

GSI LUMONICS INC  
Form 10-Q/A  
July 15, 2003

**Table of Contents**

---

---

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

---

**Form 10-Q/A**  
**Amendment No. 1**

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended March 28, 2003**
- or**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**  
**Commission File No.: 000-25705**
- 

**GSI Lumonics Inc.**

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

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

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

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

**01821**  
*(Zip Code)*

**(978) 439-5511**

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

**www.gsilumonics.com**

*(Registrant's website address)*

---

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

As at June 30, 2003, there were 40,807,797 shares of the Common Stock of GSI Lumonics Inc., no par value, issued and outstanding.

---

---

---

**TABLE OF CONTENTS**

**PART I -- FINANCIAL INFORMATION**

Item 1. Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited) (U.S. GAAP and in thousands of U.S. dollars)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (in United States dollars and in accordance with U.S. GAAP)

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

**PART II -- OTHER INFORMATION**

Item 1. Legal Proceedings

Item 6. Exhibits and Reports on Form 8-K

**SIGNATURES**

EX-99 Selected Consolidated Financial Statements

EX-99.1 Management Discussion and Analysis

EX-99.2 Section 906 Certification

EX-99.3 Section 906 Certification

---

**Table of Contents**

**GSI LUMONICS INC.**

**TABLE OF CONTENTS**

<b><u>Item No.</u></b>	<b><u>Page No.</u></b>
PART I Financial Information	3
Item 1. Financial Statements	3
Consolidated Balance Sheets (unaudited)	3
Consolidated Statements of Operations (unaudited)	4
Consolidated Statements of Cash Flows (unaudited)	5
Notes to Consolidated Financial Statements (unaudited)	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	21
Item 3. Quantitative and Qualitative Disclosures About Market Risk	39
Item 4. Controls	39
PART II Other Information	40
Item 1. Legal Proceedings	40
Item 6. Exhibits and Reports on Form 8-K	40
Signatures	41

**Table of Contents**

**EXPLANATORY NOTE**

In accordance with Rule 12b-15 under the Securities Exchange Act of 1934, as amended, we are filing this Amendment No. 1 on Form 10-Q/A in response to comments received from the staff of the Securities and Exchange Commission in connection with their review of our proxy circular-prospectus contained in the Registration Statement on Form S-4 of GSLI Corp.

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

This report speaks as of the original filing date of our on Form 10-Q (May 12, 2003) and, except as indicated below, has not been updated to reflect events occurring subsequent to that date. All information contained in this and our previous filings is subject to updating and supplementing as provided in our periodic reports filed with the Securities and Exchange Commission.

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****GSI LUMONICS INC.****CONSOLIDATED BALANCE SHEETS (Unaudited)**

(U.S. GAAP and in thousands of U.S. dollars, except share amounts)

	March 28, 2003	December 31, 2002
<b>ASSETS</b>		
Current		
Cash and cash equivalents (note 7)	\$ 97,478	\$ 83,633
Short-term investments (note 7)	17,077	28,999
Accounts receivable, less allowance of \$2,229 (December 31, 2002 \$2,681)	38,544	33,793
Income taxes receivable	8,988	8,431
Inventories (note 2)	36,916	39,671
Deferred tax assets	9,631	9,763
Other current assets	3,480	4,448
	<u>212,114</u>	<u>208,738</u>
Total current assets	212,114	208,738
Property, plant and equipment, net of accumulated depreciation of \$22,455 (December 31, 2002 \$21,453)	26,163	26,675
Deferred tax assets	7,338	7,443
Other assets	3,358	3,360
Long-term investments (note 7)	34,428	37,405
Intangible assets, net of amortization of \$17,498 (December 31, 2002 \$16,217) (note 2)	12,186	13,467
	<u>\$295,587</u>	<u>\$297,088</u>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current		
Accounts payable	\$ 10,731	\$ 9,235
Accrued compensation and benefits	5,654	6,523
Other accrued expenses (note 2)	19,507	20,845
	<u>35,892</u>	<u>36,603</u>
Total current liabilities	35,892	36,603
Deferred compensation	2,307	2,129
Accrued minimum pension liability	3,824	3,875
	<u>42,023</u>	<u>42,607</u>
Total liabilities	42,023	42,607
Commitments and contingencies (note 9)		
Stockholders' equity (note 5)		
Common shares, no par value; Authorized shares: unlimited; Issued and outstanding: 40,787,457 (December 31, 2002 40,785,922)	304,721	304,713
Additional paid-in capital	2,592	2,592
Accumulated deficit	(42,936)	(41,270)
Accumulated other comprehensive loss	(10,813)	(11,554)

Edgar Filing: GSI LUMONICS INC - Form 10-Q/A

Total stockholders' equity	<u>253,564</u>	<u>254,481</u>
	<u>\$295,587</u>	<u>\$297,088</u>

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

**Table of Contents****GSI LUMONICS INC.****CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)****(U.S. GAAP and in thousands of U.S. dollars, except share amounts)**

	<b>Three Months Ended</b>	
	<b>March 28, 2003</b>	<b>March 29, 2002</b>
Sales	\$41,119	\$ 36,888
Cost of goods sold	26,379	24,615
Gross profit	14,740	12,273
Operating expenses:		
Research and development	3,385	5,830
Selling, general and administrative	11,762	13,529
Amortization of purchased intangibles	1,279	1,278
Restructuring (note 8)	628	2,745
Other (note 8)	356	
Total operating expenses	17,410	23,382
Loss from operations	(2,670)	(11,109)
Interest income	641	645
Interest expense	(54)	(140)
Foreign exchange transaction gains	417	384
Loss before income taxes	(1,666)	(10,220)
Income tax benefit		(3,600)
Net loss	\$ (1,666)	\$ (6,620)
Net loss per common share:		
Basic	\$ (0.04)	\$ (0.16)
Diluted	\$ (0.04)	\$ (0.16)
Weighted average common shares outstanding (000 s)	40,787	40,589
Weighted average common shares outstanding and dilutive potential common shares (000 s)	40,787	40,589

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



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

	<b>Three Months Ended</b>	
	<b>March 28, 2003</b>	<b>March 29, 2002</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (1,666)	\$ (6,620)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss on disposal of assets		392
Depreciation and amortization	2,542	2,740
Unrealized loss on derivatives	504	
Deferred income taxes	(217)	(191)
Changes in current assets and liabilities:		
Accounts receivable	(4,601)	9,605
Inventories	2,833	1,625
Other current assets	1,078	425
Accounts payable, accruals and taxes (receivable) payable	(1,335)	(6,090)
Cash provided by (used in) operating activities	(862)	1,886
<b>Cash flows from investing activities:</b>		
Additions to property, plant and equipment	(598)	(622)
Proceeds from the sale and maturities of investments	41,144	39,068
Purchases of investments	(26,281)	(51,863)
Decrease in other assets	42	1,598
Cash provided by (used in) investing activities	14,307	(11,819)
<b>Cash flows from financing activities:</b>		
Proceeds of bank indebtedness		2,968
Issue of share capital	8	221
Cash provided by financing activities	8	3,189
Effect of exchange rates on cash and cash equivalents	392	
Increase (decrease) in cash and cash equivalents	13,845	(6,744)
Cash and cash equivalents, beginning of period	83,633	102,959
Cash and cash equivalents, end of period	\$ 97,478	\$ 96,215

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

**Table of Contents****GSI LUMONICS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)****As of March 28, 2003****(U.S. GAAP and tabular amounts in thousands of U.S. dollars, except share amounts)****1. Basis of Presentation**

These unaudited interim consolidated financial statements have been prepared by the Company in United States (U.S.) dollars and in accordance with accounting principles generally accepted in the U.S. for interim financial statements and with the instructions to Form 10-Q and Regulation S-X pertaining to interim financial statements. Accordingly, these interim consolidated financial statements do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. The consolidated financial statements reflect all adjustments and accruals, consisting only of adjustments and accruals of a normal recurring nature, which management considers necessary for a fair presentation of financial position and results of operations for the periods presented. The consolidated financial statements include the accounts of GSI Lumonics Inc. and its wholly-owned subsidiaries (the Company). Intercompany transactions and balances have been eliminated. The consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended December 31, 2002. The results for interim periods are not necessarily indicative of results to be expected for the year or any future periods.

As indicated in note 7, effective January 1, 2003, the Company has removed the designation of all short-term hedge contracts from their corresponding hedge relationships. Accordingly, such contracts are recorded at fair value with changes in fair value recognized currently in income starting January 1, 2003, instead of being included in accumulated other comprehensive income. Unrealized gains on these contracts included in accumulated other comprehensive income at December 31, 2002 are recognized in the same periods as the underlying hedged transactions.

**Comparative Amounts**

Certain prior year amounts have been reclassified to conform to the current year presentation in the financial statements for the quarter ended March 28, 2003. These reclassifications had no effect on the previously reported results of operations or financial position.

**2. Supplementary Balance Sheet Information**

The following tables provide details of selected balance sheet items.

***Inventories***

	<b>March 28, 2003</b>	<b>December 31, 2002</b>
	<u>                    </u>	<u>                    </u>
Raw materials	\$ 8,076	\$ 16,380
Work-in-process	11,246	7,468
Finished goods	12,861	11,114
Demo inventory	4,733	4,709
	<u>                    </u>	<u>                    </u>
Total inventories	<u>\$36,916</u>	<u>\$39,671</u>

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

	March 28, 2003		December 31, 2002	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Patents and acquired technology	\$ 28,660	\$(17,105)	\$ 28,660	\$(15,850)
Trademarks and trade names	1,024	(393)	1,024	(367)
Total cost	29,684	\$(17,498)	29,684	\$(16,217)
Accumulated amortization	(17,498)		(16,217)	
Net intangible assets	\$ 12,186		\$ 13,467	

*Other Accrued Expenses*

	March 28, 2003	December 31, 2002
Accrued warranty	\$ 3,342	\$ 3,383
Deferred revenue	3,535	3,404
Accrued restructuring (note 8)	7,987	8,790
Other	4,643	5,268
Total	\$ 19,507	\$ 20,845

*Accrued Warranty*

	For the Quarter Ended March 28, 2003
Balance at the beginning of the period	\$ 3,383
Charged to costs of goods sold	855
Use of provision	(858)
Foreign currency exchange rate changes	(38)
Balance at the end of the period	\$ 3,342

**3. New Accounting Pronouncements****Costs Associated with Exit or Disposal Activities**

## Edgar Filing: GSI LUMONICS INC - Form 10-Q/A

In July 2002, Statement of Financial Accounting Standards ( SFAS ) SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities* ( SFAS 146 ) was issued. SFAS 146 requires that a liability for costs associated with exit or disposal activities be recognized and measured initially at fair value only when the liability is incurred. SFAS 146 is effective for exit or disposal activities initiated after December 31, 2002. In the first quarter of 2003, the Company followed the accounting methods prescribed in SFAS 146 in accounting for its restructuring activities in Europe, see note 8 for additional detail.

