may be in our long-term best interests. Our failure to comply with those covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all of our borrowings thereunder.

Risks Relating to Our Internal Controls

If we fail to maintain appropriate internal controls in the future, we may not be able to report our financial results accurately, which may adversely affect our stock price and our business.

While our management and our independent registered public accounting firm concluded that our internal control over financial reporting was effective as of December 31, 2012, it is possible that material weaknesses may be identified in the future.

If we are unable to maintain effective internal controls, we may not have adequate, accurate or timely financial information, and we may be unable to meet our reporting obligations as a publicly traded company or comply with the requirements of the SEC or the Sarbanes-Oxley Act of 2002. This could result in a restatement of our financial statements, the imposition of sanctions, including the inability of registered broker dealers to make a market in our common shares, or investigation by regulatory authorities. Any such action or other negative results caused by our inability to meet our reporting requirements or comply with legal and regulatory requirements or by disclosure of an accounting, reporting or control issue could adversely affect the trading price of our securities and our business. Significant deficiencies or material weaknesses in our internal control over financial reporting could also reduce our ability to obtain financing or could increase the cost of any financing we obtain.

Item 1B. ***Unresolved Staff Comments***

None.

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Item 2. ***Properties***

The principal owned and leased properties of the Company and its subsidiaries related to our continuing operations as of December 31, 2012 are listed in the table below.

Location	Principal Use	Current Segment (a)	Approximate Square Feet	Owned/Leased
Bedford, Massachusetts, USA	Manufacturing, R&D, Marketing, Sales and Administration	1,3	147,000	Leased; expires in 2019
Rugby, United Kingdom	Manufacturing, R&D, Marketing, Sales and Administration	2	43,000	Leased; expires in 2019
Poole, United Kingdom	Manufacturing, R&D, Marketing, Sales and Administration	1	51,000	Building owned; land leased through 2078
Mukilteo, Washington, USA	Manufacturing, R&D, Marketing, Sales and Administration	2	63,000	Owned
Suzhou, People s Republic of China	Manufacturing, R&D, Marketing, Sales and Administration	1,2	55,000	Leased; expires in 2013
Santa Clara, California, USA	Manufacturing, R&D, Marketing, Sales and Administration	2	44,328	Leased; expires in 2013
Lexington, Massachusetts, USA	Manufacturing, R&D, Marketing, Sales and Administration	1	33,339	Leased; expires in 2016; Exited in January 2013
Chatsworth, California, USA	Manufacturing, R&D, Marketing, Sales and Administration	1	22,000	Owned
Taunton, United Kingdom	Manufacturing, R&D, Marketing and Sales	1	19,000	Leased; expires in 2017
Planegg, Germany	Manufacturing, Sales and Administration	1,2	15,000	Leased; expires in 2015

a) The facilities house product lines that belong to the following segments:

1 Precision Motion and Technologies Segment

2 Laser Products Segment

3 Corporate

In connection with our entering into our Original Credit Facility in 2011, we entered into open ended deeds of trust for our Orlando, Florida, Mukilteo, Washington and East Setauket, New York properties.

Additional manufacturing, research and development, sales, service and logistics sites are located in Colorado, France, Italy, Japan, China, and Sri Lanka. These additional offices are in leased facilities occupying approximately 67,000 square feet in the aggregate and are related to our Precision Motion and Technologies and Laser Products segments.

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NDS, acquired in January 2013, is headquartered in San Jose, California where its radiology and surgical display products are manufactured. Additional research and development, sales and service sites are located in the United States, Europe, Japan and China. The aggregate amount of space currently occupied by NDS is approximately 78,000 square feet.

Our owned facility in Orlando, Florida and leased facilities in Taiwan and Korea represent properties for use in our discontinued operations. These owned and leased facilities constitute approximately 80,000 and 13,000 square feet in the aggregate, respectively. In 2012, we entered into a one-year, triple net lease for our Orlando facility as part of the sale of our Laser Systems business and will receive $0.5 million of annual rental income through the lease expiration date of October 2013.

Our owned facility in East Setauket, New York and leased facilities in Oxnard, California and Darmstadt, Germany were restructured and exited as part of our plans to consolidate various facilities under the 2011 restructuring program. These owned and leased properties constitute approximately 65,000 and 22,000 square feet in the aggregate, respectively. These properties were used as part of our Laser Products segment. In January 2013, we consolidated the operations of our leased facility in Lexington, Massachusetts with our Bedford, Massachusetts operations.

Our 50% owned joint venture, Excel Laser Technology Private Limited (Excel SouthAsia JV), owns a sales, service and administration facility located in Mumbai, India. The total square footage of this facility is approximately 18,000 square feet.

As of December 31, 2012, we were productively utilizing substantially all of the space in our facilities, except for space from our abandoned facilities as part of the 2011 restructuring program and our sales and service space in Mumbai, India.

Item 3. ***Legal Proceedings***

During the third quarter of 2005, the Company s French subsidiary, GSI Lumonics SARL (GSI France), filed for bankruptcy protection, which was granted on July 7, 2005. On April 18, 2006, the commercial court of Le Creusot (France) ordered GSI France to pay approximately 0.7 million Euros to SCGI in the context of a claim filed by SCGI that a Laserdyne 890 system delivered in 1999 had unresolved technical problems. No appeal was lodged. On May 6, 2011, GSI Group Ltd. was served with summons from the official receiver of GSI France demanding that GSI Group Ltd. and the Company s German subsidiary, GSI Group GmbH, appear before the Paris commercial court. GSI Group GmbH was subsequently served with a separate summons from the official receiver. The cases against GSI Group Ltd. and GSI Group GmbH were subsequently combined into a single case (docket number 2011/088718). The receiver claimed (i) that the bankruptcy proceedings initiated against GSI France in 2005 should be extended to GSI Group Ltd. and GSI Group GmbH on the ground that GSI France s decisions were actually made by GSI Group Ltd. and that GSI Group GmbH made financial advances for no consideration, which would reveal in both cases confusion of personhood, or (ii) alternatively, that GSI Group Ltd. be ordered to pay approximately 3.1 million Euros (i.e. the aggregate of GSI France s liabilities, consisting primarily of approximately 0.7 million Euros to SCGI and approximately 2.4 million Euros to GSI Group GmbH) on the ground that GSI Group Ltd. is liable in tort for having disposed of GSI France s assets freely and for having paid all of GSI France s debts except for the liability to SCGI. On June 19, 2012, the receiver withdrew its claim with respect to extending the bankruptcy proceedings to GSI Group Ltd. and GSI Group GmbH. As a result, only the tort claim remains pending before the court. The Company currently does not believe a loss is probable. Accordingly, no accrual has been made in the Company s accompanying consolidated financial statements with respect to this claim.

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

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IRS Claim

On April 5, 2010, the IRS filed amended proofs of claim aggregating approximately $7.7 million with the Bankruptcy Court as part of the Company s proceedings under Chapter 11 of the Bankruptcy Code. On July 13, 2010, the Company filed a complaint, *GSI Group Corporation v. United States of America*, in Bankruptcy Court in an attempt to recover refunds totaling approximately $18.8 million in federal income taxes the Company asserts it overpaid to the IRS relating to tax years 2000 through 2008, together with applicable interest. The complaint includes an objection to the IRS proofs of claim which the Company believes are not allowable claims and should be expunged in their entirety. Those tax proceedings remain pending, and their resolution in the ordinary course was not affected by the closing of the Chapter 11 Cases. The Company has reached a settlement agreement with the IRS and the Department of Justice and is awaiting consent from the Joint Committee of Taxation.

Item 4. ***Mine Safety Disclosures***

Not applicable.

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PART II

Item 5. ***Market for Registrant s Common Shares, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Market Information

From December 29, 2010 to January 27, 2011, the Company s common shares were quoted on the OTC Markets Group, Inc. under the trading symbol LASRD.PK . Thereafter, until February 14, 2011, the Company s trading symbol reverted to LASR.PK . Since February 14, 2011, the Company s common shares, no par value, have traded on the NASDAQ Global Select Market under the trading symbol GSIG . The following table sets forth the high and low prices of the Company s common shares during the periods indicated.

	2012		2011	
	High	Low	High	Low
First Quarter	$ 12.24	$ 10.79	$ 13.96	$ 10.30
Second Quarter	$ 12.44	$ 11.09	$ 12.18	$ 10.31
Third Quarter	$ 11.61	$ 8.69	$ 12.65	$ 7.68
Fourth Quarter	$ 8.99	$ 7.24	$ 11.08	$ 7.27

Holders

As of the close of business on February 28, 2013, there were approximately 37 holders of record of the Company s common shares. Since many of the common shares are registered in nominee or street names, the Company believes that the total number of beneficial owners is considerably higher.

Dividend Policy

The Company has never declared or paid cash dividends on its common shares. The Company currently intends to retain any current and future earnings to finance the growth and development of its business and, therefore, does not anticipate paying any cash dividends in the foreseeable future.

Purchases of Equity Securities by the Issuer and Affiliated Purchaser

None.

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Performance Graph

The following graph compares the cumulative total return to stockholders for the Company s common shares for the period from December 31, 2007 through December 31, 2012 with the NASDAQ Composite Index and the S&P Technology Index. The comparison assumes an investment of $100 is made on December 31, 2007 in the Company s common shares and in each of the indices and in the case of the indices it also assumes reinvestment of all dividends. The performance shown is not necessarily indicative of future performance.

	December 31, 2007	December 31, 2008	December 31, 2009	December 31, 2010	December 31, 2011	December 31, 2012
GSI Group Inc.	$ 100.00	$ 6.17	$ 9.42	$ 38.17	$ 36.90	$ 31.24
NASDAQ Composite Index	$ 100.00	$ 59.46	$ 85.55	$ 100.02	$ 98.22	$ 113.85
S&P Technology	$ 100.00	$ 56.57	$ 85.64	$ 93.91	$ 89.77	$ 102.92

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Item 6. ***Selected Financial Data***

The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes thereto included in Item 8 of this Annual Report on Form 10-K to fully understand factors that may affect the comparability of the information presented below. The selected consolidated financial data in this section is not intended to replace the consolidated financial statements.

The consolidated statements of operations data for the years ended December 31, 2012, 2011 and 2010 and the consolidated balance sheet data as of December 31, 2012 and 2011 are derived from our audited financial statements in this Annual Report. The consolidated statements of operations data for the year ended December 31, 2009 and 2008 and the consolidated balance sheet data as of December 31, 2010, 2009 and 2008 are derived from our audited consolidated financial statements that are not included in this Annual Report. The prior period information stated herein has been revised to conform to the new presentation as a result of classifying certain of our businesses as discontinued operations.

