GSI GROUP INC
Form 10-K
March 10, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007

OR

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

Commission File No. 000-25705

GSI Group Inc.

(Exact name of registrant as specified in its charter)

New Brunswick, Canada	**98-0110412**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
39 Manning Road	**01821**
Billerica, Massachusetts, USA	**(Zip Code)**
(Address of principal executive offices)	

(978) 439-5511

(Registrant s telephone number, including area code)

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

Title of Class	Name of Exchange on which Registered
Common Stock, no par value	**NASDAQ**

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

None

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

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

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

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

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

Large accelerated filer ¨ Accelerated filer þ Non-accelerated filer ¨

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

The aggregate market value of the Registrant s common shares held by non-affiliates of the Registrant, based on the closing price of the common shares on The NASDAQ Stock Market on the last business day of the Registrant s most recently completed second fiscal quarter (June 29, 2007) was approximately $405,975,186 (assumes officers, directors, and all shareholders beneficially owning 5% or more of the outstanding common shares are affiliates).

There were approximately 42,161,592 of the Registrant s common shares, no par value, issued and outstanding on February 27, 2008.

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the Proxy Statement for the Registrant s 2008 Annual Meeting of Stockholders to be filed on or about April 14, 2008 are incorporated into Part III of this report.

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GSI GROUP INC.

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

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

The following trademarks and trade names of GSI Group are used in this report: WaferMark , WaferRepair , WaferTrim , CircuitTrim , SVS , MicroE® and Westwind®.

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PART I

Cautionary Note Regarding Forward-Looking Statements

Except for historical information, the matters discussed in this Annual Report on Form 10-K are forward looking statements that involve risks and uncertainties. The Company makes such forward-looking statements under the provision of the Safe Harbor section of the Private Securities Litigation Reform Act of 1995. Actual future results may vary materially from those projected, anticipated, or indicated in any forward-looking statements as a result of certain risk factors. Readers should pay particular attention to the considerations described in Part I; Item 1A of this report entitled Risk Factors. Readers should also carefully review the risk factors described in the other documents that the Company files from time to time with the Securities and Exchange Commission. In this Form 10-K, the words anticipates, believes, expects, intends, future, co and similar words or expressions (as well as other words or expressions referencing future events, conditions or circumstances) identify forward-looking statements.

Item 1. *Business*

Overview

GSI Group Inc. (GSIG or the Company) designs, develops, manufactures and sells lasers, laser systems, precision motion devices, associated precision motion control technology and systems. Our customers incorporate our technology into their products or manufacturing processes, for a wide range of applications in the industrial, electronics, semiconductor, medical and aerospace markets. Our products allow customers to make advances in materials and processing technology and to meet extremely precise manufacturing specifications, including device complexity and miniaturization. Our business consists of two segments: Precision Technology and Semiconductor Systems. These generate approximately 60% and 40% of our revenue, respectively.

We strive to create shareholder value through:

- Organic sales growth by delivering a consistent stream of successful new product launches
- Generating high levels of cash flow from operations, and
- Acquiring and successfully integrating businesses that are complementary to our core competencies.

GSI Group Inc., founded in 1968 as General Scanning, Inc., was incorporated in Massachusetts. General Scanning developed, manufactured and sold components and subsystems for high-speed micro positioning of laser beams. In 1999 General Scanning merged with Lumonics Inc., a Canadian company that developed, manufactured and sold laser-based, advanced manufacturing systems for electronics, semiconductor, and general industrial applications. GSI Lumonics Inc., the post-merger entity, incorporated under the laws of New Brunswick, Canada. In 2005, the Company renamed itself GSI Group Inc.

Industry Overview

GSI serves two primary industries or market segments precision technology and semiconductor capital equipment.

Precision Technology Segment

The Precision Technology segment sells components to original equipment manufacturers (OEMs), who then integrate our products into application specific products or systems. GSI OEM products include those based on our core competencies in laser, precision motion and motion control technology.

New product launches in this segment typically have a lead time of anywhere between three months to one year, and sometimes longer. A typical OEM customer will evaluate a GSI component before deciding to

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incorporate it into a product or system. Customers generally choose suppliers based on a number of factors, including price, product performance, the comprehensiveness of the supplier s product offering and the geographical coverage offered by the supplier. Once a GSI component has been designed into an OEM customer s product or system, there are generally high barriers to subsequent entry by competitors.

The Precision Technology segment has six major product lines. Selling prices for Precision Technology products range from $200 to $60,000.

Product Line	Key End Markets	Description
Lasers	Industrial, Electronics, Automotive, Medical, Packaging and Aerospace	Lasers used primarily for welding, cutting, drilling, surface marking, and deep engraving of metal and plastic parts for traceability and identification or performance. Applications include industrial cutting of metallic parts, drilling holes in metal for cooling aircraft engines, and cutting gemstones.
Scanners	Industrial Electronics, Aerospace and Medical Applications	High precision motors that, when coupled with a mirror, can direct a laser beam with high degrees of accuracy. Applications include product laser marking and coding, laser machining and welding, high density via hole drilling of printed circuit boards, retinal scanning, laser-based vision correction, high resolution printing, 2D or 3D imaging, and laser projection and entertainment.
Optics	Aerospace, Telecommunications	Super flat and super polished optics, and high performance mirrors primarily used with a scanner to direct a laser light. Applications include all of the above, and in addition, the deflection of laser beams in the use of aircraft gyroscopes, and bending optical light beams that transmit telecommunication data.
Printed Circuit *Board Spindles*	Electronics	High-speed air bearing spindles used in boring very small and precise holes in printed circuit boards. The printed circuit boards are used in all types of consumer electronics.
Encoders	Electronics	Linear and rotary tracking devices that measure movement at accuracy within sub-micron levels. Applications include confocal microscopes, positioning magnetic rings on hard drives to store high amounts of data and precision manufacturing and coordinate measuring systems.
Thermal Printers	Medical	Rugged paper tape printers for the medical instrumental and defibrillator markets.

