RENAL CARE GROUP INC
Form 10-Q
May 15, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2002

OR

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

For the transition period from ____________________ to ____________________

Commission File No. 0-27640

RENAL CARE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**62-1622383** (I.R.S. Employer Identification No.)

2100 West End Avenue, Suite 800, Nashville, Tennessee 37203
(Address of principal executive offices) (Zip code)
Registrant s telephone number, including area code: (615) 345-5500

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 for 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 x No o

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date.

Class	Outstanding at May 10, 2002
Common Stock, $.01 par value	49,974,735

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Note: Item 3 of Part I, and Items 2, 3, 4, and 5 of Part II are omitted because they are not applicable

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

RENAL CARE GROUP, INC.

Condensed Consolidated Balance Sheets
(*in thousands, except per share data*)

	December 31, 2001	March 31, 2002
		(unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 27,423	$ 55,520
Accounts receivable, net	127,056	133,913
Inventories	16,292	16,408
Prepaid expenses and other current assets	18,584	11,889
Income taxes receivable	7,058	
Deferred income taxes	16,894	16,894
Total current assets	213,307	234,624
Property, plant and equipment, net	175,925	180,507
Goodwill	244,738	246,282
Intangible assets, net	10,365	11,045

See accompanying notes to condensed consolidated financial statements

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RENAL CARE GROUP, INC.

Condensed Consolidated Income Statements
(in thousands, except per share data)
(unaudited)

	Three Months Ended March 31,	
	2001	**2002**
Net revenue	$174,778	$206,678
Operating costs and expenses:		
Patient care costs	113,328	134,712
General and administrative expenses	15,003	17,560
Provision for doubtful accounts	4,800	5,484
Depreciation and amortization	8,852	9,362
Total operating costs and expenses	141,983	167,118
Income from operations	32,795	39,560
Interest expense, net	999	173
Income before minority interest and income taxes	31,796	39,387
Minority interest	3,130	4,710
Income before income taxes	28,666	34,677
Provision for income taxes	10,952	13,184
Net income	$ 17,714	$ 21,493
Net income per share:		
Basic	$ 0.37	$ 0.43
Diluted	$ 0.36	$ 0.42
Weighted average shares outstanding:		
Basic	47,259	49,426
Diluted	49,611	51,222

See accompanying notes to condensed consolidated financial statements

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RENAL CARE GROUP, INC.

Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Three Months Ended March 31,	
	2001	**2002**
OPERATING ACTIVITIES		
Net income	$ 17,714	21,493
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,852	9,362
Distributions to minority shareholders	(1,469)	(2,818)
Income applicable to minority interest	3,130	4,710
Changes in operating assets and liabilities net of effects from acquisitions	(6,637)	12,459
Net cash provided by operating activities	21,590	45,206
INVESTING ACTIVITIES		
Purchases of property and equipment	(10,540)	(13,001)
Cash paid for acquisitions, net of cash acquired	(4,972)	(2,676)
Change in other assets	(3,266)	(1,048)
Net cash used in investing activities	(18,778)	(16,725)
FINANCING ACTIVITIES		
Net payments of debt	(9,105)	(152)
Net proceeds from issuance of common stock	4,176	5,181
Investment by joint venture partner		2,896
Repurchase of treasury shares		(8,309)
Net cash used in financing activities	(4,929)	(384)
(Decrease) increase in cash and cash equivalents	(2,117)	28,097
Cash and cash equivalents at beginning of period	29,902	27,423
Cash and cash equivalents at end of period	$ 27,785	$ 55,520

See accompanying notes to condensed consolidated financial statements

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RENAL CARE GROUP, INC.

Notes to Condensed Consolidated Financial Statements
For the Three Months Ended
March 31, 2002
(unaudited)

1. Basis of Presentation

Overview

Renal Care Group, Inc. (Renal Care Group or the Company) provides dialysis services to patients with chronic kidney failure, also known as end-stage renal disease (ESRD). As of March 31, 2002, the Company provided dialysis and ancillary services to approximately 19,200 patients through more than 240 outpatient dialysis centers in 26 states, in addition to providing acute dialysis services in more than 120 hospitals.

Renal Care Group s net revenue has been derived primarily from the following sources:

- outpatient hemodialysis services;
- ancillary services associated with dialysis, primarily the administration of erythropoietin (also known as Epogen® or EPO);
- home dialysis services;
- inpatient hemodialysis services provided to acute care hospitals and skilled nursing facilities;
- laboratory services; and
- management contracts with hospital-based and medical university dialysis programs.

Patients with end-stage renal disease typically receive three dialysis treatments each week, with reimbursement for services provided primarily by the Medicare ESRD program based on rates established by the Centers for Medicare & Medicaid Services (CMS). For the three months ended March 31, 2002, approximately 57% of the Company s net revenue was derived from reimbursement under the Medicare and Medicaid programs. Medicare reimbursement is subject to rate and other legislative changes by Congress and periodic changes in regulations, including changes that may reduce payments under the ESRD program. Effective January 1, 2001, Congress increased the Medicare composite rate by 1.2%. An additional increase of 1.2% took effect April 1, 2001. The April 1, 2001 increase included an adjustment factor that made that 1.2% increase effective for all of 2001. Accordingly, the net result of the 1.2% increases on January 1, 2001 and April 1, 2001, plus the April adjustment factor, was an effective increase of 2.4% for calendar year 2001. Neither Congress nor CMS approved an increase in the composite rate for 2002.

The Medicare composite rate applies to a designated group of outpatient dialysis services, including the dialysis treatment, supplies used for such treatment, certain laboratory tests and medications, and most of the home dialysis services provided by Renal Care Group. Certain other services, laboratory tests, and drugs are eligible for separate reimbursement under Medicare and are not part of the composite rate, including specific drugs such as EPO and some physician-ordered tests provided to dialysis patients.

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For patients with private health insurance, dialysis is typically reimbursed at rates higher than Medicare during the first 30 months of treatment. After that period Medicare becomes the primary payor. Reimbursement for dialysis services provided pursuant to a hospital contract is negotiated with the individual hospital and generally is higher on a per treatment equivalent basis than the Medicare composite rate. Because dialysis is a life-sustaining therapy used to treat a chronic disease, utilization is predictable and is not subject to significant seasonal fluctuations.

Renal Care Group derives a significant portion of its net revenue and net income from the administration of EPO. EPO is manufactured by a single company, Amgen. In April 2002, Amgen implemented its third increase of 3.9% in as many years. This increase will not affect Renal Care Group s results of operations in 2002 because Renal Care Group s contract with Amgen included price protection for all of 2002. The Company is currently engaged in negotiations with Amgen concerning its contract for 2003. Renal Care Group and Amgen have agreed in principle that the Company s current pricing formula will remain in effect for 2003. As a result, the Company believes, although it can give no assurances, that it will be able to mitigate a substantial portion of the 2002 price increase in 2003. This agreement in principle is conditioned on negotiating and signing a final written amendment to the contract between the Company and Amgen.

Interim Financial Statements

In the opinion of management, the information contained in this quarterly report on Form 10-Q reflects all adjustments necessary to make the results of operations for the interim periods a fair representation of such operations. All such adjustments are of a normal recurring nature. Operating results for interim periods are not necessarily indicative of results that may be expected for the year as a whole. The Company suggests that persons read these financial statements in conjunction with the consolidated financial statements and the related notes thereto included in the Company s Form 10-K, as filed with the SEC on March 29, 2002.

2. Reclassifications

Certain prior year balances have been reclassified to conform to the current period presentation. Such reclassifications had no effect on the net results of operations as previously reported.

3. Goodwill and Intangible Assets (in thousands, except per share data)

On January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets*, which addresses the financial accounting and reporting standards for the acquisition of intangible assets and for goodwill and other intangible assets subsequent to the acquisition. This accounting standard requires that goodwill be disclosed separately from other intangible assets in the balance sheet and that goodwill no longer be amortized; instead, goodwill will be tested for impairment on a periodic basis. The provisions of this accounting standard also require that the Company complete a transitional impairment test within six months of the Company s adoption of this standard, with any impairments identified treated as a cumulative effect of a change in accounting principle.

In accordance with SFAS No. 142, the Company discontinued the amortization of goodwill effective January 1, 2002. A reconciliation of previously reported net income and earnings per share to the pro forma amounts adjusted for the exclusion of goodwill amortization net of the related income tax effect follows:

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	Three Months Ended March 31,	
	2001	**2002**
Reported net income	$17,714	$21,493
Add: goodwill amortization, net of tax	863	
Pro forma adjusted net income	$18,577	$21,493
Reported basic earnings per share	$ 0.37	$ 0.43
Add: goodwill amortization, net of tax	.02	
Pro forma adjusted basic earnings per share	$ 0.39	$ 0.43
Reported diluted earnings per share	$ 0.36	$ 0.42
Add: goodwill amortization, net of tax	.01	
Pro forma adjusted diluted earnings per share	$ 0.37	$ 0.42

Changes in the carrying amount of goodwill for the quarter ended March 31, 2002, are as follows:

Balance as of December 31, 2001	$244,738
Goodwill acquired during the period	1,544
Balance as of March 31, 2002	$246,282

Information regarding the Company s separately identifiable intangible assets are as follows:

	Carrying Amount	Accumulated Amortization	Net
Noncompete and acute dialysis services agreements as of December 31, 2001	$ 16,090	$ 5,725	$10,365

	Carrying Amount	Accumulated Amortization	Net
Noncompete and acute dialysis services agreements as of March 31, 2002	$ 17,222	$ 6,177	$11,045

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The intangible assets are being amortized over their original useful lives, ranging from four to ten years. Amortization expense for the three months ended March 31, 2002 was approximately $452. Estimated amortization expense for each of the five succeeding fiscal years is as follows:

Year ending December 31,	Amount
2002	$1,943
2003	1,986
2004	1,986
2005	1,969
2006	1,914

4. Earnings Per Share (in thousands, except per share data)

The following table sets forth the computation of basic and diluted income per share:

	Three Months Ended March 31,	
	2001	2002
Numerator:		
Numerator for basic and diluted income per share	$17,714	$21,493
Denominator:		
Denominator for basic net income per share		
Weighted-average shares	47,259	49,426
Effect of dilutive securities:		
Stock options	1,940	1,700
Warrants	412	96
Denominator for diluted net income per share		
Adjusted weighted-average shares and assumed conversions	49,611	51,222
Net income per share:		
Basic	$ 0.37	$ 0.43
Diluted	$ 0.36	$ 0.42

5. Contingencies (in thousands)

On August 30, 2000, 19 patients were hospitalized and one patient died shortly after becoming ill while receiving treatment at one of the Company s dialysis centers in Youngstown, Ohio. One of the 19 hospitalized patients also died some time later. As of March 31, 2002, 11 lawsuits related to this matter were pending, and other suits could be brought in the future. Management believes Renal Care Group s insurance should be adequate to cover these events and does not anticipate a material adverse effect on the Company s consolidated financial position or results of operations.