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

In November 2002, the FASB issued Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (the Interpretation). The Interpretation will significantly change current practice in the accounting for, and disclosure of, guarantees. Guarantees meeting the characteristics described in the Interpretation, which are not included in a

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

long list of exceptions, are required to be initially recorded at fair value, which is different from the general current practice of recording a liability only when a loss is probable and reasonably estimable, as those terms are defined in FASB Statement No. 5, Accounting for Contingencies. The Interpretation also requires a guarantor to make significant new disclosures for virtually all guarantees even if the likelihood of the guarantor's having to make payments under the guarantee is remote. The initial recognition and initial measurement provisions of the Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. Accounting for guarantees issued prior to December 31, 2002 should not be revised or restated. See note 9 to the consolidated financial statements, for additional information about guarantees, including two existing operating lease agreements with terms that include residual value guarantees totaling approximately \$16 million.

**Stock Based Compensation Transition and Disclosure**

In December 2002, SFAS No. 148 ( SFAS 148 ), *Accounting for Stock-Based Compensation Transition and Disclosure*, was issued to amend SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement 123 to require more prominent and more frequent disclosures in financial statements about the effects of stock-based compensation. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of SFAS 148 did not have a material impact on our financial position, results of operations, or cash flows, because the Company continues to follow the guidance of APB 25 in recognizing stock compensation expense. The effect of stock based compensation is included in note 5 to the consolidated financial statements.

**Derivative Instruments and Hedging Activities Amendment**

On April 30, 2003, SFAS No. 149 ( SFAS 149 ), *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, was issued. The amendments set forth in SFAS 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. In particular, this statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in SFAS 133. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS 149 amends certain other existing pronouncements. Those changes will result in more consistent reporting of contracts that are derivatives in their entirety or that contain embedded derivatives that warrant separate accounting. This Statement is effective for contracts entered into or modified after June 30, 2003, except as stated below and for hedging relationships designated after June 30, 2003. The guidance should be applied prospectively. The provisions of this Statement that relate to Statement 133 Implementation Issues that have been effective for fiscal quarters that began prior to June 15, 2003, should continue to be applied in accordance with their respective effective dates. In addition, certain provisions relating to forward purchases or sales of *when-issued* securities or other securities that do not yet exist, should be applied to existing contracts as well as new contracts entered into after June 30, 2003. The Company has not yet evaluated the impact of this new pronouncement on its financial position, results of operations or accounting for derivatives.

**4. Bank Indebtedness**

At March 28, 2003 the Company had a line of credit denominated in U.S. dollars with Fleet National Bank ( Fleet ), two letters of credit ( LC ) in Canadian dollars with the Canadian Imperial Bank of Commerce ( CIBC ) and a letter of credit in United Kingdom pounds with NatWest for a total amount of available credit of U.S.\$8.5 million versus U.S.\$12.1 million at December 31, 2002. The Company's

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

agreement with Fleet provides for an \$8.0 million line of credit. CIBC provides the Company with LC's of \$0.4 million supporting its Payroll and Credit Card program. NatWest provides a \$0.1 million bank guarantee for a LC used for VAT purposes in the United Kingdom. Cash and marketable securities totaling \$10.3 million have been pledged as collateral for the Fleet and CIBC credit facilities under security agreements. The line of credit with Fleet expires on June 28, 2003. In addition to the customary representations, warranties and reporting covenants, the borrowings under the Fleet credit facility require the Company to maintain a quarterly minimum tangible net worth of \$200.0 million. The line of credit with CIBC was reviewed by the Company and a decision to cancel the line of credit was conveyed to CIBC prior to December 31, 2002. By giving CIBC appropriate advance notice, the Company initiated its right to cancel the line of credit at any time at no cost, excluding breakage fees relating to the used and outstanding amounts under fixed loan instruments, which we do not expect to be material. The \$4.0 million line of credit with CIBC was eliminated by the end of the first quarter in 2003 with only the two above mentioned letters of credit remaining. These LC's should be cancelled by the end of the second quarter of 2003. The Company also cancelled its credit facility with Bank One on December 20, 2002 without paying any breakage fees. North American inventories and receivables were pledged as collateral for the Bank One credit facility. Bank One continues to work on the release of all liens and obligations associated with the facility.

At March 28, 2003, the Company had \$8.0 million denominated in U.S. dollars that are available for general purposes, under the credit facility with Fleet discussed above. Of the available \$8.0 million, \$3.8 million was in use at March 28, 2003 consisting of funds committed at Fleet Bank for use in foreign exchange transactions. Though the Fleet Bank amount of \$3.8 million is committed for support of foreign currency hedging contracts and not available, it is not considered used for the purpose of calculating interest payments. The Fleet line of credit is due on demand and bears interest based on either prime or LIBOR depending on the borrowing notification period.

**5. Stockholders Equity****Capital Stock**

The authorized capital of the Company consists of an unlimited number of common shares without nominal or par value. During the three months ended March 28, 2003, 2,000 common shares were issued pursuant to stock options exercised for proceeds of approximately \$8.0 thousand.

**Accumulated Other Comprehensive Loss**

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

	<b>March 28, 2003</b>	<b>December 31, 2002</b>
Unrealized gain on investments, net of tax of nil	\$ 188	\$ 312
Unrealized gain (loss) on cash flow hedging instruments, net of tax of nil	27	(521)
Accumulated foreign currency translations	(7,204)	(7,470)
Accrued minimum pension liability, net of tax of nil	(3,824)	(3,875)
<b>Total accumulated other comprehensive loss</b>	<b>\$ (10,813)</b>	<b>\$ (11,554)</b>

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

The components of comprehensive loss are as follows:

	<b>Three Months Ended</b>	
	<b>March 28, 2003</b>	<b>March 29, 2002</b>
Net loss	\$(1,666)	\$(6,620)
Other comprehensive income (loss)		
Realized (gain) loss on cash flow hedging instruments, net of tax of nil (March 29, 2002 \$567) (note 7)	521	(793)
Unrealized gain on cash flow hedging instruments, net of tax of nil (March 29, 2002 \$435 (note 7)	27	606
Change in accrued minimum pension liability, net of tax of nil	51	
Foreign currency translation adjustments	266	(182)
Change in unrealized loss on investments, net of tax of nil	(124)	
	<u>          </u>	<u>          </u>
Comprehensive loss	\$ (925)	\$(6,989)
	<u>          </u>	<u>          </u>

**Net Loss Per Common Share**

Basic net loss per common share was computed by dividing net loss by the weighted-average number of common shares outstanding during the period. For diluted net loss per common share, the denominator also includes dilutive outstanding stock options and warrants determined using the treasury stock method. As a result of the net loss for the three months ended March 28, 2003 and March 29, 2002, the effect of converting options and warrants was anti-dilutive.

Common share and common share equivalent disclosures are:

	<b>Three Months Ended</b>	
	<b>March 28, 2003</b>	<b>March 29, 2002</b>
	<b>(In thousands)</b>	
Weighted average common shares outstanding	40,787	40,589
Dilutive potential common shares	<u>          </u>	<u>          </u>
Diluted common shares	40,787	40,589
	<u>          </u>	<u>          </u>

At March 28, 2003, the Company had options and warrants outstanding entitling holders to acquire up to 3,428,009 and 51,186 common shares, respectively.

**Pro Forma Stock Based Compensation**

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





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

	Three Months Ended	
	March 28, 2003	March 29, 2002
	(In thousands, except per share amounts)	
Net loss:		
As reported	\$ (1,666)	\$ (6,620)
Pro forma	\$ (2,329)	\$ (7,630)
Basic net loss per share:		
As reported	\$ (0.04)	\$ (0.16)
Pro forma	\$ (0.06)	\$ (0.19)
Diluted loss per share:		
As reported	\$ (0.04)	\$ (0.16)
Pro forma	\$ (0.06)	\$ (0.19)

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

	March 28, 2003	March 29, 2002
Risk-free interest rate	3.1%	4.1%
Expected dividend yield		
Expected lives upon vesting	1.0 years	1.0 years
Expected volatility	67%	70%
Weighted average fair value per share	\$ 5.27	\$ 4.82

**6. Related Party Transactions**

The Company recorded sales revenue from Sumitomo Heavy Industries Ltd., a significant shareholder, of \$0.8 million in the three months ended March 28, 2003 and \$0.4 million in the three months ended March 29, 2002 at amounts and terms approximately equivalent to third-party transactions. Receivables from Sumitomo of \$0.7 million and \$0.3 million as at March 28, 2003 and March 29, 2002, respectively, are included in accounts receivable on the balance sheet.

The Company has an agreement with V2Air LLC relating to the use of the LLC aircraft for Company purposes. The Company's President and Chief Executive Officer, Charles D. Winston owns V2Air LLC. Pursuant to the terms of the agreement, the Company is required to reimburse V2Air LLC for certain expenses associated with the use of the aircraft for Company business travel. During the three months ended March 28, 2003, the Company reimbursed V2Air LLC approximately \$36 thousand under the terms of the agreement and \$34 thousand for the three months ended March 29, 2002.

In January of 2001, the Company made an investment of \$2.0 million in a technology fund, managed by OpNet Partners, L.P. During 2002, the Company received a cash distribution (return of capital) from OpNet Partners in the amount of \$1.4 million. In the second quarter of 2002, the Company wrote-down the investment by \$0.2 million to its estimated fair market value and wrote-off the remainder of the investment of \$0.4 million in the fourth quarter of 2002. Richard B. Black, a member of the Company's Board of Directors, is a General Partner of OpNet Partners, L.P.

On April 26, 2002, the Company entered into an agreement with Photoniko, Inc, a private photonics company in which one of the Company's directors, Richard B. Black, was a director and stock option holder. As of August 16, 2002, Mr. Black was no longer a director or stock option holder of Photoniko, Inc. Under the



**Table of Contents**

**GSI LUMONICS INC.**

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

agreement, the Company provided a non-interest bearing unsecured loan of \$75 thousand to Photoniko, Inc. to fund designated business activities at Photoniko, Inc. in exchange for an exclusive 90 day period to evaluate potential strategic alliances. In accordance with the terms of the agreement and the promissory note which was signed by Photoniko, Inc. on April 26, 2002, the loan was to be repaid in full to the Company no later than August 28, 2002, but still remains outstanding. The Company has provided a full reserve for this receivable.

**7. Financial Instruments**

**Cash Equivalents, Short-term and Long-term Investments**

At March 28, 2003, the Company had \$71.2 million invested in cash equivalents denominated in U.S. dollars and Japanese yen with maturity dates between March 31, 2003 and June 25, 2003. At December 31, 2002, the Company had \$53.3 million invested in cash equivalents denominated in U.S. dollars with average maturity dates between January 2, 2003 and March 24, 2003. Cash equivalents, stated at amortized cost, approximate fair value.

At March 28, 2003, the Company had \$17.1 million in short-term investments and \$34.4 million in long-term investments invested in U.S. dollars with maturity dates between March 31, 2003 and December 27, 2005. At December 31, 2002 the Company had \$29.0 million in short-term investments and \$37.4 million in long-term investments invested in U.S. dollars with maturity dates between January 6, 2003 and November 23, 2004. As discussed in Note 4 to the financial statements, \$10.3 million of short-term investments is pledged as collateral for the Fleet and CIBC credit facilities at March 28, 2003 and \$18.9 million of the long-term investments is pledged as security for the lease agreements with BMO as described in Note 9 below.