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Semiconductor Systems Segment

Our Semiconductor Systems Segment designs, develops and sells production systems that process semiconductor wafers using laser beams and high precision stage technology. GSI sells manufacturing systems to integrated device manufacturers and wafer processors. GSI s systems perform laser based processing on all of the following types of semiconductors: general wafers used for logic or memory purposes, dynamic random access memory (DRAM, NAND) chips and high performance analog chips.

Semiconductor manufacturer s main technology challenge is to meet the trend toward ever shrinking circuit sizes demanded by consumers of micro-electronics like cell phones. As semiconductor manufacturers put more memory on smaller die, the two critical challenges for production system suppliers are the ability to provide systems that can process wafers with manufacturing accuracy to the sub-micron level and to increase the wafer processing throughput.

The Semiconductor systems segment has three major product lines. Selling prices for the Company s semiconductor wafer processing systems range from $150,000 to $1.5 million.

Product Line	**Key End Markets**	**Description**
WaferRepair	Semiconductor DRAM and Flash Memory chips	Wafer Repair is used to raise production yields for 300mm and 200mm DRAM and NAND wafers to commercially acceptable levels. Memory wafers have as many as 10 million individual memory cells. Each cell is tested to identify defects. These cells are extremely small on the micron level in size and distance from each other. GSI systems target defective or redundant cells in a wafer and then sever metal links embedded in the wafer substrate to remap circuits around defective cells, thus improving wafer yields. GSI wafer repair systems can sever links at upwards of 70,000 links per second.
WaferTrim	Semiconductor high performance analog and mixed signal devices	Wafer Trim systems enable production of high performance integrated circuits(IC s) by precisely trimming analog and mixed signal integrated circuits with a laser beam to achieve a specified electrical resistance. A range of IC s that utilize unique production technology including applications for the automotive industry for anti-lock brakes, engine controls and airbags and power management for portable consumer electronics.
WaferMark	Semiconductor Silicon suppliers and IC Fabs	WaferMark systems are used to mark silicon wafers with characters or markings at various stages of the wafer and integrated circuit manufacturing process. The marks are designed to aid process control and device traceability.

The Semiconductor Systems segment also includes two smaller product lines, CircuitTrim and SVS. CircuitTrim systems are used in the production of thick and thin film resistive components for surface mount technology electronic circuits, known as chip resistors, as well as thick and thin film hybrid circuits, and for adjusting the performance of complete multi-chip modules. SVS inspection equipment is used to inspect pre- and post- reflow solder paste and component placement on printed circuit boards.

Products and Services

Our revenues in 2007 were derived from the following business segments, in millions of United States dollars:

Segment	Revenue
Precision Technology Business	$ 188.3
Semiconductor Systems Business	134.4
Intersegment sales eliminations(1)	(4.9)
Total	$ 317.8

(1) Sales of Precision Technology products to Semiconductor Systems segment.

Customers

We have a diverse group of customers that includes some of the largest global leaders in their industries. Many of our customers participate in several market segments. In 2007, 2006 and 2005, revenue from our top 25 customers totaled 45.4%, 47.6% and 41.5% of our total revenue, respectively. In 2007, 2006 and 2005, no one customer accounted for more than 10% of sales.

Manufacturing

We manufacture Precision Technology products at facilities in Billerica and Natick, Massachusetts, Moorpark, California, Poole, Rugby and Taunton, United Kingdom, and Suzhou, China. Semiconductor Systems are manufactured, assembled and tested in Wilmington, Massachusetts. Most of our products are manufactured under ISO 9001 certification. Manufacturing functions are performed internally when management chooses to maintain control over critical portions of the production process or for cost related reasons. To the extent practical, we outsource the remaining portions of the production process. The Semiconductor Systems segment focuses on outsourcing low value parts and modules and internally retains the tasks of final assembly of subsystems, testing and quality control.

In 2008, we will be consolidating our Billerica, Natick and Wilmington Massachusetts facilities into a single 147,000 square foot facility located in Bedford, Massachusetts. The Company expects to incur approximately $11.5 million of costs to retrofit, furnish and move into the Bedford facility. This work and move is expected to be completed by June 2008.

Research and Development

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

In 2007, 2006 and 2005 respectively, we incurred research and development expenses of $30.5 million or 9.6% of sales, $30.6 million or 9.8% of sales and $25.7 million or 9.8% of sales, respectively.

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Marketing, Sales and Distribution

We sell worldwide with a direct sales force and through distributors and sales agents. Individual product managers are responsible for determining product strategy based on knowledge of the industry, customer requirements and product performance. These managers have direct contact with customers and, working with the sales and customer service organizations, develop and implement strategic and tactical plans aimed at serving the needs of existing customers as well as identifying new opportunities.

Precision Technology products are sold worldwide mostly through direct sales, as well as through distributors, primarily to OEMs. Precision Technology businesses have sales and service centers located in Massachusetts, Michigan, California, United Kingdom, Germany, Switzerland, Taiwan, China, Singapore and Japan. Sumitomo Heavy Industries Ltd. (a significant shareholder of the Company) is a key distributor for certain products in Japan. Because of the fundamental nature and relatively small physical size of the products, Precision Technology generally employs a factory direct strategy in support of its worldwide customer base except in its Laser product line where parts and field technical support is significant.

Semiconductor Systems are sold directly, or, in some territories, through distributors. End users include semiconductor integrated device manufacturers or electronic component and assembly firms. Sales activities are directed from the product business unit sites in North America, Europe, Japan and Asia Pacific. Field offices are located close to key customers manufacturing sites to maximize sales and support effectiveness. Significant revenues are provided from parts and servicing systems in our installed base at customer locations. We maintain field offices in Germany, Japan, South Korea, China, Taiwan and Singapore.

Competition

The industries GSI participates in are dynamic and highly competitive. Competitive factors in our Precision Technology Segment include product performance, quality, features, flexibility, technical support, product breadth, market presence and on-time delivery. The main competitive factors in the Semiconductor Systems Segment include product performance, throughput and total cost of ownership. We believe that our products offer a number of competitive advantages; however, some of our competitors are substantially larger and have greater financial and other resources than we do.

The table below illustrates the competition or lack thereof, faced by the Company in the markets that we serve.

