

GSI GROUP INC  
Form 10-Q  
November 04, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 2, 2015

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<br>(State or other jurisdiction of<br>incorporation or organization) | 98-0110412<br>(I.R.S. Employer<br>Identification No.) |
| 125 Middlesex Turnpike<br>Bedford, Massachusetts, USA                                      | 01730   |

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(Address of principal executive offices) (Zip Code)

(781) 266-5700

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of October 30, 2015, there were 34,387,509 of the Registrant's common shares, no par value, issued and outstanding.

GSI GROUP INC.

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## PART I—FINANCIAL INFORMATION

## Item 1. Financial Statements

## GSI GROUP INC.

## CONSOLIDATED BALANCE SHEETS

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

(Unaudited)

|  | October 2,<br>2015 | December 31,<br>2014 |
|--|--------------------|----------------------|
| <b>ASSETS</b>  |                    |                      |
| Current Assets   |                    |                      |
| Cash and cash equivalents  | \$80,089           | \$ 51,146            |
| Accounts receivable, net of allowance of \$311 and \$282, respectively | 56,050             | 51,494               |
| Inventories  | 61,268             | 62,943               |
| Income taxes receivable  | 5,662              | 5,906                |
| Deferred tax assets  | 3,820              | 5,971                |
| Prepaid expenses and other current assets                              | 5,361              | 5,081                |
| Assets of discontinued operations                                      | —                  | 631                  |
| Total current assets   | 212,250            | 183,172              |
| Property, plant and equipment, net                                     | 37,596             | 40,088               |
| Deferred tax assets  | 1,293              | 2,912                |
| Other assets   | 12,163             | 12,134               |
| Intangible assets, net   | 64,240             | 67,242               |
| Goodwill   | 98,358             | 90,746               |
| Total assets   | \$425,900          | \$ 396,294           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                            |                    |                      |
| Current Liabilities  |                    |                      |
| Current portion of long-term debt                                      | \$7,374            | \$ 7,345             |
| Accounts payable   | 27,507             | 25,592               |
| Income taxes payable   | 3,009              | 1,189                |
| Deferred tax liabilities   | 202                | 208                  |
| Accrued expenses and other current liabilities                         | 21,894             | 19,401               |
| Liabilities of discontinued operations                                 | —                  | 324                  |
| Total current liabilities  | 59,986             | 54,059               |
| Long-term debt   | 100,084            | 105,030              |
| Deferred tax liabilities   | 2,509              | 35                   |
| Income taxes payable   | 5,861              | 7,097                |
| Other liabilities  | 17,477             | 18,819               |
| Total liabilities  | 185,917            | 185,040              |
| Commitments and Contingencies (Note 13)                                |                    |                      |
| Stockholders' Equity:  |                    |                      |
| Common shares, no par value; Authorized shares: unlimited;             | 423,856            | 423,856              |

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|   |           |            |
|---|-----------|------------|
| Issued and outstanding: 34,341 and 34,219, respectively |           |            |
| Additional paid-in capital                              | 29,471    | 28,590     |
| Accumulated deficit                                     | (195,653) | (225,165 ) |
| Accumulated other comprehensive loss                    | (17,691 ) | (16,456 )  |
| Total GSI Group Inc. stockholders' equity               | 239,983   | 210,825    |
| Noncontrolling interest                                 | —         | 429        |
| Total stockholders' equity                              | 239,983   | 211,254    |
| Total liabilities and stockholders' equity              | \$425,900 | \$ 396,294 |

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

## GSI GROUP INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

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

(Unaudited)

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | October<br>2,<br>2015 | September 26,<br>2014 | October<br>2,<br>2015 | September 26,<br>2014 |
| Revenue   | \$ 92,271             | \$ 94,656             | \$ 283,379            | \$ 270,694            |
| Cost of revenue   | 52,361                | 54,973                | 162,118               | 160,255               |
| Gross profit  | 39,910                | 39,683                | 121,261               | 110,439               |
| Operating expenses:                                       |                       |                       |                       |                       |
| Research and development and engineering                  | 7,693                 | 7,735                 | 23,748                | 21,117                |
| Selling, general and administrative                       | 19,979                | 21,512                | 62,969                | 62,540                |
| Amortization of purchased intangible assets               | 1,852                 | 2,843                 | 5,593                 | 7,463                 |
| Restructuring, acquisition and divestiture related costs  | 1,379                 | 771                   | 4,232                 | 1,949                 |
| Total operating expenses                                  | 30,903                | 32,861                | 96,542                | 93,069                |
| Operating income from continuing operations               | 9,007                 | 6,822                 | 24,719                | 17,370                |
| Interest income (expense), net                            | (1,248 )              | (1,453 )              | (4,020 )              | (3,665 )              |
| Foreign exchange transaction gains (losses), net          | 383                   | 1,030                 | (2,253 )              | 950                   |
| Other income (expense), net                               | 878                   | 733                   | 21,641                | 1,733                 |
| Income from continuing operations before income taxes     | 9,020                 | 7,132                 | 40,087                | 16,388                |
| Income tax provision                                      | 2,452                 | 2,013                 | 10,562                | 5,007                 |
| Income from continuing operations                         | 6,568                 | 5,119                 | 29,525                | 11,381                |
| Loss from discontinued operations, net of tax             | —                     | (273 )                | (13 )                 | (4,817 )              |
| Loss on disposal of discontinued operations, net of tax   | —                     | (321 )                | —                     | (321 )                |
| Consolidated net income                                   | 6,568                 | 4,525                 | 29,512                | 6,243                 |
| Less: Net income attributable to noncontrolling interest  | —                     | —                     | —                     | (10 )                 |
| Net income attributable to GSI Group Inc.                 | \$ 6,568              | \$ 4,525              | \$ 29,512             | \$ 6,233              |
| Earnings per common share from continuing operations:     |                       |                       |                       |                       |
| Basic   | \$ 0.19               | \$ 0.15               | \$ 0.85               | \$ 0.33               |
| Diluted   | \$ 0.19               | \$ 0.15               | \$ 0.84               | \$ 0.33               |
| Loss per common share from discontinued operations:       |                       |                       |                       |                       |
| Basic   | \$ —                  | \$ (0.02 )            | \$ (0.00 )            | \$ (0.15 )            |
| Diluted   | \$ —                  | \$ (0.02 )            | \$ (0.00 )            | \$ (0.15 )            |
| Earnings per common share attributable to GSI Group Inc.: |                       |                       |                       |                       |
| Basic   | \$ 0.19               | \$ 0.13               | \$ 0.85               | \$ 0.18               |
| Diluted   | \$ 0.19               | \$ 0.13               | \$ 0.84               | \$ 0.18               |
| Weighted average common shares outstanding—basic          | 34,599                | 34,389                | 34,578                | 34,333                |
| Weighted average common shares outstanding—diluted        | 35,055                | 34,793                | 35,027                | 34,725                |

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

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GSI GROUP INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands of U.S. dollars)

(Unaudited)

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | October<br>2,<br>2015 | September 26,<br>2014 | October<br>2,<br>2015 | September 26,<br>2014 |
| Consolidated net income                                    | \$ 6,568              | \$ 4,525              | \$ 29,512             | \$ 6,243              |
| Other comprehensive income (loss):                         |                       |                       |                       |                       |
| Foreign currency translation adjustments, net of tax (1)   | (1,624 )              | (3,845 )              | (2,172 )              | (2,902 )              |
| Pension liability adjustments, net of tax (2)              | 517                   | 435                   | 937                   | 449                   |
| Total other comprehensive income (loss)                    | (1,107 )              | (3,410 )              | (1,235 )              | (2,453 )              |
| Total consolidated comprehensive income (loss)             | 5,461                 | 1,115                 | 28,277                | 3,790                 |
| Less: Comprehensive income attributable to                 |                       |                       |                       |                       |
| noncontrolling interest                                    | —                     | —                     | —                     | (10 )                 |
| Comprehensive income (loss) attributable to GSI Group Inc. | \$ 5,461              | \$ 1,115              | \$ 28,277             | \$ 3,780              |

(1) The tax effect on this component of comprehensive income was \$0.2 million for the three and nine months ended October 2, 2015. The impact was \$0.4 million and \$0.2 million for the three and nine months ended September 26, 2014, respectively.

(2) The tax effect on this component of comprehensive income was not material for all periods presented. See Note 4 for the total amount of pension liability adjustments reclassified out of accumulated other comprehensive income (loss).

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

GSI GROUP INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of U.S. dollars)

(Unaudited)

|   | Nine Months Ended |           |
|---|-------------------|-----------|
|   | October           | September |
|   | 2,                | 26,       |
|   | 2015              | 2014      |
| Cash flows from operating activities:   |                   |           |
| Consolidated net income   | \$29,512          | \$ 6,243  |
| Less: Loss from discontinued operations, net of tax   | 13                | 5,138     |
| Income from continuing operations   | 29,525            | 11,381    |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities of continuing operations:                   |                   |           |
| Depreciation and amortization   | 14,088            | 17,495    |
| Provision for inventory excess and obsolescence   | 1,303             | 704       |
| Share-based compensation  | 3,494             | 3,412     |
| Deferred income taxes   | 3,782             | (1,653 )  |
| Earnings from equity-method investment  | (2,007 )          | (1,707 )  |
| Gain on disposal of business  | (19,633)          | —         |
| Non-cash restructuring and acquisition related charges  | 511               | 944       |
| Other   | 897               | 1,478     |
| Changes in assets and liabilities which (used) provided cash, excluding effects from businesses purchased or classified as discontinued operations: |                   |           |
| Accounts receivable   | (6,996 )          | (835 )    |
| Inventories   | (5,352 )          | 116       |
| Income taxes receivable, prepaid expenses and other current assets  | 1,244             | 911       |
| Accounts payable, income taxes payable, accrued expenses and other current liabilities  | 6,602             | 1,706     |
| Other non-current assets and liabilities  | (1,982 )          | 463       |
| Cash provided by operating activities of continuing operations  | 25,476            | 34,415    |
| Cash used in operating activities of discontinued operations  | (13 )             | (761 )    |
| Cash provided by operating activities   | 25,463            | 33,654    |
| Cash flows from investing activities:   |                   |           |
| Purchases of property, plant and equipment  | (4,111 )          | (3,783 )  |
| Acquisition of businesses, net of cash acquired and escrow recovery   | (13,048)          | (88,238 ) |
| Proceeds from sale of business, net of transaction costs  | 29,570            | —         |
| Proceeds from the sale of property, plant and equipment   | 123               | 57        |
| Cash provided by (used in) investing activities of continuing operations  | 12,534            | (91,964 ) |
| Cash provided by investing activities of discontinued operations  | —                 | 4,344     |

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|  |          |           |
|--|----------|-----------|
| Cash provided by (used in) investing activities                          | 12,534   | (87,620 ) |
| Cash flows from financing activities:                                    |          |           |
| Borrowings under revolving credit facility                               | 13,000   | 77,000    |
| Repayments of long-term debt and revolving credit facility               | (18,625) | (26,625 ) |
| Payments for debt issuance costs   | —        | (712 )    |
| Payments of withholding taxes from stock-based awards                    | (1,431 ) | (1,605 )  |
| Capital lease payments   | (414 )   | (938 )    |
| Repurchase of common stock   | (997 )   | —         |
| Other financing activities   | 23       | 471       |
| Cash provided by (used in) financing activities of continuing operations | (8,444 ) | 47,591    |
| Cash provided by financing activities of discontinued operations         | —        | —         |
| Cash provided by (used in) financing activities                          | (8,444 ) | 47,591    |
| Effect of exchange rates on cash and cash equivalents                    | (610 )   | (1,056 )  |
| Increase (decrease) in cash and cash equivalents                         | 28,943   | (7,431 )  |
| Cash and cash equivalents, beginning of period                           | 51,146   | 60,980    |
| Cash and cash equivalents, end of period                                 | \$80,089 | \$ 53,549 |
| Supplemental disclosure of cash flow information:                        |          |           |
| Cash paid for interest   | \$2,939  | \$ 2,644  |
| Cash paid for income taxes   | \$6,071  | \$ 3,944  |
| Income tax refunds received  | \$63     | \$ 150    |

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

GSI GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF OCTOBER 2, 2015

(Unaudited)

## 1. Basis of Presentation

GSI Group Inc. and its subsidiaries (collectively referred to as the “Company”, “we”, “us”, “our”) design, develop, manufacture and sell precision photonic and motion control components and subsystems to Original Equipment Manufacturers (“OEMs”) in the medical and advanced industrial markets. The Company is a leader in highly engineered enabling technologies, including CO2 laser sources, laser scanning and beam delivery products, optical data collection and machine vision technologies, medical visualization and informatics solutions, and precision motion control products. The Company specializes in collaborating with OEM customers to adapt its component and subsystem technologies to deliver highly differentiated performance in their applications.