**Derivative Financial Instruments**

Effective January 1, 2003, the Company has removed the designation of all short-term hedge contracts from their corresponding hedge relationships. Accordingly, such contracts are recorded at fair value with changes in fair value recognized currently in income starting January 1, 2003, instead of included in accumulated other comprehensive income. Unrealized gains on these contracts included in accumulated other comprehensive income at December 31, 2002 are recognized in the same periods as the underlying hedged transactions. Although the Company now marks-to-market short-term hedge contracts to the statement of operations, the Company does not intend to enter into hedging contracts for speculative purposes.

At March 28, 2003, the Company had 7 foreign exchange forward contracts to purchase \$10.7 million U.S. dollars with an aggregate fair value of loss of \$35 thousand recorded in the statement of operations as foreign exchange transaction losses and 2 collars to purchase \$2.2 million U.S. dollars with an aggregate fair value of loss of \$0.5 million recorded in the statement of operations as foreign exchange transaction losses. Also, the Company had one currency swap contract with a notional value of \$8.7 million U.S. dollars and an aggregate fair value gain of \$24 thousand after-tax recorded in accumulated other comprehensive income.

At December 31, 2002, the Company had eleven foreign exchange forward contracts to purchase \$16.9 million U.S. dollars and one currency swap contract fair valued at \$8.7 million U.S. dollars with an aggregate fair value loss of \$0.5 million after-tax recorded in accumulated other comprehensive income and maturing at various dates in 2003.

**8. Restructuring and Other  
Restructuring Charges**

From 2000 through 2002, the Company faced a 57% decline in revenues and responded by streamlining operations to reduced fixed costs.

**Table of Contents**

**GSI LUMONICS INC.**

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

**2000**

During fiscal 2000, the Company took total restructuring charges of \$15.1 million, \$12.5 million of which resulted from the Company's determination to exit the high powered laser product line that was produced in its Rugby, United Kingdom facility. The \$12.5 million charge consisted of \$1 million to accrue employee severance for approximately 50 employees; \$3.8 million for reduction and elimination of the Company's United Kingdom operation and worldwide distribution system related to high power laser systems; and \$7.7 million for excess capacity at three leased facilities in the United States and Germany where high power laser systems operations were conducted. The provisions for lease costs at our Livonia and Farmington Hills, Michigan facilities and in Germany related primarily to future contractual obligations under operating leases, net of expected sublease revenue on leases that the Company cannot terminate. Additionally, for our Farmington Hills, Michigan and Maple Grove, Minnesota facilities, we accrued an anticipated loss on our contractual obligations to guarantee the value of the buildings. This charge was estimated as the excess of our cost to purchase the buildings over their estimated fair market value. The Company also recorded a non-cash write-down of land and building in the United Kingdom of \$2 million, based on market assessments as to the net realizable value of the facility. In addition, the Company recorded in cost of goods sold a reserve of \$8.5 million for raw materials, work-in-process, equipment, parts and demo equipment inventory that related to the high power laser product line in its Rugby, United Kingdom facility and other locations that supported this product line.

The remaining restructuring charge for fiscal 2000, \$0.6 million of compensation expense, resulted from the acceleration of options upon the sale of our Life Sciences business and MPG product line during that year.

Also during fiscal 2000, the Company reversed a provision of \$5 million originally recorded at the time of the 1999 merger of General Scanning, Inc. and Lumonics Inc. At the time the \$5 million provision was recorded, the Company intended to close its Rugby, United Kingdom facility and transfer those manufacturing activities to its Kanata, Ontario facility. As plans evolved, the Company realized that it would cost too much to move the manufacturing and decided to not go through with its original plan. Thus, the Company reversed the \$5 million that had initially been recorded for this proposed restructuring.

Cumulative cash draw-downs of \$6 million, a reversal of \$0.5 million recorded in the fourth quarter of 2001 for anticipated restructuring costs that will not be incurred and a non-cash draw-down of \$2.6 million have been applied against the total fiscal 2000 provision of \$15.1 million, resulting in a remaining balance at March 28, 2003 of \$6 million. All actions relating to the 2000 restructuring charge have been completed. The \$6 million accrual remaining at March 28, 2003 for the Farmington Hills, Michigan and the Maple Grove, Minnesota facilities, is expected to be used during 2003 at the end of the lease terms to offset the anticipated loss on these leases upon purchase and eventual resale of the buildings.

**2001**

In the fourth quarter of fiscal 2001, to further reduce capacity in response to declining sales, the Company determined that the remaining functions located in its Farmington Hills, Michigan facility should be integrated with its Wilmington, Massachusetts facility and that its Oxnard, California facility should be closed. In addition, the Company determined to integrate its Bedford, Massachusetts facility with its Billerica, Massachusetts manufacturing facility. The Company took total restructuring charges of \$3.4 million. The \$3.4 million charge consisted of \$0.9 million to accrue employee severance for approximately 35 employees at the Farmington Hills, Michigan and Oxnard, California locations; \$1.8 million for excess capacity at five leased locations in the United States, Canada and Germany; and \$0.7 million write-down of leasehold improvements and certain equipment associated with the existing of leased facilities located in Bedford, Massachusetts. The lease costs primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that the Company cannot terminate. The expected effects of the restructuring were to better align our ongoing expenses and cash flows in light of reduced sales.

**Table of Contents**

**GSI LUMONICS INC.**

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

Cumulative cash draw-downs of approximately \$2.5 million and non-cash draw-downs of \$0.7 million have been applied against the provision, resulting in a remaining provision balance of \$0.2 million as at March 28, 2003. The restructuring is complete, except for costs that are expected to be paid on the leased facilities in Munich, Germany (lease expiration January 2013), Oxnard, California (expected payment March 2003) and Nepean, Ontario (lease expiration January 2006).

**2002**

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

During the first quarter of 2002, the Company consolidated its electronics systems business from its facility in Kanata, Ontario into the Company's existing systems manufacturing facility in Wilmington, Massachusetts and transferred its laser business from the Company's Kanata, Ontario facility to its existing facility in Rugby, United Kingdom. In addition, the Company closed its Kanata, Ontario facility. The Company took a total restructuring charge of \$2.7 million related to these activities in the first quarter of 2002. The \$2.7 million charge consisted of \$2.2 million to accrue employee severance and benefits for approximately 90 employees; \$0.3 million for the write-off of furniture, equipment and system software; and \$0.2 million for plant closure and other related costs. During the second quarter of fiscal 2002, the Company recorded additional restructuring charges of \$1.4 million related to cancellation fees on contractual obligations of \$0.3 million, a write-down of land and building in Kanata, Ontario and Rugby, United Kingdom of \$0.8 million, and also leased facility costs of \$0.3 million at the Farmington Hills, Michigan and Oxnard, California locations. The lease costs primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that the Company cannot terminate. The write-downs of the building brings the properties offered for sale in line with market values and the recording of these write-downs has no effect on cash.

The second major restructuring plan in 2002 related to our refocusing of the Company's Nepean, Ontario operations on its custom optics business as a result of the telecom industry's severe downturn. The Company's executive team approved a plan to reduce capacity at its Nepean, Ontario facility and the Company recorded a pre-tax restructuring charge of \$2.3 million in the fourth quarter of 2002 which included \$0.6 million to accrue employee severance and benefits for approximately 41 employees. The Company also wrote-off approximately \$0.2 million of excess fixed assets and wrote-down one of the Nepean, Ontario buildings by \$0.2 million to its estimated fair market value. Additionally, the Company continued to evaluate accruals made in prior restructurings and we recorded charges of approximately \$0.8 million for an adjustment to earlier provisions for leased facilities in the United States and Germany. Specifically, the \$0.8 million in adjustments in the fourth quarter of 2002 related to earlier provisions for the leased facilities in Munich, Germany, Maple Grove, Minnesota and Farmington Hills, Michigan. We had originally estimated our restructuring reserve of \$0.5 million based upon the assumption that we would have subleased the Munich, Germany facility in 2003. We had received information from a real estate broker that the commercial office market in Munich, Germany had softened and that we would not recover our full lease rate when we finally sublease the building. As such we recorded an additional provision of \$0.5 million to cover a longer anticipated time required to sublease the space and to reflect the likelihood of subleasing at less than our existing lease rates. For the Maple Grove, Minnesota facility, we had subleased the entire building through January 2003. We had anticipated that we would find a buyer for this building by January 2003 and exercise our option to purchase the building and not have to pay the remaining lease costs. As this did not happen, we accrued the contractual lease costs through the end of the lease in June 2003, which are \$0.2 million. Similarly for the Farmington

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

Hills, Michigan facility, we had anticipated selling the building sooner, but as this did not occur by the end of 2002, we accrued the costs for the unused space through the end of the lease in June 2003, which are \$0.1 million. The Company also took a further write-down of \$0.3 million on the buildings in Kanata, Ontario and Rugby, United Kingdom and a \$0.1 million write-off for fixed assets in Kanata, Ontario and a \$0.1 million for the Maple Grove, Minnesota and Farmington Hills, Michigan facilities.

At March 28, 2003 and December 31, 2002, the net book value of two facilities, one in Kanata, Ontario and the other in Nepean, Ontario, were classified as held for sale and included in other assets.

Cumulative cash draw-downs of approximately \$3.0 million and non-cash draw-downs of \$1.8 million have been applied against the provisions taken in 2002, resulting in a remaining provision balance of \$1.6 million at March 28, 2003. For severance related costs associated with these two restructuring actions, the actions are complete and the Company does not anticipate taking additional restructuring charges and expects to finalize payment in 2003. The Company will continue to evaluate the fair value of the buildings and fixed assets that were written down. The restructuring accrual is expected to be completely utilized during January 2013 at the end of the lease term for the Munich, Germany facility. The Company estimated the restructuring charge for the Munich, Germany facility based on contractual payments required on the lease for the unused space, less what is expected to be received for subleasing. Because this is a long term lease that extends until 2013, the Company will draw-down the amount accrued over the life of the lease. Future sublease market conditions may require the Company to make further adjustments to this restructuring reserve.

**2003**

In an attempt to align the distribution and service groups with our business segments, in the first quarter of 2003 the Company commenced a restructuring plan that is expected to significantly reduce these operations around the world and to consolidate these functions at the Company's manufacturing facilities. As part of this plan, the Company provided for severance and termination benefits of approximately \$0.6 million for 22 employees in Germany, France, Italy and Belgium in the first quarter. Under the new rules for accounting for restructurings required by SFAS 146, if an employee continues to work for anything beyond a minimum period of time after their notification, then their termination benefits are to be accrued over the period that they continue to work. As the Company has retained certain employees to help with the transition of work beyond the minimum periods specified in SFAS 146, the Company anticipates that it will accrue additional termination and severance benefits for these employees of approximately \$0.5 million over the next two quarters, as a result of the actions taken in the first quarter of 2003. The Company also accrued \$5.0 thousand for the termination of an office lease in Italy during the first quarter of 2003.

Cumulative cash draw-downs of approximately \$0.4 million have been applied against the provisions taken in 2003, resulting in a remaining provision balance of \$0.2 million at March 28, 2003.

The following table summarizes changes in the restructuring provision included in other accrued expenses on the balance sheet.