In March 2001, the Company was sued in Mahoning County, Ohio by one of the affected patients for injuries related to the August 30, 2000 illnesses. Additional suits have been filed, and as of March 31, 2002, a total of 11 suits were pending. The suits allege negligence, medical malpractice and product liability. Additional defendants are named in each of the suits. Additional defendants in some of the suits include the water system vendors who installed and maintained the water system in the dialysis center. Renal Care Group has denied the allegations and has filed cross-claims against the water system vendors. Renal Care Group intends to pursue these

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cross-claims vigorously. Additional suits arising out of these illnesses may be filed in the future. Management believes that Renal Care Group s insurance should be adequate to cover these illnesses and does not anticipate a material adverse effect on the Company s consolidated financial position or results of operation.

On December 12, 2000, the Company reached an agreement in principle with the U.S. Attorney for the Southern District of Mississippi to settle claims arising out of alleged inadequacies in physician documentation related to lab tests performed by its laboratory subsidiary, RenaLab, Inc. The terms of such agreement provided that the Company pay $1,980 to the Medicare program. This amount was recorded during the fourth quarter of 2000 and was paid in January 2002, when the Company and the government finalized the terms of a corporate integrity agreement.

The Company is involved in other litigation and regulatory investigations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters will be resolved without material adverse effect on the Company s consolidated financial position or results of operations.

The Company generally engages practicing board-certified or board-eligible nephrologists to serve as medical directors for its centers. Medical directors are responsible for the administration and monitoring of the Company s patient care policies, including patient education, administration of dialysis treatment, development programs and assessment of all patients. The Company pays medical director fees that are consistent with the fair market value of the required supervisory services. Such medical director agreements typically have a term of seven years with a three-year renewal option.

6. Recent Accounting Pronouncements

On June 30, 2001, the Company adopted SFAS No. 141, *Business Combinations*, which eliminated the pooling of interests method of accounting for all business combinations initiated after June 30, 2001 and addressed the initial recognition and measurement of goodwill and other intangible assets acquired in a business combination.

As discussed in detail in Note 3, the Company adopted SFAS No. 142 on January 1, 2002.

Effective January 1, 2002, the Company adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which addresses the accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 did not have an effect on the Company s results of operations.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Results of Operations

Three Months Ended March 31, 2002 Compared to Three Months Ended March 31, 2001

Net Revenue. Net revenue increased from $174.8 million for the three months ended March 31, 2001 to $206.7 million for the three months ended March 31, 2002, an increase of $31.9 million, or 18.3%. This increase resulted primarily from a 9.8% increase in the number of treatments from 644,146 performed in the 2001 period to 707,483 performed in the 2002 period. This growth in treatments is the result of the acquisition of various dialysis facilities and a 5.8% increase in same-center treatments for 2002 over 2001. In addition, average net revenue per dialysis treatment increased 8.6% from $267 in 2001 to $290 in 2002. The increase in revenue per treatment was due in part to the implementation of the 2001 Medicare composite rate increase that was phased in with the additional 1.2% increase effective April 1, 2002. We also implemented a rate increase to private payors in the fourth quarter of 2001.

Patient Care Costs. Patient care costs consist of costs directly related to the care of patients, including direct labor, drugs and other medical supplies, and operational costs of facilities. Patient care costs increased from $113.3 million for the three months ended March 31, 2001 to $134.7 million for the three months ended March 31, 2002, an increase of 18.9%. This increase was due principally to the increase in the number of treatments performed during the period, which was reflected in corresponding increases in the use of labor, drugs and supplies, and the 3.9% increase in the cost of EPO. Patient care costs as a percentage of net revenue increased from 64.8% in 2001 to 65.2% in 2002. Patient care costs per treatment increased 8.0% from $176 in 2001 to $190 in 2002. These increases were due to the EPO price increase, increased labor costs to address wage pressures in many of the Company s markets and the increase in utilization of certain drugs.

General and Administrative Expenses. General and administrative expenses include corporate office costs and facility costs not directly related to the care of patients, including facility administration, accounting, billing and information systems. General and administrative expenses increased from $15.0 million for the three months ended March 31, 2001 to $17.6 million for the three months ended March 31, 2002, an increase of 17.0%. General and administrative expenses as a percentage of net revenue decreased slightly from 8.6% to 8.5% in 2001 and 2002, respectively.

Provision for Doubtful Accounts. The provision for doubtful accounts is determined as a function of payor mix, billing practices, and other factors. Renal Care Group reserves for doubtful accounts in the period in which the revenue is recognized based on management s estimate of the net collectibility of the accounts receivable. Management estimates the net collectibility of accounts receivable based upon a variety of factors. These factors include, but are not limited to, analyzing revenues generated from payor sources, performing subsequent collection testing and regularly reviewing detailed accounts receivable agings. The provision for doubtful accounts increased from $4.8 million for the three months ended March 31, 2001 to $5.5 million for the three months ended March 31, 2002, an increase of $0.7 million, or 14.3%. The provision for doubtful accounts as a percentage of net revenue remained consistent at 2.7% in 2001 and 2002.

Depreciation and Amortization. Depreciation and amortization increased from $8.9 million for the three months ended March 31, 2001 to $9.4 million for the three months ended March 31, 2002, an increase of 5.8%. This increase was due to the start-up of dialysis facilities, the normal replacement costs of dialysis facilities and equipment, the purchase of information systems and the amortization of intangible assets associated with

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acquisitions. Depreciation and amortization as a percentage of net revenue decreased from 5.1% in 2001 to 4.5% in 2002, primarily as a result of the implementation of SFAS No. 142.

Income from Operations. Income from operations increased from $32.8 million for the three months ended March 31, 2001 to $39.6 million for the three months ended March 31, 2002, an increase of 20.6%. Income from operations as a percentage of net revenue increased from 18.8% in the 2001 period to 19.1% in the 2002 period as a result of the factors discussed above.

Interest Expense, Net. Interest expense decreased from $1.0 million for the three months ended March 31, 2001 to $200,000 for the three months ended March 31, 2002, a decrease of 82.7%. The decrease was the result of lower average borrowings in 2002, as the Company had retired all debt outstanding under its line of credit and recognized interest expense only on equipment notes payable, commitment fees and amortization of debt issuance costs.

Minority Interest. Minority interest represents the proportionate equity interest of other partners in the Company s consolidated entities that are not wholly-owned, the financial results of which entities are included in the Company s consolidated results. Minority interest as a percentage of net revenue increased to 2.3% in 2002 from 1.8% in 2001. This increase was the result of continued expansion of the operations of Renal Care Group s joint ventures, primarily those in Ohio, Oregon and Washington, as well as an increase in the number of facilities operated as joint ventures.

Provision for Income Taxes. Income tax expense increased from $11.0 million for the three months ended March 31, 2001 to $13.2 million for the three months ended March 31, 2002, an increase of $2.2 million or 20.4%. The increase is a result of pre-tax earnings increasing by approximately 21.0%. The effective tax rate of the Company decreased slightly from 38.2% in 2001 to 38.0% in 2002. This decrease is primarily the result of the implementation of SFAS No. 142.

Net Income. Net income increased from $17.7 million for the three months ended March 31, 2001 to $21.5 million for the three months ended March 31, 2002, an increase of $3.8 million or 21.3%. The increase is a result of the items discussed above.

Liquidity and Capital Resources

Renal Care Group requires capital primarily to acquire and develop dialysis centers, to purchase property and equipment for existing centers, and to finance working capital needs. At March 31, 2002, the Company s working capital was $119.9 million, cash and cash equivalents were $55.5 million, and the Company s current ratio was approximately 2.0 to 1.

Net cash provided by operating activities was $45.2 million for the three months ended March 31, 2002. Cash provided by operating activities consists of net income before depreciation and amortization expense, adjusted for changes in components of working capital. Net cash used in investing activities was $16.7 million for the three months ended March 31, 2002. Cash used in investing activities consisted primarily of $13.0 million of purchases of property and equipment and $2.7 million of cash paid for acquisitions, net of cash acquired. Net cash used in financing activities was approximately $400,000 for the three months ended March 31, 2002. Cash used in financing activities primarily reflects repurchases of Renal Care Group common stock of $8.3 million offset by a $2.9 million investment by a joint venture partner and $5.2 million in net proceeds from the issuance of common stock.

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The Company is a party to a Second Amendment to its First Amended and Restated Loan Agreement with a group of banks. Lender commitments under the amended loan agreement were reduced to $129.5 million in August 2001. Borrowings under the credit facility may be used for acquisitions, capital expenditures, working capital and general corporate purposes. No more than $25.0 million of the credit facility may be used for working capital purposes. Within the working capital sublimit, Renal Care Group may borrow up to $5.0 million in swing line loans. Lender commitments will remain at $129.5 million through August 2002, and will then be reduced to $101.8 million through August 2003. To the extent any amounts are outstanding under this line of credit, these amounts will be due and payable in full on August 4, 2003. As of March 31, 2002, there was no amount outstanding under this agreement. This variable rate debt instrument carries a degree of interest rate risk. Specifically variable rate debt may result in higher costs to the Company if interest rates rise.

Each of Renal Care Group s wholly-owned subsidiaries has guaranteed all of Renal Care Group s obligations under the loan agreement. Further, Renal Care Group s obligations under the loan agreement, and the obligations of each of its subsidiaries under its guaranty, are secured by a pledge of the equity interests held by Renal Care Group in each of the subsidiaries. Financial covenants are customary based on the amount and duration of this commitment.