The accompanying unaudited interim consolidated financial statements have been prepared in U.S. dollars and pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”), the instructions to Form 10-Q and the provisions of Regulation S-X pertaining to interim financial statements. Accordingly, certain information and footnote disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The interim consolidated financial statements and notes included in this report should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. In the opinion of management, these interim consolidated financial statements include all adjustments and accruals of a normal and recurring nature necessary to fairly state the results of the interim periods presented. The results for interim periods are not necessarily indicative of results to be expected for the full year or for any future periods.

During the second quarter ended July 3, 2015, the Company deconsolidated its 50% owned joint venture, Excel Laser Technology Private Limited (the “India JV”), as a result of an agreement executed in June 2015 to sell 100% of the Company’s interest in the India JV. The accounts of the India JV were previously included in discontinued operations in the consolidated financial statements.

The Company owns 41% of Laser Quantum Ltd. (“Laser Quantum”), a privately held company located in the United Kingdom. The Company records the results of this entity under the equity method as it does not have a controlling interest in the entity.

The Company’s unaudited interim financial statements are prepared on a quarterly basis ending on the Friday closest to the end of the calendar quarter, with the exception of the fourth quarter which always ends on December 31.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. The Company evaluates its estimates based on historical experience, current

conditions and various other assumptions that it believes are reasonable under the circumstances. Estimates and assumptions are reviewed on an on-going basis and the effects of revisions are reflected in the period in which they are deemed to be necessary. Actual results could differ significantly from those estimates.

#### Recent Accounting Pronouncements

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

In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-08, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.” ASU 2014-08 provides guidance on determining when disposals can be presented as discontinued operations. ASU 2014-08 requires that only disposals representing a strategic shift that has (or will have) a major effect on an entity’s operations and financial results should be presented as discontinued operations. A strategic shift may include a disposal of a major line of business, a major equity method investment or a major part of an entity. Additionally, ASU 2014-08 requires expanded disclosures regarding discontinued operations. ASU 2014-08 is effective prospectively for reporting periods beginning after December 15, 2014. The Company adopted this pronouncement in January 2015.

##### Simplifying the Presentation of Debt Issuance Costs

In April 2015, the FASB issued ASU 2015-03, “Simplifying the Presentation of Debt Issuance Costs.” ASU 2015-03 requires debt issuance related costs to be presented in the balance sheet as a direct reduction to the carrying amount of the associated debt

liability, consistent with the presentation of a debt discount. The Company adopted the provisions of ASU 2015-03 retrospectively as of the fiscal quarter ended October 2, 2015. Prior period amounts have been reclassified to conform to the current period presentation. As of December 31, 2014, \$0.2 million of debt issuance costs were reclassified from prepaid expenses and other current assets to current portion of long-term debt and \$2.5 million was reclassified from other long-term assets to long-term debt in the consolidated balance sheet. Other than these reclassifications, the adoption of ASU 2015-03 did not have an impact on the Company's consolidated financial statements.

#### Customer's Accounting for Fees Paid in a Cloud Computing Arrangement

In April 2015, the FASB issued ASU 2015-05, "Customer's Accounting for Fees Paid in a Cloud Computing Arrangement," which provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. ASU 2015-05 will be effective for annual and interim reporting periods beginning after December 15, 2015, with early adoption permitted. Upon adoption, an entity may apply the new guidance either retrospectively or prospectively to all arrangements entered into or materially modified after the effective date. The Company is currently evaluating the impact of ASU 2015-05 on the Company's consolidated financial statements.

#### Business Combinations

In September 2015, the FASB issued ASU 2015-16, "Business Combinations," which requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. ASU 2015-16 requires an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment had been recognized at the acquisition date. ASU 2015-16 will be effective prospectively for reporting periods beginning after December 15, 2015. The Company is currently evaluating the impact of the new standard on the Company's consolidated financial statements.

#### Revenue from Contracts with Customers

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers", which provides guidance for revenue recognition. ASU 2014-09 supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") 605, "Revenue Recognition," and requires entities to recognize revenue in a way that depicts the transfer of goods or services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 will be effective for annual and interim reporting periods beginning after December 15, 2016. Early adoption is not permitted. Upon adoption, an entity may apply the new guidance either retrospectively to each prior reporting period presented or retrospectively only to customer contracts not yet completed as of the date of adoption with the cumulative effect of initially applying the standard recognized in beginning retained earnings at the date of the initial application. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers – Deferral of the Effective Date", which defers the effective date of ASU 2014-09 by one year, with the option of early adoption as of the original effective date. The amendment in ASU 2015-14 will result in ASU 2014-09 being effective for annual and interim reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact of the new standard on the Company's consolidated financial statements.

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

In August 2014, the FASB issued ASU 2014-15, "Presentation of Financial Statements - Going Concern (Subtopic 205-40)," which requires management to assess a company's ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. ASU 2014-15 will be effective for annual reporting periods ending after December 15, 2016. Early application is permitted. The Company does not expect the adoption of ASU 2014-15 to have any impact on the Company's consolidated financial statements.

## 2. Business Combinations

On February 19, 2015, the Company acquired 100% of the outstanding stock of Applimotion Inc. ("Applimotion"), a Loomis, California based provider of advanced precision motor and motion control technology to OEM customers in the medical and advanced industrial markets, for a total purchase price of \$14.0 million, net of working capital adjustments. The purchase price includes \$13.0 million cash paid for the acquisition and \$1.0 million estimated fair value of future contingent considerations payable upon the achievement of certain revenue targets for fiscal years 2015 to 2017. The undiscounted range of possible contingent considerations is zero to \$4.0 million. The Company expects that the addition of Applimotion will enable the Company to offer a broader range of motion control technologies and integrated solutions to customers. The Company recognized Applimotion acquisition costs of zero

and \$0.2 million during the three and nine months ended October 2, 2015, respectively. Acquisition-related costs are included in restructuring, acquisition and divestiture related costs in the consolidated statements of operations.

The acquisition of Applimotion has been accounted for as a business combination. The allocation of the purchase price is based upon the estimated fair value of assets acquired and liabilities assumed as of the acquisition date. The fair values of intangible assets were based on valuations using an income approach, with estimates and assumptions provided by management of Applimotion and the Company. The process for estimating the fair values of identifiable intangible assets and the contingent consideration liability requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill.

The total purchase price was allocated as follows (in thousands):

|   | Purchase Price<br>Allocation |
|---|------------------------------|
| Cash  | \$ 317                       |
| Accounts receivable                           | 1,821                        |
| Inventory                                     | 2,041                        |
| Prepaid expenses and other current assets     | 89                           |
| Property and equipment                        | 308                          |
| Intangible assets                             | 6,071                        |
| Goodwill                                      | 7,612                        |
| Total assets acquired                         | 18,259                       |
| Accounts payable                              | 964                          |
| Other liabilities                             | 717                          |
| Deferred tax liabilities                      | 2,248                        |
| Total liabilities assumed                     | 3,929                        |
| Total assets acquired and liabilities assumed | 14,330                       |
| Less: cash acquired                           | 317                          |
| Total purchase price, net of cash acquired    | 14,013                       |
| Less: contingent consideration                | 965                          |
| Net cash used for acquisition of business     | \$ 13,048                    |

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

|                        | Estimated Fair<br>Value | Weighted Average<br>Amortization<br>Period |
|------------------------|-------------------------|--|
| Developed technology   | \$ 2,684                | 10 years                                   |
| Customer relationships | 2,066                   | 10 years                                   |
| Non-compete covenant   | 684                     | 4 years                                    |
| Backlog                | 637                     | 1 year                                     |
| Total                  | \$ 6,071                |  |



The purchase price allocation resulted in \$7.6 million of goodwill and \$6.1 million of identifiable intangible assets, none of which is expected to be deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flow potential attributable to: (i) Applimotion's ability to grow their business with existing and new customers, (ii) the potential to realize cost improvements due to scale and more efficient operations, (iii) the opportunity to serve customers with integrated assemblies that feature products from both Applimotion and the Company and, (iv) the potential to sell the Company's products into Applimotion's customer base.

The results of the Applimotion acquisition were included in the Company's results of operations beginning on February 19, 2015. The pro forma financial information reflecting the operating results of Applimotion, as if it had been acquired on January 1,

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2014, is not presented herein as it would not differ materially from the operating results of the Company as reported for 2014. Applimotion is included in the Company's Precision Motion reportable segment.

### 3. Discontinued Operations and Divestitures

In June 2015, the Company finalized an agreement to divest its 50% owned joint venture, the India JV, and recorded a pre-tax loss of less than \$0.1 million in operating loss from discontinued operations, net of tax during the nine months ended October 2, 2015. All assets, liabilities, accumulated other comprehensive income and non-controlling interest of the India JV were derecognized as of the date of the agreement.

On April 15, 2015, the Company completed the sale of certain assets and liabilities of its JK Lasers business, previously included in the Laser Products reportable segment, for approximately \$29.6 million in cash, net of the final working capital adjustments and transaction costs. During the nine months ended October 2, 2015, the Company recognized a pre-tax gain on sale of \$19.6 million in other income (expense), net on the consolidated statement of operations. The JK Lasers business divestiture does not qualify for discontinued operations accounting treatment.

In July 2014, the Company completed the sale of certain assets and liabilities of its Scientific Lasers business for approximately \$6.5 million in cash, net of the final working capital adjustments. In accordance with the purchase and sale agreement, \$1.5 million of the sales proceeds is held in escrow until January 2016. The \$1.5 million escrow is included in prepaid expenses and other current assets on the balance sheet as of October 2, 2015 and other long-term assets as of December 31, 2014.

Assets and liabilities of discontinued operations as of December 31, 2014 included the balances of the India JV. There were no assets and liabilities of discontinued operations as of October 2, 2015. The major components of the assets and liabilities of discontinued operations as of December 31, 2014, respectively, were as follows (in thousands):

|  | December 31,<br>2014 |
|--|----------------------|
| Accounts receivable, net                       | \$ 95                |
| Inventories                                    | 161                  |
| Prepaid and other current assets               | 8                    |
| Other assets                                   | 367                  |
| Assets of discontinued operations              | \$ 631               |
| Accounts payable                               | \$ 16                |
| Accrued expenses and other current liabilities | 74                   |
| Other liabilities                              | 234                  |
| Liabilities of discontinued operations         | \$ 324               |

## operations

The following table presents the operating results which are reported as discontinued operations in the Company's consolidated statements of operations (in thousands):

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | October<br>2,<br>2015 | September 26,<br>2014 | October<br>2,<br>2015 | September 26,<br>2014 |
| Revenue from discontinued operations                           | \$ —                  | \$ 225                | \$ —                  | \$ 10,512             |
| Operating loss from discontinued operations, before income tax | \$ —                  | \$ (1,256 )           | \$ (13 )              | \$ (6,243 )           |
| Operating loss from discontinued operations, net of tax        | \$ —                  | \$ (273 )             | \$ (13 )              | \$ (4,817 )           |
| Loss on disposal of discontinued operations, net of tax        | \$ —                  | \$ (321 )             | \$ —                  | \$ (321 )             |

## 4. Accumulated Other Comprehensive Income (Loss)

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

|  | Total accumulated<br>other<br>comprehensive<br>income (loss) | Foreign currency<br>translation<br>adjustments | Pension<br>liability |
|--|--|--|----------------------|
| Balance at December 31, 2014   | \$ (16,456 )   | \$ (5,615 )                                    | \$(10,841 )          |
| Other comprehensive income (loss)  | (2,223 )   | (2,506 )                                       | 283                  |
| Amounts reclassified from other comprehensive income (loss) <sup>(1)</sup> | 988  | 334  | 654                  |
| Balance at October 2, 2015   | \$ (17,691 )   | \$ (7,787 )                                    | \$(9,904 )           |

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

## 5. Earnings per Common Share

Basic earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. For diluted earnings per common share, the denominator also includes the dilutive effect of outstanding restricted stock units determined using the treasury stock method. Dilutive effects of contingently issuable shares are included in the weighted average dilutive share calculation when the contingencies have been resolved. For periods in which net losses are generated, the dilutive potential common shares are excluded from the calculation of diluted earnings per share as the effect would be anti-dilutive.