	Year Ended December 31,				
	2012	2011	2010	2009	2008
	(In thousands, except per share data)				
Condensed Consolidated Statements of Operations:					
Sales	$ 271,498	$ 304,296	$ 285,892	$ 192,362	$ 193,562
Gross profit	114,476	133,100	130,614	77,720	66,640
Operating expenses(1)(2)	99,469	97,252	94,587	101,878	316,227
Income (loss) from operations	15,007	35,848	36,027	(24,158)	(249,587)
Reorganization items(3)			(26,156)	(23,606)	
Income (loss) from continuing operations before income taxes	11,534	24,220	(7,973)	(75,720)	(256,299)
Income tax provision (benefit)(4)	(10,940)	2,544	11,952	(920)	(39,036)
Income (loss) from continuing operations	22,474	21,676	(19,925)	(74,800)	(217,263)
Income (loss) from discontinued operations, net of tax	(5,151)	7,325	19,286	3,531	4,747
Gain on disposal of discontinued operations, net of tax(5)	2,255				8,732
Consolidated net income (loss)	19,578	29,001	(639)	(71,269)	(203,787)
Less: Net income attributable to noncontrolling interest	(40)	(28)	(48)	(61)	(60)
Net income (loss) attributable to GSI Group, Inc.	$ 19,538	$ 28,973	$ (687)	$ (71,330)	$ (203,847)
Income (loss) from continuing operations attributable to GSI Group Inc. per common share:					
Basic	$ 0.66	$ 0.65	$ (0.84)	$ (4.70)	$ (15.12)
Diluted	$ 0.66	$ 0.64	$ (0.84)	$ (4.70)	$ (15.12)
Income (loss) from discontinued operations attributable to GSI Group, Inc. per common share:					
Basic	$ (0.08)	$ 0.22	$ 0.81	$ 0.22	$ 0.94
Diluted	$ (0.08)	$ 0.22	$ 0.81	$ 0.22	$ 0.94
Net income (loss) attributable to GSI Group, Inc. per common share					
Basic	$ 0.58	$ 0.87	$ (0.03)	$ (4.48)	$ (14.18)
Diluted	$ 0.58	$ 0.86	$ (0.03)	$ (4.48)	$ (14.18)
Weighted average common shares outstanding basic	33,775	33,481	23,703	15,916	14,375
Weighted average common shares outstanding diluted	33,936	33,589	23,703	15,916	14,375

(1) The Company recorded an impairment charge of $215.1 million in 2008 related to goodwill ($131.2 million), intangible assets ($78.5 million) and property, plant and equipment ($5.4 million) primarily due to an economic downturn, which reduced the estimated future cash flow of these assets.

(2) The Company recorded $12.1 million in 2008 related to in-process research and development paid for as part of the Excel acquisition.

(3) The Company recorded $26.2 million and $23.6 million in 2010 and 2009, respectively, related to our bankruptcy proceedings.

(4) The Company released $15.3 million of valuation allowance on deferred tax assets in 2012 based on the conclusion that it is more likely than not that a portion of its deferred tax assets in the U.S., U.K., France and Japan will be realized in the future. In 2010, the Company recorded $9.6 million unfavorable permanent differences in its income tax provisions primarily related to non-deductible bankruptcy costs. In 2009, the Company recorded $22.5 million valuation allowance on deferred tax assets as a result of material losses from its operations.

(5) The Company sold its Laser Systems business in 2012 and U.S. Optics business in 2008 and recorded a gain on disposal, net of tax, of $2.3 million and $8.7 million, respectively.

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	2012	2011	December 31, 2010 (in thousands)	2009	2008
Balance Sheet Data:					
Cash, cash equivalents and short-term investments	$ 65,788	$ 54,835	$ 56,781	$ 63,328	$ 69,001
Total assets	337,460	348,503	367,167	414,670	520,317
Debt, current	7,500	10,000			185,115
Debt, long-term	42,500	58,000	107,575		
Liabilities subject to compromise(1)				220,560	
Long-term liabilities, excluding deferred revenue and debt	11,828	22,783	21,250	20,739	44,964
Total stockholders equity	227,809	209,003	178,678	84,311	152,897

(1) Includes $210.0 million related to obligations due under the 2008 Senior Notes while in bankruptcy.

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

Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with the Consolidated Financial Statements and Notes included in Item 8 of this Annual Report on Form 10-K. The MD&A contains certain forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. In addition to historical financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. These forward-looking statements include, but are not limited to, expected sale of the Semiconductor Systems business in the first half of 2013; anticipated financial performance; expected liquidity and capitalization; drivers of revenue growth; management s plans and objectives for future operations, expenditures and product development and investments in research and development; business prospects; potential of future product releases; anticipated sales performance; industry trends; market conditions; changes in accounting principles and changes in actual or assumed tax liabilities; expectations regarding tax exposure; anticipated reinvestment of future earnings; anticipated expenditures in regard to the Company s benefit plans; future acquisitions and dispositions and anticipated benefits from prior acquisitions; anticipated outcomes of legal proceedings and litigation matters; and anticipated use of currency hedges. These forward-looking statements are neither promises nor guarantees, but involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including, but not limited to, the following: economic and political conditions and the effects of these conditions on our customers businesses and level of business activity; our significant dependence upon our customers capital expenditures, which are subject to cyclical market fluctuations; our dependence upon our ability to respond to fluctuations in product demand; our ability to continually innovate; delays in our delivery of new products; our reliance upon third party distribution channels subject to credit, business concentration and business failure risks beyond our control; fluctuations in our quarterly results, and our failure to meet or exceed our expected financial performance; customer order timing and other similar factors beyond our control; our dependence on one customer in our medical components business; disruptions in or breaches in security of our information technology systems; changes in interest rates, credit ratings or foreign currency exchange rates; risk associated with our operations in foreign countries; disruptions to our manufacturing operations as a result of natural disasters; our increased use of outsourcing in foreign countries; our failure to comply with local import and export regulations in the jurisdictions in which we operate; our history of operating losses and our ability to sustain our profitability; our exposure to the credit risk of some of our customers and in weakened markets; violations of our intellectual property rights and our ability to protect our intellectual property against infringement by third parties; risk of losing our competitive advantage; our ability to make divestitures that provide business benefits; our failure to successfully integrate recent and future acquisitions into our business; our ability to attract and retain key personnel; our restructuring and realignment activities and disruptions to our operations as a result of consolidation of our operations; product defects or problems integrating our products with other vendors products; disruptions in the supply of or defects in raw materials, certain key components or other goods from our suppliers; production difficulties and product delivery delays or disruptions; our failure to comply with various federal, state and foreign regulations; changes in governmental regulation of our business or products; our failure to implement new information technology systems and software successfully; our failure to realize the full value of our intangible assets; our ability to utilize our net operating loss carryforwards and other tax attributes; fluctuations in our effective tax rates; being subject to U.S. federal income taxation even though we are a non-U.S. corporation; any need for additional capital to adequately respond to business challenges or opportunities and repay or refinance our existing indebtedness, which may not be available on acceptable terms or at all; volatility in the market price for our common shares; our dependence on significant cash flow to service our indebtedness and fund our operations; our ability to access cash and other assets of our subsidiaries; the influence over our business of certain significant shareholders; provisions of our articles of incorporation may delay or prevent a change in control; our significant existing indebtedness may limit our ability to engage in certain activities; and our failure to maintain appropriate internal controls in the future. Other important risk factors that could affect the outcome of the

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events set forth in these statements and that could affect the Company s operating results and financial condition are discussed in Item 1A of this Annual Report on Form 10-K and elsewhere in this Annual Report on Form 10-K. In this Annual Report on Form 10-K, the words anticipates, believes, expects, intends, future, could, estimates, plans, would, should, potential, continues, and similar words or expressions (as well as other words or expressions referencing future events, conditions or circumstances) identify forward-looking statements. Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date they are made. Management and the Company disclaim any obligation to publicly update or revise any such statement to reflect any change in its expectations or in events, conditions, or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those contained in the forward-looking statements.

Business Overview

We design, develop, manufacture and sell laser-based solutions, optical control devices, and associated precision technologies. Our technology is incorporated into customer products or manufacturing processes for a wide range of applications in a variety of markets, including: electronics, industrial, medical, and scientific. Our products enable customers to make advances in materials and processing technology and to meet extremely precise manufacturing specifications.

Our Laser Products segment designs, manufactures and markets photonics-based solutions to customers worldwide. The segment serves highly demanding photonics-based applications such as cutting, welding, marking and scientific research. The segment sells these products both directly utilizing a highly technical sales force and indirectly through resellers and distributors.

Our Precision Motion and Technologies segment designs, manufactures and markets air bearing spindles, optical encoders, thermal printers, laser scanning devices, optics and light and color measurement instrumentation to customers worldwide. The vast majority of the segment s product offerings in precision motion and optical control technologies are sold to original equipment manufacturers (OEMs). The segment sells these products both directly utilizing a highly technical sales force and indirectly through resellers and distributors.

Strategy

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

- driving more consistent, profitable growth by improving our business mix to increase medical sales and reduce microelectronics sales as a percentage of total revenue;
- strengthening our strategic position in medical components, scanning solutions, and fiber lasers through continual investment in differentiated new products and solutions;
- expanding our market access and reach, particularly in higher growth and emerging regions, through investment in internal sales channels as well as external channel partners;
- broadening our product and service offerings through the acquisition of innovative and complementary technologies and solutions;
- streamlining our existing operations through site consolidations and strategic divestitures and expanding our business through strategic acquisitions; and
- expanding operating margins by establishing a continuous improvement culture through formalized productivity programs and initiatives; and

attracting, retaining, and developing talented and motivated employees.

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Significant Events and Updates

Acquisition of NDS Surgical Imaging

On January 15, 2013, we completed the acquisition of NDS Surgical Imaging (NDS), a San Jose, California-based company that designs, manufactures, and markets high definition visualization solutions and imaging informatics products for the surgical and radiology end-markets, for $82.5 million in cash, subject to customary closing working capital adjustments. We expect the addition of NDS will help us leverage our existing medical OEM sales channels and our expertise in color measurement technology. In addition, the medical applications that NDS serves with its products are adjacent to several of our existing medical applications. There are also a number of common customers with some of our existing businesses, which we expect will strengthen our key OEM customer relationships.