A significant component of Renal Care Group s growth strategy is the acquisition and development of dialysis facilities. There can be no assurance that Renal Care Group will be able to identify suitable acquisition candidates or to close acquisition transactions with them on acceptable terms. Management of Renal Care Group believes that existing cash and funds from operations, together with funds available under the line of credit, will be sufficient to meet Renal Care Group s acquisition, expansion, capital expenditure and working capital needs for the foreseeable future. However, in order to finance certain large strategic acquisition opportunities, Renal Care Group may from time to time incur additional short and long-term bank indebtedness and may issue equity or debt securities. The availability and terms of any future financing will depend on market and other conditions. There can be no assurance that any additional financing, if required, will be available on terms acceptable to Renal Care Group.

Capital expenditures of between $50.0 million to $55.0 million, primarily for equipment replacement, expansion of existing dialysis facilities and construction of de novo facilities are planned in 2002. The Company has made capital expenditures of approximately $13.0 million through March 31, 2002. The Company expects that remaining capital expenditures in 2002 will be funded with cash provided by operating activities and the Company s existing credit facility. Management believes that capital resources available to Renal Care Group will be sufficient to meet the needs of its business, both on a short- and long-term basis.

Management, from time to time, determines the appropriateness of repurchasing its common stock in accordance with a repurchase plan authorized by the Board of Directors in October 2000. In the fourth quarter of 2001, Renal Care Group began its process for repurchasing shares of its common stock by purchasing 100,000 shares of common stock for approximately $3.1 million. In the first quarter of 2002, Renal Care Group repurchased 280,000 shares of common stock for approximately $8.3 million. Management expects to repurchase additional shares of common stock during 2002.

Critical Accounting Policies

On December 12, 2001, the Securities and Exchange Commission issued a financial reporting release, FR-60, *Cautionary Advice Regarding Disclosure About Critical Accounting Policies*. In accordance with FR-60, management has identified accounting policies that it considers critical to the business of Renal Care Group. Those policies include net revenue and contractual provisions, provision for doubtful accounts, self-insurance accruals, and impairment of long-lived assets and long-lived assets to be disposed of. These policies were

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identified as critical based on their importance to the consolidated financial statements as well as on the degrees of subjectivity and complexity involved in these policies. There have been no changes in Renal Care Group s critical accounting policies or in the application of those policies from those described in the annual report on Form 10-K as filed with the SEC on March 29, 2002.

RISK FACTORS

You should carefully consider the risks described below before investing in Renal Care Group. The risks and uncertainties described below ***are not*** *the only ones facing Renal Care Group. Other risks and uncertainties that we have not predicted or assessed may also adversely affect us.*

If any of the following risks occurs, our earnings, financial condition or business could be materially harmed, and the trading price of our common stock could decline, resulting in the loss of all or part of your investment.

If Medicare or Medicaid Changes its Programs for Dialysis, Our Revenue and Earnings Could Decrease

If the government changes the Medicare, Medicaid or similar government programs or the rates paid by those programs for our services, then our revenue and earnings may decline. We estimate that approximately 53% of our net revenue for 2000, 49% of our net revenue for 2001 and 50% of our net revenue for the three months ended March 31, 2002 consisted of reimbursements from Medicare, including the administration of EPO to treat anemia. We also estimate that approximately 5% of our net revenue for 2000, 6% of our net revenue for 2001 and 7% of our net revenue for the three months ended March 31, 2002 consisted of reimbursements from Medicaid or comparable state programs. Some of the states Medicaid programs reimburse us at rates higher than those paid by Medicare. Some of these programs have proposed reductions or have announced that they are considering reductions. Any action to reduce those higher Medicaid reimbursement rates would adversely affect our revenue and earnings. Any of the following actions in connection with government programs could cause our revenue and earnings to decline:

- a reduction of the amount paid to us under government programs;
- an increase in the costs associated with performing our services that are subject to inflation, such as labor and supply costs, without a corresponding increase in reimbursement rates;
- the inclusion of some or all ancillary services, for which we are now reimbursed separately, in the flat composite rate for a standard dialysis treatment; or
- changes in laws, or the interpretations of laws, which could cause us to modify our operations.

Specifically, Congress and the Centers for Medicare & Medicaid Services, or CMS (formerly known as Health Care Financing Administration), have proposed reviewing and potentially recalculating the average wholesale prices of certain drugs, including some drugs that we bill for outside of the flat composite rate. CMS has indicated that it believes the average wholesale prices on which it currently bases reimbursement are too high and that Medicare reimbursement for these drugs is, therefore, too high. Because we are unable to predict accurately whether reimbursement will be changed and, if so, by how much, we are unable to quantify what the net effect of changes in reimbursement for these drugs would have on our revenue and earnings.

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If Reimbursement for EPO Decreases, Then We Could Be Less Profitable

If government or private payors decrease reimbursement rates for EPO, for which we are currently reimbursed separately outside of the flat composite rate, our revenue and earnings will decline. EPO is a bio-engineered hormone that is used to treat anemia. Revenues from the administration of EPO were approximately 26% of our net revenue for 2000 and 25% of our net revenue for 2001 and 23% of our net revenue for the three months ended March 31, 2002. Most of our payments for EPO come from government programs. For the three months ended March 31, 2002, Medicare and Medicaid reimbursement represented approximately 57% of the total revenue we derived from EPO. A reduction in the reimbursement rate for EPO could materially and adversely affect our revenue and earnings.

If Amgen Raises the Price for EPO or if EPO Becomes in Short Supply, Then We Could Be Less Profitable

EPO is produced by a single manufacturer, Amgen Inc., and there are no substitute products currently marketed to dialysis providers in the United States. In April 2002, Amgen announced a 3.9% increase in the price of EPO. This price increase will not affect our earnings in 2002 because our contract with Amgen has pricing protection through 2002. In addition, Amgen implemented a 3.9% increase in the price of EPO in May 2001. That price increase will adversely affect our earnings in 2002. If Amgen imposes additional EPO price increases or if Amgen or other factors interrupt the supply of EPO, then our revenue and earnings will decline.

If Amgen Markets Aranesp® for ESRD Patients, then We Could Be Less Profitable

Amgen has developed and obtained FDA approval for a new drug to treat anemia marketed as Aranesp® (darbepoetin alfa). Aranesp® is a longer acting form of bio-engineered protein that, like EPO, can be used to treat anemia. EPO is usually administered in conjunction with each dialysis treatment. Aranesp® can remain effective for between two and three weeks. As of this date Amgen has not announced its plans for marketing Aranesp®. If Amgen markets Aranesp® for the treatment of dialysis patients, then our earnings could be materially and adversely affected by either of the following factors:

- Our margins realized from the administration of Aranesp® could be lower than the margins realized on the administration of EPO; or
- Physicians could decide to administer Aranesp® in their offices, and we would not recognize revenue or profit from the administration of EPO or Aranesp® .

If Payments by Private Insurers, Hospitals or Managed Care Organizations Decrease, Then Our Revenue and Earnings Could Decrease

If private insurers, hospitals or managed care organizations reduce their rates or if we experience a significant shift in our revenue mix toward additional Medicare or Medicaid reimbursement, then our revenue and earnings will decline. We estimate that approximately 42% of our net revenue for 2000, 45% of our net revenue for 2001 and 43% of our net revenue for the three months ended March 31, 2002, were derived from sources other than Medicare and Medicaid. In general, payments we receive from private insurers and hospitals for our services are at rates significantly higher than the Medicare or Medicaid rates. Additionally, payments we receive from managed care organizations are at rates higher than Medicare and Medicaid rates but lower than those paid by private insurers. As a result, any of the following events could have a material adverse effect on our revenue and earnings:

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- any number of economic or demographic factors could cause private insurers, hospitals or managed care companies to reduce the rates they pay us;

- a portion of our business that is currently reimbursed by private insurers or hospitals may become reimbursed by managed care organizations, which currently have lower rates for our services; or

- the scope of coverage by Medicare or Medicaid under the flat composite rate could expand and, as a result, reduce the extent of our services being reimbursed at the higher private-insurance rates.

If We are Unable to Make Acquisitions in the Future, Our Rate of Growth Will Slow

Much of our historical growth has come from acquisitions. Although we intend to continue to pursue growth through the acquisition of dialysis centers, we may be unable to continue to identify and complete suitable acquisitions at prices we are willing to pay or we may be unable to obtain the necessary financing. Further, due to the increased size of our Company since its formation, the amount that acquired businesses contribute to our revenue and profits will likely be smaller on a percentage basis. Also, as a result of consolidation in the dialysis industry, the four largest providers of outpatient dialysis services own approximately 65% of the total number of outpatient dialysis facilities in the United States. We compete with these other companies to identify and complete suitable acquisitions. We expect this competition to intensify in light of the smaller pool of available acquisition candidates and other market forces. As a result, we believe it will be more difficult for us to acquire suitable companies on favorable terms. Further, the businesses we acquire may not perform well enough to justify our investment. If we are unable to make additional acquisitions on suitable terms, then we may not meet our growth expectations.

If We Fail to Integrate Acquired Companies, We Will Be Less Profitable

We have grown significantly by acquisitions of other dialysis providers since our formation in February 1996. We have completed some of our acquisitions as recently as April 2002. We intend to pursue acquisitions of more dialysis businesses in the future. We are unable to predict the number and size of any future acquisitions. We face significant challenges in integrating an acquired company s management and other personnel, clinical operations, and financial and operating systems with ours, often without the benefit of continued services from key personnel of the acquired company. We may be unable to integrate the businesses we acquire successfully or to achieve anticipated benefits from an acquisition in a timely manner, which could lead to substantial costs and delays or other operational, technical or financial problems, including diverting management s attention from our existing business. Any of these results could damage our profitability and our prospects for future growth.

If We Complete Future Acquisitions, We May Dilute Existing Stockholders by Issuing More of Our Common Stock or We May Incur Additional Expenses Related to Debt and Goodwill, Which Could Reduce Our Earnings

We may issue equity securities in future acquisitions that could be dilutive to our shareholders. We also may incur additional debt in future acquisitions. On June 29, 2001, the Financial Accounting Standards Board approved rules that eliminate the pooling-of-interests accounting method. The elimination of the pooling-of-interests method results in the recording of goodwill for all acquisitions after June 30, 2001. Under these new rules goodwill and other intangible assets with indefinite lives will not be amortized to expense; however, we

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will be required to review all of these assets at regular intervals and to charge an appropriate amount to expense when impairment is identified. If we are required under these new rules to write off a significant portion of our intangible assets at one time, then there could be a material adverse impact on our stock price. Interest expense on additional debt incurred to fund our acquisitions may significantly reduce our profitability.