	<u>Severance</u>	<u>Facilities</u>	<u>Total</u>
		<b>(In millions)</b>	
Provision at December 31, 2002	\$ 1.2	\$ 7.6	\$ 8.8
Charges during Q1 2003	0.6	0.0	0.6
Cash draw-downs during Q1 2003	(0.9)	(0.5)	(1.4)
	<u>          </u>	<u>          </u>	<u>          </u>
Provision at March 28, 2003	\$ 0.9	\$ 7.1	\$ 8.0
	<u>          </u>	<u>          </u>	<u>          </u>

**Table of Contents**

**GSI LUMONICS INC.**

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

**Other**

During the first quarter of 2003, the Company recorded a reserve of approximately \$0.6 million on notes receivable from a litigation settlement initially recorded in 1998. The reserve was provided because of a default on the quarterly payment due in March 2003. Additionally, the Company recorded a benefit during the quarter of approximately \$0.2 million for royalties earned on a divested product line and earned as part of a litigation settlement agreement.

**9. Commitments and Contingencies**

**Operating Leases**

The Company leases two facilities under operating lease agreements that expire in 2003. At the end of the initial lease term, these leases require the Company to renew the lease for a defined number of years at the fair market rental rate or purchase the property at the fair market value. The lessor may sell the facilities to a third party but the leases provide for a residual value guarantee of the first 85% of any loss the lessor may incur on its \$19.1 million investment in the buildings, which may become payable by the Company upon the termination of the transaction, or the Company may exercise its option to purchase the facilities for approximately \$19.0 million. As of March 28, 2003, residual value guarantees in connection with these leases totaled approximately \$16.0 million. Upon termination of the leases, the Company expects to purchase the buildings for approximately \$19.0 million in cash and then sell them for the combined estimated market value of the two buildings of approximately \$12.5 million to \$13.3 million. During the fourth quarter of fiscal 2000, the Company took a charge of \$6.0 million associated with restructuring for excess capacity at the two leased facility locations, including the estimated residual value guarantees. In the fourth quarter of 2002, the Company took an additional restructuring charge of \$0.1 million to increase the reserve for the decline in the estimated market values of the underlying buildings. The total expected value of the buildings at the end of the leases may vary, depending on whether or not the buildings are leased at time of sale and whether the buildings are sold to a buyer/owner or to an investor. The Company will incur other costs such as lease and sales commissions. The lease agreement requires, among other things, the Company to maintain specified quarterly financial ratios and conditions. As of March 29, 2002, the Company was in breach of the fixed charge coverage ratio, but on April 30, 2002, the Company entered into a Security Agreement with the Bank of Montreal ( BMO ) pursuant to which the Company deposited with BMO and pledged approximately \$18.9 million as security in connection with the operating leases discussed above in exchange for a written waiver from BMO and BMO Global Capital Solutions for any Company defaults of or obligations to satisfy the specified financial covenants relating to the operating lease agreements until June 30, 2003. This item is included on the balance sheet in long-term investments.

**Legal Proceedings and Disputes**

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

**Table of Contents**

**GSI LUMONICS INC.**

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

however, that these or similar claims, if successful and taken in the aggregate would not have a material adverse effect upon the Company's financial condition or results of operations.

The Company is also subject to various legal proceedings and claims 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.

**Guarantees**

In the normal course of our operations, we execute agreements that provide for indemnification and guarantees to counterparties in transactions such as business dispositions, the sale of assets, sale of products and operating leases.

These indemnification undertakings and guarantees may require us to compensate the counterparties for costs and losses incurred as a result of various events including breaches of representations and warranties, intellectual property right infringement, loss of or damages to property, environmental liabilities, changes in the interpretation of laws and regulations (including tax legislation) or as a result of litigation that may be suffered by the counterparties. Also, in the context of the sale of all or a part of a business, this includes the resolution of contingent liabilities of the disposed businesses or the reassessment of prior tax filings of the corporations carrying on the business.

Certain indemnification undertakings can extend for an unlimited period and generally do not provide for any limit on the maximum potential amount. The nature of substantially all of the indemnification undertakings prevents us from making a reasonable estimate of the maximum potential amount we could be required to pay counterparties as the agreements do not specify a maximum amount and the amounts are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time.

Historically, we have not made any significant payments under such indemnifications. As at March 28, 2003, nil has been accrued in the consolidated balance sheet with respect to these indemnification undertakings.

**10. Income Taxes**

During the three months ended March 28, 2003, the income tax benefit was reduced as a result of increases in valuation allowances related to the Company's geographic distribution of its operating loss carry-forwards. This includes a full valuation allowance against the Company's Canadian deferred tax asset in accordance with the closure of the Kanata, Ontario facility described in note 8. It is expected that operations and income in Canada in the foreseeable future will not be sufficient to offset existing loss carryforwards. Our ability to recover deferred tax assets of \$17.0 million at March 28, 2003 depends primarily upon the Company's ability to generate profits in the United States and United Kingdom tax jurisdictions. If actual results differ from our plans or we do not achieve profitability, we may be required to increase the valuation allowance on our tax assets by taking a charge to the Statement of Operations, which may have a material negative result on our operations.

**11. Segment Information**  
**General Description**

During the fourth quarter of 2002, the Company changed the way it manages its business to reflect a growing focus on its three core businesses: components, lasers and laser systems. In classifying operational



**Table of Contents**

**GSI LUMONICS INC.**

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

entities into a particular segment, the Company aggregated businesses with similar economic characteristics, products and services, production processes, customers and methods of distribution. Segment information for the 2002 year has been restated to conform to the current year's presentation.

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

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

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

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

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

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

Information on reportable segments is as follows:

	<b>Three Months Ended</b>	
	<b>March 28, 2003</b>	<b>March 29, 2002</b>
<b>Sales</b>		
Components	\$ 16,655	\$ 18,090
Laser Group	6,987	5,968
Laser Systems	17,826	12,981
Intersegment sales elimination	(349)	(151)
Total	<u>\$41,119</u>	<u>\$ 36,888</u>
<b>Segment income (loss) from operations</b>		
Components	\$ 4,855	\$ 4,557
Laser Group	(472)	(696)
Laser Systems	(401)	(5,992)
Total by segment	<u>3,982</u>	<u>(2,131)</u>
Unallocated amounts:		
Corporate expenses	4,389	4,955
Amortization of purchased intangibles	1,279	1,278
Restructuring and other	984	2,745
Loss from operations	<u>\$ (2,670)</u>	<u>\$ (11,109)</u>

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

**Geographic Segment Information**

Revenues are attributed to geographic areas on the basis of the bill to customer location. Not infrequently, equipment is sold to large international companies, which may be headquartered in Asia-Pacific, but the sales of our systems are billed and shipped to locations in the United States. These sales are therefore reflected in United States totals in the table below. Long-lived assets are attributed to geographic areas in which Company assets reside.

	<b>Three Months Ended</b>			
	<b>March 28, 2003</b>		<b>March 29, 2002</b>	
<b>(In millions)</b>				
Revenues from external customers:				
United States	\$ 20.7	51%	\$ 24.1	65%
Canada	0.1		0.8	2%

Edgar Filing: GSI LUMONICS INC - Form 10-Q/A

Europe	5.7	14%	6.3	17%
Japan	9.4	23%	2.5	7%
Asia-Pacific, other	5.0	12%	3.1	9%
Latin and South America	0.2		0.1	
	<u>        </u>	<u>        </u>	<u>        </u>	<u>        </u>
Total	\$41.1	100%	\$36.9	100%

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

	As at	
	March 28, 2003	December 31, 2002
Long-lived assets:		
United States	\$22.5	\$24.2
Canada	6.9	6.7
Europe	11.2	11.5
Japan	0.6	0.6
Asia-Pacific, other	0.1	0.1
	<u>          </u>	<u>          </u>
Total	\$41.3	\$43.1
	<u>          </u>	<u>          </u>

**12. Subsequent Events**

On March 28, 2003, a registration statement was filed whereby the Company proposed its shareholders consider a Plan of Arrangement which, if approved and effected, would restructure the Company as a publicly traded United States domiciled corporation. On May 16, 2003, June 18, 2003 and again on June 26, 2003, the Company filed amendments to the registration statement in response to comments received from the Securities and Exchange Commission.

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

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

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

**Table of Contents**

**Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations (in United States dollars and in accordance with U.S. GAAP)***

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

**Overview**

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

**Highlights for the Three Months Ended March 28, 2003**

Sales for the quarter dropped to \$41.1 million from \$45.1 million in the fourth quarter of 2002 and increased from \$36.9 million in the first quarter of 2002.

Net loss for the quarter was \$1.7 million, or \$0.04 per share, compared to a net loss of \$4.6 million, or \$0.11 per share, in the fourth quarter of 2002 and \$6.6 million net loss, or \$0.16 per share, in the first quarter of last year.

Bookings of orders were \$44 million in the first quarter of 2003 compared to \$33 million in the fourth quarter of 2002 and \$43 million in the first quarter of 2002. Ending backlog was \$44 million as compared with \$42 million at the end of the fourth quarter of last year and \$57 million at the end of the first quarter of last year.

The change in cash, cash equivalents, short-term and long-term investments for the first quarter of 2003 from the end of the fourth quarter of 2002 was a decrease of \$1.0 million. Cash, cash equivalents, short-term investments and long-term investments were \$149.0 million (this includes \$18.9 million pledged as security in connection with operating leases and \$10.3 million securing lines of credit) at March 28, 2003.

**Business Environment and Restructurings**

Several significant markets for our products have been in severe decline for the past two years. Our sales of systems for semiconductor and electronics applications and precision optics for telecommunications have declined. From 2000 through 2002, the company faced a 57% decline in revenues and responded by streamlining operations to reduce fixed costs. This decline continues to the present and is due to the downturn in general economic conditions, combined with our customers' current excess of manufacturing capacity and their customers' excess inventories of semiconductor and electronic components.

In response to the business environment, we have undertaken to restructure our operations in an effort to bring costs in line with our expectations for sales of systems for the semiconductor and telecommunications markets. Our emphasis has predominantly been on consolidation of operations at various locations and reducing overhead. The company expects to incur additional restructuring charges in the first three quarters of 2003 as it continues to reduce and consolidate operations around the world.

**2000**

During fiscal 2000, the company took total restructuring charges of \$15.1 million, \$12.5 million of which resulted from the company's determination to exit the high powered laser product line that was produced in its Rugby, United Kingdom facility. The \$12.5 million charge consisted of \$1 million to accrue employee

**Table of Contents**

severance for approximately 50 employees; \$3.8 million for reduction and elimination of the company's United Kingdom operation and worldwide distribution system related to high power laser systems; and \$7.7 million for excess capacity at three leased facilities in the United States and Germany where high power laser systems operations were conducted. The provisions for lease costs at our Livonia and Farmington Hills, Michigan facilities and in Germany related primarily to future contractual obligations under operating leases, net of expected sublease revenue on leases that the company cannot terminate. Additionally, for our Farmington Hills, Michigan and Maple Grove, Minnesota facilities, we accrued an anticipated loss on our contractual obligations to guarantee the value of the buildings. This charge was estimated as the excess of our cost to purchase the buildings over their estimated fair market value. The company also recorded a non-cash write-down of land and building in the United Kingdom of \$2 million, based on market assessments as to the net realizable value of the facility. Included in the expected savings in earnings and cash on an annual go forward basis was approximately \$1.1 million related to salaries and benefits of employees terminated in the company's Rugby, United Kingdom manufacturing facility as part of the elimination of this product line. In addition, the company recorded in cost of goods sold a reserve of \$8.5 million for raw materials, work-in-process, equipment, parts and demo equipment inventory that related to the high power laser product line in its Rugby, United Kingdom facility and other locations that supported this product line.