Greater than 10% of NDS historical revenues in recent years were derived from one customer within the surgical display business. There is a risk that this customer may reduce some of its purchases of NDS products in the future. We are actively exploring options to remediate the risk.

Amended and Restated Senior Credit Facility

On December 27, 2012, we entered into an amended and restated credit agreement (the Amended and Restated Credit Agreement), which matures on December 27, 2017 and provides for an aggregate of $125.0 million credit facility, consisting of a $50.0 million, 5-year, term loan facility and a $75.0 million, 5-year, revolving credit facility (collectively, the Senior Credit Facilities). The Amended and Restated Credit Agreement amended and restated the existing credit agreement dated October 19, 2011 that had a maturity date of October 19, 2015 and consisted of a $40.0 million, 4-year, term loan facility and a $40.0 million, 4-year, revolving credit facility (as amended prior to December 27, 2012, the Original Senior Credit Facility).

Appointment and Departure of Executive Officers

In October 2012, Matthijs Glastra joined the Company as corporate officer and Group President of our Laser Products segment. Mr. Glastra brings significant experience in the opto-electronics space, most recently as Chief Executive Officer of Philips Entertainment Lighting and formerly as Chief Operating Officer of Phillips Lumileds. In September 2012, our former Vice President, Group President of Laser Products and President of Synrad, departed the organization after 18 years of service with the Company.

Discontinued Operations Update

Beginning in 2011, we initiated a strategic review of our businesses to focus our growth priorities and simplify our business model. In June 2012, we committed to a plan for the sale of the Semiconductor Systems operating segment, sold under the GSI brand name, and Laser Systems product lines, sold under the Control Laser and Baublys brand names, and began accounting for these businesses as discontinued operations in the second quarter of 2012. In October 2012, we sold certain assets and liabilities of the Lasers Systems business for $7.0 million, subject to working capital adjustments, and recorded a $2.3 million gain, in the consolidated statement of operations. The Laser Systems facility in Orlando, Florida, which has an estimated fair value less costs to sell of $5.7 million as of December 31, 2012, was retained by the Company. We continue to make progress in the marketing of the Semiconductor Systems business and the Laser Systems facility and expect to sell the Semiconductor Systems business by the end of the second quarter of 2013 and the Laser Systems facility by the fourth quarter of 2013.

2011 Restructuring Plan Update

We have substantially completed our 2011 restructuring program that began in the fourth quarter of 2011, with a goal of eliminating up to twelve (12) facilities and targeting as much as $5.0 million in annualized costs savings. These reductions are expected to be achieved through a combination of site consolidations and divestitures, with divestitures resulting in the elimination of up to five facilities. Nine facilities have been exited, including three facilities exited as part of the sale of the Laser Systems business. We completed the consolidation of multiple operations during the year. We consolidated the manufacturing operations of our specialty lasers and optics products, consolidated our German operations into one facility and, in January 2013, consolidated our laser scanners business into our corporate headquarters located in Bedford, Massachusetts. We expect to substantially complete the consolidation and exit of up to three additional facilities in the first half of 2013 primarily as part of the expected sale of our Semiconductor Systems business.

We incurred $6.1 million of charges during the year ended December 31, 2012, related to the 2011 restructuring plan. These consisted of cash and non-cash charges of $4.1 million and $2.0 million, respectively. Cash charges primarily relate to severance, consulting and exit costs associated with the consolidation of our various facilities. Non-cash charges primarily relate to accelerated depreciation resulting from changes in estimated useful lives of certain long-lived assets for which we intend to exit. We expect to incur $1.2 million of cash related charges and $0.1 million of non-cash charges in 2013 related to the plan.

2012 Restructuring Plan Update

During the third quarter of 2012, we initiated a program (the 2012 restructuring program) to identify additional cost savings due to the continued uncertainty and volatility of the macroeconomic environment. This program identified an additional $1.0 million to $2.0 million of annualized cost savings beyond the savings expected from the 2011 restructuring program. We incurred $1.8 million of severance costs associated with the 2012 restructuring program during the year ended December 31, 2012. This plan was completed during the fourth quarter of 2012.

Release of our Valuation Allowance

During fiscal year 2012, based on an accumulation of positive evidence such as cumulative profits over the prior three years and projections for future growth, we determined that it is more likely than not that the benefits of our deferred tax assets will be realized. Accordingly, a deferred tax valuation allowance release of $15.3 million was recorded as an income tax benefit for the year.

As of December 31, 2012, a deferred tax valuation allowance of $15.5 million continues to be provided on state net operating losses, state tax credit carryforwards and certain foreign tax attributes that the Company determined are not more likely than not to be realized. In conjunction with our ongoing review of our actual results and anticipated future earnings, we will continue to reassess the possibility of releasing the valuation allowance currently in place on our deferred tax assets.

Overview of Financial Results

In 2012, we initiated actions to focus on strategic initiatives, including committing to a plan to sell our Laser Systems and Semiconductor Systems businesses and reporting the results of operations associated with these businesses in discontinued operations. We focused the Company s investments around three strategic growth areas, specifically, medical components, scanning solutions, and fiber lasers. In addition, we consolidated several manufacturing and R&D locations to improve our operating efficiencies while significantly enhancing our employee talent pool with the hiring of new business line leaders, functional leaders, and sales leaders.

Overall sales for 2012 decreased $32.8 million, or 10.8%, versus the prior year primarily as a result of a steep downturn in the capital equipment market, particularly in the microelectronics market. We currently are not expecting a recovery in these markets in 2013. To a lesser extent, the decrease was also attributable to lower specialty laser sales, which primarily serve scientific end markets. In addition, the year-over-year comparison is also affected by our adoption of Accounting Standards Update (ASU) 2009-13, Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements (ASU 2009-13), which amended the revenue recognition

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guidance for multi-element arrangements. Following our adoption of ASU 2009-13 as of the beginning of 2011, we did not defer any revenue on new multiple-element orders received from customers during the period but delivered over multiple periods. For orders that had been deferred under multi-element arrangements, delivered over multiple periods, entered into prior to the adoption of ASU 2009-13, we recognized $8.1 million of net revenue with net gross profit of $3.5 million in 2011, with no comparable amounts for 2012.

Income from operations for 2012 of $15.0 million decreased $20.8 million, or 58.1%, versus the prior year. This decrease was primarily attributable to the drop in sales, an $8.0 million charge driven by our 2011 and 2012 restructuring programs, compared to a $2.0 million restructuring charge for the prior year related to our 2011 restructuring program, and $0.8 million in acquisition related costs compared to none in the prior year. Partially offsetting the decrease in income from operations was lower spending on operating costs resulting from restructuring actions taken in the fourth quarter of 2011 and during 2012.

Diluted earnings per share (EPS) from continuing operations of $0.66 in 2012 increased $0.02 from the prior year. The decrease was largely because of a drop in income from operations of $20.8 million, offset by a $10.2 million reduction in interest expense for 2012 as a result of the reduction in our overall debt levels and refinancing of our debt in Q4 2011 and a release of the Company s valuation allowance of $15.3 million during 2012.

The specific components of our operating results for 2012, 2011 and 2010 are further discussed below.

Results of Operations

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

	Year Ended December 31,		
	2012	**2011**	**2010**
Sales	100.0%	100.0%	100.0%
Cost of goods sold	57.8	56.3	54.3
Gross profit	42.2	43.7	45.7
Operating expenses:			
Research and development and engineering	8.2	7.7	7.8
Selling, general and administrative	24.2	22.3	22.6
Amortization of purchased intangible assets	1.0	1.1	1.6
Restructuring, restatement related costs, post-emergence fees and other	3.3	0.8	1.1
Total operating expenses	36.7	31.9	33.1
Income from operations	5.5	11.8	12.6
Interest expense, net	(1.1)	(4.3)	(7.0)
Foreign exchange transaction gains (losses), net	(0.5)	0.1	0.1
Other income (expense), net	0.3	0.4	0.7
Income from continuing operations before reorganization items and income taxes	4.2	8.0	6.4
Reorganization items			(9.2)
Income (loss) from continuing operations before income taxes	4.2	8.0	(2.8)
Income tax provision (benefit)	(4.0)	0.9	4.2
Income (loss) from continuing operations	8.2	7.1	(7.0)
Income (loss) from discontinued operations, net of tax	(1.9)	2.4	6.8
Gain on disposal of discontinued operations, net of tax	0.9		
Consolidated net income (loss)	7.2	9.5	(0.2)

Less: Net income attributable to noncontrolling interest			
Net income (loss) attributable to GSI Group Inc.	7.2%	9.5%	(0.2)%

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Sales

The following table sets forth external sales by reportable segment for 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010	% Change 2012 vs. 2011	% Change 2011 vs. 2010
Laser Products	$ 108,186	$ 112,914	$ 105,020	(4.2)%	7.5%
Precision Motion and Technologies	163,312	191,382	180,872	(14.7)%	5.8%
Total	$ 271,498	$ 304,296	$ 285,892	(10.8)%	6.4%

Laser Products

2012 Compared with 2011

Laser Products sales decreased by $4.7 million, or 4.2%, primarily due to a decline in sales of our specialty lasers, which was adversely impacted by delays in government spending in the scientific laser market. This decrease was partially offset by a significant increase in our fiber laser sales, and an increase in sales volume of our sealed CO^2 lasers year over year.

2011 Compared with 2010

Laser Products sales increased by $7.9 million, or 7.5%, primarily due to stronger demand in many of our laser products, particularly demand in our industrial lasers and specialty lasers that serve the industrial, electronics and scientific markets. These increases in sales were partially offset by a slight decrease in sales of certain sealed CO^2 lasers.

Precision Motion and Technologies

2012 Compared with 2011

Precision Motion and Technologies sales decreased by $28.1 million, or 14.7%, primarily due to a significant decline in demand in the microelectronics market principally related to mechanical drilling of printed circuit boards. The decline in demand in this market resulted in a decline of approximately $18.8 million in sales of our Westwind spindles product line as compared to the prior year. In addition, the decrease in our Precision Motion and Technologies segment sales was also partially attributable to approximately $7.7 million of net revenue recognized in 2011, with no comparable amount recognized in 2012, for orders that had been deferred under multiple-element arrangements, delivered over multiple periods, entered into prior to the adoption of ASU 2009-13.

