CEO CFO

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With a New Board and Management Team in place, Headed by CEO, John A. Roush, GSI Group, Inc. has Written a Strong Turnaround Story over the Past Two Years

Technology
Scientific & Technical Instruments
(GSIG-NASDAQ)

GSI Group, Inc.

125 Middlesex Turnpike
Bedford, MA 01730
Phone: 781-266-5700
Website: www.gsig.com

John A. Roush
Chief Executive Officer

BIO:
Mr. Roush was appointed the Company's Chief Executive Officer and elected as a member of the Board of Directors on December 14, 2010. Mr. Roush joined the Company after a 12-year career with PerkinElmer, Inc., a provider of technology and services to the diagnostics, research, environmental, safety and security, industrial and laboratory services markets, where he was a corporate officer and served in several senior leadership positions. Since 2009, Mr. Roush served as president of PerkinElmer's Environmental Health business. From 2004 to 2009, Mr. Roush led PerkinElmer's Optoelectronics business unit, which supplies specialty photonics products to biomedical and industrial OEMs. From 1999 to 2004, Mr. Roush served in various general management roles within the Optoelectronics business unit. Prior to joining PerkinElmer, Mr. Roush held management positions with Outboard Marine Corporation, AlliedSignal, Inc., now Honeywell International, McKinsey & Company Inc. and General Electric.

Company Profile:
With corporate offices in Bedford, MA, GSI Group develops and delivers the enabling technology solutions that bring our customers' advanced manufacturing applications to life.

Our leading brands include precision motion products, lasers, and laser systems, and are used to boost efficiency and productivity in the global medical, semiconductor, electronics, and industrial markets.

GSI Group's common shares are listed on The NASDAQ Global Select Market under ticker symbol GSIG.

Interview conducted by:
Lynn Fosse, Senior Editor
CEOCFO Magazine

CEOCFO: Mr. Roush, what attracted you to GSI, and what strengths was GSI looking for that you bring to the table?

Mr. Roush: I saw the opportunity to stabilize and then reshape a company that was a capable and respected supplier and was seen that way by customers. But, it lost its way in terms of what I would say was leadership at the top of the company. I had known GSI for more than a decade in my prior employer PerkinElmer. I knew GSI both as a supplier and customer of the company. What I learned in the recruiting process when I was contacted about the CEO role is that the company had been through a lot of difficult times. In the 2008-2010 time period there was an accounting scandal, a bunch of financial restatements, ultimately there was a chapter 11 filing, a delisting of the stock off Nasdaq exchange, SEC investigation and shareholder lawsuits. There were a number of problems and at first, I was inclined to steer clear, but as I met with the board (a new board was named in July 2010) I became more comfortable. Both the board and the chairman were new. I met with them in the process and I came to understand the nature of the problems; that they were solvable things and that the company was very viable from a technology and a market perspective. It was really this sort of corporate oversight in leadership that had been the problem. I also saw the stock was clearly undervalued so I saw an opportunity in coming to join as CEO to build a strong franchise in the company and also create shareholder value in the process. As I understand it, when the company set out to look for a new CEO a lot of people said to me in the early days "are you a turnaround expert?" A lot of bankrupt and post chapter 11 companies look for a turnaround expert or a distressed company expert. That certainly was not me. The board concluded the company's problems were solvable and what they wanted was someone who had expertise both in technology and in strategic growth, somebody who could really build the company over time. So, they were looking past this initial period of time and saying maybe the early days will involve resolving some of these problems but looking into the medium and longer term what you really need is someone with expertise and strategic growth and building a business over time in a technology kind of environment.

CEOCFO: How has GSI changed under your leadership?

Mr. Roush: In the early days given some of those problems I discussed, we had a significant rebuilding job to do at the corporate center. The business units themselves were functioning fairly well. But, three years of these kinds of these external problems with the company led to a lot of decay in the corporate organization and the infrastructure of the company. Areas like IT, telecommunications, the financial reporting processes; there was essentially a temporary organization in place at the corporate center. There was no performance management process across the company. Compensation and benefits plans were lacking. The first six months I was here, which really made up the first half of 2011, there was a lot of rebuilding going on and we hired a whole new team across the corporate organization and have been rebuilding these processes. Today we have those capabilities back in place so now we are focusing on implementing our strategy to deliver sustainable profitable growth over time. Things have definitely changed in that the company is able to function in a more normal way and the emphasis has shifted to our growth strategy. So we are putting that in place. To some of our managers it is a new concept. I would say "profitable growth". The company was in maintenance mode, or you could even say survival mode, for several years. Our managers in the company were not expected to drive growth or enter new markets or try to find new ways to deliver value to their customers, they were really more just hanging on in a wait and see mode to see how things turned out. We have now put in place a new culture that sets an expectation around profitable growth and gives managers the financial resources and the tools and processes to drive that growth. But, it is a new culture and I think some of our people can and will survive and thrive in the new culture and will make the transition. Some of the managers are having a hard time with that and they may ultimately not make the grade in this new environment.