The remaining restructuring charge for fiscal 2000, \$0.6 million of compensation expense, resulted from the acceleration of options upon the sale of our Life Sciences business and MPG product line during that year.

Also during fiscal 2000, the company reversed a provision of \$5 million originally recorded at the time of the 1999 merger of General Scanning, Inc. and Lumonics Inc. At the time the \$5 million provision was recorded, the company intended to close its Rugby, United Kingdom facility and transfer those manufacturing activities to its Kanata, Ontario facility. As plans evolved, the company realized that it would cost too much to move the manufacturing and decided to not go through with its original plan. Thus, the company reversed the \$5 million that had initially been recorded for this proposed restructuring.

Cumulative cash draw-downs of \$6 million, a reversal of \$0.5 million recorded in the fourth quarter of 2001 for anticipated restructuring costs that will not be incurred and a non-cash draw-down of \$2.6 million have been applied against the total fiscal 2000 provision of \$15.1 million, resulting in a remaining balance at March 28, 2003 of \$6 million. All actions relating to the 2000 restructuring charge have been completed. The \$6 million accrual remaining at March 28, 2003 for the Farmington Hills, Michigan and the Maple Grove, Minnesota facilities is expected to be used during 2003 at the end of the lease terms to offset the anticipated loss on these leases upon purchase and eventual resale of the buildings.

***2001***

In the fourth quarter of fiscal 2001, to further reduce capacity in response to declining sales, the company determined that the remaining functions located in its Farmington Hills, Michigan facility should be integrated with its Wilmington, Massachusetts facility and that its Oxnard, California facility should be closed. In addition, the company determined to integrate its Bedford, Massachusetts facility with its Billerica, Massachusetts manufacturing facility. The company took total restructuring charges of \$3.4 million. The \$3.4 million charge consisted of \$0.9 million to accrue employee severance for approximately 35 employees at the Farmington Hills, Michigan and Oxnard, California locations; \$1.8 million for excess capacity at five leased locations in the United States, Canada and Germany; and \$0.7 million for a write-down of leasehold improvements and certain equipment associated with the exiting of leased facilities located in Bedford, Massachusetts. The lease costs primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that the company cannot terminate. The expected effects of the 2001 restructuring were to better align our ongoing expenses and cash flows in light of reduced sales. The company anticipated savings of approximately \$2.4 million on an annual basis related to salaries and benefits of employees terminated at these facilities in connection with this restructuring.

Cumulative cash draw-downs of approximately \$2.5 million and non-cash draw-downs of \$0.7 million have been applied against the provision, resulting in a remaining provision balance of \$0.2 million as at March 28, 2003. The restructuring is complete, except for costs that are expected to be paid on the leased

**Table of Contents**

facilities in Munich, Germany (lease expiration January 2013), Oxnard, California (expected payment March 2003) and Nepean, Ontario (lease expiration January 2006).

**2002**

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

During the first quarter of 2002, the company consolidated its electronics systems business from its facility in Kanata, Ontario into the company's existing systems manufacturing facility in Wilmington, Massachusetts and transferred its laser business from the company's Kanata, Ontario facility to its existing facility in Rugby, United Kingdom. The company then closed its Kanata, Ontario facility. The company took a total restructuring charge of \$2.7 million related to these activities in the first quarter of 2002. The \$2.7 million charge consisted of \$2.2 million to accrue employee severance and benefits for approximately 90 employees; \$0.3 million for the write-off of furniture, equipment and system software; and \$0.2 million for plant closure and other related costs. Future expense and cash outflow associated with the termination of the 90 employees will be avoided, improving income before tax and cash flow by approximately \$1.2 million per quarter. During the second quarter of fiscal 2002, the company recorded additional restructuring charges of \$1.4 million related to cancellation fees on contractual obligations of \$0.3 million, an aggregate write-down of land and building in Kanata, Ontario and Rugby, United Kingdom of \$0.8 million and leased facility costs of \$0.3 million at the Farmington Hills, Michigan and Oxnard, California locations. The lease costs primarily related to future contractual obligations under operating leases, net of expected sublease revenue on leases that the company cannot terminate. The write-downs of the land and building brings the properties offered for sale in line with market values and the recording of these write-downs has no effect on cash.

The second major restructuring plan in 2002 related to the refocusing of our Nepean, Ontario operations on the custom optics business as a result of the telecom industry's severe downturn. The company's executive team approved a plan to reduce capacity at its Nepean, Ontario facility and the company recorded a pre-tax restructuring charge of \$2.3 million in the fourth quarter of 2002 which included \$0.6 million to accrue employee severance and benefits for approximately 41 employees. Future expense and cash outflow associated with the 41 terminated employees will be avoided, improving quarterly income before tax and cash flow by approximately \$0.5 million per quarter. The company also wrote-off approximately \$0.2 million of excess fixed assets and wrote-down one of the Nepean, Ontario buildings by \$0.2 million to its estimated fair market value. Additionally, the company continued to evaluate accruals made in prior restructurings and we recorded charges of approximately \$0.8 million for an adjustment to earlier provisions for leased facilities in the United States and Germany. Specifically, the \$0.8 million in adjustments in the fourth quarter of 2002 related to earlier provisions for the leased facilities in Munich, Germany, Maple Grove, Minnesota and Farmington Hills, Michigan. We had originally estimated our restructuring reserve of \$0.5 million based upon the assumption that we would have subleased the Munich, Germany facility in 2003. We had received information from a real estate broker that the commercial office market in Munich, Germany had softened and that we would not recover our full lease rate when we finally sublease the building. As such we recorded an additional provision of \$0.5 million to cover a longer anticipated time required to sublease the space and to reflect the likelihood of subleasing at less than our existing lease rates. For the Maple Grove, Minnesota facility, we had subleased the entire building through January 2003. We had anticipated that we would find a buyer for this building by January 2003 and exercise our option to purchase the building and not have to pay the remaining lease costs. As this did not happen, we accrued the contractual lease costs through the end of the lease in June 2003, which are \$0.2 million. Similarly for the Farmington Hills, Michigan facility, we had anticipated selling the building sooner, but as this did not occur by the end of 2002, we accrued the costs for the unused space through the end of the lease in June 2003, which are \$0.1 million. The company also took a further write-down of \$0.3 million on the buildings in Kanata, Ontario and Rugby, United Kingdom and a \$0.1 million write-off

**Table of Contents**

for fixed assets in Kanata, Ontario and a \$0.1 million for the Maple Grove, Minnesota and Farmington Hills, Michigan facilities.

At March 28, 2003, the net book value of two facilities, one in Kanata, Ontario and the other in Nepean, Ontario, were classified as held for sale and included in other assets.

Cumulative cash draw-downs of approximately \$3.0 million and non-cash draw-downs of \$1.8 million have been applied against the provisions taken in 2002, resulting in a remaining provision balance of \$1.6 million at March 28, 2003. For severance related costs associated with these two restructuring actions, the actions are complete and the company does not anticipate taking additional restructuring charges and expects to finalize payment in 2003. The company will continue to evaluate the fair value of the buildings and fixed assets that were written down. The restructuring accrual is expected to be completely utilized during January 2013 at the end of the lease term for the Munich, Germany facility. The company estimated the restructuring charge for the Munich, Germany facility based on contractual payments required on the lease for the unused space, less what is expected to be received for subleasing. Because this is a long term lease that extends until 2013, the company will draw-down the amount accrued over the life of the lease. Future sublease market conditions may require the company to make further adjustments to this restructuring reserve.

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

**2003**

In an attempt to align the distribution and service groups with our business segments, in the first quarter of 2003 the company commenced a restructuring plan that is expected to significantly reduce these operations around the world and to consolidate these functions at the company's manufacturing facilities. As part of this plan, the company provided for severance and termination benefits of approximately \$0.6 million for 22 employees in Germany, France, Italy and Belgium in the first quarter. Under the new rules for accounting for restructurings required by SFAS 146, if an employee continues to work for anything beyond a minimum period of time after their notification, then their termination benefits are to be accrued over the period that they continue to work. As the company has retained certain employees to help with the transition of work beyond the minimum periods specified in SFAS 146, the company anticipates that it will accrue additional termination and severance benefits for these employees of approximately \$0.5 million over the next two quarters, as a result of the actions taken in the first quarter of 2003. The company also accrued \$5,000 for the termination of an office lease in Italy during the first quarter of 2003.

Cumulative cash draw-downs of approximately \$0.4 million have been applied against the provisions taken in 2003, resulting in a remaining provision balance of \$0.2 million at March 28, 2003.



**Table of Contents****Results of Operations**

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

	Three Months Ended	
	March 28, 2003	March 29, 2002
Sales	100.0%	100.0%
Cost of goods sold	64.2	66.7
Gross profit	35.8	33.3
Operating expenses:		
Research and development	8.2	15.8
Selling, general and administrative	28.6	36.7
Amortization of purchased intangibles	3.1	3.5
Restructuring	1.5	7.4
Other	0.9	
Total operating expenses	42.3	63.4
Loss from operations	(6.5)	(30.1)
Interest income	1.5	1.7
Interest expense	(0.1)	(0.3)
Foreign exchange transaction gains	1.0	1.0
Loss before income taxes	(4.1)	(27.7)
Income tax benefit		(9.8)
Net loss	(4.1)%	(17.9)%

**Three Months Ended March 28, 2003 Compared to Three Months Ended March 29, 2002**

Our customers and markets continue to evolve. During the fourth quarter of 2002, the company changed the way it manages its business to reflect a growing focus on its three core business segments: Components, Lasers and Laser Systems. In classifying operational entities into a particular segment, the company aggregated businesses with similar economic characteristics, products and services, production processes, customers and methods of distribution. Segment information for the 2002 year has been restated to conform to the current year's presentation.

The following table sets forth sales in thousands of dollars by our business segments for the first three months of 2003 and 2002.

	Three Months Ended	
	March 28, 2003 Sales	March 29, 2002 Sales
Components	\$ 16,655	\$ 18,090
Lasers	6,987	5,968
Laser Systems	17,826	12,981
Intersegment sales elimination	(349)	(151)

Edgar Filing: GSI LUMONICS INC - Form 10-Q/A

Total	\$41,119	\$36,888
-------	----------	----------

*Sales.* Sales for the three months ended March 29, 2003 increased by \$4.2 million compared to the same period in 2002. Our sales for the past seven quarters continue in the range of \$37 million to \$45 million, which reflects a lack of recovery in the semiconductor and electronics markets. Sales for our Components segment decreased by \$1.4 million for the first quarter of 2003 as compared to the same period in 2002

**Table of Contents**

primarily due to a decrease in sales of printer products. In the first quarter of 2002, our sales of printer products were larger than normal driven by higher sales to two customers who had new product launches. These product launches by our customers caused a spike in demand for our printer products in the first quarter of 2002. Once new products are launched by our customers, their demand for our components begins to normalize. There were no comparable spikes in demand for our components in the first quarter of 2003. The decrease from the first quarter of last year to the first quarter of this year is not indicative of the business. On an annualized basis, we do not anticipate there to be a large decline in our printer products business. Sales in our Lasers segment in the first quarter of 2003 increased by \$1 million over first quarter last year, mostly due to increases in our JK series of products, as a result of increases in the volume of sales related to new product introductions within that series. In the first quarter of 2003, sales in our Laser Systems segment increased by approximately \$4.8 million over sales in the same period last year. Equipment sales accounted for \$4.4 million of that gain with \$3.3 million generated by volume and \$1.1 million generated by favorable pricing. Sales in our corporate segment represent elimination of sales between segments. There was a \$0.2 million increase in sales between segments for the three months ended March 28, 2003 as compared to the same period last year.