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

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | October<br>2,<br>2015 | September 26,<br>2014 | October<br>2,<br>2015 | September 26,<br>2014 |
| <b>Numerators:</b>   |                       |                       |                       |                       |
| Income from continuing operations                                | \$ 6,568              | \$ 5,119              | \$ 29,525             | \$ 11,381             |
| Loss from discontinued operations                                | —                     | (594 )                | (13 )                 | (5,138 )              |
| Less: Income attributable to noncontrolling interest             | —                     | —                     | —                     | (10 )                 |
| Loss from discontinued operations attributable to GSI Group Inc. | —                     | (594 )                | (13 )                 | (5,148 )              |
| Net income attributable to GSI Group Inc.                        | \$ 6,568              | \$ 4,525              | \$ 29,512             | \$ 6,233              |
| <b>Denominators:</b>   |                       |                       |                       |                       |
| Weighted average common shares outstanding— basic                | 34,599                | 34,389                | 34,578                | 34,333                |

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|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Dilutive potential common shares                    | 456    | 404    | 449    | 392    |
| Weighted average common shares outstanding— diluted | 35,055 | 34,793 | 35,027 | 34,725 |
| Antidilutive common shares excluded from above      | —      | —      | —      | 29     |

Basic Earnings (Loss) per Common Share:

|   |         |            |           |            |
|---|---------|------------|-----------|------------|
| From continuing operations                              | \$ 0.19 | \$ 0.15    | \$0.85    | \$ 0.33    |
| From discontinued operations                            | \$ —    | \$ (0.02 ) | \$(0.00 ) | \$ (0.15 ) |
| Basic earnings per share attributable to GSI Group Inc. | \$ 0.19 | \$ 0.13    | \$0.85    | \$ 0.18    |

Diluted Earnings (Loss) per Common Share:

|   |         |            |           |            |
|---|---------|------------|-----------|------------|
| From continuing operations                                | \$ 0.19 | \$ 0.15    | \$0.84    | \$ 0.33    |
| From discontinued operations                              | \$ —    | \$ (0.02 ) | \$(0.00 ) | \$ (0.15 ) |
| Diluted earnings per share attributable to GSI Group Inc. | \$ 0.19 | \$ 0.13    | \$0.84    | \$ 0.18    |

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## Common Stock Repurchases

In October 2013, the Company's Board of Directors authorized a share repurchase plan under which the Company may repurchase outstanding shares of the Company's common stock up to an aggregate amount of \$10.0 million. The shares may be repurchased from time to time, at the Company's discretion, based on ongoing assessment of the capital needs of the business, the market price of the Company's common stock, and general market conditions. Shares may also be repurchased through an accelerated stock purchase agreement, on the open market or in privately negotiated transactions in accordance with applicable federal securities laws. Repurchases may be made under certain SEC regulations, which would permit common stock to be purchased when the Company would otherwise be prohibited from doing so under insider trading laws. The share repurchase plan does not obligate the Company to acquire any particular amount of common stock. No time limit was set for the completion of the share repurchase program, and the program may be suspended or discontinued at any time. As of December 31, 2014, the Company had cumulatively repurchased 50 thousand shares of its common stock for an aggregate amount of \$0.5 million. During the third quarter of 2015, the Company repurchased 77 thousand shares in the open market for an aggregate purchase price of \$1.0 million at an average price of \$13.03 per share.

## 6. Fair Value Measurements

ASC 820, "Fair Value Measurements," establishes a fair value hierarchy based on the following three levels of inputs:

- Level 1: Quoted prices for identical assets or liabilities in active markets which the Company can access.
- Level 2: Observable inputs other than those described in Level 1.
- Level 3: Unobservable inputs.

The Company's cash equivalents are investments in money market accounts, which represent the only asset the Company measures at fair value on a recurring basis. The Company determines the fair value of our cash equivalents using a market approach based on quoted prices in active markets which is classified as Level 1. The contingent consideration is classified as Level 3 as the fair value is based on unobservable inputs. The fair values of cash, accounts receivable, income taxes receivable, accounts payable, income taxes payable, accrued expenses and other current liabilities approximate their carrying values because of their short-term nature.

The following table summarizes the fair values of our financial assets and liabilities as of October 2, 2015 (in thousands):

|                          | Fair Value | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant Other<br>Unobservable<br>Inputs<br>(Level 3) |
|--------------------------|------------|---|---|--|
| <b>Assets</b>            |            |   |   |  |
| Cash equivalents         | \$ 521     | \$ 521  | \$ —  | \$ —   |
| <b>Liabilities</b>       |            |   |   |  |
| Contingent consideration | \$ 965     | \$ —  | \$ —  | \$ 965   |

The following table summarizes the fair values of our financial assets as of December 31, 2014 (in thousands):

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|                  | Fair Value | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant Other<br>Unobservable<br>Inputs<br>(Level 3) |
|------------------|------------|---|---|--|
| <b>Assets</b>    |            |   |   |  |
| Cash equivalents | \$ 2,255   | \$ 2,255  | \$ —  | \$ —   |

Contingent consideration relates to the Company's acquisition of Applimotion on February 19, 2015. The former shareholders of Applimotion are eligible to receive contingent consideration based on the achievement of certain revenue targets for fiscal years 2015 to 2017. If such targets are achieved, the contingent consideration will be payable in cash in two installments in 2017 and 2018, respectively. The estimated fair value of the contingent consideration was determined based on the Monte Carlo valuation method and has been recorded as part of the purchase price as of the acquisition date. Subsequent changes in the estimated fair value of this contingent liability will be recorded in the consolidated statement of operations as acquisition related costs until the liability is fully

settled. There have been no changes to the fair value of the contingent consideration since the acquisition date. The estimated fair value of the contingent consideration is reported as a long-term liability in the consolidated balance sheet.

See Note 9 to Consolidated Financial Statements for a discussion of the estimated fair value of the Company's outstanding debt.

## 7. Goodwill and Intangible Assets

### Goodwill

Goodwill is recorded when the consideration for a business combination exceeds the fair value of net tangible and identifiable intangible assets acquired. The Company tests its goodwill balances annually for impairment as of the beginning of the second quarter or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. The Company performed its annual goodwill impairment test as of the beginning of the second quarter of 2015 and noted no impairment of goodwill.

The following table summarizes changes in goodwill during the nine months ended October 2, 2015 (in thousands):

|  |          |
|--|----------|
| Balance at beginning of the period                 | \$90,746 |
| Goodwill acquired from the Applimotion acquisition | 7,612    |
| Balance at end of the period                       | \$98,358 |

Goodwill acquired from the Applimotion acquisition is reflected in the Precision Motion segment. Goodwill by reportable segment as of October 2, 2015 was as follows (in thousands):

|                                    | Reportable Segment |              |           | Total     |
|------------------------------------|--------------------|--------------|-----------|-----------|
|                                    | Laser              | Vision       | Precision |           |
|                                    | Products           | Technologies | Motion    |           |
| Goodwill                           | \$132,954          | \$ 82,730    | \$33,903  | \$249,587 |
| Accumulated impairment of goodwill | (102,461)          | (31,722)     | (17,046)  | (151,229) |
| Total                              | \$30,493           | \$ 51,008    | \$16,857  | \$98,358  |

Goodwill by reportable segment as of December 31, 2014 was as follows (in thousands):



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|                                    | Reportable Segment |              |           | Total     |
|------------------------------------|--------------------|--------------|-----------|-----------|
|                                    | Laser              | Vision       | Precision |           |
|                                    | Products           | Technologies | Motion    |           |
| Goodwill                           | \$132,954          | \$ 82,730    | \$26,291  | \$241,975 |
| Accumulated impairment of goodwill | (102,461)          | (31,722 )    | (17,046)  | (151,229) |
| Total                              | \$30,493           | \$ 51,008    | \$9,245   | \$90,746  |

Intangible Assets

Intangible assets as of October 2, 2015 and December 31, 2014, respectively, are summarized as follows (in thousands):

|   | October 2, 2015       |                          |                     | December 31, 2014     |                          |                     |
|---|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|   | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| <b>Amortizable intangible assets:</b>     |                       |                          |                     |                       |                          |                     |
| Patents and acquired technologies         | \$80,695              | \$ (65,236 )             | \$ 15,459           | \$78,253              | \$ (62,010 )             | \$ 16,243           |
| Customer relationships                    | 65,030                | (35,581 )                | 29,449              | 63,029                | (31,531 )                | 31,498              |
| Customer backlog                          | 2,447                 | (2,265 )                 | 182                 | 1,810                 | (1,641 )                 | 169                 |
| Non-compete covenant                      | 2,514                 | (747 )                   | 1,767               | 1,830                 | (366 )                   | 1,464               |
| Trademarks and trade names                | 10,160                | (5,804 )                 | 4,356               | 10,205                | (5,364 )                 | 4,841               |
| Amortizable intangible assets             | 160,846               | (109,633 )               | 51,213              | 155,127               | (100,912 )               | 54,215              |
| <b>Non-amortizable intangible assets:</b> |                       |                          |                     |                       |                          |                     |
| Trade names                               | 13,027                | —                        | 13,027              | 13,027                | —                        | 13,027              |
| Totals                                    | \$173,873             | \$ (109,633 )            | \$ 64,240           | \$168,154             | \$ (100,912 )            | \$ 67,242           |

All definite-lived intangible assets are amortized either on a straight-line basis or an economic benefit basis over their remaining useful life. Amortization expense for customer relationships and definite-lived trademarks, trade names and other intangibles is included in operating expenses in the accompanying consolidated statements of operations. Amortization expense for patents and acquired technologies is included in cost of revenue in the accompanying consolidated statements of operations. Amortization expense reported in the consolidated statements of operations is summarized as follows (in thousands):

|   | Three Months Ended |                    | Nine Months Ended |                    |
|---|--------------------|--------------------|-------------------|--------------------|
|   | October 2, 2015    | September 26, 2014 | October 2, 2015   | September 26, 2014 |
| Amortization expense – cost of revenue    | \$ 1,175           | \$ 1,614           | \$ 3,468          | \$ 4,529           |
| Amortization expense – operating expenses | 1,852              | 2,843              | 5,593             | 7,463              |
| Total amortization expense                | \$ 3,027           | \$ 4,457           | \$ 9,061          | \$ 11,992          |

Estimated amortization expense for each of the five succeeding years and thereafter as of October 2, 2015 was as follows (in thousands):

| Year Ending December 31, | Operating       |           |          |
|--------------------------|-----------------|-----------|----------|
|                          | Cost of Revenue | Expenses  | Total    |
| 2015 (remainder of year) | \$ 1,175        | \$ 1,851  | \$3,026  |
| 2016                     | 3,550           | 7,256     | 10,806   |
| 2017                     | 3,229           | 6,634     | 9,863    |
| 2018                     | 1,754           | 6,000     | 7,754    |
| 2019                     | 1,487           | 4,008     | 5,495    |
| Thereafter               | 4,264           | 10,005    | 14,269   |
| Total                    | \$ 15,459       | \$ 35,754 | \$51,213 |

## 8. Supplementary Balance Sheet Information

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

### Inventories

December 31,

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October 2014  
2,

2015

|                              |          |           |
|------------------------------|----------|-----------|
| Raw materials                | \$39,005 | \$ 38,934 |
| Work-in-process              | 10,624   | 9,899     |
| Finished goods               | 9,673    | 11,945    |
| Demo and consigned inventory | 1,966    | 2,165     |
| Total inventories            | \$61,268 | \$ 62,943 |

Accrued Expenses and Other Current Liabilities

October  
2,      December 31,

2015      2014

|                                   |          |           |
|-----------------------------------|----------|-----------|
| Accrued compensation and benefits | \$8,602  | \$ 7,741  |
| Accrued warranty                  | 3,529    | 3,044     |
| Accrued professional services     | 1,332    | 1,827     |
| Other                             | 8,431    | 6,789     |
| Total                             | \$21,894 | \$ 19,401 |

## Accrued Warranty

|  | Nine Months Ended |               |
|--|-------------------|---------------|
|  | October 2,        | September 26, |
|  | 2015              | 2014          |
| Balance at beginning of the period     | \$ 3,044          | \$ 3,315      |
| Provision charged to cost of revenue   | 1,878             | 1,361         |
| Acquisition related warranty accrual   | 94                | 90            |
| Use of provision                       | (1,084 )          | (1,529 )      |
| Divestiture of JK Lasers               | (392 )            | —             |
| Foreign currency exchange rate changes | (11 )             | (14 )         |
| Balance at end of period               | \$ 3,529          | \$ 3,223      |

## Other Long Term Liabilities

|                             | October 2, | December 31, |
|-----------------------------|------------|--------------|
|                             | 2015       | 2014         |
| Capital lease obligations   | \$9,100    | \$ 9,507     |
| Accrued pension liabilities | 4,805      | 6,037        |
| Other                       | 3,572      | 3,275        |
| Total                       | \$17,477   | \$ 18,819    |

## 9. Debt

Debt consisted of the following (in thousands):

|  | October 2, | December 31, |
|--|------------|--------------|
|  | 2015       | 2014         |
| Senior Credit Facilities – term loan                 | \$7,500    | \$ 7,500     |
| Less: unamortized debt issuance costs                | (126 )     | (155 )       |
| Total current portion of long-term debt              | \$7,374    | \$ 7,345     |
| Senior Credit Facilities – term loan                 | \$21,875   | \$ 27,500    |
| Senior Credit Facilities – revolving credit facility | 80,000     | 80,000       |

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|                                       |            |            |
|---------------------------------------|------------|------------|
| Less: unamortized debt issuance costs | (1,791 )   | (2,470 )   |
| Total long-term debt                  | \$ 100,084 | \$ 105,030 |
| Total Senior Credit Facilities        | \$ 107,458 | \$ 112,375 |

### Senior Credit Facilities

The Company's amended and restated senior secured credit agreement (the "Amended and Restated Credit Agreement") provides for a \$50.0 million, 5-year term loan facility due in quarterly installments of \$1.9 million beginning in January 2013 and a \$175.0 million, 5-year revolving credit facility (collectively, the "Senior Credit Facilities") that matures in December 2017. Quarterly installments due in the next twelve months under the term loan amount to \$7.5 million and are classified as a current liability in the consolidated balance sheet. The Company adopted the provisions of ASU 2015-03 during the fiscal quarter ended October 2, 2015. The adoption of ASU 2015-03 resulted in the reclassification of unamortized debt issuance costs related to the Senior Credit Facilities from other assets to debt in the consolidated balance sheet.