CEOCFO: Would you tell us about your flagship products and the industries that you target?

Mr. Roush: In general, GSI plays in highly engineered precision components and subsystems, most of which have a photonics or an optical side to these products, and they are supplied to OEMs generally in demanding applications. We did have several business units where we are involved in, systems integration, where we are, in fact, the OEM, and we are building the final system. We have those businesses in a divestiture process, so going forward the company will be focused on components and sub systems in highly engineered demanding areas. Over half of our revenue is in our precision motion group and we have a number of different technologies that are creating, managing, or measuring some type of precision motion. We tend to operate at the high end of the performance curve. We have sub micron position sensors, sub micron beam positioning technology for lasers, and high speed rotating devices that rotate and 300,000 rpms or greater so this precision motion is a major area. We also have a laser products business that makes a variety of laser sources that are sold to OEMs and systems integrators so we have CO_2 lasers, fiber lasers, and solid state lasers. The majority of our lasers are sold to OEMS and integrators for industrial and scientific applications. That is really the product side. When you look at the market side of the company, we really serve four major market areas and those would be industrial, scientific, microelectronics and medical. Those are the major markets.

I also saw the stock was clearly undervalued so I saw an opportunity in coming to join as CEO to build a strong franchise in the company and also create shareholder value in the process. - John A. Roush

CEOCFO: What is the geographic reach for GSI?

Mr. Roush: We actually have a significant presence in Asia and we do have a manufacturing site but nearly forty percent of our revenue comes out of Asia. So given that we supply OEMs we are really selling into the area where products are manufactured rather than selling to where the products are used in their end-use. When you think that China and Asia have become the manufacturing location for a lot of our products today, we are shipping significantly into Asia. So that is a major focus area for the company to the sales channels and we have both direct sales and a lot of reps and distributors that we use throughout Asia.

CEOCFO: What is the competitive landscape, and why should companies want to use a GSI product?

Mr. Roush: I would say our competitors set differs by product line. We do not have any group of three or four competitors that we see as direct competition across our entire offering so the specific competitors vary from product line to product line. But our critical core competency; one of them is our strong ability to work with our OEM customers on a "collaborate" design effort. What we will typically do is take one of our off-the-shelf component technologies, but then work closely with a customer, an OEM over a period of time. That may be a year or more and in some cases even two years. Then really adapt and optimize that component technology so that it performs in a highly tailored and optimized manner within the customers system. And then we will typically be sole sourced, so that when the customer launches their product to the end market, we are designed into that and we will enjoy some years worth of revenue based on that design effort. This is really the distinctive competency that we see across the company at this collaborative product development. It is not a start-from-scratch product development.

We typically do take a base technology we have and then we will adapt that. But, that adaptation process is significant, so I don't want to give the impression that all of our products are completely custom. There is a lot of adaptation and application specific development. Then you end up with something that works very well in a given customer's end product and that creates customer loyalty, because the performance is better and typically your sole source because customers don't want to go through that long adaptation process twice with two different suppliers and then end up with two different incompatible components. So, we are generally single-sourced, and we have a high degree of loyalty and customer retention. This is really the significant part of our competitive advantage.

CEOCFO: Are acquisitions part of your strategy going forward?
Mr. Roush: Absolutely! We have identified several different growth platforms. The company, prior to my being here, was fairly fragmented and ran maybe more than twenty distinct P and L business units. We have consolidated our groups down into several areas as described previously; the precision motion group, the laser products group, and within those we have identified a few areas where we think we have more significant growth opportunities. We are investing primarily in those growth platforms, not in all twenty product lines. The growth platforms are where we are investing for organic growth through R&D and the internal process. These are the same three areas where we are focusing our acquisition efforts. The first is in the scanning area and this is within our precision motion business. We are the global market leader in scanning galvanometer technology. These are the devices that are small, very accurate, basically rotational motors that have mirrors on top and the mirrors are rotated very accurately and rapidly to aim a laser beam. If you can imagine a laser being used for marking characters or for cutting some material at high-speed, that laser is being continually aimed often times with a scanning device. Those scanning devices use our technology. We historically supply components in this area. There is a subsystem play where we can create scanning modules that combine components and electronics and controls. So the scanning area is an area where we are investing organically and we also see acquisition opportunities in that area that would support that strategy and this whole motion control area.