If Acquired Businesses Have Unknown Liabilities, Then We Could Be Exposed to Liabilities That Could Harm Our Business and Profitability

Businesses we acquire may have unknown or contingent liabilities, including liabilities for failure to comply with health care laws. Although we generally attempt to identify practices that may give rise to unknown or contingent liabilities and conform them to our standards after the acquisition, private plaintiffs or governmental agencies may still assert claims. Even though we generally seek to obtain indemnification from prospective sellers, unknown and contingent liabilities may not be covered by indemnification or may exceed contractual limits or the financial capacity of the indemnifying party.

If Our Referring Physicians Stop Referring To Our Centers or Were Prohibited From Referring for Regulatory Reasons, Our Revenue and Earnings Would Decline

Our dialysis centers depend on referrals from local nephrologists. Typically, one or a few physicians patients make up all or a significant portion of the patient base at each of our dialysis centers, and the loss of the patient base of one or more referring physicians could have a material adverse effect on the operations of that center. The loss of the patient base of a significant number of referring physicians could cause our revenue and earnings to decline. In many instances, the primary referral sources for our centers are physicians who are also stockholders and serve as medical directors of our centers. If stock ownership or the medical director relationship were deemed to violate applicable federal or state law, including fraud and abuse laws and laws prohibiting self-referrals, then the physicians owning our stock or acting as medical directors could be forced to stop referring patients to our centers. Further, we may not be able to renew or renegotiate our medical director agreements successfully, which could result in a loss of patients since dialysis patients are typically treated at a center where their physician serves as a medical director.

If Our Business Is Alleged or Found To Violate Heath Care or Other Applicable Laws, Our Revenue and Earnings Could Decrease

We are subject to extensive federal, state and local regulation regarding the following:

- fraud and abuse prohibitions under health care reimbursement laws;
- prohibitions and limitations on patient referrals;
- billing and reimbursement, including false claims prohibitions under health care reimbursement laws;
- collection, use, storage and disclosure of patient health information, including the federal Health Insurance Portability and Accountability Act of 1996, referred to as HIPAA, and state law equivalents of HIPAA;
- facility licensure;
- health and safety requirements;

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- environmental compliance; and
- medical and toxic waste disposal.

Much of this regulation, particularly in the areas of fraud and abuse and patient referral, is complex and open to differing interpretations. Due to the broad application of the statutory provisions and the absence in many instances of regulations or court decisions addressing the specific arrangements by which we conduct our business, including our arrangements with medical directors, physician stockholders and physician joint venture partners, governmental agencies could challenge some of our practices under these laws.

New regulations governing electronic transactions and the collection, use, storage, and disclosure of health information impose significant administrative and financial obligations on our business. If, after the required compliance date, we are found to have violated these restrictions, we could be subject to:

- criminal or civil penalties;
- claims by persons who believe their health information has been improperly used or disclosed; and
- administrative penalties by payors.

Government investigations of health care providers, including dialysis providers, have continued to increase. We have been the subject of investigations in the past, and the government may investigate our business in the future. One of our competitors, DaVita, Inc., has announced that it is the subject of an investigation by the U.S. Attorney for the Eastern District of Pennsylvania, and another competitor, Gambro Healthcare, Inc., has announced that it is the subject of an investigation by the U.S. Attorney s Office in St. Louis, Missouri. If any of our operations are found to violate applicable laws, we may be subject to severe sanctions or be required to alter or discontinue the challenged conduct or both. If we are required to alter our practices, we may not be able to do so successfully. If any of these events occurs, our revenue and earnings could decline.

Changes In the Health Care Delivery, Financing or Reimbursement Systems Could Adversely Affect Our Business

The health care industry in the United States remains in a period of change and uncertainty. Health care organizations, public or private, may dramatically change the way they operate and pay for services. Our business is designed to function within the current health care financing and reimbursement system. During the past several years, the health care industry has been subject to increasing levels of government regulation of, among other things, reimbursement rates and capital expenditures. In addition, proposals to reform the health care system have been considered by Congress. These proposals, if enacted, could further increase government regulation of or other involvement in health care, lower reimbursement rates and otherwise change the operating environment for health care companies. We cannot predict the likelihood of those events or what impact they may have on our business.

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The Dialysis Business Is Highly Competitive. If We Do Not Compete Effectively in Our Markets, We Could Lose Market Share and Our Rate of Growth Could Slow

The dialysis industry is rapidly consolidating. There is a small number of large dialysis companies that compete for the acquisition of outpatient dialysis centers and the development of relationships with referring physicians. Several of our competitors are part of larger companies that also manufacture dialysis equipment, which allows them to benefit from lower equipment costs. Several of our competitors, including these equipment manufacturers, are significantly larger than we are and have greater financial resources and more established operations. We cannot assure you that we will be able to compete effectively with any of our competitors.

If We Lose Any of Our Executive Officers, or Are Unable To Attract and Retain Qualified Management Personnel and Medical Directors, Our Ability To Run Our Business Could Be Adversely Affected, and Our Revenue and Earnings Could Decline

We are dependent upon the services of our executive officers Sam A. Brooks, Jr., our Chairman, Chief Executive Officer and President, Raymond Hakim, M.D., Ph.D., R. Dirk Allison and Gary Brukardt, each an Executive Vice President. Mr. Brooks, Dr. Hakim and Mr. Brukardt have each been with Renal Care Group since its formation. The services of Mr. Brooks and these three Executive Vice Presidents would be very difficult to replace. We do not carry key-man life insurance on any of our officers. Further, our growth will depend in part upon our ability to attract and retain skilled employees, for whom competition is intense. We also believe that our future success will depend on our ability to attract and retain qualified physicians to serve as medical directors of our dialysis centers.

If We Are Liable for Damages in Litigation, Our Insurance May Not be Sufficient to Cover Such Potential Damages

On August 30, 2000, 19 patients were hospitalized and one patient died shortly after becoming ill while receiving treatment at one of our dialysis centers in Youngstown, Ohio. One of the 19 hospitalized patients also died some time later. Eleven lawsuits had been filed against us as of March 31, 2002, and other suits could be brought in the future. While management believes Renal Care Group s insurance should be adequate to cover these events, if we are found liable for damages in litigation stemming from these illnesses, our present insurance coverage may not be sufficient to cover such damages.

If Our Board of Directors Does Not Approve an Acquisition or Change in Control of Renal Care Group, Our Shareholders May Not Realize the Full Value of Their Stock

Our certificate of incorporation and bylaws contain a number of provisions that may delay, deter or inhibit a future acquisition or change in control of Renal Care Group that is not first approved by our board of directors. This could occur even if our shareholders receive an attractive offer for their shares or if a substantial number or even a majority of our shareholders believe the takeover may be in their best interest. These provisions are intended to encourage any person interested in acquiring Renal Care Group to negotiate with and obtain approval from our board of directors prior to pursuing the transaction. Provisions that could delay, deter or inhibit a future acquisition or change in control of Renal Care Group include the following:

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- a staggered board of directors that would require two annual meetings to replace a majority of the board of directors;
- restrictions on calling special meetings at which an acquisition or change in control might be brought to a vote of the shareholders;
- blank check preferred stock that may be issued by our board of directors without shareholder approval and that may be substantially dilutive or contain preferences or rights objectionable to an acquiror; and
- a poison pill that would substantially dilute the interest sought by an acquiror.

These provisions could also discourage bids for our common stock at a premium and cause the market price of our common stock to decline.

Our Stock Price Is Volatile and as a Result, the Value of Your Investment May Go Down for Reasons Unrelated To the Performance of Our Business

Our common stock is traded on the New York Stock Exchange. The market price of our common stock has been volatile, ranging from a low of $28.05 per share to a high of $34.00 per share during the three months ended March 31, 2002. The market price for our common stock could fluctuate substantially based on a variety of factors, including the following:

- future announcements concerning us, our competitors or the health care market;
- the threat of litigation or government investigation;
- changes in government regulations; and
- changes in earnings estimates by analysts.

Furthermore, stock prices for many companies fluctuate widely for reasons that may be unrelated to their operating results. These fluctuations, coupled with changes in demand or reimbursement levels for our services and general economic, political and market conditions, could cause the market price of our common stock to decline.

Forward Looking Statements

Some of the information in this quarterly report on Form 10-Q contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as may, will, expect, anticipate, believe, intend, estimat continue or similar words. You should read statements that contain these words carefully for the following reasons:

- the statements discuss our future expectations;
- the statements contain projections of our future earnings or of our financial condition; and
- the statements state other forward-looking information.

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We believe it is important to communicate our expectations to our investors. There may be events in the future, however, that we are not accurately able to predict or over which we have no control. The risk factors listed above, as well as any cautionary language in or incorporated by reference into this quarterly report on Form 10-Q, provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. The SEC allows us to incorporate by reference the information we file with them, which means we can disclose important information to you by referring you to those documents. Before you invest in our common stock, you should be aware that the occurrence of any of the events described in the above risk factors, elsewhere in or incorporated by reference into this quarterly report on Form 10-Q and other events that we have not predicted or assessed could have a material adverse effect on our earnings, financial condition and business. If the events described above or other unpredicted events occur, then the trading price of our common stock could decline and you may lose all or part of your investment.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

As disclosed in Renal Care Group s annual report on Form 10-K filed with the SEC on March 29, 2002, we are subject to a number of lawsuits arising out of events on August 30, 2000. On that day 19 patients were hospitalized and one patient died shortly after becoming ill while receiving treatment at one of Renal Care Group s dialysis centers in Youngstown, Ohio. One of the 19 hospitalized patients also died some time later. There have been no material developments in these lawsuits in the quarter ended March 31, 2002.

Additional suits arising out of these illnesses may be filed in the future. Management believes that Renal Care Group s insurance should be adequate to cover these illnesses and does not anticipate a material adverse effect on the Company s consolidated financial position

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits:

10.60 Restricted Stock Award Agreement dated August 2, 2001 between the Company and Sam A. Brooks

(b) Reports on Form 8-K

Form 8-K filed January 22, 2002.