The Company is required to satisfy certain financial and non-financial covenants under the Amended and Restated Credit Agreement. The Company was in compliance with these covenants as of October 2, 2015.

### Fair Value of Debt

As of October 2, 2015 and December 31, 2014, the outstanding balance of the Company's debt approximated its fair value based on current rates available to the Company for debt of the same maturity.

## 10. Share-Based Compensation

The table below summarizes activities relating to restricted stock units issued and outstanding under the Company's Amended and Restated 2010 Incentive Plan during the nine months ended October 2, 2015:

|  | Restricted<br>Stock Units | Weighted<br>Average Grant<br>Date Fair Value |
|--|---------------------------|--|
|  | (In thousands)            |  |
| Unvested at December 31, 2014          | 749                       | \$ 10.80                                     |
| Granted                                | 305                       | \$ 13.34                                     |
| Vested                                 | (311 )                    | \$ 11.01                                     |
| Forfeited                              | (42 )                     | \$ 11.03                                     |
| Unvested at October 2, 2015            | 701                       | \$ 11.80                                     |
| Expected to vest as of October 2, 2015 | 685                       |  |

The total fair value of restricted stock units that vested during the nine months ended October 2, 2015, based on the market price of the underlying stock on the date of vesting, was \$3.9 million.

The table below summarizes share-based compensation expense recorded in income from continuing operations in the consolidated statements of operations (in thousands):

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | October<br>2,<br>2015 | September 26,<br>2014 | October<br>2,<br>2015 | September 26,<br>2014 |
| Selling, general and administrative                      | \$ 849                | \$ 886                | \$ 3,165              | \$ 3,156              |
| Research and development and engineering                 | 42                    | 49                    | 122                   | 144                   |
| Cost of revenue  | 70                    | 43                    | 207                   | 112                   |
| Restructuring, acquisition and divestiture related costs | —                     | 268                   | (321 )                | 572                   |
| Total share-based compensation expense                   | \$ 961                | \$ 1,246              | \$ 3,173              | \$ 3,984              |

The expense recorded during each of the nine-month periods ended October 2, 2015 and September 26, 2014, respectively, included \$0.5 million related to deferred stock units granted to the members of the Company's Board of Directors, pursuant to the Company's Amended and Restated 2010 Incentive Plan. The expense associated with the respective deferred stock units was recognized in full on the date of grant, as the deferred stock units were fully vested and non-forfeitable upon grant.

In March 2014, the Company granted restricted stock units in an aggregate of 180,000 shares as employment inducement awards related to an acquisition. These restricted stock units are performance based awards and would vest after two years if certain financial targets and service conditions have been achieved. During the nine months

ended October 2, 2015, these financial targets were no longer deemed probable and the cumulative expense was reversed.

## 11. Income Taxes

The Company determines its estimated annual effective tax rate at the end of each interim period based on full-year forecasted pre-tax income and facts known at that time. The estimated annual effective tax rate is applied to the year-to-date pre-tax income at the end of each interim period. The tax effect of significant unusual items is reflected in the period in which they occur. Since the Company is incorporated in Canada, it is required to use Canada's statutory tax rate of 27.0% in the determination of the estimated annual effective tax rate.

The Company's effective tax rate on income from continuing operations of 27.2% and 26.3%, respectively, for the three and nine month periods ended October 2, 2015 differ from the Canadian statutory rate of 27.0% primarily due to the gain from JK Lasers divestiture, the audit settlement with the U.S. Internal Revenue Service (the "IRS"), mix of income earned in jurisdictions with varying tax rates, losses in jurisdictions with a full valuation allowance, and the impact of discrete items for the periods. The Company's effective tax rate on income from continuing operations of 28.2% and 30.6%, respectively, for the three and nine month periods ended September 26, 2014 differ from the Canadian statutory rate of 27.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, losses in jurisdictions with a valuation allowance which are not benefitted in the income tax provision during the periods, and the impact of discrete items for the periods.

The Company maintains a valuation allowance on some of its deferred tax assets in certain jurisdictions. A valuation allowance is required when, based upon an assessment of various factors, including recent operating loss history, anticipated future earnings, and prudent and reasonable tax planning strategies, it is more likely than not that some portion of the deferred tax assets will not be realized.

In conjunction with the Company's ongoing review of its actual results and anticipated future earnings, the Company continuously reassesses the possibility of releasing the remaining valuation allowance currently in place on its deferred tax assets. A release would be reported as a reduction to income tax expense without any impact on cash flows in the quarter in which it is released.

## 12. Restructuring, Acquisition and Divestiture Related Costs

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

|  | Three Months Ended |                       | Nine Months Ended  |                       |
|--|--------------------|-----------------------|--------------------|-----------------------|
|  | October 2,<br>2015 | September 26,<br>2014 | October 2,<br>2015 | September 26,<br>2014 |
| 2011 restructuring   | \$ 300             | \$ 233                | \$ 953             | \$ 139                |
| 2013 restructuring   | —                  | —                     | —                  | (66 )                 |
| 2015 restructuring   | —                  | —                     | 1,484              | —                     |
| 2016 restructuring   | 751                | —                     | 751                | —                     |
| Total restructuring charges                                    | 1,051              | 233                   | 3,188              | 73                    |
| Acquisition charges  | 282                | 26                    | 546                | 774                   |
| Acquisition related incentive compensation                     | —                  | 512                   | (612 )             | 1,102                 |
| Divestiture related charges                                    | 46                 | —                     | 1,110              | —                     |
| Total acquisition and divestiture related charges              | 328                | 538                   | 1,044              | 1,876                 |
| Total restructuring, acquisition and divestiture related costs | \$ 1,379           | \$ 771                | \$ 4,232           | \$ 1,949              |

### 2011 Restructuring

In November 2011, the Company announced a strategic initiative ("2011 restructuring"), which aimed to consolidate operations to reduce the Company's cost structure and improve operational efficiency. As part of this initiative, the Company eliminated facilities through the consolidation of certain manufacturing, sales and distribution facilities and the exit of Semiconductor and Laser Systems businesses. The Company substantially completed the 2011 restructuring program by the end of 2013. Restructuring costs for the three and nine months ended October 2, 2015 included facility costs related to the Company's vacant Orlando, Florida facility, which the Company owns and was previously occupied by the Laser Systems business. These costs were recorded in the Unallocated Corporate and



Shared Services Costs segment.

#### 2015 Restructuring

During the first quarter of 2015, the Company implemented a program to eliminate redundant costs, as a result of acquisition and divestiture activities, to better align our operations to our strategic growth plans, to further integrate our business lines, and as a consequence of our productivity initiatives. During the nine months ended October 2, 2015, the Company incurred restructuring costs of \$1.5 million related to the 2015 restructuring plan. Restructuring costs incurred during the nine months ended October 2, 2015 of \$0.6 million, \$0.5 million, \$0.1 million and \$0.3 million related to the Laser Products, Vision Technologies, Precision Motion and Unallocated Corporate and Shared Services Costs reportable segments, respectively.

#### 2016 Restructuring

During the third quarter of 2015, the Company initiated a program targeting annualized savings of \$4.5 million to \$5.5 million after the program is fully executed. The 2016 restructuring program includes consolidating our manufacturing operations to optimize our facility footprint and better utilize resources, and reducing redundant costs due to productivity cost savings and business volume reductions. We expect to incur cash charges of \$3.5 million to \$4.5 million related to this program, which we anticipate completing

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during the second quarter of 2016. During the three and nine months ended October 2, 2015, the Company incurred restructuring costs of \$0.8 million related to the 2016 restructuring plan. Restructuring costs incurred during the three and nine months ended October 2, 2015 of \$0.4 million, \$0.1 million and \$0.3 million related to the Vision Technologies, Precision Motion and Unallocated Corporate and Shared Services Costs reportable segments, respectively.

#### Rollforward of Accrued Expenses Related to Restructuring

The following table summarizes the accrual activities, by component, related to the Company's restructuring plans recorded in the accompanying consolidated balance sheets (in thousands):

|   | Total   | Severance | Facility | Depreciation | Other  |
|---|---------|-----------|----------|--------------|--------|
| Balance at December 31, 2014              | \$231   | \$ 102    | \$ 105   | \$ —         | \$ 24  |
| Restructuring charges                     | 3,188   | 2,021     | 139      | 832          | 196    |
| Cash payments                             | (1,742) | (1,438 )  | (222 )   | —            | (82 )  |
| Non-cash write-offs and other adjustments | (827 )  | 5         | —        | (832 )       | —      |
| Balance at October 2, 2015                | \$850   | \$ 690    | \$ 22    | \$ —         | \$ 138 |

### 13. Commitments and Contingencies

#### Leases

The Company leases certain equipment and facilities under operating and capital lease agreements. There have been no material changes to the Company's leases through October 2, 2015 from those discussed in Note 15 to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

#### Purchase Commitments

There have been no material changes to the Company's purchase commitments from those discussed in Note 15 to Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

#### Legal Proceedings

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

#### Guarantees and Indemnifications

In the normal course of its operations, the Company executes agreements that provide for indemnification and guarantees to counterparties in transactions such as business dispositions, sale of assets, sale of products and operating leases. Additionally, the by-laws of the Company require it to indemnify certain current or former directors, officers, and employees of the Company against expenses incurred by them in connection with each proceeding in which he or she is involved as a result of serving or having served in certain capacities. Indemnification is not available with respect to a proceeding as to which it has been adjudicated that the person did not act in good faith in the reasonable belief that the action was in the best interests of the Company. Certain of our officers and directors are also a party to indemnification agreements with the Company. These indemnification agreements provide, among other things, that the director and officer shall be indemnified to the fullest extent permitted by applicable law against all expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred by such officer or director in connection with any proceeding by reason of his or her relationship with the Company. In addition, the indemnification agreements provide for the advancement of expenses incurred by such director or officer in connection with any proceeding covered by the indemnification agreement, subject to the conditions set forth therein and to the extent such advancement is not prohibited by law. The indemnification agreements also set out the procedures for determining entitlement to indemnification, the requirements relating to notice and defense of claims for which indemnification is sought, the procedures for enforcement of indemnification rights, the limitations on and exclusions from indemnification, and the minimum levels of directors' and officers' liability insurance to be maintained by the Company.

## 14. Segment Information

The Company evaluates the performance of, and allocates resources to, its segments based on revenue, gross profit and operating profit. The Company's reportable segments have been identified based on commonality of end markets, customers, applications and technologies amongst the Company's individual product lines, which is consistent with the Company's operating structure, associated management structure, and management compensation programs.

We operate in three reportable segments: Laser Products, Vision Technologies (formerly known as Medical Technologies), and Precision Motion. The reportable segments and their principal activities are summarized below.