2011 Compared with 2010

Precision Motion and Technologies sales increased by $10.5 million, or 5.8%, primarily attributable to strong growth and demand in certain scanning products as a result of the rebound of the electronics and industrial end markets that started in 2010. We also experienced growth in our printed circuit board spindles product line, which serves the PCB drilling industry. These sales increases were partially offset by a decrease in sales in our encoder product line due to weaker demand in the data storage industry.

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Gross Profit

The following table sets forth the external gross profit and external gross profit margin for each of our reportable segments for 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Gross profit:			
Laser Products	$ 36,582	$ 43,948	$ 43,542
Precision Motion and Technologies	78,819	91,142	88,779
Corporate	(925)	(1,990)	(1,707)
Total	$ 114,476	$ 133,100	$ 130,614
Gross profit margin:			
Laser Products	33.8%	38.9%	41.5%
Precision Motion and Technologies	48.3%	47.6%	49.1%
Total	42.2%	43.7%	45.7%

Gross profit and gross profit margin can be influenced by a number of factors, including product mix, pricing, volume, manufacturing efficiencies and utilization, costs for raw materials and outsourced manufacturing, headcount, inventory obsolescence, warranty and freight expenses.

Laser Products

2012 Compared with 2011

Laser Products segment gross profit for 2012 decreased $7.4 million, or 16.8%, primarily due to the 4.2% decline in sales. The 5.1 percentage point decrease in gross profit margin was primarily attributable to product mix, as a higher proportion of our sales were from our fiber lasers product line. We are currently taking significant measures that we expect will lower the costs of our fiber lasers and improve their profitability, including manufacturing efficiencies and designing a lower cost product. In addition, gross profit margin was adversely impacted by lower absorption in our manufacturing facility for specialty lasers, as a result of delays in government funding in the scientific laser market.

2011 Compared with 2010

Laser Products segment gross profit for 2011 increased $0.4 million, or 0.9%, primarily due to the 7.5% increase in sales. The 2.6 percentage point decrease in gross profit margin was primarily attributable to unfavorable product mix and pricing among various product lines.

Precision Motion and Technologies

2012 Compared with 2011

Precision Motion and Technologies segment gross profit for 2012 decreased $12.3 million, or 13.5%, primarily due to the significant drop in sales of our Westwind Spindles product line due to a significant decline in demand in the microelectronics market; principally related to mechanical drilling of printed circuit boards. In addition, we recognized $3.3 million of net gross profit during 2011, with no comparable amount during 2012, for orders that had been deferred under multiple-element arrangements, delivered over multiple periods, entered into prior to the adoption of ASU 2009-13. Precision Motion and Technologies segment gross profit margin remained relatively flat year over year.

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2011 Compared with 2010

Precision Motion and Technologies segment gross profit for 2011 increased $2.4 million, or 2.7%, due to the 5.8% increase in sales. The 1.5 percentage point decrease in gross profit margin was primarily attributable to an unfavorable mix of products sold in 2011 compared to 2010.

Operating Expenses

The following table sets forth operating expenses for 2012, 2011 and 2010 (dollars in thousands):

				% Change	
	2012	**2011**	**2010**	**2012 vs. 2011**	**2011 vs. 2010**
Research and development and engineering	$ 22,393	$ 23,454	$ 22,297	(4.5)%	5.2%
Selling, general and administrative	65,584	67,877	64,535	(3.4)%	5.2%
Amortization of purchased intangible assets	2,650	3,515	4,436	(24.6)%	(20.8)%
Restructuring, restatement related costs, post emergence fees and other	8,842	2,406	3,319	NM	(27.5)%
Total	$ 99,469	$ 97,252	$ 94,587	2.3%	2.8%

Research and Development and Engineering Expenses

Research and development and engineering (R&D) expenses are primarily comprised of employee compensation and related expenses and cost of materials for R&D projects.

2012 Compared with 2011

R&D expenses were $22.4 million, or 8.2% of sales, in 2012, compared with $23.5 million, or 7.7% of sales, in 2011. R&D expenses, in terms of total dollars, decreased primarily attributable to lower employee related costs as a result of our 2011 and 2012 restructuring plans.

2011 Compared with 2010

R&D expenses were $23.5 million, or 7.7% of sales, in 2011, compared with $22.3 million, or 7.8% of sales, in 2010. R&D expenses, in terms of total dollars, increased as a result of increased headcount and higher project spending for the development of new products and technologies in several of our product lines.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses include costs for sales and marketing, sales administration, finance, human resources, legal, information systems, facilities and executive management.

2012 Compared with 2011

SG&A expenses were $65.6 million, or 24.2% of sales, in 2012, compared to $67.9 million, or 22.3% of sales, in 2011. SG&A expenses decreased $2.3 million versus 2011, primarily driven by lower outside services, partially offset by higher employee compensation as a result of strategic hires in the areas of business development, process excellence, and corporate functions.

2011 Compared with 2010

SG&A expenses were $67.9 million, or 22.3% of sales, in 2011, compared to $64.5 million, or 22.6% of sales, in 2010. SG&A expenses, in terms of total dollars, increased primarily as a result of an increase in

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employee personnel costs and an increase in selling and marketing costs. These increases were partially offset by decreases in various professional fees, which were significantly higher in 2010 due to the costs associated with the filing of various quarterly and annual financial statements with the SEC related to 2008, 2009 and 2010.

Amortization of Purchased Intangible Assets

Amortization of purchased intangible assets is charged to our Precision Motion and Technologies and Laser Products segments. Amortization for core technology is included in cost of goods sold in the consolidated statement of operations. Amortization for customer relationships, trademarks and other intangibles are included in operating expenses in the consolidated statement of operations.

2012 Compared with 2011

Amortization of purchased intangible assets, excluding the amortization for core technology, was $2.7 million, or 1.0% of sales, in 2012, compared to $3.5 million, or 1.1% of sales, in 2011. The decrease, in terms of total dollars and as a percentage of sales, was related to the completion of amortization related to non-compete agreements acquired as part of the 2008 Excel acquisition.

2011 Compared with 2010

Amortization of purchased intangible assets, excluding the amortization for core technology, was $3.5 million, or 1.1% of sales, in 2011, compared to $4.4 million, or 1.6% of sales, in 2010. The decrease, in terms of total dollars and as a percentage of sales, was primarily related to the completion of amortization related to non-compete agreements acquired as part of the 2008 Excel acquisition and completion of amortization of certain customer relationships.

Restructuring, Restatement Related Costs, Post-Emergence Fees and Other

We recorded restructuring, restatement related costs, post-emergence fees and other charges of $8.8 million, $2.4 million and $3.3 million during 2012, 2011 and 2010, respectively. These charges primarily relate to our 2011 and 2012 restructuring programs and acquisition related costs incurred in 2012 related to the acquisition of NDS in January 2013. In addition, post-emergence professional fees represent costs incurred subsequent to bankruptcy emergence for financial and legal advisors to assist with matters in finalizing the bankruptcy process. Post-emergence professional fees totaled $0.3 million and $0.7 million during 2011 and 2010, respectively, with no comparable amount for 2012.

2012 Compared with 2011

We recorded restructuring charges of $8.0 million in 2012 compared to $2.0 million in 2011. The increase in restructuring costs primarily relate to our 2011 and 2012 restructuring programs for which we recorded cash and non-cash costs of $5.9 million and $2.0 million, respectively, in 2012.

As part of our 2011 restructuring program, which began in December 2011, we incurred cash and non-cash restructuring charges of $1.1 million and $0.9 million, respectively, in 2011 primarily related to the consolidation of operations in Japan and the United States. As of December 31, 2012, we substantially completed our 2011 restructuring program and exited nine facilities, including three facilities exited as part of the sale of the Laser Systems businesses. We expect to substantially complete the consolidation and exit of up to three additional facilities in the first half of 2013 primarily as part of the expected sale of our Semiconductor Systems business. In 2012 we consolidated the manufacturing operations of our specialty lasers and optics product lines; consolidated each of our sales and service operations in Germany and Japan and; in January 2013, consolidated our laser scanners business into our corporate headquarters located in Bedford, Massachusetts. We incurred cash and non-cash charges of $4.1 million and $2.0 million, respectively, related to the plan during 2012. Cash charges incurred were primarily related to severance, moving and consulting costs while non-cash charges recorded were primarily related to accelerated depreciation for changes in estimated useful lives of certain long-lived assets which we intend to exit.

In 2012, we initiated and completed the 2012 restructuring program to identify additional cost savings due to the continued uncertainty and volatility of the macroeconomic environment, primarily related to our Westwind Spindles product line. We recorded cash charges of $1.8 million in 2012 related to severance costs under the 2012 restructuring program.

We also incurred non-recurring acquisition-related costs of $0.8 million in 2012. The acquisition costs primarily related to due diligence services with respect to the NDS acquisition.

2011 Compared with 2010

We recorded restructuring charges of $2.0 million in 2011, compared to $0.4 million, in 2010. During 2011, we recorded cash and non-cash charges of $1.1 million and $0.9 million, respectively, related to our 2011 restructuring program. In 2010, we recorded net cash charges of $0.4 million, primarily related to revised sublease assumptions associated with our abandoned Munich, Germany facility.

In 2010, we also recorded charges of $2.2 million associated with legal costs for services performed in connection with the SEC investigation and accounting and tax fees associated with the restatement of our previously issued financial statements.

Interest Expense, Foreign Exchange Transaction Gains (Losses), and Other Income (Expense), Net

The following table sets forth interest expense, net, foreign exchange transactions and other income (expense), net (in thousands):

	2012	**2011**	**2010**
Interest expense, net	$ (2,788)	$ (12,977)	$ (19,829)
Foreign exchange transaction gains (losses), net	(1,267)	172	204
Other income (expense), net	582	1,177	1,781
Total	$ (3,473)	$ (11,628)	$ (17,844)

Interest Expense, Net

2012 Compared with 2011

The decrease in net interest expense was primarily attributable to the substantial reduction and refinancing of our debt in 2011, which was achieved through a partial redemption of our Senior Secured PIK Elections Notes (the 2014 Notes), which carried a 12.25% fixed rate interest, versus interest on our Senior Credit Facilities, which carried a weighted average interest rate of 3.35%, inclusive of unused commitment fees. In addition, we recorded non-cash interest expense of $1.0 million and $1.9 million in 2012 and 2011, respectively. In 2012, our non-cash interest expense was related to the amortization of deferred financing fees for our Senior Credit Facilities. In 2011, our non-cash interest expense was comprised of a $1.1 million loss on extinguishment of debt related to unamortized deferred financing fees on our 2014 Notes, $0.3 million of PIK interest and $0.5 million related to the amortization of deferred financing costs for our 2014 Notes and our Original Senior Credit Facility.