Segment	Product Line	Main Competitor(s)
Precision Technology	Lasers	Trumpf-Haas, Rofin-Sinar, Coherent, Spectra Physics, Lambda Physik, Unitek-Miyachi, IPG Photonics and Lasag.
	Scanners	Excel Technology, Scanlabs GmbH
	Optics	Fragmented among numerous suppliers.
	Printed circuit board spindles	ABL (50% owned by Hitachi), Mechatronics, Precise and Jevco.
	Encoders	Renishaw and Heidenhain
	Thermal Printers	Advanced Printing Solutions
Semiconductor Systems	All semiconductor product lines	Electro Scientific Industries, Shibaura, Omron, CyberOptics, Koh Young and Innolas.

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Sources of Supply

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

In the Precision Technology Segment we manufacture many of our own parts, particularly in the air bearing spindle business. However, non-critical machined parts are often purchased externally. We also purchase fully-functional electronics as well as certain key components, such as laser diodes, from external sources, and we cannot guarantee that those suppliers will continue to perform in satisfactory fashion.

In the Semiconductor Systems Segment, we purchase major subsystems, such as lasers, motion stages, vision systems and software, fully-functional electronics and frames and racks, from the merchant market. Our optics components are both internally manufactured and externally purchased. In some cases, upper level assemblies and entire systems are outsourced to electronic manufacturing services companies.

Patents and Intellectual Property

Our intellectual property includes copyrights, patents, trademarks and tradenames involving proprietary software, technical know-how and expertise, designs, process techniques and inventions. We currently hold beneficial ownership of 222 United States and 182 foreign patents; with applications pending for 88 United States and 240 foreign patents. We have also obtained licenses under a number of patents in the United States and foreign countries. Licenses under additional patents may be required in the future. There can be no assurance as to the degree of protection offered by our patents or as to the likelihood that additional patents will be issued under our pending applications.

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

Human Resources

Employees by area:

	Number of Employees	Percentage
Production operations and field service	897	66%
Research and development	171	13%
Selling, general and administrative	295	21%
Total at December 31, 2007	1,363	100%

Government Regulation

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

Other

Information concerning product lines, backlog, working capital and research and development expenses may be found in Item 7, Management Discussion and Analysis. Information about geographic segments may be found in note 13 to the financial statements.

Available Information, Website and Access to Financial Filings

The Company files annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 as amended (Exchange Act). Our SEC filings are available on the Internet at the SEC s website at http://www.sec.gov. You may also access any document we have filed by visiting the SEC s public reference room in Washington, D.C. Please call the SEC at 1-800-SEC-0330 for further information about the public reference rooms. Financial and other information relating to the Company can also be accessed from the Company s Internet website at http://www.gsig.com/investors/. Information on, or linked to, our website is not part of this Annual Report on Form 10-K. The Company makes available, free of charge, copies of its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act as soon as reasonably practicable after filing such material electronically or otherwise furnishing it to the SEC. In addition, our reports and other information are filed with securities commissions or other similar authorities in Canada, and are available over the Internet at http://www.sedar.com.

Additionally, the Company posts a copy of its Code of Ethics on the Company website at http://www.gsig.com/about.

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

The statements contained in this report that are not statements of historical fact, including without limitation statements containing the words believes, expects, anticipates, and similar words, constitute forward-looking statements that are subject to a number of risks and uncertainties. We make forward-looking statements from time to time. Investors are cautioned that forward-looking statements are subject to an inherent risk that actual results may be different.

The following information highlights some of the factors that could cause actual results to differ materially from the results expressed or implied by our forward-looking statements. Forward-looking statements should be considered in light of these factors. Factors that may result in such variances include, but are not limited to the following:

Market Volatility

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

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of order levels or results of operations for following periods. We can not assure investors that demand for our products will increase or that demand will not decrease. For the foreseeable future, our operations will continue to depend upon these industries, which, in turn, depend upon the market demand for their products.

Cyclical variations may have the most pronounced effect on our Semiconductor Systems Segment which has a concentration in the semiconductor and electronics industries. There is no assurance that we will not be impacted from a slowdown as we have experienced in previous cyclical fluctuations or that the impact will be more or less significant compared to historical fluctuations.

Our business success depends upon our ability to respond to fluctuations in product demand. If business declines, we may be required to reduce costs while at the same time maintaining the ability to motivate and retain key employees. We must also continually invest in research and development which may inhibit our ability to reduce costs in a down cycle. Additionally, long product lead-times create a risk that we may purchase or manufacture inventories of products that we are unable to sell. While we practice inventory management we can offer no assurances that our efforts to mitigate this risk will be successful.

During a period of increasing demand and rapid growth, we must be able to increase manufacturing capacity quickly. Our inability to quickly increase production in response to a surge in demand could harm our reputation, and, prompt customers to look for alternative sources of supply.

New Product Introduction

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

Delays in delivery of new products could have a negative impact on our business. Our research and development efforts may not lead to the successful introduction of products within the time period our customers demand. Additionally, our competitors may introduce new or improved products, processes or technologies that make our current or proposed products obsolete or less competitive.

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

- Changing product specifications and customer requirements;
- The inability to manufacture products cost effectively;
- Difficulties in reallocating engineering resources and overcoming resource limitations;
- Changing market or competitive product requirements; and
- Unanticipated engineering complexities.

New products often take longer to develop, have fewer features than originally considered desirable and achieve higher cost targets than initially estimated. There may be delays in starting volume production of new products and/or new products may not be commercially successful.

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Financial Matters

There may be a failure to properly identify when revenue should be recognized, leading to a material adverse effect on financial results. The Company has multiple locations, in various countries, where orders are entered. Entry, shipment and invoicing of an order that is premature, may result in revenue being recognized earlier than required by generally accepted accounting principles. To mitigate this risk, the Company reviews large semiconductor orders for revenue recognition issues before they are booked. Additionally, the Company is putting in place more stringent processes to identify revenue recognition treatment on all orders.

Failure of internal controls or inability to identify or manage a key internal control could have a material adverse effect on our operating results. We mitigate this risk by employing internal auditors to document and test our internal control procedures pursuant to Section 404 of the Sarbanes-Oxley Act. If we fail to achieve and maintain the adequacy of our internal controls, we may not be able to conclude that we have effective internal controls over financial reporting in accordance with Section 404. Effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, as investors could lose confidence in our reported financial information.