*Sales by Region.* We distribute our systems and services via our global sales and service network and through third-party distributors and agents. Our sales territories are divided into the following regions: the United States; Canada; Latin and South America; Europe, consisting of Europe, the Middle East and Africa; Japan; and Asia-Pacific, consisting of ASEAN countries, China and other Asia-Pacific countries. Sales are attributed to these geographic areas on the basis of the bill to customer location. Not infrequently, equipment is sold to large international companies, which may be headquartered in Asia-Pacific, but the sales of our systems are billed and shipped to locations in the United States. These sales are therefore reflected in United States totals in the table below. The following table shows sales in millions of dollars to each geographic region for the first three months of 2003 and 2002.

	Three Months Ended			
	March 28, 2003		March 29, 2002	
	Sales	% of Total	Sales	% of Total
United States	\$20.7	51%	\$24.1	65%
Canada	0.1		0.8	2
Europe	5.7	14	6.3	17
Japan	9.4	23	2.5	7
Asia-Pacific, other	5.0	12	3.1	9
Latin and South America	0.2		0.1	
	—	—	—	—
Total	\$41.1	100%	\$36.9	100%

For the quarter ended March 28, 2003, all of our segments experienced increased business in Japan. With respect to our Laser Systems business, we expect that all of Asia Pacific, including Japan, to be a larger percentage of the business going forward.

*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. Order backlog at March 28, 2003 was \$44 million compared to \$57 million at March 29, 2002 and \$42 million at December 31, 2002. Of the \$44 million in backlog at March 28, 2003, 51% is in our Components segment, 8% is in our Lasers segment and 41% in the Laser Systems market.

*Gross Profit.* Gross profit was 35.8% in the three months ended March 28, 2003 compared to 33.3% in the same period in 2002. As a percent of sales, gross profit increased primarily from decreases in fixed manufacturing costs as a result of restructuring actions. Also, warranty expense as a percentage of sales was lower in the first quarter of 2003 compared to the first quarter of 2002 due to unfavorable warranty experience expense adjustments in the Laser Systems segment in the first quarter of 2002. Warranty adjustments are caused by a variety of factors, such as the introduction of new products, demands placed on the product by customers, fluctuation of repair and labor costs and vendor repair charges. As a result, warranty provisions are adjusted and the expense will vary within a range that we consider normal. There was not a specific reason that

**Table of Contents**

caused the higher warranty expense in the first quarter of 2002, but a combination of the above factors. The decrease in warranty expense in the first quarter of 2003 was offset by an increase in inventory loss provisions over the first quarter of 2002. Additionally, the mix of products sold in the quarter had an impact on our gross profit percent, as we had sold more of our higher margin memory repair products in the first quarter of 2003 than in the first quarter of 2002. We are unable to provide a breakdown of gross profit by segment, because at a consolidated level we reclassify service sales support and service management costs from cost of sales to selling, general and administrative expenses, but do not attribute these amounts to particular segments.

*Research and Development Expenses.* Research and development expenses for the three months ended March 28, 2003 were 8.2% of sales or \$3.4 million compared with 15.8% of sales or \$5.8 million in the three months ended March 29, 2002. Research and development expenses for the Components group decreased by \$0.1 million in the first quarter of 2003 to \$0.9 million from \$1 million in the first quarter of 2002. In the first quarter of 2003, research and development expenses in our Lasers segment were \$0.6 million, which was a \$0.1 million decrease from \$0.7 million in the first quarter of 2002. For our Laser Systems segment, research and development expenses were \$1.6 million for the three months ended March 28, 2003, a \$2.2 million decrease from the same period last year, which is mostly a result of decreased spending on engineering projects as result of both completion of projects and efforts to reduce costs. Most of the decrease in research and development expenses is the result of a personnel reduction of 40% from the first quarter of 2002 to the first quarter of 2003. In our corporate segment, research and development expenses, which are mostly in support of our patent application management were \$0.3 million for both the first quarter of 2003 and 2002.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses were 28.6% of sales or \$11.8 million in the three months ended March 28, 2003, compared with 36.7% of sales or \$13.5 million in the three months ended March 29, 2002. A major portion of the decrease is from reductions in pay and benefits that reflect the impact of restructuring activities and mandatory factory shut down days. There was a 28% reduction in personnel assigned to selling, general and administrative functions from the first quarter of 2002 to the first quarter of 2003. Additionally, depreciation expense decreased from first quarter of 2002 to first quarter of 2003, as property, plant and equipment became fully depreciated and our capital spending was controlled as part of our cost saving initiatives. We are unable to provide a breakdown of selling, general and administrative expenses by segment, because at a consolidated level we reclassify service sales support and service management costs from cost of sales to selling, general and administrative expenses, but do not attribute these amounts to particular segments.

*Amortization of Purchased Intangibles.* Amortization of purchased intangibles was 3.1% of sales or \$1.3 million for the quarter ended March 28, 2003 primarily as a result of amortizing intangible assets from acquisitions. This compares to \$1.3 million or 3.5% of sales for the same period in 2002.

*Restructuring.* As described above and in note 8 to the consolidated financial statements for the three months ended March 28, 2003, we recorded restructuring charges of \$0.6 million.

*Other.* During the first quarter of 2003, the company recorded a reserve of approximately \$0.6 million on notes receivable from a litigation settlement initially recorded in 1998. The reserve was provided because of a default on the quarterly payment due in March 2003. Additionally, the company recorded a benefit during the quarter of approximately \$0.2 million for royalties earned on a divested product line and earned as part of a litigation settlement agreement.

**Table of Contents**

*Loss from Operations.* The following table sets forth loss from operations in millions of dollars by our business segments for the first quarter of 2003 and 2002.

	Three Months Ended	
	March 28, 2003	March 29, 2002
<b>Segment income (loss) from operations</b>		
Components	\$ 4,855	\$ 4,557
Lasers	(472)	(696)
Laser Systems	(401)	(5,992)
Total by segment	3,982	(2,131)
Unallocated amounts:		
Corporate expenses	4,389	4,955
Amortization of purchased intangibles	1,279	1,278
Restructuring and other	984	2,745
Loss from operations	\$(2,670)	\$(11,109)

*Interest Income.* Interest income was \$0.6 million in both of the three months ended March 28, 2003 and the three months ended March 29, 2002. The average investment balance in both quarters was approximately the same.

*Interest Expense.* Interest expense was approximately \$0.1 million in the three months ended March 28, 2003, compared to \$0.1 million in the three months ended March 29, 2002.

*Foreign Exchange Transaction Gains.* Foreign exchange transaction gains were approximately \$0.4 million in both of the three months ended March 28, 2003 and the three months ended March 29, 2002.

*Income Taxes.* The effective tax rate was 0% for the first quarter of 2003, compared with 35.2% in the same period in 2002 and 24.5% for fiscal 2002. The tax rate reflects the reduction in income tax benefit as a result of increases in valuation allowances related to the company's geographic distribution of its operating loss carry-forwards. The company did not reflect any income tax benefit to offset the operating loss based on the continuing evaluation of deferred tax assets. While the company believes it can recover the current deferred tax assets within the next three years, the company is not increasing its deferred tax assets based on current year performance.

*Net Loss.* As a result of the foregoing factors, net loss for the first quarter of 2003 was \$1.7 million, compared with net loss of \$6.6 million in the same period in 2002.

**Critical Accounting Policies and Estimates**

Our consolidated financial statements are based on the selection and application of significant accounting policies, which require management to make significant estimates and assumptions. There is no change in our critical accounting policies included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of the Company's Form 10-K for the year ended December 31, 2002, as amended.

**Liquidity and Capital Resources***Cash Flows for Three Months Ended March 28, 2003 and March 29, 2002*

## Edgar Filing: GSI LUMONICS INC - Form 10-Q/A

Cash and cash equivalents totaled \$97.5 million at March 28, 2003 compared to \$83.6 million at December 31, 2002. In addition, the company had \$17.1 million in short-term investments and \$34.4 million in long-term investments at March 28, 2003 compared to \$29 million in short-term investments and \$37.4 million in long-term investments at December 31, 2002. As discussed in Note 4 to the financial statements for the three months ended March 28, 2003, \$10.3 million of short-term investments are pledged as collateral for the Fleet and CIBC credit facilities at March 28, 2003 and \$18.9 million of the long-term investments is pledged as security for the lease agreements with BMO as described in Note 9 to the financial statements.

**Table of Contents**

Cash flows from operating activities used \$0.9 million for the first three months of 2003 compared to \$1.9 million that was generated by operating activities during the same period in 2002. Net income, after adjustment for non-cash items, generated cash of \$1.1 million in the first quarter of 2003. Decreases in, inventories and other current assets provided \$3.9 million. The decrease in inventories was mostly generated by a reduction in raw materials in the Laser Systems segment. This was offset by an increase in accounts receivable and income taxes receivable and a decrease in current liabilities using \$5.9 million. The increase in receivables, and corresponding increase in days sales outstanding, was due to slower collections resulting largely from a shift in sales volume to Japan where we have experienced historically longer collection cycles. In the normal course of business, days sales outstanding tend to fluctuate and the increase experienced in the first quarter of 2003 falls within historical ranges. In the first quarter of 2002, net loss, after adjustment for non-cash items, used cash of \$3.7 million. Decrease in accounts receivable provided \$9.6 million and a decrease in inventories and other current assets provided \$2.1 million. The decrease in receivables was due to improved collection resulting in a reduction in days sales outstanding of 17 days, combined with the impact on receivables of a \$5.5 million reduction in sales in the first quarter of 2002 compared to the fourth quarter of 2001. This was offset by a decrease in current liabilities using \$6.1 million. The decrease in current liabilities was due to spending cut backs and a reduction in manufacturing activities.

Cash flows from investing activities generated \$14.3 million during the first three months ended March 28, 2003, primarily from net maturities of \$14.9 million of short-term and long-term investments offset by \$0.6 million of property, plant and equipment additions. In the first quarter of 2002, investing activities used \$11.8 million, primarily from net purchases of \$12.8 million of short-term and other investments and \$0.6 million of property, plant and equipment. This was offset by a \$1.6 million reduction of other assets.

Cash flows provided by financing activities during the first three months ended March 28, 2003 were \$8,000 from the issue of share capital, compared to \$3.2 million for the same period in 2002, which included \$3 million from proceeds of bank indebtedness and \$0.2 million from the issue of share capital.