2011 Compared with 2010

The decrease in net interest expense was primarily attributable to the reduction of our debt from $210.0 million to $107.0 million upon our emergence from bankruptcy in July 2010. We further reduced and refinanced our debt in 2011 to $68.0 million by entering into the variable rate Original Senior Credit Facility in October 2011, with an interest rate that approximated 3.2% as of December 31, 2011 as compared to 12.25% fixed rate interest on our 2014 Notes. The decrease in interest expense was partially offset by a $1.1 million loss on extinguishment of debt related to the write-off of unamortized deferred financing fees on our 2014 Notes. In addition, during 2011 and 2010, we incurred $0.3 million and $0.8 million, respectively, of non-cash interest expense related to the reporting default PIK interest of 2% on our 2014 Notes, and $0.5 million and $0.2 million, respectively, of non-cash interest expense related to the amortization of deferred financing costs.

Foreign Exchange Transaction Gains (Losses), Net

Foreign exchange transaction gains (losses), net, were ($1.3) million, $0.2 million and $0.2 million during 2012, 2011 and 2010, respectively, due to the performance of the U.S. Dollar against several foreign currencies, which weakened from 2011 to 2012.

Other Income (Expense), Net

We recognized $0.6 million and $1.2 million in 2012 and 2011, respectively, related to earnings on our equity investment in Laser Quantum.

In 2010, we recognized a $1.0 million gain on the sale of auction rate securities and $0.8 million related to earnings on our equity investment in Laser Quantum.

Reorganization Items

Reorganization items represent expense or income amounts that were recorded in the consolidated financial statements as a result of the bankruptcy proceedings. Reorganization items totaled $26.2 million in 2010 with no comparable amount in 2012 or 2011. The reorganization items recorded in 2010 consisted of $21.4 million of professional fees and $4.8 million of other fees, which included a $4.2 million charge related to a fee paid by us to certain of the holders of our 2008 Senior Notes to ensure that at least $20 million of our common shares were issued in connection with our rights offering pursuant to a backstop commitment.

Discontinued Operations

Income (loss) from discontinued operations, net of tax, was ($5.2) million, $7.3 million and $19.3 million during 2012, 2011 and 2010, respectively. The substantial decrease in 2012 compared with 2011 is primarily due to a decline in sales from our discontinued businesses in 2012, an inventory provision for our Semiconductor Systems business of $1.9 million, and a $0.9 million impairment related to our Orlando building, which was retained by the Company after the sale of our Laser Systems business and was the location of our Control Laser business. The increase in the inventory provision was caused by recent industry trends in the memory repair market, which resulted in lower expected future demand for our memory repair products. In addition, in 2012 we recognized severance costs of $0.7 million primarily related to our memory repair product line and Laser Systems business and consulting costs primarily related to legal and due diligence services of $0.9 million related to our discontinued businesses.

In 2012, we sold certain assets and liabilities of the Laser Systems business for cash proceeds of $7.0 million, subject to working capital adjustments. We recognized a gain of $2.3 million from the sale of the assets, which included a $1.5 million gain from cumulative translation adjustments recognized in the consolidated statement of operations associated with the liquidation of one of our German subsidiaries as part of the Laser Systems divestiture.

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Income Taxes

2012 Compared with 2011

We recorded a tax benefit of $10.9 million in 2012, as compared to tax expense of $2.5 million in 2011. The effective tax rate for 2012 was (94.9%) of income before taxes, compared to an effective tax rate of 10.5% of income before taxes for 2011. We are incorporated in Canada and therefore use the Canadian statutory rate. Our tax rate in 2012 differs from the Canadian statutory rate of 25.0% primarily due to a release of a portion of our valuation allowance on deferred tax assets of $15.3 million which we believe are more likely than not to be realized. In addition, we recorded a benefit of $4.1 million due to a decrease in unrecognized tax benefits relating mainly to settlement of a multi-year IRS examination. These benefits were partially offset by $1.4 million of international tax rate differences and $1.8 million of additional taxes resulting from the aforementioned IRS examination.

2011 Compared with 2010

We recorded a tax expense of $2.5 million in 2011, as compared to $12.0 million in 2010. The effective tax rate for 2011 was 10.5% of income before taxes, compared to an effective tax rate of 149.9% of losses before taxes for 2010. Our tax rate in 2011 differs from the Canadian statutory rate of 27.0% primarily due to a $6.0 million net decrease in valuation allowance which was largely attributable to 2011 income in valuation allowance jurisdictions. The aforementioned benefit was partially offset by $0.6 million in international tax rate differences and a $0.4 million net increase in our liability for uncertain tax positions.

Our tax rate in 2010 differs from the Canadian statutory rate of 28.0% due to a $9.6 million charge for unfavorable permanent differences primarily related to non-deductible bankruptcy costs, a $3.9 million net increase in valuation allowance largely attributable to 2010 losses, a net increase in our liability for uncertain tax positions of $1.0 million and a $0.9 million charge related to the expiration of net operating losses in Canada. The aforementioned charges were partially offset by a $2.0 million benefit due to losses in higher tax rate jurisdictions.

Liquidity and Capital Resources

We assess our liquidity in terms of our ability to generate cash to fund our operating, investing, and financing activities. Our primary ongoing cash requirements are funding operations, capital expenditures, investments in businesses, and repayment of our debt and related interest expense. Our primary sources of liquidity are cash flows from operations and borrowings under our revolving credit facility. We believe our future operating cash flows will be sufficient to meet our future operating and investing cash needs for the foreseeable future, including at least the next 12 months. The availability of borrowings under our revolving credit facility provides an additional potential source of liquidity should it be required. In addition, we may seek to raise additional capital, which could be in the form of bonds, convertible debt or equity, to fund business development activities or other future investing cash requirements, subject to approval by the lenders in the Amended and Restated Credit Agreement.

Significant factors affecting the management of our ongoing cash requirements are the adequacy of available bank lines of credit and our ability to attract long-term capital with satisfactory terms. The sources of our liquidity are subject to all of the risks of our business and could be adversely affected by, among other factors, a decrease in demand for our products, our ability to integrate future acquisitions, including NDS, deterioration in certain financial ratios, and market changes in general. See Risks Relating to Our Common Shares and Our Capital Structure included in Item 1A of this Annual Report on Form 10-K.

Although much of our business is conducted through our subsidiaries, none of our subsidiaries are obligated to make funds available to us. Accordingly, our ability to make payments on our indebtedness and fund our operations may be dependent on the earnings and the distribution of funds from our subsidiaries. Local laws and regulations and/or the terms of our indebtedness may restrict certain of our subsidiaries from paying dividends and otherwise transferring assets to us. We cannot assure you that applicable laws and regulations and/or the terms of our indebtedness will permit our subsidiaries to provide us with sufficient dividends, distributions or loans when necessary.

As of December 31, 2012, $31.5 million of our $65.8 million cash and cash equivalents was held by our subsidiaries outside of Canada and the United States. Generally, our intent is to use cash held in these foreign subsidiaries to fund our local operations or acquisitions by those local subsidiaries. However, in certain instances, we have identified excess cash for which we may repatriate and we have established liabilities for the expected tax cost.

Amended and Restated Credit Agreement

In December 2012, we entered into an amended and restated senior secured credit agreement (the Amended and Restated Credit Agreement), consisting of a $50.0 million, 5-year term loan facility and a $75.0 million, 5-year revolving credit facility (collectively, the Senior Credit Facilities). The Senior Credit Facilities mature in December 2017. As of December 31, 2012, we had outstanding term loans in the amount of $50.0 million and had no revolving loans outstanding under the Amended and Restated Credit Agreement. In January 2013, we borrowed $60.0 million under the revolving credit facility to fund our NDS acquisition.

The Amended and Restated Credit Agreement contains various covenants that we believe are usual and customary for this type of agreement, including a maximum allowed leverage ratio, and a minimum required fixed charge coverage ratio (as defined in the Amended and Restated Credit Agreement). The following table summarizes these financial covenant requirements and our compliance as of December 31, 2012:

	Requirement	Actual
Maximum consolidated leverage ratio	2.75	1.21
Minimum consolidated fixed charge coverage ratio	1.50	2.72

In addition, the Amended and Restated Credit Agreement contains various other customary representations, warranties and covenants applicable to the Company and its subsidiaries, including, without limitation, (i) limitations on restricted payments, including dividend payments and stock repurchases, provided that the Company may repurchase its equity interests, so long as immediately after giving effect to the repurchase, the Company s consolidated leverage ratio is no more than 2.25:1.00, the Company has unrestricted cash plus amounts available for borrowing under the Senior Credit Facilities of at least $25.0 million, and other customary conditions; (ii) limitations on fundamental changes involving the Company or its subsidiaries; (iii) limitations on the disposition of assets; and (iv) limitations on indebtedness, investments, and liens.

Cash Flows

Cash and cash equivalents totaled $65.8 million at December 31, 2012, compared to $54.8 million at December 31, 2011. The net increase in cash and cash equivalents is primarily related to net cash inflows from operating activities of $28.4 million and the sale of our Laser Systems business for $7.0 million. These cash inflows were partially offset by net repayments of our debt of $18.0 million, payments of deferred financing costs of $1.8 million due to the Amended and Restated Credit Agreement, and capital expenditures of $4.3 million.

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The following table summarizes our cash and cash equivalent balances, cash flows and unused and available funds on our revolving credit facility for the years indicated (in thousands):

	2012	2011	2010
Cash and cash equivalents	$ 65,788	$ 54,835	$ 56,781
Net cash provided by (used in) operating activities	$ 28,430	$ 45,173	$ (4,738)
Net cash provided by (used in) investing activities	$ 2,975	$ (4,217)	$ 8,749
Net cash used in financing activities	$ (21,112)	$ (43,095)	$ (11,565)
Unused and available funds under revolving credit facility	$ 75,000	$ 12,000	$

Operating Cash Flows

Cash provided by operating activities was $28.4 million in 2012 compared to $45.2 million and $4.7 million used in operations in 2011 and 2010, respectively. Our operating cash flow declined in 2012 by $16.7 million which was primarily due to a reduction in income from operations of $20.8 million driven by a decline in revenues. The decline in income from operations was partially offset by a reduction in interest paid of $10.4 million and working capital improvements which primarily related to better vendor payments management as our days payable outstanding increased from 29 days at December 31, 2011 to 42 days at December 31, 2012.