Our tax rates are subject to fluctuation, which could impact our financial position, and our estimates of tax liabilities may be subject to audit, which could result in additional tax assessments. Our effective tax rates are subject to fluctuation as the income tax rates for each year are a function of taxable income levels in numerous tax jurisdictions, our ability to utilize recorded deferred tax assets, taxes or penalties resulting from tax audits and credits and deductions as a percentage of total taxable income. Further, tax law changes may cause our effective tax rates to fluctuate between periods.

Customer order timing and other factors beyond our control may lead to an inability to meet our financial forecasts. Factors include:

- Fluctuations in our customers businesses;
- Timing and recognition of revenues from customer orders;
- Timing and market acceptance of new products or enhancements introduced by us or our competitors;
- Availability of parts from our suppliers and the manufacturing capacity of our subcontractors;
- Timing and level of expenditures for sales, marketing and product development;
- Changes in the prices of our products or of our competitors products; and
- Fluctuations in exchange rates for foreign currency.

A large percentage of our sales come from products with high selling prices and significant lead times. We may receive several large orders in one quarter from a customer and then receive no orders from that customer in the next quarter. As a result, the timing and recognition of sales from customer orders can cause significant fluctuations in our operating results from quarter to quarter.

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

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

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GSI maintains large cash balances and foreign exchange contracts where significant changes in interest rates, credit ratings or foreign currency rates could result in materially adverse effects to income. The Company has a strong cash balance and there are exposures to foreign exchange that total in the millions of dollars. These balances create financial exposure to changing interest and currency rates. The Company has attempted to mitigate these risks by both purchasing foreign exchange contracts and investing in government issued treasury bills. However, if long term interest rates or foreign currency rates were to change rapidly, the Company could incur material losses. Further, if management chooses to invest in less risk adverse investment vehicles, the risk of losing principle and/or interest could increase.

International Operations

Our operations in foreign countries subject us to risks not faced by companies operating exclusively in the United States. During the year ended December 31, 2007, approximately 72% of our revenue was derived from operations outside North America. International operations are an expanding part of our business both from a sales focus and an operating base.

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

- Foreign exchange rate fluctuations;
- Social unrest in countries where we operate;
- Climatic or other natural disasters in regions where we operate;
- Increases in shipping costs or increases in fuel costs;
- Longer payment cycles;
- Acts of terrorism;
- Greater difficulty in collecting accounts receivable;
- Use of incompatible systems and equipment;
- Problems staffing and managing foreign operations in diverse cultures;
- Protective tariffs;
- Trade barriers and export/import controls;
- Transportation delays and interruptions;

- Reduced protection for intellectual property rights in some countries; and

- The impact of recessionary foreign economies.

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

There are inherent risks as we increase our focus on overseas operations. This includes the possibility that as operations are transferred or expanded in foreign locations, we may not be able to produce products to the quality standards or deliver products on time as our customers have come to expect. This possibility may come about due to an inability to find qualified personnel overseas. It is also possible that after an overseas transition, we may find that we have been producing products with latent defects that come to light only after a long period of operation. Transitioning a business to an overseas location has many additional risks such as developing solid financial, ERP and CRM systems.

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Economic, political or trade problems with foreign countries could negatively impact our business. We are increasingly outsourcing the manufacture of sub assemblies to suppliers based in China and elsewhere overseas. Economic, political or trade problems with foreign countries could substantially impact our ability to obtain critical parts needed in the manufacture of our products.

Customs rules are complex and vary within legal jurisdictions in which we operate. Failure to comply with local customs regulations could be found during a foreign government customs audit that may produce a substantial penalty. We mitigate this risk by maintaining an internal customs staff charged with the responsibility of strictly complying with all applicable import/export laws, and shipping to bonded warehouses, when applicable. Further, we maintain arms-length transactions with our foreign subsidiaries and their customers. There can be no assurance, despite these precautions, that there will be no control failure around customs enforcement. A failure could result in a material impact on our financial results.

Economic Conditions

A halt in economic growth or a slowdown will put pressure on our ability to meet anticipated revenue levels. A large portion of our sales is dependent on the need for increased capacity or replacement of inefficient manufacturing processes, because of the capital-intensive nature of our customers businesses. These sales also tend to lag behind in an economic recovery longer than other businesses. If a down turn lasts longer than expected, if a recovery does not begin or if a general economic slowdown commences, we may not be able to meet anticipated revenue levels on a quarterly or annual basis.

Sustainable Profitability

If the Company is not able to grow, the business will be at greater risk to operate independently. As a publicly traded company, GSI is competing for capital and investment against larger companies. As a company with a relatively low level of stock capitalization, GSI is at a disadvantage. Its cost of capital is higher than larger companies and it has less of a base to spread the operating costs that all public companies face. Examples of these costs include Sarbanes-Oxley and audit costs. If GSI can not grow its revenues and spread these costs across a larger revenue base, it will be at a competitive disadvantage and potentially subject to a takeover bid from a larger company. We can not assure investors such a situation would be in shareholders best interests.

GSI has a history of operating losses. The Company may not be able to sustain or grow the current level of profitability. Since the second half of 2003, we have consistently generated profits from operations. However, we incurred operating losses on an annual basis from 1998 through 2003. No assurances can be given that we will sustain or increase the level of profitability in the future and the market price of our common shares may decline as a result.

We will lose the benefit of our significant recorded deferred tax assets if our future profitability comes into question. In determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets require subjective judgment and analysis. We consistently evaluate our current deferred tax assets based on profitability in 2007 and beyond. Our ability to maintain our deferred tax assets at December 31, 2007 depends upon our ability to continue to generate future profits in the United States, Canada, Germany, Japan and United Kingdom tax jurisdictions. If actual results differ from our plans or we do not achieve the desired level of profitability in a given jurisdiction, we may be required to increase the valuation allowance on our tax assets by taking a charge to the Statement of Operations, which could have a material negative result on our financial results.