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SIGNATURE

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

RENAL CARE GROUP, INC. (Registrant)

May 15, 2002

BY: /s/ R. Dirk Allison

R. Dirk Allison
Executive Vice President, Chief Financial Officer,
and Principal Financial Officer and
Principal Accounting Officer

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RENAL CARE GROUP, INC.

EXHIBIT INDEX

Number and Description of Exhibit	
10.60	Restricted Stock Award Agreement dated August 2, 2001 between the Company and Sam A. Brooks

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Jamie B. Bader, our Vice President, Group President of Precision Motion and Technologies;

Matthijs Glastra, our Vice President, Group President of Laser Products hired on October 15, 2012;

Deborah A. Mulryan, our Vice President, Human Resources; and

David Clarke, our Vice President, Group President of Laser Products who resigned effective on September 28, 2012.

Executive Summary

Compensation Philosophy

The Compensation Committee evaluates and sets executive compensation consistent with the Company s philosophy to provide a compensation package that incentivizes and retains a highly qualified executive team and rewards both short-term and long-term sustainable performance as measured against established goals. Our executive compensation structure seeks to promote this philosophy through a combination of the following types of awards: base salary, cash bonus incentive awards and long-term equity-based incentive awards in the form of service-based restricted stock units. The key elements of our stated philosophy are as follows:

Pay-for-Performance. The Compensation Committee reviews the overall design of our executive compensation program on an annual basis to ensure that our executive compensation is aligned with both annual and long-term performance goals.

Compensation mix with a larger percentage of at-risk compensation. Through the adoption of a compensation structure offering cash based incentives and equity-based incentives, the Compensation Committee has increased the percentage of at-risk compensation for named executive officers. The Compensation Committee may also consider further increasing the emphasis on at-risk elements of compensation in the future by reducing or maintaining base salaries and increasing short-term and/or long-term incentive potentials.

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Prudent corporate governance. We are committed to maintaining a prudent corporate governance model and to continually improving our compensation practices and policies. Key practices include:

- Annual review of the compensation philosophy of the Company by the Compensation Committee.
- Maintenance of a Compensation Committee composed entirely of independent, non-employee directors who satisfy applicable independence requirements.
- Engagement of an independent outside compensation consultant, Towers Watson, to perform market-based analyses of competitive pay levels and practices for key positions within the company.

For a full description of our 2012 executive compensation program, please see Executive Compensation Philosophy and Executive Compensation and Comparable Company Data.

Highlights of our 2012 Executive Compensation Program

When we emerged from bankruptcy and consummated our reorganization in 2010, we began rebuilding our executive team and implementing new executive compensation practices to reinforce our compensation philosophy. The rebuilding of our executive team was completed in 2012 with the hiring of Mr. Glastra as the Vice President and Group President of Laser Products on October 15, 2012.

The compensation practices and arrangements implemented in 2011 were continued in 2012. A summary of the compensation practices are set forth below:

Continuation of the Senior Management Incentive Plan (SMIP), a pay-for- performance compensation structure for senior executives, which seeks to balance the percentage of compensation provided in the forms of base salary, cash bonus incentive awards and long-term equity-based awards. The SMIP provides a competitive market-based compensation structure with direct alignment to shareholder interests that enables the Company to attract and retain key management talent.

Equity incentive awards were granted pursuant to the SMIP to align executive compensation with the long-term goal of enhancing shareholder value and to promote executive retention with the Company by granting awards that vest over several years.

The cash bonus incentive awards pursuant to the SMIP are determined based on several performance metrics, based on the Board s belief that the Company s growth and future success are dependent upon the achievement of both financial results and key business goals that are not necessarily financial in nature. The metrics are: (1) Business Group adjusted EBITDA target, (2) Company adjusted EBITDA target, (3) individual non-financial objectives, and (4) with respect to the SMIP for the second half of 2012, certain objectives related to discontinued operations. The Company currently defines adjusted EBITDA as earnings before deducting interest expense (net of interest income), income taxes, depreciation, amortization, non-cash stock-based compensation and other non-recurring or non-operating charges. The respective adjusted EBITDA target levels of performance are correlated with the Company s annual sales and income growth objectives. The individual, non-financial performance objectives target strategic, operational and organizational goals and objectives within the Company, which are aligned to the Company s overall strategic and financial success. The discontinued operations objectives are tied to the adjusted EBITDA targets and successfully entering into a definitive agreement to sell the Semiconductor Systems business unit and the Laser Systems business unit, in each case within a certain time frame and for a predetermined purchase price. See the Executive Compensation Program Elements section below for additional information about the performance metrics applicable to the 2012 cash bonus incentive awards.

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In addition to the compensation practices described above, the Company has agreed to certain compensation terms and conditions that are set forth in employment or severance agreements or letters with the named executive officers. For a full description of the Company s executive compensation program, please also see Executive Compensation Program Elements. For a description of the employment and severance agreements and letters, see Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table and Potential Payments upon Termination or Change of Control .

Compensation Committee Members and Independence

The Compensation Committee is comprised of Messrs. Bershad, Fortino and Lamel. None of the current members were, at any time, officers or employees of the Company or its subsidiaries and the Board has determined that each member of the Compensation Committee is an independent director under the applicable rules of NASDAQ.

Role of the Compensation Committee

The Compensation Committee is responsible for designing, implementing and evaluating the Company s executive compensation plans and policies. Among its responsibilities, the Compensation Committee establishes our compensation philosophy and the framework for determining the compensation of our named executive officers and reviews, evaluates and approves base salaries, cash based incentives, long-term equity-based incentives and all other forms of compensation for these individuals.

The Compensation Committee receives advice and input, as applicable, from the Board of Directors, the Chief Executive Officer of the Company (the CEO), members of management, outside consultants, human resources representatives and the Company s outside legal counsel on compensation issues and regarding general compensation policies, including the appropriate level and mix of compensation for executive officers.

The Compensation Committee operates pursuant to a written charter (the Charter). The Charter sets forth the Compensation Committee s purpose, composition, authority, responsibilities, and procedures. The Compensation Committee reviews the Charter and recommends any proposed changes to the Board. The Charter is available at the Investor Relations page of the Company s website (http://gsig.investorroom.com/charters). In summary, the Compensation Committee has been established by the Board to determine the appropriate compensation of the Company s senior management. The Compensation Committee meets as often as the chair of the Compensation Committee deems necessary or advisable to fulfill its responsibilities. The Compensation Committee reports its actions and recommendations to the full Board of Directors at each quarterly meeting of the Board of Directors. The Compensation Committee meets in executive session and, where appropriate, with members of management, including the CEO, outside consultants, human resources representatives and the Company s outside legal counsel.

The Compensation Committee establishes all elements of compensation paid to the CEO, including the establishment of goals and objectives for the CEO, evaluation of the performance of the CEO in light of those goals and objectives and determination and approval of the compensation payable to the CEO based on such evaluation. The Compensation Committee has sole authority to determine the CEO s compensation and the CEO may not be present during voting or deliberations concerning his compensation.

The CEO is authorized by the Compensation Committee to evaluate the performance of the other named executive officers annually, or semi-annually with respect to cash-based incentives, and reports his findings to the Compensation Committee, together with his recommendations for compensation adjustments. The Compensation Committee meets with the CEO to discuss his evaluations and recommendations and retains the ultimate responsibility and authority for all compensation decisions made with respect to each of the named executive officers. Additionally, the Compensation Committee reviews and approves the establishment of the performance objectives, including the target financial objectives for the cash based incentives, applicable to each of the named executive officers.

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In its review of compensation to the named executive officers, the Compensation Committee assesses whether the Company s financial performance for the preceding year justifies adjustments to base salaries and granting of equity-based compensation. With regard to the cash bonus incentives, which are payable based on semi-annual performance targets, the Compensation Committee reviews (and, if necessary, certifies) performance against all objectives to confirm the appropriate level of payout. In addition, from time to time, the Compensation Committee may consider discretionary bonuses for performance exceeding expectations. The Compensation Committee then recommends its compensation proposal to the full Board for its approval.

Pursuant to the Charter, the Compensation Committee may form and delegate authority to subcommittees of the Compensation Committee, to the extent consistent with the Company s Articles of Association, Bylaws, Corporate Governance Guidelines, applicable law and NASDAQ rules, except that it may not delegate its responsibilities for any matters that involve executive compensation or any matters where it has determined such compensation is intended to comply with Section 162(m) of the Internal Revenue Code of 1986,as amended (the Internal Revenue Code), by virtue of being approved by a committee of outside directors or is intended to be exempt from Section 16(b) under the Securities Exchange Act of 1934 pursuant to Rule 16b-3 by virtue of being approved by a committee of non-employee directors.

Executive Compensation Philosophy

The Company s compensation policy seeks to build long-term sustainable shareholder value by tying compensation to financial performance and important Company goals, and by incentivizing and retaining a highly qualified executive team in an extremely competitive market for talent. Accordingly, the Compensation Committee believes executive compensation packages provided by the Company to its named executive officers should include both cash and equity-based compensation that reward performance as measured against established goals.

The following principles guide the Company s executive compensation program:

- provide competitive compensation to attract and retain executive talent with the capability to lead within a global company;
- emphasize variable pay to align executive compensation with the achievement of results that drive the Company s business strategy;
- use equity-based incentive plans to tie a significant portion of compensation to the Company s long-term results, to align the executive s financial interests with those of our shareholders and to facilitate an ownership culture among executives;
- design executive compensation programs that are affordable for the Company, including their impact on earnings and cash flow, that do not promote inappropriate or excessive risk-taking and that are flexible to respond to the changing needs of the business; and
- provide transparency so that both executives and other stakeholders understand the executive compensation program and the objectives it seeks to achieve.

Executive Compensation and Comparable Company Data

Generally, each year, the Compensation Committee reviews each named executive officer s total compensation and, in connection therewith, considers market data for similar positions at other public companies and other relevant sources. The Compensation Committee works directly with the Company s human resources organization, which evaluates and presents the Compensation Committee with information gathered from public sources for officers at other public companies in order to help the Compensation Committee assess whether the total compensation paid to the named executive officers is fair, reasonable and competitive. Generally, the types of compensation and benefits provided to the named executive officers are similar to those provided to executive officers at other public companies.