*Lines of Credit*

At March 28, 2003 the Company had a line of credit denominated in U.S. dollars with Fleet National Bank ( Fleet ), two letters of credit ( LC ) in Canadian dollars with the Canadian Imperial Bank of Commerce ( CIBC ) and a letter of credit in United Kingdom pounds with NatWest for a total amount of available credit of U.S.\$8.5 million versus U.S.\$12.1 million at December 31, 2002. The Company's agreement with Fleet provides for an \$8.0 million line of credit. CIBC provides the Company with LC's of \$0.4 million supporting its Payroll and Credit Card program. NatWest provides a \$0.1 million bank guarantee for a LC used for VAT purposes in the United Kingdom. Cash and marketable securities totaling \$10.3 million have been pledged as collateral for the Fleet and CIBC credit facilities under security agreements. The line of credit with Fleet expires on June 28, 2003. In addition to the customary representations, warranties and reporting covenants, the borrowings under the Fleet credit facility require the Company to maintain a quarterly minimum tangible net worth of \$200.0 million. The line of credit with CIBC was reviewed by the Company and a decision to cancel the line of credit was conveyed to CIBC prior to December 31, 2002. By giving CIBC appropriate advance notice, the Company initiated its right to cancel the line of credit at any time at no cost, excluding breakage fees relating to the used and outstanding amounts under fixed loan instruments, which we do not expect to be material. The \$4.0 million line of credit with CIBC was eliminated by the end of the first quarter in 2003 with only the two above mentioned letters of credit remaining. These LC's should be cancelled by the end of the second quarter of 2003. The Company also cancelled its credit facility with Bank One on December 20, 2002 without paying any breakage fees. North American inventories and receivables were pledged as collateral for the Bank One credit facility. Bank One continues to work on the release of all liens and obligations associated with the facility.

The company had approximately \$8.5 million denominated in Canadian dollars and United States dollars available for general purposes under the credit facilities discussed above at March 28, 2003. Of the \$8.5 million available at March 28, 2003, \$3.8 million was in use consisting of funds committed at Fleet Bank for use in foreign exchange transactions, \$0.4 million was in use under CIBC credit facilities for letters of credit supporting the Company's payroll and credit card program, and \$0.1 million at NatWest. Though the

**Table of Contents**

Fleet Bank amount of \$3.8 million is committed for support of foreign currency hedging contracts and not available, it is not considered used for the purpose of calculating interest payments. The aggregate unused portion of credit available under the credit facilities amounts to \$4.2 million at March 28, 2003. The Fleet line of credit is due on demand and bears interest based on either prime or LIBOR depending on the borrowing notification period.

*Other Liquidity Matters*

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

Effective January 1, 2003, the company has removed the designation of all short-term hedge contracts from their corresponding hedge relationships. Accordingly, such contracts are recorded at fair value with changes in fair value recognized currently in income starting January 1, 2003, instead of being included in accumulated other comprehensive income. Unrealized gains on these contracts included in accumulated other comprehensive income at December 31, 2002 are recognized in the same periods as the underlying hedged transactions. Although the company now marks-to-market short-term hedge contracts to the statement of operations, the company does not intend to enter into hedging contracts for speculative purposes. At March 28, 2003, the company had seven foreign exchange forward contracts to purchase \$10.7 million United States dollars with an aggregate fair value of loss of \$35,000 recorded in the statement of operations as foreign exchange transaction losses and two collars to purchase \$2.2 million United States dollars with an aggregate fair value of loss of \$0.5 million recorded in the statement of operations as foreign exchange transaction losses. Also, the company had one currency swap contract with a notional value of \$8.7 million United States dollars and an aggregate fair value gain of \$24,000 after-tax recorded in accumulated other comprehensive income. At December 31, 2002, the company had eleven foreign exchange forward contracts to purchase \$16.9 million United States dollars and one currency swap contract fair valued at \$8.7 million United States dollars with an aggregate fair value loss of \$0.5 million after-tax recorded in accumulated other comprehensive income and maturing at various dates in 2003. The ineffective portion of the derivative instruments totaled a combined loss



## **Table of Contents**

of \$0.3 million and is recorded in the consolidated statements of operations in foreign exchange gain (loss). The company expects an estimated \$0.5 million to be reclassified into earnings during fiscal 2003.

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

On April 21, 2003, the company announced that it has entered into a definitive agreement for the acquisition of the principal assets of Spectron Laser Systems, a subsidiary of Lumenis Ltd., located in Rugby, United Kingdom. The Spectron assets are being acquired for U.S.\$6.3 million in cash, subject to adjustment, and the assumption of certain liabilities. This transaction closed on May 7, 2003. The integration of Spectron into GSI Canada's Laser Group in Rugby, United Kingdom is scheduled for completion by the end of August, 2003. This acquisition is consistent with the company's strategy of expanding the product lines and technology in its laser and precision motion control components business groups. It is expected that this acquisition will be accretive to earnings in the fourth quarter of this year. The company expects to account for this transaction as a business combination under SFAS No. 141 *Business Combinations*.

On May 2, 2003, the company announced that it has acquired the principal assets of the Encoder division of Dynamics Research Corporation, located in Wilmington, Massachusetts. The Encoder division assets were acquired for US\$3.3 million in cash, subject to adjustment, and the assumption of certain liabilities. The integration of the Encoder division into GSI Canada's Component Products Group in Billerica, Massachusetts is currently scheduled for completion by the end of August, 2003. This acquisition is consistent with the company's strategy to acquire new technologies and expand into new products complementary with our existing markets. The addition of the Encoder division assets represents the addition of technology and products that expand the company's offering of precision motion control components. It is currently expected that this acquisition will be accretive to earnings in the fourth quarter of this year. The company expects to account for this transaction as a business combination under SFAS No. 141 *Business Combinations*.

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

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

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

## **Table of Contents**

from those anticipated. We do not assume any obligation to update these forward-looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

### **Risk Factors**

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

*A prolonged economic slowdown will continue to put pressure on our ability to meet anticipated revenue levels.* We are in a broad-based economic slowdown affecting most technology sectors and semiconductors and electronics in particular. As a result, many of our customers continue to order low quantities. A large portion of our sales is dependent on the need for increased capacity or replacement of inefficient manufacturing processes, because of the capital-intensive nature of our customers' businesses. These also tend to lag behind in an economic recovery longer than other businesses. Because it is difficult to predict how long this slowdown will continue, we may not be able to meet anticipated revenue levels on a quarterly or annual basis.

*We have experienced operating losses and may not return to profitability.* We have incurred operating losses since 1998. For the three months ended March 28, 2003, we incurred a net loss of \$1.7 million. For the years ended December 31, 2002 and 2001, we reported net losses of approximately \$27.7 million and \$14.7 million, respectively. For the year ended December 31, 2000, we did achieve overall profitability, even though we experienced operating losses of approximately \$2 million, primarily as a result of the sale of assets of company's Life Science business which resulted in a non-operating gain of \$73.1 million. Our operating losses in fiscal 2000 were attributable primarily to restructuring activities relating to the discontinuance of product lines in our high power laser business. No assurances can be given that we will not continue to sustain losses in the future and the market price of our common shares may decline as a result.

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

*Our business depends significantly upon capital expenditures, including by manufacturers in the semiconductor, electronics, machine tool and automotive industries, each of which are subject to cyclical fluctuations.* The semiconductor and electronics, machine tool and automotive industries are cyclical and have historically experienced periods of oversupply, resulting in significantly reduced demand for capital equipment, including the products that we manufacture and market. The timing, length and severity of these cycles, and their impact on our business, are difficult to predict. For the foreseeable future, our operations will continue to depend upon capital expenditures in these industries, which, in turn, depend upon the market demand for their products. The cyclical variations in these industries have the most pronounced effect on our Laser Systems segment, due in large measure to that segment's historical focus on the semiconductor and electronics industries and the company's need to support and maintain a comparatively larger global infrastructure (and, therefore, lesser ability to reduce fixed costs) than in our other segments. Our margins, net sales, financial condition and results of operations have been and will likely continue to be materially adversely affected by continued or further downturns or slowdowns in the semiconductor and electronics, machine tool and automotive industries that we serve.

*The success of our business is dependant upon our ability to respond to fluctuations in demand for our products.* During a period of declining demand, we must be able quickly and effectively to reduce expenses

## **Table of Contents**

while continuing to motivate and retain key employees. Our ability to reduce expenses in response to any downturn is limited by our need for continued investment in engineering and research and development and extensive ongoing customer service and support requirements. In addition, the long lead-time for production and delivery of some of our products creates a risk that we may incur expenditures or purchase inventories for products which we cannot sell. We attempt to manage this risk by employing inventory management practices such as outsourcing portions of the development and manufacturing processes, limiting our purchase commitments and focusing on production to order rather than to stock, but no assurances can be given that our efforts in this regard will be successful in mitigating this risk or that our financial condition or results of operations will not be materially adversely affected thereby.

During a period of increasing demand and rapid growth, we must be able to increase manufacturing capacity quickly to meet customer demand and hire and assimilate a sufficient number of qualified personnel. Our inability to ramp up in times of increased demand could harm our reputation and cause some of our existing or potential customers to place orders with our competitors rather than with us.

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

fluctuations in our customers' businesses;

timing and recognition of revenues from customer orders;

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

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

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

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

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

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

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

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

*Our reliance upon third party distribution channels subjects us to credit, inventory, business concentration and business failure risks beyond our control.* The company sells approximately 55% of its products through

**Table of Contents**

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

*The steps we take to protect our intellectual property may not be adequate to prevent misappropriation or the development of competitive technologies or products by others that could harm our competitive position and materially adversely affect our results of operations.* Our future success depends in part upon our intellectual property rights, including trade secrets, know-how and continuing technological innovation. There can be no assurance that the steps we take to protect our intellectual property rights will be adequate to prevent misappropriation or that others will not develop competitive technologies or products. As of April 23, 2003, we held 110 United States and 82 foreign patents, and had filed 61 United States and 112 foreign patent applications, which are under review by the patent authorities. There can be no assurance that other companies are not investigating or developing other technologies that are similar to ours, that any patents will issue from any application filed by us or that, if patents do issue, the claims allowed will be sufficiently broad to deter or prohibit others from marketing similar products. In addition, there can be no assurance that any patents issued to us will not be challenged, invalidated or circumvented, or that the rights thereunder will provide a competitive advantage to us.

*Our success depends upon our ability to protect our intellectual property and to successfully defend against claims of infringement by third parties.* From time to time we receive notices from third parties alleging infringement of such parties' patent or other proprietary rights by our products. While these notices are common in the laser industry and we have in the past been able to develop non-infringing technology or license necessary patents or technology on commercially reasonable terms, there can be no assurance that we would in the future prevail in any litigation seeking damages or expenses from us or to enjoin us from selling our products on the basis of such alleged infringement, or that we would be able to develop any non-infringing technology or license any valid and infringed patents on commercially reasonable terms. In the event any third party made a valid claim against us or our customers for which a license was not available to us on commercially reasonable terms, we would be adversely affected. Our failure to avoid litigation for infringement or misappropriation of propriety rights of third parties or to protect our propriety technology could result in a loss of revenues and profits.

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

## **Table of Contents**

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

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

*Delays or deficiencies in research, development, manufacturing, delivery of or demand for new products or of higher cost targets could have a negative affect on our business, operating results or financial condition.* We are active in the research and development of new products and technologies. Our research and development efforts may not lead to the successful introduction of new or improved products. The development by others of new or improved products, processes or technologies may make our current or proposed products obsolete or less competitive. Our ability to control costs is limited by our need to invest in research and development. Because of intense competition in the industries in which we compete, if we were to fail to invest sufficiently in research and development, our products could become less attractive to potential customers and our business and financial condition could be materially and adversely affected. As a result of our need to maintain our spending levels in this area, our operating results could be materially harmed if our net sales fall below expectations. In addition, as a result of our emphasis on research and development and technological innovation, our operating costs may increase further in the future and research and development expenses may increase as a percentage of total operating expenses and as a percentage of net sales.