### Laser Products

The Laser Products segment designs, manufactures and markets photonics-based solutions, including CO2 laser sources, laser scanning and beam delivery products, to customers worldwide. The segment serves highly demanding photonics-based applications such as industrial material processing, and medical and life science imaging and laser procedures. The vast majority of the segment's product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

### Vision Technologies

The Vision Technologies segment designs, manufactures and markets a range of medical grade technologies, including visualization solutions, imaging informatics products, optical data collection and machine vision technologies, thermal printers, and light and color measurement instrumentation, to customers worldwide. The vast majority of the segment's product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

### Precision Motion

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

### Reportable Segment Financial Information

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

|                     | Three Months Ended |                    | Nine Months Ended |                    |
|---------------------|--------------------|--------------------|-------------------|--------------------|
|                     | October 2, 2015    | September 26, 2014 | October 2, 2015   | September 26, 2014 |
| <b>Revenue</b>      |                    |                    |                   |                    |
| Laser Products      | \$ 41,330          | \$ 45,806          | \$ 128,475        | \$ 131,494         |
| Vision Technologies | 30,992             | 32,680             | 93,319            | 89,838             |

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|                  |           |           |            |            |
|------------------|-----------|-----------|------------|------------|
| Precision Motion | 19,949    | 16,170    | 61,585     | 49,362     |
| Total            | \$ 92,271 | \$ 94,656 | \$ 283,379 | \$ 270,694 |

|   | Three Months Ended |                    | Nine Months Ended |                    |
|---|--------------------|--------------------|-------------------|--------------------|
|   | October 2, 2015    | September 26, 2014 | October 2, 2015   | September 26, 2014 |
| <b>Gross Profit</b>                       |                    |                    |                   |                    |
| Laser Products                            | \$ 18,851          | \$ 20,269          | \$ 57,176         | \$ 54,437          |
| Vision Technologies                       | 12,152             | 12,945             | 36,823            | 35,672             |
| Precision Motion                          | 9,233              | 6,776              | 28,309            | 21,141             |
| Unallocated Corporate and Shared Services | (326 )             | (307 )             | (1,047 )          | (811 )             |
| Total                                     | \$ 39,910          | \$ 39,683          | \$ 121,261        | \$ 110,439         |

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|                            | Three Months Ended |               | Nine Months Ended |               |
|----------------------------|--------------------|---------------|-------------------|---------------|
|                            | October 2,         | September 26, | October 2,        | September 26, |
|                            | 2015               | 2014          | 2015              | 2014          |
| <b>Gross Profit Margin</b> |                    |               |                   |               |
| Laser Products             | 45.6 %             | 44.2 %        | 44.5 %            | 41.4 %        |
| Vision Technologies        | 39.2 %             | 39.6 %        | 39.5 %            | 39.7 %        |
| Precision Motion           | 46.3 %             | 41.9 %        | 46.0 %            | 42.8 %        |
| Total                      | 43.3 %             | 41.9 %        | 42.8 %            | 40.8 %        |

|   | Three Months Ended |               | Nine Months Ended |               |
|---|--------------------|---------------|-------------------|---------------|
|   | October 2,         | September 26, | October 2,        | September 26, |
|   | 2015               | 2014          | 2015              | 2014          |
| <b>Operating Income (Loss) from Continuing Operations</b> |                    |               |                   |               |
| Laser Products  | \$ 10,145          | \$ 9,857      | \$ 28,586         | \$ 23,828     |
| Vision Technologies                                       | (388 )             | (1,115 )      | (1,056 )          | (1,194 )      |
| Precision Motion  | 4,417              | 2,796         | 14,357            | 9,525         |
| Unallocated Corporate and Shared Services                 | (5,167 )           | (4,716 )      | (17,168 )         | (14,789 )     |
| Total   | \$ 9,007           | \$ 6,822      | \$ 24,719         | \$ 17,370     |

|   | Three Months Ended |               | Nine Months Ended |               |
|---|--------------------|---------------|-------------------|---------------|
|   | October 2,         | September 26, | October 2,        | September 26, |
|   | 2015               | 2014          | 2015              | 2014          |
| <b>Depreciation and Amortization</b>      |                    |               |                   |               |
| Laser Products                            | \$ 1,394           | \$ 1,618      | \$ 4,373          | \$ 4,838      |
| Vision Technologies                       | 2,109              | 3,745         | 6,449             | 9,552         |
| Precision Motion                          | 680                | 444           | 1,842             | 1,451         |
| Unallocated Corporate and Shared Services | 520                | 537           | 1,424             | 1,654         |
| Total                                     | \$ 4,703           | \$ 6,344      | \$ 14,088         | \$ 17,495     |

## 15. Subsequent Events

On November 3, 2015, the Company entered into an agreement to acquire Lincoln Laser Company, a Phoenix, Arizona-based provider of ultrafast precision polygon scanners and other optical scanning solutions for the medical, food processing, and advanced industrial markets. The initial purchase price is \$11 million in cash, subject to

customary working capital adjustments. The transaction is expected to close in November 2015. Lincoln Laser Company specializes in ultrafast scanning, leveraging their expertise in polygon motor design and electro-optic subsystems. The acquisition creates an expanded range of highly competitive beam delivery technologies that significantly enhances the Company's value proposition with OEM customers in growth applications. The Lincoln Laser business will be integrated into the Company's beam delivery business line, which is part of the Company's Laser Products segment.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Consolidated Financial Statements and Notes included in Item 1 of this Quarterly Report on Form 10-Q. The MD&A contains certain forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. In addition to historical financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. These forward-looking statements include, but are not limited to, expected benefits of the business acquisitions; our belief that the Purchasing Managers Index (PMI) may provide an indication of the impact of general economic conditions on our sales into the advanced industrial end market; expectations regarding the 2015 and 2016 restructuring programs, including anticipated cash charges and anticipated savings; anticipated financial performance; expected liquidity and capitalization; drivers of revenue growth; management's plans and objectives for future operations, expenditures and product development and investments in research and development; business prospects; potential of future product releases; anticipated sales performance; changes in accounting principles and changes in actual or assumed tax liabilities; and expectations regarding tax exposure. 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: the PMI may not provide an indication of the impact of general economic conditions on our sales into the advanced industrial end market in any particular period or at all; economic and political conditions and the effects of these conditions on our customers' businesses and level of business activities; our significant dependence upon our customers' capital expenditures, which are subject to cyclical market fluctuations; our dependence upon our ability to respond to fluctuations in product demand; our ability to continually innovate and successfully commercialize our innovations; failure to introduce new products in a timely manner; customer order timing and other similar factors beyond our control; disruptions or breaches in security of our information technology systems; changes in interest rates, credit ratings or foreign currency exchange rates; risk associated with our operations in foreign countries; our increased use of outsourcing in foreign countries; our failure to comply with local import and export regulations in the jurisdictions in which we operate; our exposure to the credit risk of some of our customers and in weakened markets; our reliance on third party distribution channels; violations of our intellectual property rights and our ability to protect our intellectual property against infringement by third parties; risk of losing our competitive advantage; our failure to successfully integrate recent and future acquisitions into our business or grow acquired businesses; our ability to make divestitures that provide business benefits; our ability to attract and retain key personnel; our restructuring and realignment activities and disruptions to our operations as a result of consolidation of our operations; product defects or problems integrating our products with other vendors' products; disruptions in the supply of certain key components and other goods from our suppliers; production difficulties and product delivery delays or disruptions; our compliance, or our failure to comply, with various federal, state and foreign regulations; changes in governmental regulation of our business or products; effects of compliance with conflict minerals regulations; our compliance, or failure to comply, with environmental regulations; our failure to implement new information technology systems and software successfully; our failure to realize the full value of our intangible assets; our ability to utilize our net operating loss carryforwards and other tax attributes; changes in tax laws, and fluctuations in our effective tax rates; being subject to U.S. federal income taxation even though we are a non-U.S. corporation; any need for additional capital to adequately respond to business challenges or opportunities and repay or refinance our existing indebtedness, which may not be available on acceptable terms or at all; volatility in the market price for our common shares; our ability to access cash and other assets of our subsidiaries; the influence of certain significant shareholders over our business; provisions of our articles of incorporation may delay or prevent a change in control; our significant existing indebtedness may limit our ability to engage in certain activities; and our failure to maintain appropriate internal controls in the future. Other important



risk factors that could affect the outcome of the events set forth in these statements and that could affect the Company's operating results and financial condition are discussed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 under the heading "Risk Factors." In this Quarterly Report on Form 10-Q, the words "anticipates," "believes," "expects," "intends," "future," "could," "estimates," "plans," "would," "should," "potential," "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.

#### Accounting Period

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

## Business Overview

We design, develop, manufacture and sell precision photonics and motion control components and subsystems to Original Equipment Manufacturers (“OEM”) in the medical and advanced industrial markets. We are a leader in highly engineered enabling technologies, including CO2 laser sources, laser scanning and beam delivery products, optical data collection and machine vision technologies, medical visualization and informatics solutions, and precision motion control products. We specialize in collaborating with OEM customers to adapt our component and subsystem technologies to deliver highly differentiated performance in their applications.

## Reportable Segments

We operate in three reportable segments: Laser Products, Vision Technologies (formerly known as Medical Technologies), and Precision Motion. The reportable segments and their principal activities are summarized below.

### Laser Products

Our Laser Products segment designs, manufactures and markets photonics-based solutions, including CO2 laser sources, and laser scanning and beam delivery products, to customers worldwide. The segment serves highly demanding photonics-based applications such as industrial material processing, and medical and life science imaging and laser procedures. The vast majority of the segment’s product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

### Vision Technologies

Our Vision Technologies segment designs, manufactures and markets a range of medical grade technologies, including visualization solutions, imaging informatics products, optical data collection and machine vision technologies, thermal printers, and light and color measurement instrumentation, to customers worldwide. The vast majority of the segment’s product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

### Precision Motion

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

## End Markets

We primarily operate in two end markets: the advanced industrial market and the medical market.

### Advanced Industrial Market

For the nine months ended October 2, 2015, the advanced industrial market accounted for approximately 60% of the Company's revenue. Revenue from our advanced industrial market products are affected by a number of factors, including changing technology requirements and preferences of our customers, the financial condition of our advanced industrial customers, and general economic conditions. We believe that the Purchasing Managers Index (PMI) on manufacturing activities specific to different regions around the world may provide an indication of the impact of general economic conditions on our sales into the advanced industrial market.

### Medical Market

For the nine months ended October 2, 2015, the medical market accounted for approximately 40% of the Company's revenue. Our revenue from sales to the medical market is generally affected by hospital and other health care provider capital spending, changes in regulatory requirements and laws, aggregation of purchasing by healthcare networks, and demographics.

## Strategy

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

- improving our business mix to increase medical sales as a percentage of total revenue by:
  - introducing new products aimed at attractive medical applications such as minimally invasive and robotic surgery, ophthalmology, patient monitoring, drug delivery, diagnostic testing and life science research;
  - cross selling our entire product offerings to the leading medical manufacturers; and
  - pursuing complementary medical technology acquisitions;
- increasing our penetration of high growth advanced industrial applications such as laser materials processing, robotics, automation, metrology, and via hole drilling by working closely with OEM customers to launch application specific products that closely match the requirements of each application;
- broadening our portfolio of precision motion control products and capabilities through increased new product development investment in motion control product lines, expanded sales and marketing channels to reach target customers, and acquisitions of additional motion control product technologies used by existing customers;
- broadening our product and service offerings through the acquisition of innovative and complementary technologies and solutions in medical and advanced industrial applications;
- upgrading our existing operations to expand profit margins and improve customer satisfaction by implementing lean manufacturing principles and strategic sourcing across our major production sites; and
- attracting, retaining, and developing talented and motivated employees.

## Significant Events and Updates

### Acquisition of Applimotion

On February 19, 2015, we acquired 100% of the outstanding stock of Applimotion Inc. ("Applimotion"), a Loomis, California based provider of advanced precision motor and motion control technology to OEM customers in the medical and advanced industrial markets, for a total purchase price of \$14.0 million, net of working capital adjustments. This total purchase price includes \$13.0 million in cash paid for the acquisition and \$1.0 million in estimated fair value of future contingent considerations payable upon the achievement of certain revenue targets for

the fiscal years 2015 to 2017. The undiscounted range of contingent considerations is zero to \$4.0 million. Applimotion specializes in motor applications that require highly precise and dynamic motion control. The acquisition enhances our strategic position in precision motion control by enabling us to offer a broader range of motion control technologies and integrated solutions. Applimotion is included in our Precision Motion reportable segment.

#### JK Lasers Divestiture

On April 15, 2015, we completed the sale of our JK Lasers business for \$29.6 million in cash, net of the final working capital adjustments and transaction costs, and recognized a \$19.6 million pre-tax gain on sale during the nine months ended October 2, 2015.

During the nine months ended October 2, 2015, we incurred \$1.1 million of consulting fees related to the JK Lasers business divestiture, which are included in restructuring, acquisition and divestiture related costs in the consolidated statement of operations. The JK Lasers business divestiture does not qualify for discontinued operations accounting treatment.

### 2015 Restructuring

During the first quarter of 2015, the Company implemented a program to eliminate redundant costs, as a result of acquisition and divestiture activities, to better align our operations to our strategic growth plans, to further integrate our business lines, and as a consequence of our productivity initiatives. We incurred severance costs related to the 2015 restructuring amounting to \$1.1 million during the nine months ended October 2, 2015. We principally intend to reallocate resources and reinvest savings from the 2015 restructuring into higher growth businesses and lower cost regions.

### 2016 Restructuring

During the third quarter of 2015, the Company initiated a program targeting annualized savings of \$4.5 million to \$5.5 million after the program is fully executed. The 2016 restructuring program includes consolidating our manufacturing operations to optimize our facility footprint and to better utilize resources, and reducing redundant costs due to productivity cost savings and business volume reductions. We expect to incur cash charges of \$3.5 million to \$4.5 million related to this program, which we anticipate completing during the second quarter of 2016. We incurred severance costs related to the 2016 restructuring amounting to \$0.7 million in the three and nine months ended October 2, 2015.