The $45.2 million of cash provided by operating activities in 2011 was primarily related to our net income of $29.0 million and non-cash adjustments of $27.3 million. Cash provided by operations also improved significantly from 2010 due to a decrease in bankruptcy related professional fees and a decrease in cash interest payments of $13.4 million, a portion of which were offset by changes in operating assets and liabilities.

The $4.7 million of cash used in operating activities in 2010 was primarily related to a net loss of $0.6 million, before non-cash adjustments to reconcile net loss to net cash used in operating activities totaling $28.2 million. Cash used in operations was primarily attributable to cash paid for reorganization items totaling $26.7 million, cash paid for interest of $25.9 million, and financial and accounting related consulting and professional fees related to the issuance of various quarterly and annual SEC filings.

Investing Cash Flows

Cash provided by investing activities was $3.0 million during 2012 primarily due to cash received from the sale of the Laser Systems business of $7.0 million partially offset by capital expenditures of $4.3 million as compared to cash used in investing activities of $4.2 million in 2011 for capital expenditures. During 2010, we received cash proceeds of $11.4 million due to the sale of auction rate securities, offset by capital expenditures of $2.7 million.

Subsequent to the balance sheet date, we paid $82.5 million for the acquisition of NDS, utilizing $22.5 million of cash on hand as well borrowings of $60.0 million under our revolving credit facility. We have no material commitments to purchase property, plant and equipment and expect such expenditures to be approximately $7.0 million to $8.0 million in 2013.

Financing Cash Flows

Cash used in financing activities was $21.1 million during 2012, primarily due to the $18.0 million net reduction of our Original Senior Credit Facility, resulting from mandatory repayments of our term loan of $10.0 million and optional repayments of our revolving credit facility of $13.0 million, offset by the $5.0 million of proceeds from our Senior Credit Facilities as a result of the Amended and Restated Credit Agreement signed in December 2012. We also paid $1.8 million for debt issuance costs as part of the amendment.

Cash used in financing activities was $43.1 million during 2011, primarily due to the $40.1 million net reduction of our principal debt, resulting from repayments and extinguishment of our 2014 Notes of $113.2 million, offset by the $73.1 million of proceeds from our Original Senior Credit Facility. We also paid $3.0 million for debt issuance costs.

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Cash used in financing activities was $11.6 million during 2010, primarily due to proceeds of $64.9 million from the sale of our common shares in connection with a rights offering offset by $74.9 million of cash used to repay a portion of the principal amount outstanding on our 2008 Senior Notes, and $1.6 million for cash paid for debt issuance costs.

We expect to use $8.3 million of cash in 2013 for financing activities, comprised of quarterly payments of $1.875 million on our term loan facility and $0.8 million for our capital lease obligations.

Other Liquidity Matters

Pension Plans

We maintain two defined benefit pension plans one plan in the U.K. (the U.K. Plan) and one plan in Japan (the Japan Plan). Our U.K. Plan was closed to new members in 1997 and stopped accruing additional pension benefits for existing members in 2002, thereby limiting our obligation to benefits earned through that date. Benefits under this plan were based on the employees years of service and compensation. Our Japan Plan is an active plan.

Our funding policy is to fund pensions and other benefits based on actuarial methods as permitted by regulatory authorities. The results of funding valuations depend on the assumptions that we make with regard to attributes such as asset returns, rates of members benefits increases, mortality, retail price inflation and other market driven changes. The assumptions used represent one estimate of a possible future outcome. The final cost to us will be determined by events as they actually become known. Due to the underfunded positions that our pension plans currently have and potential changes in the actual outcomes relative to our assumptions, we may have to increase payments to fund these plans in the future.

In October 2010, we agreed to increase our annual funding contributions for the U.K. Plan from approximately $0.6 million to $0.8 million annually through 2021. The Japanese plan includes a guarantee of return of principal and yearly interest of 0.75%; therefore, there are no significant fluctuations in this plan. See Note 12 to Consolidated Financial Statements for further information about these plans.

As a result of the covenant that exists between our U.K. subsidiary and the Plan Trustees regarding the funding of the U.K. Plan, our ability to transfer assets outside our U.K. subsidiary, and its wholly owned subsidiary in China, may be limited.

Off-Balance Sheet Arrangements, Contractual Obligations

Contractual Obligations

The following table summarizes our contractual obligations at December 31, 2012 and the effect such obligations are expected to have on liquidity and cash flow in future years. We have excluded the future cash payments for FIN 48 (codified within ASC 740) tax liabilities because the timing of the settlement of these liabilities cannot be estimated by year. However, these FIN 48 liabilities have been reported in both current and long-term income taxes payable on the consolidated balance sheets.

Contractual Obligations	Total	2013	2014-2015	2016-2017	Thereafter
			(In thousands)		
Senior Credit Facilities(1)	$ 50,000	$ 7,500	$ 15,000	$ 27,500	$
Interest on Senior Credit Facilities(2)	3,700	1,114	1,675	911	
Capital leases	1,590	795	795		
Operating leases(3)	21,560	4,014	5,701	4,001	7,844
Purchase commitments(4)	24,322	24,095	214	13	
U.K. pension plan(5)	6,564	812	1,624	1,624	2,504
Total contractual cash obligations	$ 107,736	$ 38,330	$ 25,009	$ 34,049	$ 10,348

(1) On December 27, 2012, we entered into an amended and restated credit agreement. As of December 31, 2012, a total of $50.0 million of term loan debt was outstanding under the Senior Credit Facilities. The term loan is payable in 20 quarterly installments of $1.875 million with the remaining amount due upon maturity in December 2017. There was no revolving credit facility borrowing outstanding as of December 31, 2012. In January 2013, we drew $60.0 million on our revolving credit facility as part of the acquisition of NDS which is excluded from the contractual obligations table above.
(2) For the purpose of this calculation, interest rates on floating rate obligations, LIBOR plus applicable margin, as defined in the Amended and Restated Credit Agreement, were used throughout the contractual life of the term loan.
(3) These amounts primarily represent the gross amounts due for facilities that are leased. The amounts include payments due with respect to both continuing operating facilities and facilities that have been vacated as a result of our restructuring actions.
(4) Purchase commitments represent unconditional purchase obligations as of December 31, 2012.
(5) Assumes funding obligations equivalent to $0.8 million per year through January 2021 based on annual funding contributions in effect as of December 31, 2012. Future funding requirements will be affected by various actuarial assumptions and actual experience of the pension plan.

Off-Balance Sheet Arrangements

Through December 31, 2012, we have not entered into any off-balance sheet arrangements or material transactions with unconsolidated entities or other persons.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires us 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 revenues and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates, assumptions and judgments, including those related to revenue recognition, inventory costing and reserves, the assessment of the valuation of goodwill, intangible assets and tangible long-lived assets, employee benefit plans, restructuring charges, accounting for income taxes, and accounting for loss contingencies. Actual results could differ significantly from our estimates in the future.

We believe that the following critical accounting policies and estimates most significantly affect the portrayal of our financial condition and results of operations and require the most difficult and subjective judgments.

Revenue Recognition. Revenue from the sale of products is recognized when we meet all of the criteria for revenue recognition in financial statements. These criteria include: 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 reasonably assured. Revenue recognition requires judgment and estimates, which may affect the amount and timing of revenue recognized in any given period.

On January 1, 2011, we adopted the provisions of Accounting Standards Update (ASU) 2009-13, Revenue Recognition (Topic 605) Multiple-Deliverable Revenue Arrangements (ASU 2009-13) using the modified prospective approach. All multiple-element revenue arrangements entered into after January 1, 2011 have been accounted for under ASU 2009-13 guidance. ASU 2009-13 addresses the accounting for multiple-element arrangements by providing two significant changes. First, this guidance removes the requirement to have objective and reliable evidence of fair value for undelivered elements in an arrangement, which generally results in more elements being treated as separate units of accounting. Specifically, this guidance amends the criteria in Subtopic 605-25, Revenue Recognition-Multiple-Element Arrangements (ASC 605-25), for separating

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consideration in multiple-element arrangements. This guidance establishes a selling price hierarchy for determining the selling price of an element, which is based on: (a) vendor-specific objective evidence; (b) third-party evidence; or (c) management s best estimate. Our best estimates are based on factors such as gross margin, volume discounts, new strategic customers, geography, customer class and competitive pressures. The second change modifies the manner in which the transaction consideration is allocated across the separately identified elements. Entities are no longer able to apply the residual method of allocation. Instead, the arrangement consideration is required to be allocated at the inception of the arrangement to all elements using the relative selling price method. The relative selling price method uses the weighted average of the selling price and applies that to the contract value to establish the consideration for each element.

For transactions entered into prior to the adoption of ASU 2009-13, we followed the provisions of ASC 605-25 for all multiple-element arrangements. Under the guidance prior to ASU 2009-13, we assessed whether the elements specified in a multiple-element arrangement should be treated as separate units of accounting for revenue recognition purposes and whether objective and reliable evidence of fair value existed for these separate units of accounting. We applied the residual method when objective and reliable evidence of fair value existed for all of the undelivered elements in a multiple-element arrangement. When objective and reliable evidence of fair value did not exist for all of the undelivered elements in a multiple-element arrangement, we recognized revenue under the multiple units shipped methodology, whereby revenue was recognized in each period based upon the lowest common percentage of the products shipped in the period. This approximated a proportional performance model (the Proportional Performance Model) of revenue recognition. This generally resulted in a partial deferral of revenue to a later reporting period. No revenue was recognized unless one or more units of each product had been delivered.

Based on the guidance in ASC 985-605, multiple purchase orders may be deemed to be interrelated and considered to constitute a multiple-element arrangement for accounting purposes.

Semiconductor Systems transactions are generally multiple-element arrangements which may include hardware, software, installation, training, an initial standard warranty, and optional extended warranty arrangements. Generally, we design, market and sell these products as standard configurations. Typically, revenue is recorded at the time of shipment or acceptance, which is the same pre and post-adoption of ASU 2009-13. Acceptance is generally required for sales of our Semiconductor Systems segment products to Japanese customers and sales of New Products . New Products are considered by us, for purposes of revenue recognition determination, to be either (a) a product that is newly released to all customers, including a product which may have been existing previously but which has been substantially upgraded with respect to its features or functionality; or (b) the sale of an existing product to a customer who has not previously purchased that product. We follow a set of predetermined criteria when changing the classification of a New Product to a standard configuration whereby acceptance criteria are considered to be demonstrated at the time of shipment.