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

changing product specifications and customer requirements;

difficulties in hiring and retaining necessary technical personnel;

difficulties in reallocating engineering resources and overcoming resource limitations;

changing market or competitive product requirements; and

unanticipated engineering complexities.

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

*We may not be able to find suitable targets or consummate acquisitions in the future, and there can be no assurance that the acquisitions we have made and do in the future make will provide expected benefits.* We have recently consummated two strategic acquisitions and intend in the future to continue to pursue other strategic acquisitions of businesses, technologies and products complementary to our own. Our identification

**Table of Contents**

of suitable acquisition candidates involves risks inherent in assessing the values, strengths, weaknesses, risks and profitability of acquisition candidates, including the effects of the possible acquisition on our business, diversion of management's attention from our core businesses and risks associated with unanticipated problems or liabilities. No assurances can be given that management's efforts in this regard will be sufficient, or that identified acquisition candidates will be receptive to our advances or, consistent with our acquisition strategy, accretive to earnings.

Should we acquire another business, the process of integrating acquired operations into our existing operations may result in unforeseen operating difficulties and may require the allocation of significant financial resources that would otherwise be available for the ongoing development or expansion of our existing business. 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. Other difficulties we may encounter, and which we may or may not be successful in addressing, include those risks associated with the potential entrance into markets in which we have limited or no prior experience and the potential loss of key employees, particularly those of the acquired business.

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

The determination of whether a corporation is a PFIC is a fact-sensitive inquiry that depends, among other things, on the fair market value of its assets (and such value is subject to change from time to time). We believe that the company is not now and has not in the past been a PFIC. However, there is a risk that United States holders of our shares will be deemed to hold shares in a PFIC.

The tax consequences to United States holders of disposing of shares in a PFIC are as follows. All gains recognized on the disposition of PFIC shares by a United States shareholder are taxable as ordinary income. Additionally, at the time of disposition, the United States shareholder incurs an interest charge. The interest is computed at the rate for underpayments of tax, generally as though the gain had been included in the United States shareholder's gross income ratably over the period the United States shareholder held the PFIC's stock, but payment of the resulting tax had been delayed until the sale or distribution. Similar rules apply to excess distributions. An excess distribution is a current year distribution received by a United States shareholder on PFIC stock, to the extent the distribution exceeds his or her ratable portion of 125% of the average amount so received during the three preceding years. The portion of an actual distribution that is not an excess distribution is not taxed under the excess distribution rules, but rather is treated as a distribution subject to the normal tax rules. A United States shareholder may avoid the effect of the forgoing rules if he or she makes a qualified electing fund election or a mark-to-market election, but then becomes subject to the special rules that apply to such elections.

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

If we are treated as a CFC, this status should have no adverse effect on any shareholder who does not own (directly, indirectly, or constructively) 10% or more of the total combined voting power of all classes of our

**Table of Contents**

shares. If, however, we are treated as a CFC for an uninterrupted period of thirty (30) days or more during any taxable year, any United States shareholder who owns (directly, indirectly, or constructively) 10% or more of the total combined voting power of all classes of our shares on any day during the taxable year, and who directly or indirectly owns any shares on the last day of the year in which we are a CFC, will have to include in its gross income for United States federal income tax purposes its pro rata share of the company's subpart F income (primarily consisting of investment income such as dividends, interest and capital gains on the sale of assets producing such income) relating to the period during which we are or were a CFC.

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

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

*We depend on limited source suppliers that could cause substantial manufacturing delays and additional cost if a disruption in supply occurs.* While we attempt to mitigate risks associated with our reliance on single suppliers by actively managing our supply chain, we do obtain some components used in our business segments from a single source. We also rely on a limited number of independent contractors to manufacture subassemblies for some of our products, particularly in our Laser Systems segment. Despite our and their best efforts, 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 that result in a reduction or interruption in supply to us, or fail to meet any of our manufacturing requirements, our business would be harmed until we are able to secure alternative sources, if any, on commercially reasonable terms.

Each of our suppliers can be replaced, either by contracting with another supplier or through internal production of the part or parts previously purchased in the market, but no assurances can be given that we would be able to do so quickly enough to avoid an interruption or delay in delivery of our products to our customers and any associated harm to our reputation and customer relationships. Unavailability of necessary parts or components, or suppliers of the same, could require us to reengineer our products to accommodate available substitutions. Any such actions would likely increase our costs and could have a material adverse effect on manufacturing schedules, product performance and market acceptance, each or all of which could be expected to have a material adverse effect on our financial condition or results of operations.

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

changing process technologies;

ramping production;

installing new equipment at our manufacturing facilities; and

shortage of key components.

*Our operations in foreign countries subject us to risks not faced by companies operating exclusively in the United States.* In addition to operating in the United States, Canada and the United Kingdom, we currently have sales and service offices in France, Germany, Italy, Japan, Singapore, Hong Kong, Korea, Taiwan, Malaysia and the Philippines. By the end of the second quarter of 2003, we intend to close our offices in France, Italy, Hong Kong, Malaysia and the Philippines, but we may in the future expand into other

**Table of Contents**

international regions. During the three months ended March 28, 2003 and March 29, 2002, approximately 49% and 35% of our revenue, respectively, were derived from our international operations.

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

- foreign exchange rate fluctuations;
- longer payment cycles;
- greater difficulty in collecting accounts receivable;
- use of different systems and equipment;
- difficulties in staffing and managing foreign operations and diverse cultures;
- protective tariffs;
- trade barriers and export/import controls;
- transportation delays and interruptions;
- reduced protection for intellectual property rights in some countries; and
- the impact of recessionary foreign economies.

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

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

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

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

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





## **Table of Contents**

the regulatory requirements. We are subject to similar regulatory oversight, including comparable enforcement remedies, in the European markets we serve.

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

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

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

*Interest Rate Risk.* Our exposure to market risk associated with changes in interest rates relates primarily to our cash equivalents, short-term investments and debt obligations. As described in note 7 to the consolidated financial statements, at March 28, 2003, the Company had \$71.2 million invested in cash equivalents and \$51.5 million invested in short-term and long-term investments. At December 31, 2002, the Company had \$53.3 million invested in cash equivalents and \$66.4 million invested in short-term and long-term investments. Due to the average maturities and the nature of the current investment portfolio, a one percent change in interest rates could have approximately a \$1.0 million to \$1.5 million effect on our interest income on an annual basis. We do not use derivative financial instruments in our investment portfolio. We do not actively trade derivative financial instruments but may use them to manage interest rate positions associated with our debt instruments. We currently do not hold interest rate derivative contracts.

*Foreign Currency Risk.* We have substantial sales and expenses and working capital in currencies other than U.S. dollars. As a result, we have exposure to foreign exchange fluctuations, which may be material. To reduce the Company's exposure to exchange gains and losses, we generally transact sales and costs and related assets and liabilities in the functional currencies of the operations. We have a foreign currency hedging program using currency forwards, currency swaps and currency options to hedge exposure to foreign currencies. These financial instruments are used to fix the cash flow variable of local currency costs or selling prices denominated in currencies other than the functional currency. We do not currently use currency forwards or currency options for trading purposes. Effective January 1, 2003, the Company has removed the designation of all short-term hedge contracts from their corresponding hedge relationships. Accordingly, such contracts are recorded at fair value with changes in fair value recognized currently in income starting January 1, 2003, instead of included in accumulated other comprehensive income. Unrealized gains on these contracts included in accumulated other comprehensive income at December 31, 2002 are recognized in the same periods as the underlying hedged transactions. Although the Company now marks-to-market short-term hedge contracts to the statement of operations, the Company does not intend to enter into hedging contracts for speculative purposes. At March 28, 2003, the Company had 7 foreign exchange forward contracts to purchase \$10.7 million U.S. dollars with an aggregate fair value of loss of \$35 thousand recorded in the statement of operations as foreign exchange transaction losses and 2 collars to purchase \$2.2 million

**Table of Contents**

U.S. dollars with an aggregate fair value of loss of \$0.5 million recorded in the statement of operations as foreign exchange transaction losses. Also, the Company had one currency swap contract with a notional value of \$8.7 million U.S. dollars and an aggregate fair value gain of \$24 thousand after-tax recorded in accumulated other comprehensive income.

At December 31, 2002, the Company had eleven foreign exchange forward contracts to purchase \$16.9 million U.S. dollars and one currency swap contract fair valued at \$8.7 million U.S. dollars with an aggregate fair value loss of \$0.5 million after-tax recorded in accumulated other comprehensive income and maturing at various dates in 2003.

**Item 4. Controls and Procedures**

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

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

See the description of legal proceedings in Note 9 to the Consolidated Financial Statements.

**Item 6. Exhibits and Reports on Form 8-K**

**a) List of Exhibits**

Exhibit Number	Description
99	Selected Consolidated Financial Statements and Notes in U.S. Dollars and in accordance with Canadian Generally Accepted Accounting Principles
99.1	Management's Discussion and Analysis of Financial Condition and Results of Operations - Canadian Supplement
99.2	Chief Executive Officer Certification pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.3	Chief Financial Officer Certification pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**b) Reports on Form 8-K**

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

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

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

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



**Table of Contents**

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

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

Form 8-K dated May 23, 2003 Item 5, Other Events

Disclosed, and included as an exhibit, a press release announcing that the company's annual general meeting of shareholders will be held on Tuesday, June 24 in Bedford, Massachusetts.

Form 8-K dated July 14, 2003 Item 9, Regulation FD Disclosure

Disclosed, and included as an exhibit, written communication comprised of slides which were provided and disseminated in both written and oral form to participants in a series of investor presentations delivered by officers of the company beginning on July 8, 2003.

**Table of Contents**

**SIGNATURES**

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

GSI LUMONICS INC.  
*(Registrant)*

<u>Name</u>	<u>Title</u>	<u>Date</u>
/s/ CHARLES D. WINSTON _____ Charles D. Winston	President and Chief Executive Officer (Principal Executive Officer)	July 15, 2003
/s/ THOMAS R. SWAIN _____ Thomas R. Swain	Vice President Finance and Chief Financial Officer (Principal Financial and Accounting Officer)	July 15, 2003

**Table of Contents**

**CERTIFICATIONS PURSUANT TO**

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

**Certification**

I, Charles D. Winston, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of GSI Lumonics Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ CHARLES D. WINSTON

---

Charles D. Winston  
*President and Chief Executive Officer*

Date: July 15, 2003

**Table of Contents**

**Certification**

I, Thomas R. Swain, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of GSI Lumonics Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ THOMAS R. SWAIN

---

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

Date: July 15, 2003



**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>	<b>Page</b>
99	Selected Consolidated Financial Statements and Notes in U.S. Dollars and in accordance with Canadian Generally Accepted Accounting Principles	45
99.1	Management's Discussion and Analysis of Financial Condition and Results of Operations - Canadian Supplement	63
99.2	Chief Executive Officer Certification pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	65
99.3	Chief Financial Officer Certification pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	66