### Results of Operations for the Three and Nine Months Ended October 2, 2015 Compared with the Three and Nine Months Ended September 26, 2014

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

|  | Three Months Ended |                    | Nine Months Ended |                    |
|--|--------------------|--------------------|-------------------|--------------------|
|  | October 2, 2015    | September 26, 2014 | October 2, 2015   | September 26, 2014 |
| Revenue  | 100.0 %            | 100.0 %            | 100.0 %           | 100.0 %            |
| Cost of revenue  | 56.7               | 58.1               | 57.2              | 59.2               |
| Gross profit   | 43.3               | 41.9               | 42.8              | 40.8               |
| Operating expenses:                                      |                    |                    |                   |                    |
| Research and development and engineering                 | 8.3                | 8.2                | 8.4               | 7.8                |
| Selling, general and administrative                      | 21.7               | 22.7               | 22.2              | 23.1               |
| Amortization of purchased intangible assets              | 2.0                | 3.0                | 2.0               | 2.8                |
| Restructuring, acquisition and divestiture related costs | 1.5                | 0.8                | 1.5               | 0.7                |
| Total operating expenses                                 | 33.5               | 34.7               | 34.1              | 34.4               |
| Operating income from continuing operations              | 9.8                | 7.2                | 8.7               | 6.4                |
| Interest income (expense), net                           | (1.4 )             | (1.5 )             | (1.4 )            | (1.4 )             |

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|  |     |        |        |        |
|--|-----|--------|--------|--------|
| Foreign exchange transaction gains (losses), net         | 0.4 | 1.1    | (0.8 ) | 0.4    |
| Other income (expense), net                              | 1.0 | 0.7    | 7.6    | 0.7    |
| Income from continuing operations before income taxes    | 9.8 | 7.5    | 14.1   | 6.1    |
| Income tax provision                                     | 2.7 | 2.1    | 3.7    | 1.9    |
| Income from continuing operations                        | 7.1 | 5.4    | 10.4   | 4.2    |
| Loss from discontinued operations, net of tax            | —   | (0.3 ) | —      | (1.8 ) |
| Loss on disposal of discontinued operations, net of tax  | —   | (0.3 ) | —      | (0.1 ) |
| Consolidated net income                                  | 7.1 | 4.8    | 10.4   | 2.3    |
| Less: Net income attributable to noncontrolling interest | —   | —      | —      | —      |
| Net income attributable to GSI Group Inc.                | 7.1 | % 4.8  | % 10.4 | % 2.3  |

Overview of Financial Results

Total revenue decreased by 2.5% for the three months ended October 2, 2015 and increased by 4.7% for the nine months ended October 2, 2015, compared to the prior year. Our acquisitions and divestitures accounted for a 2.3% net decrease in revenue during the three months ended October 2, 2015 and a 3.9% net increase during the nine months ended October 2, 2015. In addition, foreign

currency exchange rates adversely impacted our revenue by 3.8% and 4.5% during the three and nine months ended October 2, 2015, respectively. Excluding the impact of acquisitions, divestitures and changes in foreign exchange rates, total revenue for the three and nine months ended October 2, 2015 increased 3.6% and 5.3%, respectively, compared to the prior year. Our organic revenue growth is summarized as follows:

|  | Three Months Ended |    | Nine Months Ended |   |
|--|--------------------|----|-------------------|---|
|  | October 2, 2015    |    | October 2, 2015   |   |
|  | Percentage Change  |    | Percentage Change |   |
| Reported growth (decline)                                  | (2.5)              | )% | 4.7               | % |
| Less: Change attributable to acquisitions and divestitures | (2.3)              | )% | 3.9               | % |
| Plus: Change due to foreign currency                       | 3.8                | %  | 4.5               | % |
| Organic growth   | 3.6                | %  | 5.3               | % |

The organic growth in our revenue for the three months ended October 2, 2015 versus the prior year was primarily attributable to growth in our Laser Products segment, offset by a decrease in revenue of our Vision Technologies segment. The organic growth in our revenue for the nine months ended October 2, 2015 versus the prior year was attributable to growth in our Laser Products and Precision Motion segments, offset by a decrease in revenue of our Vision Technologies segment.

Operating income from continuing operations increased \$2.2 million, or 32.0%, from \$6.8 million for the three months ended September 26, 2014 to \$9.0 million for the three months ended October 2, 2015. This increase was primarily attributable to a decrease in operating expenses. Operating income from continuing operations increased \$7.3 million, or 42.3%, from \$17.4 million for the nine months ended September 26, 2014 to \$24.7 million for the nine months ended October 2, 2015. This increase was primarily due to an increase in gross profit and a decrease in amortization of purchased intangible assets, partially offset by an increase in restructuring expenses related to the 2015 and 2016 restructuring programs and JK Lasers divestiture related costs as well as Research, Development and Engineering (“R&D”) expenses.

Diluted earnings per share (“Diluted EPS”) from continuing operations of \$0.19 for the three months ended October 2, 2015 increased \$0.04 from the prior year. This increase was primarily attributable to higher operating income from continuing operations, partially offset by a decrease in foreign currency gains. Diluted EPS from continuing operations of \$0.84 for the nine months ended October 2, 2015 increased by \$0.51 from the prior year due to higher operating income from continuing operations, higher other income resulting from the gain recognized from the JK Lasers divestiture and lower effective tax rate, partially offset by foreign currency losses in the current year versus foreign currency gains in the prior year.

## Revenue

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

| Three Months Ended |               |          |            |
|--------------------|---------------|----------|------------|
|                    | September 26, | Increase | Percentage |

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|                     | October 2014 | October 2, 2015 | (Decrease)  | Change |   |
|---------------------|--------------|-----------------|-------------|--------|---|
| Laser Products      | \$41,330     | \$ 45,806       | \$ (4,476 ) | -9.8   | % |
| Vision Technologies | 30,992       | 32,680          | (1,688 )    | -5.2   | % |
| Precision Motion    | 19,949       | 16,170          | 3,779       | 23.4   | % |
| Total               | \$92,271     | \$ 94,656       | \$ (2,385 ) | -2.5   | % |

|                     | Nine Months Ended |                    | Increase    | Percentage |   |
|---------------------|-------------------|--------------------|-------------|------------|---|
|                     | October 2, 2015   | September 26, 2014 | (Decrease)  | Change     |   |
| Laser Products      | \$128,475         | \$ 131,494         | \$ (3,019 ) | -2.3       | % |
| Vision Technologies | 93,319            | 89,838             | 3,481       | 3.9        | % |
| Precision Motion    | 61,585            | 49,362             | 12,223      | 24.8       | % |
| Total               | \$283,379         | \$ 270,694         | \$ 12,685   | 4.7        | % |

Laser Products

Laser Products segment revenue for the three months ended October 2, 2015 decreased by \$4.5 million, or 9.8%, versus the prior year primarily as a result of the JK Lasers divestiture which accounted for \$5.9 million of the decrease, partially offset by an increase in revenue of our beam delivery and CO2 lasers products due to an increase in demand in the advanced industrial market.



Laser Products segment revenue for the nine months ended October 2, 2015 decreased by \$3.0 million, or 2.3%, versus the prior year primarily as a result of the JK Lasers divestiture which accounted for \$10.6 million of the decrease, partially offset by an increase in revenue of our beam delivery and CO2 lasers products due to an increase in demand in the advanced industrial market.

#### Vision Technologies

Vision Technologies segment revenue for the three months ended October 2, 2015 decreased by \$1.7 million, or 5.2%, versus the prior year. The decrease was primarily driven by a decline in our revenue as a result of softness in medical equipment spending impacting our customers' demand for our products, partially offset by increased demand in our light and color measurement products.

Vision Technologies segment revenue for the nine months ended October 2, 2015 increased by \$3.5 million, or 3.9%, versus the prior year. The increase was primarily due to revenue from our optical data collection business being included in the reported revenue in the prior year only following the acquisition in March 2014 and increases in revenue from our thermal printers and light and color measurement products, partially offset by a decline in our visualization solutions revenue as a result of softness in medical equipment spending.

#### Precision Motion

Precision Motion segment revenue for the three months ended October 2, 2015 increased by \$3.8 million, or 23.4%, versus the prior year. The increase was principally driven by the Applimotion acquisition and higher revenue from our optical encoder products as a result of increased customer volumes, partially offset by a decline in revenue of our air bearing spindles products due to lower demand from the printed circuit board industry.

Precision Motion segment revenue for the nine months ended October 2, 2015 increased by \$12.2 million, or 24.8%, versus the prior year. The increase was principally driven by the Applimotion acquisition and higher revenue from our optical encoder products as a result of increased customer volumes, partially offset by a decline in revenue of our air bearing spindles products due to lower demand from the printed circuit board industry.

#### Gross Profit and Gross Profit Margin

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

|   | Three Months Ended |                    | Nine Months Ended |                    |
|---|--------------------|--------------------|-------------------|--------------------|
|   | October 2, 2015    | September 26, 2014 | October 2, 2015   | September 26, 2014 |
| Gross profit:                             |                    |                    |                   |                    |
| Laser Products                            | \$ 18,851          | \$ 20,269          | \$ 57,176         | \$ 54,437          |
| Vision Technologies                       | 12,152             | 12,945             | 36,823            | 35,672             |
| Precision Motion                          | 9,233              | 6,776              | 28,309            | 21,141             |
| Unallocated Corporate and Shared Services | (326 )             | (307 )             | (1,047 )          | (811 )             |

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|                      |           |   |           |   |            |   |            |   |
|----------------------|-----------|---|-----------|---|------------|---|------------|---|
| Total                | \$ 39,910 |   | \$ 39,683 |   | \$ 121,261 |   | \$ 110,439 |   |
| Gross profit margin: |           |   |           |   |            |   |            |   |
| Laser Products       | 45.6      | % | 44.2      | % | 44.5       | % | 41.4       | % |
| Vision Technologies  | 39.2      | % | 39.6      | % | 39.5       | % | 39.7       | % |
| Precision Motion     | 46.3      | % | 41.9      | % | 46.0       | % | 42.8       | % |
| Total                | 43.3      | % | 41.9      | % | 42.8       | % | 40.8       | % |

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 and warranty expenses.

#### Laser Products

Laser Products segment gross profit for the three months ended October 2, 2015 decreased \$1.4 million, or 7.0%, versus the prior year due to a decline in revenue as a result of the JK Lasers divestiture which accounted for \$1.9 million of the decrease, partially offset by revenue growth in our current product lines and an increase in gross profit margin. Laser Products segment gross

profit margin was 45.6% for the three months ended October 2, 2015, versus a gross profit margin of 44.2% for the prior year due to the JK Lasers divestiture which accounted for a 1.9 percentage point increase in gross profit margin.

Laser Products segment gross profit for the nine months ended October 2, 2015 increased \$2.7 million, or 5.0%, versus the prior year due to an increase in gross profit margin. Laser Products segment gross profit margin was 44.5% for the nine months ended October 2, 2015, versus a gross profit margin of 41.4% for the prior year due to the JK Lasers divestiture which accounted for a 1.1 percentage point of the 3.1 percentage point increase in gross profit margin. The remaining increase in gross profit margin was driven by increases in volume in our current product lines, product mix, and continuous improvement productivity initiatives.

#### Vision Technologies

Vision Technologies segment gross profit for the three months ended October 2, 2015 decreased \$0.8 million, or 6.1%, versus the prior year due to a decline in revenue. Vision Technologies segment gross profit margin was 39.2% for the three months ended October 2, 2015, versus a gross profit margin of 39.6% for the prior year. The 0.4 percentage point decrease in gross profit margin was primarily attributable to lower volumes, partially offset by lower intangible asset amortization expense. Included in gross profit for the three months ended October 2, 2015 was the amortization of developed technologies of \$0.5 million. Gross profit for the three months ended September 26, 2014 included amortization of developed technologies of \$0.9 million.

Vision Technologies segment gross profit for the nine months ended October 2, 2015 increased \$1.2 million, or 3.2%, versus the prior year. The increase was primarily attributable to a decline in intangible asset amortization expense. Vision Technologies segment gross profit margin was 39.5% for the nine months ended October 2, 2015, versus a gross profit margin of 39.7% for the prior year. The 0.2 percentage point decrease in gross profit margin was primarily attributable to product mix, offset by lower intangible asset amortization expense. Included in gross profit for the nine months ended October 2, 2015 was the amortization of developed technologies of \$1.6 million. Gross profit for the nine months ended September 26, 2014 included amortization of developed technologies and amortization of inventory fair value step-ups of \$2.8 million.

#### Precision Motion

Precision Motion segment gross profit for the three months ended October 2, 2015 increased \$2.5 million, or 36.3%, versus the prior year. The increase was primarily attributable to an increase in revenue and gross profit margin. Precision Motion segment gross profit margin was 46.3% for the three months ended October 2, 2015, versus a gross profit margin of 41.9% for the prior year. The 4.4 percentage point increase in gross profit margin was primarily attributable to an increase in volumes, product mix and continuous improvement productivity initiatives.

Precision Motion segment gross profit for the nine months ended October 2, 2015 increased \$7.2 million, or 33.9%, versus the prior year. The increase was primarily attributable to the increase in revenue and gross profit margin. Precision Motion segment gross profit margin was 46.0% for the nine months ended October 2, 2015, versus a gross profit margin of 42.8% for the prior year. The 3.2 percentage point increase in gross profit margin was primarily attributable to an increase in volumes, product mix and continuous improvement productivity initiatives.