The Laser Products and Precision Motion and Technologies segments have revenue transactions that are comprised of both single-element and multiple-element transactions. Multiple-element transactions may include two or more products and occasionally also contain installation, training or preventative maintenance plans. For multiple-element transactions entered into or materially modified after January 1, 2011, revenue is recognized under ASU 2009-13, generally upon shipment using the relative selling price method. For multiple-element transactions entered into prior to January 1, 2011, revenue was generally recognized under the Proportional Performance Model described above. Single-element transactions are generally recognized upon shipment. Installation is generally a routine process that occurs within a short period of time from delivery and we have concluded that this obligation is inconsequential and perfunctory.

The Company generally provides warranties for its products. The standard warranty period is typically 12 to 24 months. The initial standard warranty for product sales is accounted for under the provisions of ASC 450, Contingencies, as the Company has the ability to ascertain the likelihood of the liability and can estimate the amount of the liability. A provision for the estimated cost related to warranty is recorded to cost of goods sold at

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the time revenue is recognized. The Company s estimate of costs to service the warranty obligations is based on historical experience and expectations of future conditions. To the extent the Company experiences warranty claims or costs associated with servicing those claims that differ from the original estimates, revisions to the estimated warranty liability are recorded at that time, with an offsetting entry recorded to cost of goods sold. We also sell optional extended warranty services and preventative maintenance contracts. We account for these agreements in accordance with provisions of ASC 605-20-25-3, Separately Priced Extended Warranty and Product Maintenance Contracts , under which we recognize the separately priced extended warranty and preventative maintenance fees over the associated period.

At the request of our customers, we may at times perform professional services for our customers, generally for the maintenance and repairs of products previously sold to those customers. These services are usually in the form of time and materials based contracts which are short in duration. Revenue for time and materials services is recorded at the completion of services requested under a customer s purchase order. Customers may, at times subsequent to the initial product sale, purchase a service contract whereby services, including preventative maintenance plans, are provided over a defined period, generally one year. Revenue for such service contracts are recorded ratably over the period of the contract while related costs of such services are recorded when incurred.

We typically negotiate trade discounts and agreed terms in advance of order acceptance and record any such items as a reduction of revenue. Our revenue recognition policy allows for revenue to be recognized under arrangements where the payment terms are 180 days or less, presuming all other revenue recognition criteria have been met. From time to time, based on our review of customer creditworthiness and other factors, we may provide our customers with payment terms that exceed 180 days. To the extent all other revenue recognition criteria have been met, we recognize revenue for these extended payment arrangements as the payments become due. We currently have no payment terms with customers that exceed 180 days.

Inventories. Inventories, which include materials and conversion costs, are stated at the lower of cost or market, using a first-in, first-out method. We periodically review these values to ascertain that market value of the inventory continues to exceed its recorded cost. Generally, reductions in value of inventory below cost are caused by technological obsolescence of the inventory.

We regularly review inventory quantities on hand and, when necessary, record provisions for excess and obsolete inventory based on either our forecasted product demand and production requirements or historical trailing usage of the product. If our sales do not materialize as planned or at historic levels, we may have to increase our reserve for excess and obsolete inventory, which would reduce our earnings. If actual market conditions are more favorable than anticipated, inventory previously written down may be sold, resulting in lower costs of sales and higher income from operations than expected in that period.

Valuation of Long-lived Assets. The purchase price we pay for acquired companies is allocated first to the identifiable assets acquired and liabilities assumed at their fair value. Any excess purchase price is then allocated to goodwill. We make various assumptions and estimates in order to assign fair value to acquired tangible and intangible assets and liabilities, including those associated with cash flow forecasts, as well as discount rates and terminal values, among others. Actual cash flows may vary from forecasts used to value the intangible assets at the time of the business combination.

Our most significant intangible assets are acquired technologies, customer relationships, trademarks and trade names. In addition to our review of the carrying values of each asset, the useful life assumptions for each asset, including the classification of certain intangible assets as indefinite lived , are reviewed on a periodic basis to determine if changes in circumstances warrant revisions to them. All definite-lived intangible assets are amortized over the periods in which their economic benefits are expected to be realized.

Impairment analyses of goodwill and indefinite-lived intangible assets are conducted in accordance with ASC 350, Intangibles Goodwill and Other. We test our goodwill balances annually as of the beginning of the

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second quarter or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. In performing the test, we utilize the two-step approach which requires a comparison of the carrying value of each of our reporting units to the fair value of these reporting units. If the carrying value of a reporting unit exceeds its fair value, we calculate the implied fair value of the reporting unit s goodwill and compare it to the goodwill s carrying value. If the carrying value of goodwill exceeds its implied fair value, an impairment charge is recorded for the difference. The fair value of a reporting unit is primarily based on a discounted cash flow (DCF) method. The DCF approach requires that we forecast future cash flows for each of the reporting units and discount the cash flow streams based on a weighted average cost of capital (WACC) that is derived, in part, from comparable companies within similar industries. The DCF calculations also include a terminal value calculation that is based upon an expected long-term growth rate for the applicable reporting unit. The carrying values of each reporting unit include assets and liabilities which relate to the reporting unit s operations. Additionally, reporting units that benefit from corporate assets or liabilities are allocated a portion of those corporate assets and liabilities on a proportional basis.

Our indefinite-lived intangible assets represent trade names that were acquired in the Excel acquisition. We assess these indefinite-lived intangible assets for impairment on an annual basis, and more frequently if impairment indicators are identified. We also periodically reassess their continuing classification as indefinite-lived. Impairment exists if the fair value of the intangible asset is less than its carrying value. An impairment charge equal to the difference is recorded to reduce the carrying value to its fair value.

We evaluate amortizable intangible assets and other long-lived assets for impairment in accordance with ASC 360-10-35-15, Impairment or Disposal of Long-Lived Assets , whenever changes in events or circumstances indicate carrying values may exceed their undiscounted cash flow forecasts. If undiscounted cash flow forecasts indicate the carrying value of a definite-lived intangible asset or other long-lived asset may not be recoverable, a fair value assessment is performed. For intangible assets, fair value estimates are derived from discounted cash flow forecasts. For other long-lived assets (primarily property, plant and equipment), fair value estimates are derived from the sources most appropriate for the particular asset and have historically included such approaches as: sales comparison approach, income approach and replacement cost approach. If fair value is less than carrying value, an impairment charge equal to the difference is recorded. We also review the useful life and residual value assumptions for definite-lived intangible assets and other long-lived assets on a periodic basis to determine if changes in circumstances warrant revisions to them.

Factors which may trigger an impairment of our goodwill, intangible assets and other long-lived assets include the following:

- underperformance relative to historical or projected future operating results;
- changes in our use of the acquired assets or the strategy for our overall business;
- negative industry or economic trends;
- interest rate changes;
- technological changes or developments;
- changes in competition;
- loss of key customers or personnel;
- adverse judicial or legislative outcomes or political developments;

significant declines in our stock price for a sustained period of time; and

the decline of our market capitalization below net book value as of the end of any reporting period.

The occurrence of any of these events or any other unforeseeable event or circumstance that materially affects future results or cash flows may cause an impairment that is material to our results of operations or financial position in the reporting period in which it occurs or is identified.

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The most recent annual goodwill and indefinite-lived intangible asset impairment test was performed as of the beginning of the second quarter of 2012, noting no impairment.

We maintain a significant balance in our goodwill, intangible assets and other long-lived assets. The following table shows the December 31, 2012 breakdown of goodwill, intangibles and property, plant and equipment by reportable segment (in thousands):

	Goodwill	Intangible Assets	Property, Plant & Equipment
Laser Products	$ 13,827	$ 13,645	$ 14,023
Precision Motion and Technologies	30,751	26,375	7,636
Corporate			10,679
Total	$ 44,578	$ 40,020	$ 32,338

A total of $5.7 million of property, plant and equipment is related to our discontinued operations. The amount recorded primarily relates to the estimated fair value less costs to sell of our Orlando facility.

Pension Plans. Two of our subsidiaries, located in the U.K. and Japan, maintain defined benefit pension plans.

Our U.K. Plan was closed to new membership in 1997 and we stopped accruing for additional pension benefits for existing members in 2001, limiting our obligation to benefits earned through that date. Benefits under this plan were based on the employees years of service and compensation. At December 31, 2012, the market value of the plan assets was $6.1 million less than the projected benefit obligation.

The cost and obligations of our U.K. Plan are calculated using many assumptions to estimate the benefits, the amount of which cannot be completely determined until the benefit payments cease. Major assumptions used in the accounting for this pension plan include the discount rate, rate of inflation, and expected return on plan assets. Assumptions are determined based on data and appropriate market indicators in consultation with a third-party actuary, and is evaluated each year. Should any of these assumptions change, they would have an effect on net periodic pension cost and the unfunded benefit obligation at year end. A 50 basis point change in the discount rate as of December 31, 2012 would change the pension obligation by $3.1 million.

Our Japanese pension plan is a tax qualified plan that covers substantially all Japanese employees. Benefits are based on years of service and the employee s compensation at retirement. We fund the plan sufficient to meet current benefits as well as a portion of future benefits as permitted by local regulations. Since this is an active plan, a significant portion of the pension benefit obligation is determined based on the rate of future compensation increases. We deposit funds under various fiduciary-type arrangements and/or purchase annuities under group insurance contracts. At December 31, 2012, the market value of the plan assets was $1.0 million less than the projected benefit obligation.

Restructuring Charges. In accounting for our restructuring activities, we follow the provisions of ASC 420, Exit or Disposal Cost Obligations . In accounting for these obligations, we make assumptions related to the amounts of employee severance and benefits related costs, the time period over which facilities will remain vacant, sublease terms, sublease rates, and discount rates. Additionally, we make assumptions on the estimated remaining useful lives of assets being restructured and the residual value of the assets. Estimates and assumptions are based on the best information available at the time the obligation has arisen. These estimates are reviewed and revised as facts and circumstances dictate. Changes in these estimates could have a material effect on the amount previously expensed against our earnings and currently accrued on our consolidated balance sheet.

Accounting for Income Taxes. As part of the process of preparing our consolidated financial statements, we are required to calculate our income tax provision (benefit) in each of the jurisdictions in which we operate. This process involves estimating our current income tax provision (benefit) together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet.