Business Partnerships

Our reliance upon third party distribution channels subjects us to credit, inventory, business concentration and business failure risks beyond our control. We sell products through resellers, distributors, OEMs and system integrators. This subjects us to credit and business risks. Our sales also depend upon the ability of our OEM

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customers to develop and sell systems that incorporate our products. Adverse economic conditions, large inventory positions, limited marketing resources and other factors influencing these OEM customers could have a substantial impact upon our financial results. We can not assure investors that our OEM customers will not experience financial or other difficulties that could adversely affect their operations and, in turn, our financial condition or results of operations.

Intellectual Property

We are exposed to the risks that others may violate our intellectual property rights. Our future success depends in part upon our intellectual property rights, including trade secrets, know-how and continuing technological innovation. There can be no assurance that the steps we take to protect our intellectual property rights will be adequate to prevent misappropriation, or that others will not develop competitive technologies or products outside of our patented property. There can be no assurance that other companies are not investigating or developing other technologies that are similar to ours, that any patents will issue from any application filed by us or that, if patents do issue, the claims allowed will be sufficiently broad to deter or prohibit others from marketing similar products. In addition, there can be no assurance that any patents issued to us will not be challenged, invalidated or circumvented in a legal or administrative proceeding, or that our patents and know how will provide a competitive advantage to us.

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

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

Competition

We operate in highly competitive industries, and if we lose competitive advantages, our business would suffer adverse consequences. Some of our competition comes from established competitors, some of which have greater financial, engineering, manufacturing and marketing resources than we do. Our competitors will continue to improve the design and performance of their products and introduce new products. It is possible that we may not successfully differentiate our current and proposed products from the products of our competitors, or that the marketplace will not consider our products to be superior to competing products. To remain competitive, we will be required to invest heavily in research and development, marketing and customer service and support. It is also possible that we may not be able to make the technological advances necessary to maintain our competitive position, or our products will not receive market acceptance. We may not be able to compete successfully in the future, and increased competition may result in price reductions, reduced profit margins, loss of market share and an inability to generate cash flows that are sufficient to maintain or expand our development of new products.

Mergers and Acquisitions

Our business strategy includes finding and making strategic acquisitions. There can be no assurance that we will be able to continue to make acquisitions that provide business benefit. In 2007, we acquired a business in the UK. We expect to continue to evaluate potential acquisitions. Our identification of suitable acquisition

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candidates involves risks inherent in assessing the values, strengths, weaknesses, risks, synergy and profitability of acquisition candidates, including the effects of the possible acquisition on our business, diversion of management s attention from our core businesses and risks associated with unanticipated problems or liabilities. We cannot assure investors our efforts will be sufficient, or that acquisition candidates will be receptive to our advances or that any acquisition we may make would be accretive to earnings.

Integrating an acquisition could have significant disruptive consequences on our existing operations. As with any acquisition, those persons selling have an advantage in better understanding the specific markets and their associated direction. They also better know the strengths and weaknesses of the business they are selling. We attempt to mitigate these risks by focusing our attention on the acquisition of businesses, technologies and products that have current relevancy to our existing lines of business and that are complementary to our existing product lines. However, we may not be successful in addressing these risks, or the risks associated with the potential entrance into markets in which we have limited or no prior experience. We could lose key employees, particularly those of the acquired business, in connection with an acquisition.

Key Personnel

GSI is undergoing a leadership transition. In 2007, the Company has begun to change its management structure. Although the Company will still operate in two segments, the management structure is going from four primary general managers to nine product line managers. There are risks associated with possible changes in strategy at the executive and/or director level, and changes in product or operational focus. There can be no assurance that prospective management changes will not have a material effect on the Company.

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

Changes in accounting for equity compensation could adversely affect earnings. The Financial Accounting Standards Board has issued changes to U.S. generally accepted accounting principles requiring us and other companies to record a charge to earnings for employee stock grants and other equity incentives. Moreover, applicable stock exchange listing standards relating to obtaining shareholder approval of equity compensation plans could make it more difficult or expensive for us to grant equity awards such as options or restricted stock to employees in the future. As a result, we may incur increased compensation costs, change our equity compensation strategy or find it difficult to attract, retain and motivate employees, any of which could materially adversely affect our business.

Our reputation and our ability to do business may be impaired by improper conduct by any of our employees, agents or business partners. We cannot provide assurance that our internal controls will always protect us from reckless or criminal acts committed by our employees, agents or business partners that would violate US and/or non-US laws, including the laws governing payments to government officials, competition, money laundering and data privacy. Any such improper actions could subject us to civil or criminal investigations in the US and in other jurisdictions, and could lead to substantial civil or criminal, monetary and non monetary penalties against us or our subsidiaries.

Operations

We expect to be consolidating some of our operations for greater efficiency. There is execution risk in these plans. Historically, GSI operated as several independent business divisions, each with a separate management, finance, sales and operating structure. The new strategy requires greater consolidation and integration. We can not assure investors that economies of scale will or can be realized as a result of the planned consolidation. This

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move will take time and will include substantial operational risks, including disruption of manufacturing lines. We can not assure investors that any moves would not disrupt business operations or have a material impact on results.

In addition, any decision to limit investment in, dispose of or otherwise exit business activities may result in the recording of special charges, such as technology write-offs, workforce reduction costs, or charges relating to consolidation of excess facilities. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including intangible assets, could change as a result of such decisions. Further, our estimates related to the liabilities for excess facilities are affected by changes in real estate market conditions. Additionally, we are required to perform goodwill impairment tests on an annual basis and during the year in certain circumstances. There can be no assurance that future goodwill impairment tests will not result in a change to earnings.

We have recently undergone a significant restructuring and we will continue to change our management structure. Our ability to reduce operating expenses is dependent upon the nature of the actions we take to reduce expense and subsequent ability to implement those actions and realize expected cost savings. In the past year, management took significant actions to expand our operations in China and to reduce expenses, particularly in the UK. There can be no assurance that these actions will provide economic benefit to the Company. Further, there is a risk that these actions may ultimately prove detrimental to operations and sales, or to our intellectual property protections.