#### Operating Expenses

The following table sets forth operating expenses for the periods noted (in thousands):

|  | Three Months Ended |                    | Nine Months Ended |                    |
|--|--------------------|--------------------|-------------------|--------------------|
|  | October 2, 2015    | September 26, 2014 | October 2, 2015   | September 26, 2014 |
| Research and development and engineering                 | \$ 7,693           | \$ 7,735           | \$ 23,748         | \$ 21,117          |
| Selling, general and administrative                      | 19,979             | 21,512             | 62,969            | 62,540             |
| Amortization of purchased intangible assets              | 1,852              | 2,843              | 5,593             | 7,463              |
| Restructuring, acquisition and divestiture related costs | 1,379              | 771                | 4,232             | 1,949              |
| <b>Total</b>   | <b>\$ 30,903</b>   | <b>\$ 32,861</b>   | <b>\$ 96,542</b>  | <b>\$ 93,069</b>   |

#### Research and Development and Engineering Expenses

R&D expenses are primarily comprised of employee compensation related expenses and cost of materials for R&D projects. R&D expenses were \$7.7 million, or 8.3% of revenue, during the three months ended October 2, 2015, compared with \$7.7 million, or 8.2% of revenue, during the prior year. R&D expenses slightly decreased in terms of total dollars, primarily due to the JK Lasers divestiture, partially offset by a current year acquisition.

R&D expenses were \$23.7 million, or 8.4% of revenue, during the nine months ended October 2, 2015, compared with \$21.1 million, or 7.8% of revenue, during the prior year. R&D expenses increased primarily due to higher investments across the majority of our product lines and acquisitions, partially offset by the JK Lasers divestiture.

#### 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, and executive management functions. SG&A expenses were \$20.0 million, or 21.7% of revenue, during the three months ended October 2, 2015, compared with \$21.5 million, or 22.7% of revenue, during the prior year. SG&A expenses decreased primarily due to the JK Lasers divestiture, partially offset by a current year acquisition.

SG&A expenses were \$63.0 million, or 22.2% of revenue, during the nine months ended October 2, 2015, compared with \$62.5 million, or 23.1% of revenue, during the prior year. SG&A expenses increased in terms of total dollars primarily due to acquisitions, partially offset by the JK Lasers divestiture.

#### Amortization of Purchased Intangible Assets

Amortization of purchased intangible assets, excluding the amortization of developed technologies included in cost of revenue, was \$1.9 million, or 2.0% of revenue, during the three months ended October 2, 2015, compared with \$2.8 million, or 3.0% of revenue, during the prior year. The decrease, in terms of total dollars, was related to the decrease in amortization of acquired intangible assets from acquisitions.

Amortization of purchased intangible assets, excluding the amortization of developed technologies included in cost of revenue, was \$5.6 million, or 2.0% of revenue, during the nine months ended October 2, 2015, compared with \$7.5 million, or 2.8% of revenue, during the prior year. The decrease, in terms of total dollars, was related to the decrease in amortization of acquired intangible assets from acquisitions.

#### Restructuring, Acquisition and Divestiture Related Costs

We recorded restructuring, acquisition and divestiture related costs of \$1.4 million during the three months ended October 2, 2015, versus \$0.8 million during the prior year. The increase in restructuring, acquisition and divestiture related costs versus the prior year was mainly due to an increase in restructuring charges related to our 2016 restructuring program and an increase in acquisition related charges.

During the nine months ended October 2, 2015, we recorded \$4.2 million in restructuring, acquisition and divestiture related costs, versus \$1.9 million during the prior year. The increase in restructuring, acquisition and divestiture related costs versus the prior year was mainly due to an increase in restructuring charges related to our 2015 and 2016 restructuring programs and costs related to the JK Lasers divestiture.

#### Operating Income from Continuing Operations by Segment

The following table sets forth operating income from continuing operations by segment for the periods noted (in thousands):

| Three Months Ended<br>September 26, | Nine Months Ended<br>September 26, |
|-------------------------------------|------------------------------------|
|-------------------------------------|------------------------------------|

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|  | October<br>2, | 2014     | October<br>2, | 2014      |
|--|---------------|----------|---------------|-----------|
|  | 2015          |          | 2015          |           |
| <b>Operating Income (Loss) from Continuing Operations:</b> |               |          |               |           |
| Laser Products   | \$ 10,145     | \$ 9,857 | \$28,586      | \$ 23,828 |
| Vision Technologies  | (388 )        | (1,115 ) | (1,056 )      | (1,194 )  |
| Precision Motion   | 4,417         | 2,796    | 14,357        | 9,525     |
| Unallocated Corporate and Shared Services                  | (5,167 )      | (4,716 ) | (17,168)      | (14,789 ) |
| Total  | \$ 9,007      | \$ 6,822 | \$24,719      | \$ 17,370 |

### Laser Products

Laser Products operating income from continuing operations for the three months ended October 2, 2015 increased by \$0.3 million, or 2.9%, versus the prior year. The increase in operating income from continuing operations was primarily due to lower operating expenses as a result of the JK Lasers divestiture.

Laser Products operating income from continuing operations for the nine months ended October 2, 2015 increased by \$4.8 million, or 20.0%, versus the prior year. The increase in operating income from continuing operations was primarily due to higher gross profit from our beam delivery and CO2 lasers products and lower operating expenses as a result of the JK Lasers divestiture.

### Vision Technologies

Vision Technologies operating loss from continuing operations for the three months ended October 2, 2015 decreased by \$0.7 million, or 65.2%, versus the prior year. The decrease in operating loss from continuing operations was primarily attributable to a decrease in amortization of purchased intangibles, partially offset by lower gross profit.

Vision Technologies operating loss from continuing operations for the nine months ended October 2, 2015 decreased by \$0.1 million, or 11.6%, versus the prior year. The decrease in operating loss from continuing operations was primarily attributable to an increase in gross profit, a decrease in acquisition related charges and amortization of purchased intangibles, partially offset by higher R&D and SG&A expenses as a result of a prior year acquisition. Acquisition related charges for the nine months ended October 2, 2015 decreased by \$1.6 million from the prior year mainly due to the reversal of incentive compensation related to an acquisition.

### Precision Motion

Precision Motion operating income from continuing operations for the three months ended October 2, 2015 increased by \$1.6 million, or 58.0%, versus the prior year. The increase was primarily due to the increase in gross profit, partially offset by higher operating expenses due to the Applimotion acquisition.

Precision Motion operating income from continuing operations for the nine months ended October 2, 2015 increased by \$4.8 million, or 50.7%, versus the prior year. The increase was primarily due to the increase in gross profit, partially offset by higher operating expenses due to the Applimotion acquisition.

### Unallocated Corporate and Shared Services

Unallocated Corporate and Shared Services costs primarily represent costs of corporate and shared services functions that are not allocated to the operating segments, including certain restructuring and most acquisition related costs. These costs for the three months ended October 2, 2015 increased by \$0.5 million, or 9.6%, versus the prior year primarily due to an increase in restructuring and acquisition related costs of \$0.5 million. These costs for the nine months ended October 2, 2015 increased by \$2.4 million, or 16.1%, versus the prior year primarily due to an increase in restructuring and acquisition related costs of \$0.9 million and an increase in professional services costs.

### Other Income and Expense Items

The following table sets forth other income and expense items for the periods noted (dollars in thousands):

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|  | Three Months Ended |                    | Nine Months Ended |                    |
|--|--------------------|--------------------|-------------------|--------------------|
|  | October 2, 2015    | September 26, 2014 | October 2, 2015   | September 26, 2014 |
| Interest income (expense), net                   | \$ (1,248 )        | \$ (1,453 )        | \$ (4,020 )       | \$ (3,665 )        |
| Foreign exchange transaction gains (losses), net | 383                | 1,030              | (2,253 )          | 950                |
| Other income (expense), net                      | 878                | 733                | 21,641            | 1,733              |

Interest Income (Expense), Net

Net interest expense was \$1.2 million for the three months ended October 2, 2015, versus \$1.5 million in the prior year. The \$0.2 million decrease in net interest expense from the prior year was primarily due to a decrease in average debt levels. The weighted average interest rate on our Senior Credit Facilities was 3.15% and 3.23% during the three months ended October 2, 2015 and September 26, 2014, respectively.



Net interest expense was \$4.0 million for the nine months ended October 2, 2015, versus \$3.7 million in the prior year. The \$0.4 million increase in net interest expense from the prior year was primarily due to an increase in average debt levels and interest paid on capital leases. The weighted average interest rate on our Senior Credit Facilities was 3.30% and 3.22% during the nine months ended October 2, 2015 and September 26, 2014, respectively.

#### Foreign Exchange Transaction Gains (Losses), Net

Foreign exchange transaction gains (losses), net, were \$0.4 million net gains for the three months ended October 2, 2015, versus \$1.0 million net gains for the prior year due to changes in the U.S. Dollar exchange rates against the Euro, British Pound and Japanese Yen.

Foreign exchange transaction gains (losses), net, were \$2.3 million net losses for the nine months ended October 2, 2015, versus \$1.0 million net gains for the prior year due to changes in the U.S. Dollar exchange rates against the Euro, British Pound and Japanese Yen and a \$1.2 million foreign currency loss related to the cash proceeds in U.S. dollars from the JK Lasers divestiture being held for a period of time by our UK subsidiary.

#### Other Income (Expense), Net

Other income was \$0.9 million for the three months ended October 2, 2015, versus \$0.7 million in the prior year due to higher earnings from our equity-method investment in Laser Quantum. Other income was \$21.6 million for the nine months ended October 2, 2015, versus \$1.7 million in the prior year due to a gain recognized as a result of the JK Lasers divestiture and higher earnings from our equity-method investment in Laser Quantum.

#### Income Taxes

The effective tax rate for the three months ended October 2, 2015 was 27.2%, versus 28.2% for the prior year. The effective tax rates for the three months ended October 2, 2015 and September 26, 2014 differ from the Canadian statutory rate of 27.0%, primarily due to the U.S. IRS audit settlement, mix of income earned in jurisdictions with varying tax rates, losses in jurisdictions with a full valuation allowance, and the impact of discrete items for the period.

The effective tax rate for the nine months ended October 2, 2015 was 26.3%, versus 30.6% for the prior year. The effective tax rates for the nine months ended October 2, 2015 and September 26, 2014 differ from the Canadian statutory rate of 27.0%, primarily due to the gain from JK Lasers divestiture, the audit settlement with the U.S. Internal Revenue Service, mix of income earned in jurisdictions with varying tax rates, losses in jurisdictions with a full valuation allowance, and the impact of discrete items for the period. During the nine months ended October 2, 2015 and September 26, 2014, respectively, the Company recognized \$0.2 million and \$1.1 million of net tax benefits associated with uncertain tax positions upon expiration of statute of limitations.

#### Discontinued Operations

Loss from discontinued operations, net of tax, was zero and less than \$0.1 million, respectively, during the three and nine months ended October 2, 2015, compared to loss from discontinued operations, net of tax, of \$0.3 million and \$4.8 million, respectively, for the three and nine months ended September 26, 2014. The decline in loss from discontinued operations, net of tax, was due to losses related to the Scientific Lasers business, which was sold in July 2014.

## 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 capital expenditure 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 current and future acquisitions, 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 our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

Our ability to make payments on our indebtedness and to fund our operations may be dependent upon the earnings and the distribution of funds from our subsidiaries. Local laws and regulations and/or the terms of our indebtedness restrict certain of our subsidiaries from paying dividends and 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.

In October 2013, the Company’s Board of Directors authorized a share repurchase plan under which the Company may repurchase outstanding shares of the Company’s common stock up to an aggregate amount of \$10.0 million. The shares may be repurchased from time to time, at the Company’s discretion, based on ongoing assessment of the capital needs of the business, the market price of the Company’s common stock, and general market conditions. Shares may also be repurchased through an accelerated stock purchase agreement, on the open market or in privately negotiated transactions in accordance with applicable federal securities laws. Repurchases may be made under certain SEC regulations, which would permit common stock to be purchased when the Company would otherwise be prohibited from doing so under insider trading laws. The share repurchase plan does not obligate the Company to acquire any particular amount of common stock. No time limit was set for the completion of the share repurchase program, and the program may be suspended or discontinued at any time. The Company expects to fund share repurchases through cash on hand and future cash flows from operations. As of December 31, 2014, the Company had cumulatively repurchased 50 thousand shares of its common stock for an aggregate amount of \$0.5 million. During the third quarter of 2015, the Company repurchased 77 thousand shares in the open market for an aggregate purchase price of \$1.0 million at an average price of \$13.03 per share.

As of October 2, 2015, \$31.8 million of our \$80.1 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 deferred tax liabilities for the expected tax cost. Additionally, we may use intercompany loans to address short-term cash flow needs for various subsidiaries.

#### Amended and Restated Credit Agreement

Our amended and restated senior secured credit agreement (the “Amended and Restated Credit Agreement”) consists of a \$50.0 million, 5-year term loan facility and a \$175.0 million, 5-year revolving credit facility (collectively, the “Senior Credit Facilities”) that mature in December 2017. As of October 2, 2015, we had outstanding term loans of \$29.4 million and revolving loans of \$80.0 million under the Senior Credit Facilities.