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Judgment is required in determining our worldwide income tax provision. In the ordinary course of global business, there are many transactions and calculations where the ultimate outcome is uncertain. Although we believe our estimates are reasonable, no assurance can be given that the final outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. Such differences could have a material impact on our income tax provision and operating results in the period in which such determination is made.

We record a valuation allowance on our deferred tax assets when it is more likely than not that they will not be realized. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. In the event we determine that we are able to realize our deferred tax assets in the future in excess of their net recorded amount, an adjustment to the valuation allowance for the deferred tax assets would increase our net income in the period such determination is made. Likewise, should we determine that we will not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the valuation allowance for the deferred tax assets will reduce our net income in the period such determination is made.

In conjunction with our ongoing review of our actual results and anticipated future earnings, we continuously reassess the possibility of releasing the valuation allowance currently in place on our deferred tax assets. We released $15.3 million of our valuation allowance during the year ended December 31, 2012 related to tax benefits in the United States, United Kingdom, France and Japan which we expect to realize in the future. The partial release of our valuation allowance was determined in accordance with the provisions of ASC 740, Income Taxes, which requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable. Such assessment is required on a jurisdiction by jurisdiction basis. Evidence such as historical operating income and continuing projected income, future reversals of temporary differences and tax planning strategies represent sufficient positive evidence that we have concluded that it is more likely than not that deferred tax assets will be realized. Accordingly, the partial release of our valuation allowance was recorded in the fourth quarter of 2012 with no impact on cash flows in the quarter in which it was released.

The amount of income taxes we pay is subject to audits by federal, state and foreign tax authorities, which may result in proposed assessments. We believe that we have adequately provided for any reasonably foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our tax liabilities in the period that the assessments are made or resolved, or when the statute of limitations for certain periods expires. As of December 31, 2012, the total amount of gross unrecognized tax benefits was $7.6 million, of which $4.3 million would favorably affect our effective tax rate, if recognized. As of December 31, 2011, the amount of gross unrecognized tax benefits totaled approximately $7.3 million all of which would favorably affect our effective tax rate, if recognized. As a result of settling a federal examination within the United States, we released $3.0 million of unrecognized tax benefits during the year ended December 31, 2012. Over the next twelve months, the Company may need to record up to $0.8 million of previously unrecognized tax benefits in the event of statute of limitations closures. We believe that there are no other jurisdictions in which the outcome of unresolved issues or claims is likely to be material to our results of operations, financial position or cash flows. Furthermore, we believe that we have adequately provided for all income tax uncertainties.

As of December 31, 2012, the amount of non-Canadian earnings that are expected to remain indefinitely reinvested in the business as defined in the provisions of ASC 740 and for which we have not provided any tax costs of repatriation, is approximately $18.7 million. In general, the determination of the amount of the unrecognized deferred tax liability related to the reinvested earnings is not practical because of the complexities associated with its hypothetical calculation.

On January 2, 2013, the President signed into law The American Taxpayer Relief Act of 2012. Under prior law, a taxpayer was entitled to a research tax credit for qualifying amounts paid or incurred on or before December 31, 2011. The 2012 Taxpayer Relief Act extends the research credit for two years to December 31,

2013. The extension of the research credit is retroactive and includes amounts paid or incurred after December 31, 2011. As a result of the retroactive extension, we expect to recognize a benefit in the range of approximately $0.4 million to $0.7 million for qualifying amounts incurred in 2012. The benefit will be recognized in the period of enactment, which is the first quarter of 2013.

Loss Contingencies. We are subject to legal proceedings, lawsuits and other claims relating to labor, service and other matters arising in the ordinary course of business. Quarterly, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure is reasonably estimable. Because of uncertainties related to these matters, accruals are based only on the best information available at the time. As additional information becomes available, we reassess the potential liability related to our pending claims and litigation and may revise our estimates. Such revisions in the estimates of the potential liabilities could have a material impact on our results of operations and financial position. We expense legal fees as incurred.

Recent Accounting Pronouncements

See Note 3 to Consolidated Financial Statements for recent accounting pronouncements that could have an effect on us.

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

We are exposed to market risk from changes in foreign currency exchange rates and interest rates, which could affect our operating results, financial position and cash flows. We manage our exposure to these market risks through our regular operating and financing activities. We generally do not enter into derivative financial instruments to manage foreign currency exposure.

Foreign Currency Exchange Rate Risk and Sensitivity

We are exposed to changes in foreign currency exchange rates which could affect operating results as well as our financial position and cash flows. The primary foreign currency denominated transactions include revenue and expenses and the resulting accounts receivable and accounts payable balances reflected on our balance sheet. Therefore, the change in the value of the U.S. dollar compared to foreign currencies will have either a positive or negative effect on our financial position and results of operations. Historically, our primary exposure has related to transactions denominated in the Japanese Yen, Euro and British Pound.

A hypothetical depreciation of 10% in foreign currency exchange rates from the quoted foreign currency exchange rates as of December 31, 2012 would impact shareholder equity, primarily cumulative translation adjustments, by $ 9.9 million or 5%.

Interest Rates

Our exposure to market risk associated with changes in interest rates relates primarily to our cash and cash equivalents and debt obligations. At December 31, 2012, we had $65.8 million invested in cash and cash equivalents, as compared to $54.8 million at December 31, 2011. Due to the average maturities and the nature of the cash portfolio at December 31, 2012, a 100 basis point increase in interest rates could have a $0.7 million impact on interest income on an annual basis. In addition, we have $50.0 million of outstanding variable rate debt as of December 31, 2012. A 100 basis point increase in interest rates at December 31, 2012 would increase our annual pre-tax interest expense by approximately $0.5 million. We do not actively trade derivative financial instruments, but may use them in the future to manage interest rate positions associated with our debt instruments. We did not hold interest rate derivative contracts as of December 31, 2012.

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

GSI GROUP INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of GSI Group Inc.

We have audited the accompanying consolidated balance sheets of GSI Group Inc. as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), stockholders equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about 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. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of GSI Group Inc. at December 31, 2012 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 3 to the consolidated financial statements, the Company adopted the guidance of Accounting Standards Update (ASU) No. 2009-13, Revenue Recognition (Topic 605): *Multiple-Deliverable Revenue Arrangements* effective January 1, 2011.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), GSI Group Inc. s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 18, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts

March 18, 2013

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GSI GROUP INC.

CONSOLIDATED BALANCE SHEETS

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

	December 31, 2012	December 31, 2011
ASSETS		
Current Assets		
Cash and cash equivalents	$ 65,788	$ 54,835
Accounts receivable, net of allowance of $374 and $337, respectively	42,652	38,847
Income taxes receivable	16,540	22,707
Inventories	52,801	51,539
Deferred tax assets	7,583	5,335
Prepaid expenses and other current assets	5,486	5,385
Assets of discontinued operations	17,618	35,663
Total current assets	208,468	214,311
Property, plant and equipment, net	32,338	35,955
Deferred tax assets	3,884	814
Other assets	8,172	7,048
Intangible assets, net	40,020	45,797
Goodwill	44,578	44,578
Total assets	$ 337,460	$ 348,503
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Current portion of long-term debt	$ 7,500	$ 10,000
Accounts payable	18,824	12,532
Income taxes payable	3,317	1,835
Deferred revenue	316	852
Deferred tax liabilities	402	109
Accrued expenses and other current liabilities	18,962	18,927
Liabilities of discontinued operations	5,605	14,806
Total current liabilities	54,926	59,061
Long-term debt	42,500	58,000
Deferred tax liabilities	255	8,722
Income taxes payable	1,764	8,057
Other liabilities	9,809	5,303
Total liabilities	109,254	139,143
Commitments and Contingencies (Note 15)		
Stockholders Equity:		
Common shares, no par value; Authorized shares: unlimited; Issued and outstanding: 33,796 and 33,478, respectively	423,856	423,856
Additional paid-in capital	21,924	17,931
Accumulated deficit	(208,222)	(227,760)
Accumulated other comprehensive loss	(9,749)	(5,024)
Total GSI Group Inc. stockholders equity	227,809	209,003

Noncontrolling interest	397	357
Total stockholders equity	228,206	209,360
Total liabilities and stockholders equity	$ 337,460	$ 348,503

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

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GSI GROUP INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Year Ended December 31,		
	2012	**2011**	**2010**
Sales	$ 271,498	$ 304,296	$ 285,892
Cost of goods sold	157,022	171,196	155,278
Gross profit	114,476	133,100	130,614
Operating expenses:			
Research and development and engineering	22,393	23,454	22,297
Selling, general and administrative	65,584	67,877	64,535
Amortization of purchased intangible assets	2,650	3,515	4,436
Restructuring, restatement related costs, post-emergence fees and other	8,842	2,406	3,319
Total operating expenses	99,469	97,252	94,587
Income from operations	15,007	35,848	36,027
Interest expense, net	(2,788)	(12,977)	(19,829)
Foreign exchange transaction gains (losses), net	(1,267)	172	204
Other income (expense), net	582	1,177	1,781
Income from continuing operations before reorganization items and income taxes	11,534	24,220	18,183
Reorganization items			(26,156)
Income (loss) from continuing operations before income taxes	11,534	24,220	(7,973)
Income tax provision (benefit)	(10,940)	2,544	11,952
Income (loss) from continuing operations	22,474	21,676	(19,925)
Income (loss) from discontinued operations, net of tax	(5,151)	7,325	19,286
Gain on disposal of discontinued operations, net of tax	2,255		
Consolidated net income (loss)	19,578	29,001	(639)
Less: Net income attributable to noncontrolling interest	(40)	(28)	(48)
Net income (loss) attributable to GSI Group Inc.	$ 19,538	$ 28,973	$ (687)
Earnings (Loss) per common share from continuing operations:			
Basic	$ 0.66	$ 0.65	$ (0.84)
Diluted	$ 0.66	$ 0.64	$ (0.84)
Earnings (Loss) per common share from discontinued operations:			
Basic	$ (0.08)	$ 0.22	$ 0.81
Diluted	$ (0.08)	$ 0.22	$ 0.81
Earnings (Loss) per common share attributable to GSI Group Inc.:			
Basic	$ 0.58	$ 0.87	$ (0.03)
Diluted	$ 0.58	$ 0.86	$ (0.03)
Weighted average common shares outstanding basic	33,775	33,481	23,703
Weighted average common shares outstanding diluted	33,936	33,589	23,703
Amounts attributable to GSI Group Inc.:			

Income (loss) from continuing operations	$ 22,434	$ 21,648	$ (19,973)
Income (loss) from discontinued operations	(2,896)	7,325	19,286