Product defects or problems with integrating our products with other vendors products may seriously harm our business and reputation. Complex products that we produce can contain latent errors or performance problems. There have been instances where we have found errors immediately after launch of new products and we have also found latent errors in our products. We can not always resolve all errors that we believe would be considered serious by our customers before implementation, thus our products are not error-free. These errors or performance problems could be detrimental to our business and reputation. In addition, customers frequently integrate our products with other vendor s products. When problems occur in a combined environment, it may be difficult to identify the source of the problem. These problems may cause us to incur significant warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relations problems. To date, defects in our products or those of other vendors products with which our products are used by our customers have not had a material negative effect on our business. However, we cannot be certain that a material negative impact will not occur in the future.

We depend on limited source suppliers that could cause substantial manufacturing delays if supply disruption occurs. Many of our products are manufactured with components that are designed by an outside supplier specifically to our design. While we attempt to mitigate risks associated with our reliance on single suppliers by actively managing our supply chain, we still source some components from single vendors. We also rely on a limited number of independent contractors to manufacture subassemblies for some of our products, particularly in our Semiconductor Systems. There can be no assurance that our current or alternative sources will be able to continue to meet all of our demands on a timely basis. If suppliers or subcontractors experience difficulties, or fail to meet any of our manufacturing requirements, our business would be harmed until we are able to secure alternative sources, if any, on commercially reasonable terms.

We also depend on suppliers that provide high precision parts. Any of these parts that have latent or known defects, may materially impact relations with our customers if they cause us to miss our scheduled shipment deadlines. If latent defects are incorporated into our products and discovered later, there could be material impact on our revenues. We seek to reduce the risk of defects by selecting and qualifying alternative suppliers for key parts, and by monitoring the quality of products coming from key suppliers.

Production difficulties and product delivery delays could materially adversely affect our business. We assemble our products at our facilities in the United States, the United Kingdom and China. If use of any of our

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manufacturing facilities was interrupted by natural disaster or otherwise, our operations could be negatively impacted until we could establish alternative production and service operations. In addition, we may experience production difficulties and product delivery delays in the future as a result of:

- Mistakes made while transferring manufacturing processes between locations
- Changing process technologies;
- Ramping production;
- Installing new equipment at our manufacturing facilities; and
- Shortage of key components.

Governance

Certain provisions of our articles of incorporation may delay or prevent a change in control of our company. Our corporate documents and our existence as a corporation under the laws of New Brunswick subject us to provisions of Canadian law that may enable our board of directors to resist a change in control of our company. These provisions include:

- Staggered board of directors;
- Limitations on persons authorized to call a special meeting of stockholders;
- Advance notice procedures required for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of stockholders; and
- A shareholder rights plan.

These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for stockholders to elect directors of their choosing and cause us to take other corporate actions that stockholders desire.

Political and Governmental

Increased governmental regulation of our business could materially adversely affect our business. We are subject to many governmental regulations, including but not limited to the laser radiation safety regulations of the Radiation Control for Health and Safety Act administered by the National Center for Devices and Radiological Health, a branch of the United States Food and Drug Administration, and certain health regulations related to the manufacture of products using beryllium, an element used in some of our structures and mirrors. Among other things, these regulations require us to file annual reports, to maintain quality control and sales records, to perform product testing, to distribute appropriate operating manuals, to incorporate design and operating features in products sold to end-users and to certify and label our products. Various warning labels must be affixed and certain protective devices installed depending on the class of product. We are subject to regulatory oversight, including comparable enforcement remedies, in the markets we serve.

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

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

Not applicable

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Item 2. ***Properties***

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

Location	Principal Use	Current Segment	Approximate Square Feet	Owned/Leased
Facilities				
Billerica, Massachusetts, USA	Manufacturing, R&D, Marketing, Sales, Administrative and Corporate	1, 3	90,000 (two sites)	Leased; both expire in 2008
Natick, Massachusetts, USA	Manufacturing, R&D, Marketing and Sales	1	24,000 (two sites)	Leased; both expire in 2008
Bedford, Massachusetts, USA	Not yet occupied - being retrofitted for occupancy in the summer of 2008	1,2,3	147,000	Leased; expires in 2020, with two five-year renewal options
Moorpark, California, USA	Manufacturing, R&D, Marketing and Sales	1	49,000 (three sites)	Leased; all expire in 2010, all with 5-year renewal options
Novi, Michigan USA	Customer support, Marketing and Sales	1	13,000	Leased; expires in 2012
Poole, United Kingdom	Manufacturing, R&D, Marketing, Sales and Administrative	1	109,000 (three sites)	3 units owned; 2 units with land leases through 2073 and 2078, respectively
Rugby, United Kingdom	Manufacturing, R&D, Marketing, Sales and Administrative	1	113,000	Owned; approximately 14% of the space is leased through 2012 and 2014
Taunton, United Kingdom	Manufacturing, R&D, Marketing and Sales	1	19,000	Leased; expires in 2017
Wilmington, Massachusetts, USA	Manufacturing, R&D, Marketing and Sales	2	78,000	Leased; expires in 2008
Suzhou, People s Republic of China	Manufacturing, R&D, Marketing, Sales and Administrative	1	55,000	Leased; expires in 2008

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

1 Precision Technology Group

2 Semiconductor Systems Group

3 Corporate

Additional research and development, sales, service and logistics sites are located in Colorado, Switzerland, Germany, Japan, Korea, Taiwan and China. These additional offices are in leased facilities occupying approximately 41,000 square feet in the aggregate.

At December 31, 2007, the Company has two of its properties in Poole UK available for sale. The buildings are approximately 65,000 square feet of space. The Company has received expressions of interest in both properties.

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The Company leases a 29,000 square foot building in Munich, Germany. As a result of prior year restructuring activities this building was more space than the Company needed in this location. In 2007 this building was fully sub-let through the end of the lease in 2013.

On November 1, 2007, the Company signed a 12 year lease for a 147,000 square foot facility in Bedford, Massachusetts. The Company intends to consolidate the Natick, Billerica and Wilmington operations into the Bedford facility. The Company is undertaking extensive renovations of this facility which are expected to cost $11.3 million and expects to be completed with the project in 2008.