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The Compensation Committee does not believe it is appropriate to set executive compensation levels based exclusively on compensation surveys and comparable company data. Rather, the Compensation Committee uses these surveys and comparable company data as tools for internally assessing whether the Company s executive compensation program is, in the aggregate, reasonable in scope, market-competitive, and consistent from year to year. The surveys referenced by the Compensation Committee in 2012 include the Towers Watson CDB General Industry Executive Compensation Survey for 2012, Towers Watson s Top Management Compensation Survey for 2012, and the Mercer Executive Compensation Survey for 2012. When making its determinations, the Compensation Committee was not aware of the constituent companies used in such surveys or any other surveys described herein. Other important factors that drive compensation decisions include individual qualifications and expertise, responsibility, particular industry and market conditions of a business segment, complexity of position and specific market factors in the locations in which our named executive officers are employed. The Compensation Committee also considers the performance of the Company s named executive officers on an individual basis before determining the compensation arrangement for each of them.

The Compensation Committee may retain the services of advisors and it has the budgetary authority to hire such advisors as it deems necessary. Towers Watson, a leading global professional services company well known for its executive compensation practice, was engaged in prior years and in 2012, at the request of the Compensation Committee, to provide independent guidance regarding current market-based compensation structures, pay practices and rates of compensation for positions identified as named executive officer positions. The Company has assessed the independence of Towers Watson and its representatives and has determined that no conflicts of interest exist.

In addition to reviewing the general publicly-available survey data described above, the Compensation Committee also develops a list of competitor companies for consideration as the Company s peer group based on relevant factors including, industry, fiscal year and trailing twelve months revenue, market capitalization, total shareholder return and EBITDA. The peer group list is reviewed, amended and approved on an annual basis by the Compensation Committee. The external advisor, Towers Watson, is asked to develop a compensation report that identifies market-based compensation structures, pay practices and rates of compensation for targeted positions as compared to the Company s peer group. The peer group used in the 2012 Executive Market Review report prepared by Towers Watson dated March 6, 2012 was comprised of the following companies:

Analogic Corp.

Coherent Inc.

Newport Corp.

Rofin-Sinar Technologies Inc.

II-VI Inc.

Cymer Inc.

IPG Photonics Corporation

Electro Scientific Industries Inc.

Zygo Corp.

The source data for the analysis is a blend of peer group proxy data and standard Executive Compensation Survey report data. The Towers Watson reports are provided to the Compensation Committee to be used as a reference point when considering compensation packages for new hire named executive officers and are also generally requested on an annual basis for the Chief Executive Officer and Chief Financial Officer positions. The consultant fees for these services have not been significant.

In summary, in order to determine the competitiveness of the Company s overall compensation for executive officers, the Company reviews data provided by its external advisor, including compensation for comparable positions within its industry, the historical compensation levels of the executive officers and the individual performance of the executive officers evaluated against their individual objectives established for the

preceding year, as applicable. These factors were considered in the compensation decisions made in 2012, including the compensation packages developed for the named executive officer hired in 2012 and the compensation adjustments made for other named executive officers.

Shareholder Say-On-Pay Vote

The Company was a smaller reporting company as of January 21, 2011 and therefore is not required to conduct shareholder advisory votes on (i) executive compensation or (ii) the frequency of advisory votes on executive compensation until the first annual or other meeting of shareholders on or after January 21, 2013. Thus, the votes described in this proxy statement are the first such votes being conducted by the Company.

Executive Compensation Program Elements

Executive compensation at the Company includes base salary, short-term cash bonus incentives, long-term equity-based incentives, employee benefits and, in certain situations, severance and other compensation. These elements were selected because the Compensation Committee believes they are necessary to help us attract and retain executive talent which is fundamental to our success. The elements of compensation may vary among executives based on the Compensation Committee s determination as to what is appropriate under the policies set forth above. Below is a summary of the current executive compensation programs as they relate to our named executive officers.

The following graphs depict the average target pay mix of base salary, short-term cash bonus incentives and long-term equity-based incentives, for our Chief Executive Officer and Chief Financial Officer and for our other named executive officers (other than Mr. Clarke).

(1) Based on: annual base salary, annual target bonus and annual equity grant per their 2012 compensation agreements.

(2) Based on: annual base salary, annual target bonus and annual equity grant per their 2012 compensation packages for Mr. Bader and Ms. Mulryan. Mr. Glastra s annual 2012 base salary, annual target bonus and 2012 annual equity grant is per his respective employment letter. Excludes one-time sign-on equity grant to Mr. Glastra for purposes of demonstrating target average annual pay mix.

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Base Salary

Base salary is intended to be a fixed level of competitive income and is compensation for services rendered in the job that the named executive officer was hired to perform. In setting base salary, the Compensation Committee considers qualifications and experience, prior employment (including historical compensation), industry knowledge, scope and complexity of responsibilities (including potential growth in responsibilities), individual performance, quality of leadership, internal pay equity, survey data, and tax deductibility. No specific weighting is applied to the factors. Salaries are set once per year as part of the compensation review process. Annual increases to salaries, when approved and implemented, are based on individual performance, peer group data and cost of living adjustments. The annual base salaries for 2012 for each of our named executive officers are listed below:

	Annual Base Salary	
Mr. Roush	$	525,000
Mr. Buckley	$	340,000
Mr. Bader	$	309,000
Mr. Glastra	$	380,000 (1)
Mr. Clarke	$	260,000 (2)
Ms. Mulryan	$	250,000

(1) Employment commenced on October 15, 2012.

(2) Employment terminated on September 28, 2012.

Cash Bonus Incentives

In 2011, the Compensation Committee implemented the SMIP for key management team members, including our named executive officers. The SMIP includes cash bonus incentives that are intended to motivate and reward the Company s key management team members for driving short-term performance within their respective organizations and across the Company, with the ultimate goal of creating shareholder value. The cash bonus incentives pursuant to the SMIP are earned semi-annually. The cash bonus incentives earned during the first half of 2012 were based upon the following performance metrics: (1) for some named executive officers, group adjusted EBITDA target (the Group Financial Objective), (2) Company adjusted EBITDA target (the Company Financial Objective and, together with the Group Financial Objective, the Financial Objectives), and (3) individual non-financial objectives (the Non-Financial Objectives). The cash bonus incentives earned during the second half of 2012 were based upon the following performance metrics: (1) for some named executive officers, the Group Financial Objective, (2) the Company Financial Objective, (3) the Non-Financial Objectives and (4) for some named executive officers, Company achievement of objectives related to discontinued operations (the Discontinued Operations Objectives). The Discontinued Operations Objectives were intended to incentivize the applicable named executive officers in their efforts to successfully enter into a definitive agreement to sell the Semiconductor Systems business unit and Laser Systems business unit and were also based on the operating performance of these business units.

For purposes of payment of Cash Bonus Incentives, adjusted EBITDA is defined as earnings before deducting interest expense (net of interest income), income taxes, depreciation, amortization, non-cash stock-based compensation and other non-recurring or non-operating charges. The target level of the Financial Objectives (provided below) is correlated with the Company s annual growth objectives. Although the target financial metrics of the SMIP are intended to be achievable, a maximum bonus would require very high levels of performance. Actual performance against the Financial Objectives must be within an established range of the target to result in any payout for the respective Financial Objectives, as described in more detail below. The Non-Financial Objectives were also designed to be challenging and spanned across strategic, operational and organizational areas.

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Each of our current named executive officers has an established bonus incentive target, which is based on a percentage of his or her current annual base salary. Pursuant to the SMIP, the target bonus would be payable upon 100% achievement of each of the applicable Financial Objectives, 100% achievement of the Non-Financial Objectives and 100% achievement of the Discontinued Operations Objectives. The table below describes the cash bonus incentive for each named executive officer under the SMIP, including the annual target as a percentage of base salary and the annual target in dollars. Refer to the Grants of Plan-Based Awards table for the maximum potential payouts of cash bonus incentives to each of the named executive officers pursuant to the SMIP.

	Cash Bonus Incentive Annual Target (% of base)	Cash Bonus Incentive Annual Target ($)
Mr. Roush	100%	525,000
Mr. Buckley	70%	238,000
Mr. Bader	30%	92,700
Mr. Glastra	50% (1)	190,000 (1)
Mr. Clarke	50% (2)	130,000 (2)
Ms. Mulryan	35%	87,500

(1) Mr. Glastra was hired in the latter half of 2012 and was eligible for a prorated three-month bonus for the second half of the SMIP; as such, for 2012 his respective target was 12.5% of base salary ($47,500), or one-quarter of the annual 50% target.

(2) Mr. Clarke terminated on September 28, 2012 and per the terms of his Separation Agreement will be paid, as severance, 100% of the portions of his target bonus that were based on the Company Financial Objective and the Group Financial Objective for the second half of 2012 and 100% of the portion based on his Non-Financial Objectives for 2012 (as well as 100% of his 2013 first half target bonus).

The general parameters of the cash bonus incentives pursuant to the SMIP, as it relates to the named executive officers, are as follows:

In setting cash bonus incentive targets, the Compensation Committee considers the Company s strategic plan, scope of individual responsibilities, internal total cash compensation equity, external competitive market data, and other relevant factors.

Cash bonus payments are calculated as a percentage of the participant s base salary and are payable based on achievement of the Group Financial Objective (if applicable), the Company Financial Objective, the Non-Financial Objectives and the Discontinued Operations Objectives (if applicable), unless otherwise determined by the CEO and Board of Directors.

For Messrs. Roush, Buckley, Bader and Clarke and Ms. Mulryan, cash bonus incentives are earned in six-month cycles, subject to availability of consolidated financial statements for the respective six-month cycle. Payouts for all named executive officers are calculated for each cycle as the achievement against the respective Financial Objectives multiplied by the target bonus percentages and the base salary for the applicable period for each participant. Performance against the Non-Financial Objectives is assessed annually and such amounts earned are payable annually with the second half Financial Objectives. The target date for the first-half payout is August 15 of the then-current year and the target date for the second-half payout is March 15 of the following year. For Mr. Glastra, 2012 cash bonus incentives were earned in a three-month cycle for the second half of 2012.

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The following charts show the weightings of each of the performance metrics under the SMIP for each named executive officer:

Performance Metrics

First Half of 2012	Group plan participants (1)	Corporate plan participants (2)
Group Financial Objective	10% of target bonus	
Company Financial Objective	30% of target bonus	40% of target bonus

(1) Mr. Bader (Precision Motion and Technology) and Mr. Clarke (Laser Products).