The second area is fiber lasers. Fiber lasers are a new technology that offers a lower total ownership cost to the end user, smaller footprint, and better beam quality. IPG Photonics, a publicly traded company, has quite a large share of the market and very strong capabilities, but the market is looking for alternative sources and we have some good capability there and some strong customer relationships. We are investing to grow our fiber laser business and we also see the fiber laser area is an area where there might be acquisitions. It could be of some of the underlying technologies in fiber lasers but that could be a focus area.

The third area we are looking to for growth is really in the medical and life sciences. Today, this end market makes up about fifteen percent of our sales. It is kind of an undiscovered jewel within our portfolio. When I got here no one was talking about medical. It was kind of buried within what we do. But we really have some very attractive opportunities in medical and life sciences applications, so we are investing money to grow that business organically. We are pursuing a variety of acquisition ideas that would supplement our component capabilities into the medical and life sciences end markets.

CEOCFO: What is the financial picture like today for GSI?
Mr. Roush: In 2011, we had full year revenue of $366 million. We focus a lot on adjusted EBITDA as our profitability metric. We did $65 million there, so that is something over 17% margins at the EBITDA line. From an earnings per share perspective we made $0.86 cents per share in 2011 and that was up from a loss of $0.3 cents in 2010. Earnings have trended up nicely. I will say that as a company that went through a chapter 11 restructuring there are a lot of moving parts on the P&L because of the tax treatment of a lot of the bankruptcy related items that hit us in 2010 or 2011. There is a lot of legacy accounting treatment there and thus we tended to focus on the adjusted EBITDA method because it was simpler for investors to comprehend. But whether you look at EBITDA or you look at earnings per share there has been a strong trend in profitability. From a balance sheet perspective, we now have total debt of $68 million with a current interest rate of only about three percent. We have cash on hand of fifty five million so o we have only $13 million of net debt. We are generating about $10 million or more per quarter and free cash flow. So if you look at the company and project forward we have a very strong balance sheet with effectively no debt within a few quarters. As I mentioned earlier in the discussion, we also have several businesses that are in a divestiture process, and post divestitures will generate proceeds. We also have an expected IRS refund from prior year taxes, it is on our balance sheet we are holding a net asset of about $15 million. You add all that up and not only do we have minimal debt, we are generating significant cash. So we are really in a strong position, balance sheet wise, to pursue our strategic objectives of investing for organic growth and investing in acquisitions to drive our future growth.

CEOCFO: Has the investment community started to pay attention?
Mr. Roush: I would say we are in the early days of that. We currently trade somewhere between one and two turns of EBITDA lower than, let's say, a basket of pure stocks. We are undervalued almost any way that you look at it. Some of this is related to relatively high inside ownership at the company at the board level and there is also low trading volume, so it is a stock that is kind of under the radar screen. On Wall Street, to some degree, there is a lack of awareness about the company. Investor relations activities at GSI were essentially put on hold at some point in 2008 and we are not a focus area all the way through the end of 2011. Since the beginning of this year, we have

started to ramp that back up. We have now been trading on NASDAQ more than a year. We do have now three analysts following the stock and publishing research and more analysts are likely to initiate coverage in the near future. In 2012 we began attending and presenting at investor conferences. We have presented at two so far this year and there are a number of others scheduled throughout the rest of this year. So, there is a new board, a new management team, and kind of a new direction for the company. There is a new story and we are now getting that new story out there, so I suspect there will continue to be increased interest in the stock. Presently, investors can come into the stock at what we consider to be a reasonable multiple. We don't intend for that to be the case for a long time but we think investors are starting to take note and they generally like the story and they want to learn more about us. We are trying support those efforts and get out there with our story.

CEOCFO: Why should investors pay attention today?

Mr. Roush: I think that in GSI you have some distinctive capabilities and opportunities, for one thing from a technology perspective. However, we also have this kind of dual capability. We have lasers and in addition to lasers, we have some of these other capabilities and motion controls, so we bring kind of two sides of the capability. There are many laser companies out there that really just do lasers. And there are motion control companies that just do those. But we have this dual capability. We also had the opportunity to put in place effectively a new board and a new management team all at one time and that group came together with a shared sense of purpose and intention for the company. A lot of CEOs come in and have to change a culture. In some ways we were putting a brand-new culture in place; there was a little bit of a void so getting everyone on the same page. So we have a motivated and aligned team at the top and you can still get into this company in a good industry sector and lasers, photonics, and precision technology. It is a good sector that tends to support high multiples and we are an affordable stock relative to that peer group. I think we make for an attractive investment.

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