Item 3. ***Legal Proceedings***

In March 2007, the Company and Lumenis Ltd. settled a dispute that began in 2005 over representations made to the Company by Lumenis, prior to the Company s acquisition of certain Lumenis product lines. A settlement of the Company s claim resulted in a cash payment from Lumenis to the Company. A portion of the payment was applied in full satisfaction of a receivable from Lumenis. The remainder ($2.0 million) was recorded as an offset to selling, general and administrative expenses in 2007, as it represents a recovery of previously expensed amounts.

The Company s French subsidiary (GSI France) is subject to a claim by SCGI, a customer of the French subsidiary, that a Laserdyne 890 system delivered in 1999 had unresolved technical problems. In May 2001, the Le Creusot commercial court determined that the machine breached its warranty. An expert appointed by the court estimated the cost to repair at approximately ₣ 800,000, and SCGI thereafter repaired the system after advancing the repair costs itself. In the third quarter of 2003, the Company was notified that SCGI was seeking aggregate damages of 1.9 million. In July 2004, a court appointed expert estimated the actual damages at 900,000.

SCGI had previously withheld 300,000 of the purchase price, which the Company argued should offset against any damages. On April 18, 2006, the court fixed SCGI s claim at 598,079, plus court costs and expert fees of 85,945. SCGI accepted the court s determination. Since then, SCGI has been appointed Controller by the bankruptcy court with general supervisory responsibilities during the liquidation. SCGI is now demanding that the Liquidator bring an action against GSI Group Ltd. in the UK based on two possible causes of action: that GSI France was financed by a third party (not a related group party) to misrepresent its solvency to customers, including SCGI; or alternatively, that GSI France had no independent identity apart from its parent corporation (akin to piercing the corporate veil under US common law). The Company is not aware of any facts to support either legal theory. The Company s French counsel is addressing these points directly with the Liquidator.

The Company is also subject to various legal proceedings and claims that arise in the ordinary course of business. The Company does not believe that the outcome of these claims will have a material adverse effect upon the Company s financial conditions 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 the Company s financial condition or results of operations.

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

No matters were submitted to a vote of security holders during the quarter ended December 31, 2007.

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PART II

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

Market Information

Our common shares, no par value, trade on The NASDAQ Stock Market under the symbol GSIG . The following table sets forth the high and low sales prices during the periods indicated.

	2007		2006	
	High	**Low**	**High**	**Low**
First Quarter	$ 9.96	$ 8.26	$ 13.47	$ 10.77
Second Quarter	10.80	9.59	11.43	8.59
Third Quarter	11.30	9.34	9.48	7.89
Fourth Quarter	11.57	9.10	10.18	8.99

Holders

As of the close of business on, February 29, 2008, there were approximately 100 holders of record of our common shares. Since many of the common shares are registered in nominee or street names, we estimate that the total number of beneficial owners is considerably higher.

Dividends

We have never declared or paid cash dividends on our common shares. We currently intend to retain any current and future earnings to finance the growth and development of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table gives information about the Company s common shares that may be issued upon the exercise of options, Warrants and rights under all of its existing equity compensation plans as of December 31, 2007, the Company s most recently completed fiscal year, including the 2006 Equity Incentive Plan, 1995 Award Plan, the 1981 stock option plan of General Scanning, Inc., the 1992 stock option plan of General Scanning, Inc., the Warrants (as described below) and the Company s employee stock purchase plan.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options/Warrants	Weighted-Average Exercise Price of Outstanding Options/Warrants	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in First Column)
Plans approved by shareholders	1,187,623(1)	$ 10.35	892,066
Plans not approved by shareholders (the Warrants)	40,410	$ 13.58	
Total	1,228,033(1)	$ 10.46	892,066

(1) Does not include 1,166,549 shares of restricted common stock issued under the 2006 Equity Incentive Plan, since shares are issued and outstanding.

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

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Purchases of Equity Securities by the Issuer

The following table provides information about purchases by the Company during the year ended December 31, 2007 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Period	Total Number of Shares Purchased in 2007	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Programs	Maximum Approximate Dollar Value that May Yet be Purchased Under Plans or Programs
March 5 March 23, 2007	50,000	$ 9.47	431,300	$ 10,753,730
April 2 April 17, 2007	21,000	9.82	452,300	10,547,480
May 4 May 22, 2007	8,000	9.94	460,300	10,467,929
July 3 July 13, 2007	18,000	9.68	478,300	10,293,695
August 9 August 30, 2007	121,000	9.62	599,300	9,129,978
September 4 September 18, 2007	32,000	9.91	631,300	8,812,787
October 30 October 31, 2007	19,000	9.51	650,300	8,632,023
November 1 November 30, 2007	301,830	9.56	952,130	5,745,145
December 3 December 21, 2007	246,000	9.60	1,198,130	3,383,279
Total	**816,830**		**1,198,130**	**$ 3,383,279**

All of the purchases shares noted above were made on the open market at prevailing prices using the Company s available cash. The Stock Repurchase Program was announced on December 21, 2005 and provides for the repurchase of up to $15.0 million of the Company s common shares.

NASDAQ Listing Requirements

The Company is subject to the listing requirements of the NASDAQ Global Market.

Performance Graph

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

The following selected consolidated financial data as of and for the five years ended December 31, 2007 is derived from our audited consolidated financial statements. This information should be read together with consolidated financial statements of GSI Group Inc., including the related notes, and Management s Discussion and Analysis of Financial Condition and Results of Operations. The selected consolidated financial data in this section is not intended to replace the consolidated financial statements.