(2) Messrs. Roush and Buckley and Ms. Mulryan.

Performance Metrics

Second Half of 2012	Group plan participants (1)	Corporate plan participants (2)	Corporate participant (3)
Group Financial Objective	10% of target bonus		
Company Financial Objective	30% of target bonus	30% of target bonus	40% of target bonus
Discontinued Operations Financial Objective		10% of target bonus	

(1) Messrs. Bader (Precision Motion and Technology) and Glastra (Laser Products) (and Mr. Clarke (Laser Products) prior to his resignation).

(2) Messrs. Roush and Buckley.

(3) Ms. Mulryan.

Performance Metrics

Full Year 2012	Group plan participants (1)	Corporate participants (2)
Non-Financial Objectives	20% of target bonus	20% of target bonus

(1) Messrs. Bader (Precision Motion and Technology) and Glastra (Laser Products) and Clarke (Laser Products) prior to his resignation.

(2) Messrs. Roush and Buckley and Ms. Mulryan.

Amounts earned based on the Financial Objectives will vary depending upon the level of achievement of the assigned Financial Objectives, and are calculated on payout curves. The threshold, target and maximum payouts pursuant to the respective Financial Objectives are presented below:

	Performance against Financial Objectives	Payout for respective Financial Objectives
Threshold First Half 2012	Less than 75% of performance target	0% of target payout
Threshold Second Half 2012	50% or less of performance target	0% of target payout
Target	100% of performance target	100% of target payout
Maximum	150%+ of performance target	200% of target payout

The targets that would have resulted in a 100% payout of the respective Financial Objectives, as applicable, to each of the named executive officers in 2012, are as follows: first half financial targets: Company Financial Objective adjusted EBITDA of $29.2 million, Laser Products Group Financial Objective adjusted EBITDA of $9.4 and Precision Motion and Technologies Group Financial Objective adjusted EBITDA of $25.8 million; second half financial targets: Company Financial Objective adjusted EBITDA of $34.0 million, Laser Products Group Financial Objective adjusted EBITDA of $11.1 million and Precision Motion and Technologies Group Financial Objective adjusted EBITDA of $32.6 million.

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Amounts earned based on the Non-Financial Objectives will also vary depending upon the level of achievement thereof. The Non-Financial Objectives for the CEO and the other named executive officers in 2012 spanned strategic, operational and organizational areas. The goals of the CEO specifically included: stabilizing the Company, building the organization, delivering financial results and implementing a growth strategy for the business. Each of the other named executive officers was assigned objectives with similar areas of focus. Actual performance against these goals is ultimately determined by the Compensation Committee and in no instance will exceed 100% of the target.

The targets that would have resulted in a 100% payout of the Discontinued Operations Objectives during the second half of the year are based on the following: (1) Semiconductor Systems adjusted EBITDA of $5.0 million, (2) Laser Systems adjusted EBITDA of $1.7 million, (3) successfully entering into a definitive agreement to sell the Semiconductor Systems business unit for a pre-determined purchase price and (4) successfully entering into a definitive agreement to sell the Laser Systems business unit for a pre-determined purchase price.

The table below presents the actual cash bonus incentives earned in 2012 under the SMIP, by performance objective, as applicable, for each of the named executive officers:

	Financial Objectives First half		**Financial Objectives Second half**				
	Group ($)	**Corporate ($)**	**Group ($)**	**Corporate ($)**	**Discontinued Operations Objectives ($)**	**Non-Financial Objectives ($)**	**Total year ($)**
Mr. Roush (1)		136,700		20,326		99,960	256,986
Mr. Buckley (2)		61,970		9,195		45,220	116,385
Mr. Bader (3)	7,889	17,576	4,811	3,584		15,759	49,619
Mr. Clarke (4)		25,387	13,000	39,000		26,000	103,387
Mr. Glastra (5)				3,671		9,500	13,171
Ms. Mulryan (6)		21,416		4,508		17,500	43,424

(1) Mr. Roush s cash bonus incentive earned was determined based on achievement of 83% of the Company Financial Objective in the first half, resulting in a payout of 65% of the target amount with respect to such objective based on the payout curve; achievement of 56% of the Company Financial Objective in the second half, resulting in a payout of 13% of the target amount with respect to such objective based on the payout curve; 0% of the Discontinued Operations Objectives in the second half; and 95% of the Non-Financial Objectives. The resulting amounts determined based on each objective were weighted as described above to determine the total payout.

(2) Mr. Buckley s cash bonus incentive earned was determined based on achievement of 83% of the Company Financial Objective in the first half, resulting in a payout of 65% of the target amount with respect to such objective based on the payout curve; achievement of 56% of the Company Financial Objective in the second half, resulting in a payout of 13% of the target amount with respect to such objective based on the payout curve; 0% of the Discontinued Operations Objectives in the second half; and 95% of the Non-Financial Objectives. The resulting amounts determined based on each objective were weighted as described above to determine the total payout.

(3) Mr. Bader s cash bonus incentive earned was determined based on achievement of 95% of the Precision Motion and Technologies Group Financial Objective in the first half, resulting in a payout of 88% of the target amount with respect to such objective based on the payout curve; achievement of 83% of the Company Financial Objective in the first half, resulting in a payout of 65% of the target amount with respect to such objective based on the payout curve; achievement of 66% of Precision Motion and Technologies Group Objective in the second half, resulting in a payout of 52% of the target amount with respect to such objective based on the payout curve; achievement of 56% of the Company Financial Objective in the second half, resulting in a payout of 13% of the target amount with respect to such objective based on the payout curve; and achievement of 85% of the Non-Financial Objectives. The resulting amounts determined based on each objective were weighted as described above to determine the total payout.

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(4) Mr. Clarke s cash bonus incentive earned was determined based on achievement of 0% of the Laser Products Group Financial Objective in the first half, resulting in a payout of 0% of the target amount with respect to such objective based on the payout curve; and achievement of 83% of the Company Financial Objective in the first half, resulting in a payout of 65% of the target amount with respect to such objective based on the payout curve. The resulting amounts determined based on each objective were weighted as described above to determine Mr. Clarke s total payout for the first half. Pursuant to his Separation Agreement, Mr. Clarke will be paid 100% of the portions of his target bonus that were based on the Company Financial Objective and the Group Financial Objective for the second half and 100% of the portion based on his Non-Financial Objectives for the year.

(5) Mr. Glastra did not participate in the incentive plan for the first half of 2012. His bonus earned for the second half was determined based on achievement of 0% of the Laser Products Group Financial Objective, resulting in a payout of 0% of the target amount with respect to such objective based on the payout curve; achievement of 56% of the Company Financial Objective, resulting in a payout of 13% of the target amount with respect to such objective based on the payout curve; and achievement of 100% of the Non-Financial Objectives. The resulting amounts determined based on each objective were weighted as described above to determine the total payout.

(6) Ms. Mulryan s cash bonus incentive earned was determined based on achievement of 83% of the Company Financial Objective in the first half, resulting in a payout of 65% of the target amount with respect to such objective based on the payout curve; achievement of 56% of the Company Financial Objective in the second half, resulting in a payout of 13% of the target amount with respect to such objective based on the payout curve; and 100% of the Non-Financial Objectives. The resulting amounts determined based on each objective were weighted as described above to determine the total payout.

Equity-Based Compensation

The Company uses equity-based compensation to align executive compensation with long-term goals that enhance shareholder value and to promote executive retention with the Company by extending vesting periods over several years. Accordingly, the Company intends to make equity-based compensation a significant portion of compensation for the named executive officers, as demonstrated by the significant grants made to named executive officers in 2012.

Our annual grants of equity-based compensation are currently in the form of service-based restricted stock units that generally vest in one-third increments over three years based on continued service. The named executive officers employment agreements or letters mandate the minimum values of their annual equity grants.

It is the Company s practice to make an initial equity-based grant in the form of restricted stock units to all executives at the time they commence employment in an amount that is consistent with those granted to executive officers within the Company and in the industry at similar levels of seniority using information obtained from sources such as the comparable company data provided by Towers Watson and the Mercer Executive Compensation Survey. The initial equity-based grants awarded to new hires, such as that awarded to Mr. Glastra, may also be in part intended to compensate them for equity awards which they forfeited as a result of their terminations of employment with their prior employer. We believe that these make-whole awards helped us attract recently hired named executive officers to the Company.

The restricted stock unit awards granted to each of the named executive officers vest in certain change of control situations. Additionally, certain restricted stock unit awards granted to Mr. Roush and Mr. Buckley provide for vesting upon certain terminations of employment, including termination without cause or for good reason, because these awards are intended to mirror the terms of equity awards and other compensation which each forfeited as a result of terminating employment with their prior employer. In the future, the Company will determine whether equity awards will vest upon any terminations of employment on a case-by-case basis. Further discussion of accelerated vesting of restricted stock units is described in Potential Payments Upon Termination or Change of Control below.

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The following table presents the equity grants awarded to the Company s named executive officers in 2012, including equity awards granted upon commencement of employment and annual equity awards granted, as applicable:

	Restricted Stock Units (#)(1)	Value of Restricted Stock Units ($)(2)
Mr. Roush	91,304 (3)	1,049,996
Mr. Buckley	44,348 (3)	510,002
Mr. Bader	16,957 (3)	195,006
Mr. Glastra	75,000 (4)	597,000
Ms. Mulryan	10,217 (3)	117,496
Mr. Clarke	10,000 (3)	204,100

(1) Our annual grants of restricted stock units vest over a three-year period and are subject to accelerated vesting in certain situations as described more fully in the Potential Payments Upon Termination or Change of Control section below.

(2) Based on the stock price on the respective date of grant.

(3) 2012 annual equity grant. The number of restricted stock units are granted pursuant to the terms and conditions of the officer s employment agreement.

(4) 2012 equity grant pursuant to the employment letter entered into on August 24, 2012. Mr. Glastra s restricted stock units cliff vest on October 30, 2015 and are subject to accelerated vesting in certain situations as described more fully in the Potential Payments Upon Termination or Change of Control section below.