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 October 2, 2015:

|  | Requirement | Actual |
|--|-------------|--------|
| Maximum consolidated leverage ratio              | 3.00        | 1.80   |
| Minimum consolidated fixed charge coverage ratio | 1.50        | 3.95   |

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Cash Flows for the Nine Months Ended October 2, 2015 and September 26, 2014

The following table summarizes our cash flows from continuing operations, cash and cash equivalent balances and unused and available funds under our revolving credit facility for the periods indicated (dollars in thousands):

|  | Nine Months Ended |               |
|--|-------------------|---------------|
|  | October 2,        | September 26, |
|  | 2015              | 2014          |
| Net cash provided by operating activities of continuing operations           | \$25,476          | \$ 34,415     |
| Net cash provided by (used in) investing activities of continuing operations | \$ 12,534         | \$ (91,964 )  |
| Net cash provided by (used in) financing activities of continuing operations | \$(8,444 )        | \$ 47,591     |

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|  | October<br>2,<br><br>2015 | December 31,<br><br>2014 |
|--|---------------------------|--------------------------|
| Cash and cash equivalents                                  | \$80,089                  | \$ 51,146                |
| Unused and available funds under revolving credit facility | \$95,000                  | \$ 95,000                |

### Operating Cash Flows

Cash provided by operating activities of continuing operations was \$25.5 million for the nine months ended October 2, 2015, versus \$34.4 million for the prior year. Income from continuing operations for the nine months ended October 2, 2015 increased from the prior year while changes in operating assets and liabilities decreased cash provided by operating activities of continuing operations by \$6.5 million. Cash provided by operating activities of continuing operations was positively impacted by an increase in our days payables outstanding from 46 days at December 31, 2014 to 48 days at October 2, 2015. Cash provided by operating activities of continuing operations was negatively impacted by an increase in our days sales outstanding from 51 days at December 31, 2014 to 55 days at October 2, 2015 and an increase in inventories excluding inventories sold as part of the JK Lasers divestiture and inventories from the Applimotion acquisition. In addition, cash provided by operating activities of continuing operations was impacted by the timing of sales in the three months ended October 2, 2015, compared to the three months ended December 31, 2014.

Cash provided by operating activities of continuing operations for the nine months ended September 26, 2014 was primarily related to income from continuing operations and an improvement in our working capital. Cash provided by operating activities of continuing operations was impacted by a decrease in our days sales outstanding from 56 days at December 31, 2013 to 54 days at September 26, 2014, an increase in our days payables outstanding from 48 days at December 31, 2013 to 52 days at September 26, 2014, and a decrease in inventories excluding inventories from the JADAK acquisition.

As a result of the sale of our Scientific Lasers business in July 2014, cash used in operating activities of discontinued operations was less than \$0.1 million for the nine months ended October 2, 2015.

### Investing Cash Flows

Cash provided by investing activities of our continuing operations was \$12.5 million during the nine months ended October 2, 2015, compared to cash used of \$92.0 million during the prior year. Cash provided by investing activities for the nine months ended October 2, 2015 was primarily due to cash proceeds received from the sale of the JK Lasers business in April 2015, partially offset by cash consideration paid for the Applimotion acquisition in February 2015 and \$4.1 million in capital expenditures. Cash outflows from investing activities of continuing operations during the nine months ended September 26, 2014 were primarily related to cash consideration paid for the JADAK acquisition in March 2014 and \$3.8 million in capital expenditures, partially offset by proceeds of \$5.4 million related to the recovery of an escrow claim for the NDS acquisition.

As a result of the sale of our Scientific Lasers business in July 2014, there were no cash flows from investing activities of discontinued operations for the nine months ended October 2, 2015.

### Financing Cash Flows

Cash used in financing activities of continuing operations was \$8.4 million during the nine months ended October 2, 2015, consisting of \$5.6 million of contractual term loan payments, \$13.0 million of optional repayments of borrowings under our revolving credit facility and the repurchase of \$1.0 million of the Company's common stock, partially offset by \$13.0 million of borrowings under our revolving credit facility to fund the Applimotion acquisition. The Company also made payroll tax payments on stock-based awards of \$1.4 million and capital lease payments of \$0.4 million.

Cash provided by financing activities of continuing operations was \$47.6 million during the nine months ended September 26, 2014, consisting of \$77.0 million of borrowings under our revolving credit facility to fund the JADAK acquisition, partially offset by \$5.6 million of contractual term loan payments, \$21.0 million of optional repayments of borrowings under our revolving credit facility and \$0.7 million fees paid in connection with the fourth amendment to the Amended and Restated Credit Agreement entered into in February 2014. The Company also made payroll tax payments on stock-based awards of \$1.6 million and capital lease payments of \$0.9 million.

## Off-Balance Sheet Arrangements, Contractual Obligations

### Contractual Obligations

Our contractual obligations primarily consist of the principal and interest associated with our debt, operating and capital leases, purchase commitments and pension obligations. Such contractual obligations are described in our Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to Consolidated Financial Statements, each included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014. Excluding the drawdown on our Senior Credit Facilities to fund the Applimotion acquisition, through October 2, 2015, we have not entered into any material new or modified contractual obligations since the end of the fiscal year ended December 31, 2014.

### Off-Balance Sheet Arrangements

The Company has an equity method investment in Laser Quantum Ltd. Group ("Laser Quantum"), a privately held company located in the United Kingdom. The Company has an ownership interest of approximately 41% in the Laser Quantum business. We continue to recognize our share of the earnings of this entity under the equity method.

Through October 2, 2015, we have not entered into any other off-balance sheet arrangements or material transactions with any unconsolidated entities or other persons.

### Critical Accounting Policies and Estimates

The critical accounting policies that we believe impact significant judgments and estimates used in the preparation of our consolidated financial statements presented in this report are described in our Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to Consolidated Financial Statements, each included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014. There have been no material changes to our critical accounting policies through October 2, 2015 from those discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

### Recent Accounting Pronouncements

See Note 1 to Consolidated Financial Statements.

## Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our primary market risk exposures are foreign currency exchange rate fluctuation and interest rate sensitivity. During the nine months ended October 2, 2015, there have been no material changes to the information included under Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

## Item 4. Controls and Procedures

### Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15(b) under the Exchange Act, our management carried out an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) as of October 2, 2015, the end of the period covered by this report. Based upon this evaluation, our Chief Executive Officer

and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of October 2, 2015.

#### Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting that occurred during the fiscal quarter ended October 2, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## PART II—OTHER INFORMATION

## Item 1. Legal Proceedings

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

## Item 1A. Risk Factors

The Company's risk factors are described in Part I, Item 1A, "Risk Factors", of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014. There have been no material changes in the risks affecting the Company since the filing of such Annual Report on Form 10-K.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets forth certain information with respect to repurchases of the Company's common stock during the three months ended October 2, 2015.

## ISSUER PURCHASES OF EQUITY SECURITIES

| Period                      | Total<br>Number of<br>Shares<br>Purchased | Average Price Paid<br>per Share | Total Number<br>of Shares<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs <sup>(1)(2)</sup> | Approximate<br>Dollar Value<br>that May<br>Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs <sup>(1)</sup> |
|-----------------------------|---|---------------------------------|---|--|
| July 4 - July 31, 2015      | —   | \$—                             | —   | \$9,474,000  |
| August 1 - August 28, 2015  | 63,300                                    | \$13.10                         | 63,300  | \$8,644,884  |
| August 29 - October 2, 2015 | 13,200                                    | \$12.70                         | 13,200  | \$8,477,236  |
| Total                       | 76,500                                    | \$                              | 13.03   | 76,500   |

(1) In October 2013, the Company's Board of Directors authorized a share repurchase plan for the repurchase of up to an aggregate of \$10.0 million of the Company's common stock, which was announced in the quarterly report for the period ended September 27, 2013 filed on November 5, 2013. The shares may be repurchased from time to time, at the Company's discretion, based on ongoing assessment of the capital needs of the business, the market price of the Company's common stock, and general market conditions. No time limit was set for the completion of the share repurchase program, and the program may be suspended or discontinued at any time.

(2) The Company has repurchased 126,500 shares of its common stock pursuant to the share repurchase program since its adoption.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

## Item 6. Exhibits

## List of Exhibits

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

| Exhibit Number | Exhibit Description  | Incorporated by Reference |         |             | Filed/             |
|----------------|--|---------------------------|---------|-------------|--------------------|
|                |  | Form No.                  | Exhibit | Filing Date | Furnished Herewith |
| 3.1            | Certificate and Articles of Continuance of the Registrant, dated March 22, 1999. | <del>S333</del> -202597   | 3.1     | 03/09/15    |                    |
| 3.2            | Articles of Amendment of the Registrant, dated May 26, 2005.                     | <del>S333</del> -202597   | 3.2     | 03/09/15    |                    |
| 3.3            | By-Laws of the Registrant, as amended  | <del>1000</del> -25705    | 3.2     | 04/13/10    |                    |
| 3.4            | Articles of Reorganization of the Registrant, dated July 23, 2010.               | <del>8000</del> -25705    | 3.1     | 07/23/10    |                    |
| 3.5            | Articles of Amendment of the Registrant, dated December 29, 2010.                | <del>8000</del> -25705    | 3.1     | 12/29/10    |                    |
| 31.1           | Chief Executive Officer Certification  |                           |         |             | *                  |

|         |  |    |
|---------|--|----|
|         | pursuant to<br>Section 302 of<br>the<br>Sarbanes-Oxley<br>Act of 2002.   |    |
| 31.2    | Chief Financial<br>Officer<br>Certification<br>pursuant to<br>Section 302 of<br>the<br>Sarbanes-Oxley<br>Act of 2002.  | *  |
| 32.1    | Chief Executive<br>Officer<br>Certification<br>pursuant to 18<br>U.S.C. Section<br>1350, as<br>adopted<br>pursuant to<br>Section 906 of<br>the<br>Sarbanes-Oxley<br>Act of 2002. | ** |
| 32.2    | Chief Financial<br>Officer<br>Certification<br>pursuant to 18<br>U.S.C. Section<br>1350, as<br>adopted<br>pursuant to<br>Section 906 of<br>the<br>Sarbanes-Oxley<br>Act of 2002. | ** |
| 101.INS | XBRL Instance<br>Document.   | *  |
| 101.SCH | XBRL Schema<br>Document  | *  |
| 101.CAL | XBRL<br>Calculation<br>Linkbase<br>Document.   | *  |

|         |   |   |
|---------|---|---|
| 101.DEF | XBRL<br>Definition<br>Linkbase<br>Document.   | * |
| 101.LAB | XBRL Labels<br>Linkbase<br>Document.          | * |
| 101.PRE | XBRL<br>Presentation<br>Linkbase<br>Document. | * |

\* Filed herewith

\*\* Furnished herewith

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets at October 2, 2015 and December 31, 2014, (ii) Consolidated Statements of Operations for the three and nine months ended October 2, 2015 and September 26, 2014, (iii) Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended October 2, 2015 and September 26, 2014, (iv) Consolidated Statements of Cash Flows for the nine months ended October 2, 2015 and September 26, 2014, and (v) Notes to Consolidated Financial Statements.

SIGNATURES

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

GSI Group Inc. (Registrant)

| Name                                       | Title                             | Date             |
|--|-----------------------------------|------------------|
| /s/ John A. Roush<br>John A. Roush         | Director, Chief Executive Officer | November 4, 2015 |
| /s/ Robert J. Buckley<br>Robert J. Buckley | Chief Financial Officer           | November 4, 2015 |

## EXHIBIT INDEX

| Exhibit Number | Exhibit Description   | Incorporated by Reference |         | Filing Date | Filed/<br>Furnished<br>Herewith |
|----------------|---|---------------------------|---------|-------------|---------------------------------|
|                |   | File No.                  | Exhibit |             |                                 |
| 3.1            | Certificate and Articles of Continuance of the Registrant, dated March 22, 1999.    | <del>333</del> -202597    | 3.1     | 03/09/15    |                                 |
| 3.2            | Articles of Amendment of the Registrant, dated May 26, 2005.                        | <del>333</del> -202597    | 3.2     | 03/02/15    |                                 |
| 3.3            | By-Laws of the Registrant, as amended   | <del>1000</del> -25705    | 3.2     | 04/13/10    |                                 |
| 3.4            | Articles of Reorganization of the Registrant, dated July 23, 2010.                  | <del>8000</del> -25705    | 3.1     | 07/23/10    |                                 |
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| 31.1           | Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley |                           |         |             | *                               |

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Act of 2002.

|         |   |    |
|---------|---|----|
| 31.2    | Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  | *  |
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| 101.DEF | XBRL Definition Linkbase  | *  |



Document.

|         |   |   |
|---------|---|---|
| 101.LAB | XBRL Labels<br>Linkbase<br>Document.          | * |
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