	Years Ended December 31,				
	2007	2006	2005	2004	2003
	(In thousands except per share amounts)				
Condensed Consolidated Statement of Operations:					
Sales	$ 317,800	$ 313,609	$ 260,784	$ 330,012	$ 185,561
Gross profit	126,720	130,161	103,870	133,439	68,477
Operating expenses:					
Research and development and engineering	30,489	30,639	25,671	23,975	13,822
Selling, general and administrative, and other	60,126	64,199	59,640	57,256	49,856
Amortization of purchased intangibles	6,810	6,794	6,656	5,951	5,657
Acquired in-process research and development				390	
Restructuring	6,649	110	457	573	3,228
Income (loss) from operations	22,646	28,419	11,446	45,294	(4,086)
Other income (expense)	7,115	2,385	2,418	(308)	2,238
Income (loss) before income taxes	29,761	30,804	13,864	44,986	(1,848)
Income tax provision (benefit)	10,717	9,061	4,207	3,515	322
Net income (loss)	$ 19,044	$ 21,743	$ 9,657	$ 41,471	$ (2,170)
Net income (loss) per common share:					
Basic	$ 0.45	$ 0.52	$ 0.23	$ 1.01	$ (0.05)
Diluted	$ 0.45	$ 0.51	$ 0.23	$ 0.98	$ (0.05)
Weighted average common shares outstanding (000 s)	42,364	41,896	41,548	41,124	40,837
Weighted average common shares outstanding for diluted net income (loss) per common share (000 s	42,645	42,251	41,856	42,125	40,837

	December 31,				
	2007	2006	2005	2004	2003
	(In thousands)				
Balance Sheet Data:					
Working capital	$ 289,775	$ 247,500	$ 207,060	$ 174,660	$ 174,854
Total assets	440,210	411,405	373,444	386,164	313,707
Long-term liabilities, excluding current portion	17,221	25,029	25,578	23,607	5,594
Total stockholders equity	374,117	343,073	306,556	305,563	260,788

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

We intend for this discussion and analysis to provide you with information that will assist you in understanding our consolidated financial statements, the changes in certain key items in those consolidated financial statements from year to year and the primary factors that accounted for those changes. Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. This discussion and analysis should be read in conjunction with our consolidated financial statements as of December 31, 2007 and for the year then ended and the notes accompanying those consolidated financial statements. This report contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those indicated in the forward-looking statements. See Part I for the special note regarding forward looking statements.

Overview

We design, develop, manufacture and sell enabling technology components, lasers and advanced laser systems for a wide range of applications. Our products allow customers to make advances in materials and process technology and to meet demanding manufacturing specifications, including device complexity and miniaturization. Our products are used to enable and boost efficiency and productivity in the global industrial, electronics, semiconductor, aerospace and medical markets.

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

	Year Ended December 31, 2007	2006	2005
Sales	100.0%	100.0%	100.0%
Cost of goods sold	60.1	58.5	60.2
Gross profit	39.9	41.5	39.8
Operating expenses:			
Research and development	9.6	9.8	9.8
Selling, general and administrative and other	18.9	20.4	22.8
Amortization of purchased intangibles	2.1	2.2	2.6
Restructuring	2.1		0.2
Operating expenses	32.7	32.4	35.4
Income (loss) from operations	7.2	9.1	4.4
Other income (expense)			(0.1)
Interest income	2.1	1.5	0.8
Interest expense		(0.3)	(0.1)
Foreign exchange transaction (losses) gains	0.1	(0.5)	0.3
Income (loss) before income taxes	9.4	9.8	5.3
Income tax provision (benefit)	3.4	2.9	1.6
Net income (loss)	6.0%	6.9%	3.7%

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2007 Compared to 2006

Sales by Segment. The following table sets forth sales by business segment for 2007 and 2006.

All dollars in millions	2007 Sales	2006 Sales	Increase (Decrease)
Precision Technology	$ 188.3	$ 196.7	$ (8.4)
Semiconductor Systems	134.4	127.6	6.8
Intersegment sales eliminations(1)	(4.9)	(10.7)	5.8
Total	$ 317.8	$ 313.6	$ 4.2

(1) Sales of Precision Technology products to Semiconductor systems segment

Sales. Increased $4.2 million or 1.3% in 2007 compared to 2006. Sales increased primarily as a result of a favorable semiconductor capital equipment cycle and new model introductions in our WaferRepair product line.

Sales in the Precision Technology segment decreased $8.4 million or 4.3% in 2007 to $188.3 million. The reduction is partially due to lower intersegment sales to the Semiconductor System Group along with lower volumes. Also, lower sales of Thermal Printer products due to reduced shipments to a large medical defibrillator customer that voluntarily suspended U.S. shipments to address quality systems issues in their manufacturing facility and Scanners and Laser product lines. The decreases were partly offset with higher volume sales of PCB spindles and the Optics product lines, which includes revenue from the beryllium mirror and structures business of the UK-based Thales Optronics acquired in June 2007.

Semiconductor Systems sales increased $6.8 million or 5.3% in 2007 to $134.4 million. The increase was a result of aggressive semiconductor capital spending by our customers.

The WaferMark business experienced strong demand for 300mm equipment, particularly from the manufacturers of silicon wafers. Silicon suppliers increased wafer production capacity for 300mm wafers and the overall increase in consumer demand for DRAM and Flash memory. Covering both hard and soft marking with the DSC 300 and the SC300, over 80% of our business was derived from suppliers in Japan.

WaferTrim sales decreased despite expansion in portable consumer electronics like cell phones and iPods® and a corresponding increased need for power management ICs. The Wafer Trim business remained slow in terms of increasing production capacity and demand for wafer trimming equipment. Our business was primarily generated by key customers in North America and Japan and was split between our new M350 system and the existing M310. The principal North American account represented approximately 33% of our business as they continued to expand business albeit at a much slower pace than in previous years. Additionally, the automotive segment continued to grow in 2007, responding to the need for advanced control electronics in hybrid cars and general automotive safety systems. In the automotive segment, our primary account in Japan represented over 17% of the total for WaferTrim business.

In the WaferRepair product line our new M550 and M555 wafer repair introductions supported both existing and new strategic customer wins.

Sales between our segments decreased $5.8 million in 2007 as compared to 2006. The decrease is a result of the decreased volume of products sold from the Precision Technology segment to the Semiconductor Systems segment.

Sales by Region. Our foreign operations consist primarily of sales operations and manufacturing facilities. Sales, marketing and customer service activities are conducted through sales subsidiaries throughout the world. Please refer to Note 13 of the financial statements for a breakdown of sales by region.

Backlog. We define backlog as unconditional purchase orders or other contractual agreements for products for which customers have requested delivery within the next twelve months. Backlog was $90.2 million at December 31, 2007, compared to $76.6 million at December 31, 2006.

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Gross Profit by Segment. The following table sets forth gross profit in thousands of dollars by our business segments for 2007 and 2006.

	Year Ended December 31,	
	2007	2006