Other Factors Influencing Compensation

When making compensation decisions, the Compensation Committee takes many other factors into account, including the individual s performance in his or her role and against individual goals (particularly over the past year), the individual s expected future contributions to the Company s success, the financial and operational results of our business groups and the Company as a whole, the individual s historical compensation and any retention concerns, and the Chief Executive Officer s recommendations (in the case of named executive officers other than the Chief Executive Officer). In looking at historical compensation, the Compensation Committee looks at the progression of salary increases over time, and also looks at the unvested and vested value of outstanding equity awards. The Compensation Committee uses the same factors in evaluating the Chief Executive Officer s performance and compensation that it uses for the other named executive officers.

Employee Benefits and Other Compensation

In addition to the elements of compensation discussed above, the Company offers the named executive officers contributions towards health, dental, life, accidental death and dismemberment, and disability insurance premiums consistent with the Company s contribution levels offered to all other employees of the Company. The Company does not offer a deferred compensation program, nor does it offer retirement benefits other than a 401(k) defined contribution plan. This plan provides for Company matching contributions of 50% of the first six percent of compensation up to the maximum amount allowed under the Internal Revenue Code.

Messrs. Roush and Buckley are provided with life insurance benefits in excess of those available to all other employees, to comply with the terms of their respective employment agreements that stipulate that the Company will provide life insurance benefits in the face amount equal to no less than 400% of their respective annual base salaries. The life insurance benefits were negotiated in connection with our hiring of Messrs. Roush

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and Buckley to assist in their recruitment and retention. The cost of such supplemental life insurance benefits for Messrs. Roush and Buckley in 2012 equaled $1,245 and $540, respectively. The Company does not intend to offer life insurance benefits in excess of the maximum allowed under its Group Life Insurance policy to its other named executive officers.

Severance and Change of Control Benefits

The Company has certain obligations to its named executive officers in specified circumstances, including termination of employment or a change of control of GSI Group Inc., pursuant to the terms of individualized employment and severance agreements and letters. See Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table for a description of the employment agreements and letters and Potential Payments Upon Termination or Change of Control for a description of the severance and change in control obligations in such agreements and letters.

As described under Potential Payments Upon Termination or Change of Control , on September 7, 2012, the Company entered into a letter agreement with Mr. Clarke (the Clarke Letter Agreement) in which the terms and conditions related to his resignation from employment effective September 28, 2012 were specified. The letter agreement provides for 12 months of salary and benefits continuation as severance. In addition, the letter agreement provides for a cash payment in an aggregate amount equal to $130,000, based on his target amounts under the SMIP, as described above, payable in two installments of $78,000 and $52,000, respectively. Finally, the letter agreement provides for the accelerated vesting of certain restricted stock unit awards. Mr. Clarke was required to execute a release of claims in favor of the Company and to agree to comply with certain restrictive covenants in exchange for these severance benefits.

The respective employment agreements with Messrs. Roush and Buckley contain a Section 280G tax gross-up provision, which provides for a payment to Messrs. Roush and Buckley if they should become subject to parachute payment excise taxes imposed in connection with any change of control of the Company. These provisions were negotiated in connection with our hiring of Messrs. Roush and Buckley. Although the Company determined that such provisions were appropriate for Messrs. Roush and Buckley in order to assist in their recruitment and retention and in order to help ensure a stable senior management team in the event of any future change of control transaction, the Company does not currently plan to implement similar tax gross-ups for other executives in the future.

Tax and Accounting Implications

In 2012, the Company s compensation programs were affected by each of the following:

Accounting for Stock-Based Compensation: The Company accounts for stock-based compensation in accordance with the requirements of Accounting Standards Codification (ASC) 718, Stock Compensation . The Company also takes into consideration ASC 718 and other generally accepted accounting principles in determining changes to policies and practices for its stock-based compensation programs.

Section 162(m) of the Internal Revenue Code: This section generally limits the deductibility, for U.S. corporate income tax purposes, of compensation for a public company s chief executive officer and its four other most highly compensated officers unless the compensation is less than $1 million during any fiscal year or is performance-based under Section 162(m). The Company periodically reviews the potential consequences of Section 162(m), and it generally intends to structure the performance-based portion of executive compensation, where feasible, to comply with exemptions in Section 162(m) so that the compensation remains tax deductible to the Company. The Compensation Committee in its judgment may, however, authorize compensation payments that do not comply with the exemptions in Section 162(m) when it believes that such compensation is appropriate and in the best interests of the shareholders after taking various factors into consideration, including business conditions and the performance of such executive officer.

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Compensation Committee Report

The Compensation Committee has reviewed and discussed with management the Company s Compensation Discussion and Analysis , and based on such review and discussions, has recommended to the board of directors that the Compensation Discussion and Analysis be included in the Company s 2013 Management Proxy Circular.

Mr. Stephen W. Bershad (Chairperson)

Mr. Dennis J. Fortino

Mr. Ira J. Lamel

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EXECUTIVE COMPENSATION

Summary Compensation Table

The following table sets forth information regarding the compensation earned during the fiscal years ended December 31, 2012, 2011 and 2010 by each of the Company s named executive officers. For the year ended December 31, 2012, the Company s named executive officers consisted of: (i) the individual who served as the Chief Executive Officer during the year ended December 31, 2012 (J. Roush), (ii) the individual who served as the Chief Financial Officer during the year ended December 31, 2012 (R. Buckley), (iii) the three most highly compensated executive officers other than the Chief Executive Officer and the Chief Financial Officer who were serving as of December 31, 2012 (J. Bader, M. Glastra, and D. Mulryan), and (iv) one additional executive officer who would have met the requirements in (iii), but for the fact that the individual was not serving as an executive officer as of December 31, 2012 (D. Clarke) (the individuals described in (i) through (iv) above, collectively, the Named Executive Officers or NEOs).

Name and Principal Position (a)	Year (b)	Salary ($) (c)	Bonus ($)(1) (d)	Stock Awards ($)(2) (e)	Non-Equity Incentive Plan Compensation ($)(3) (g)	All Other Compensation ($)(4) (i)	Total ($) (j)
Executive Officers							
John A. Roush	2012	520,769		1,049,996	256,986	8,211	1,835,962
Chief Executive Officer	2011	500,000	340,000	1,556,008	122,733	3,336	2,522,077
	2010	28,846	176,375	3,290,007		28	3,495,256
Robert J. Buckley	2012	337,558		510,002	116,386	6,306	970,252
Chief Financial Officer	2011	280,000	179,563	2,005,800	50,443	3,849	2,519,655
Jamie B. Bader	2012	304,581		195,006	49,619	5,914	555,120
Vice President, Group President of Precision Motion and Technologies	2011	132,692		440,250	20,397	4,847	598,186
Matthijs Glastra *Vice President, Group President of Laser Products*	2012	81,846	121,829	597,000	13,171	2,240	816,086
Deborah A. Mulryan	2012	240,808		117,496	43,424	6,778	408,506
Vice President, Human Resources	2011	70,500		177,000	18,759	2,526	268,785
Former Executive Officers							
David Clarke	2012	168,326		204,100(5)	38,387	169,790	580,603 (6)
Vice President, Group President of Laser Products	2011	221,072		103,000	163,597	7,584	495,253 (6)

(1)

Amount shown for Mr. Glastra in 2012 represents a $115,000 sign-on bonus pursuant to his employment agreement and an additional $6,829 sign-on bonus that the Compensation Committee later decided to award him because of his forfeiture of certain compensation from his previous employer, both payable in March 2013. Amounts shown for Messrs. Roush and Buckley in 2011 represent a portion of their cash bonus under the SMIP that was guaranteed pursuant to their respective employment agreements. However, the amount of the SMIP bonuses actually paid to Messrs. Roush and Buckley with respect to 2011 based on actual Company and individual performance exceeded the guaranteed amounts and thus the guarantee was not applicable. Amount shown for Mr. Roush in 2010 represents a sign-on bonus pursuant to his employment agreement.

(2) Amounts shown do not reflect compensation actually received. Rather, amounts shown represent the aggregate grant date fair value of these awards determined in accordance with ASC 718 (disregarding any reduction in such value due to any estimate of forfeitures related to service-based vesting conditions). Under

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ASC 718, compensation expense with respect to stock awards is generally recognized over the vesting periods applicable to the awards. For further discussion regarding the assumptions used in the estimation of the fair value of the 2012 awards and details regarding the associated calculation of compensation cost related thereto, refer to Note 11 to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

(3) Amounts shown consist of awards earned during the period based on performance under the applicable annual cash bonus incentive plan. There was no cash bonus incentive plan applicable to the NEOs in 2010. Amounts shown in 2012 and 2011 relate to the SMIP, which is applicable to each of the NEOs. Amounts earned under the SMIP are generally payable semi-annually, subject to continued employment through the date of payment. The amounts earned in the first half of the year for Financial Objectives are payable by August 15 of the current year. The amounts earned in the second half for Financial Objectives and Discontinued Operations Objectives and the amounts earned for Non-Financial Objectives are payable by March 15 of the following year.

(4) Amounts in 2012 include the following:

	Mr. Roush ($)	Mr. Buckley ($)	Mr. Bader ($)	Mr. Glastra ($)	Ms. Mulryan ($)	Mr. Clarke ($)
Defined Contribution Plan Match	6,606	5,550	5,362	2,192	5,746	7,297
Group Term Life Insurance	360	216	552	48	1,032	210
Supplemental Life Insurance	1,245	540				
Severance: Salary Continuation					-	55,000[1]
Severance: Bonus						78,000[2]
Vacation Payout					-	42,283[3]
	8,211	**6,306**	**5,914**	**2,240**	**6,778**	**182,790**

[1] Amount represents salary continuation payments received by Mr. Clarke in 2012 in accordance with Mr. Clarke s Letter Agreement. Mr. Clarke is entitled to salary continuation payments for 12 months after termination of employment. The aggregate value of all salary continuation payments expected to be paid equals $260,000.

[2] Amount represents bonus in respect to the second half of 2012, in accordance with Mr. Clarke s Letter Agreement. In addition, Mr. Clarke will be paid a $52,000 bonus related to the first half of 2013, which is expected to be paid in August 2013.

[3] Amount represents payment for earned and accrued unused vacation time through the date of employment termination (September 28, 2012), in accordance with Mr. Clarke s Letter Agreement.

(5) Mr. Clarke was granted 10,000 restricted stock units on March 31, 2011 and 10,000 restricted stock units on March 8, 2012 in connection with his 2011 and 2012 annual equity grants. On the date of termination (September 28, 2012), 16,667 restricted stock units remained unvested. Pursuant to the terms of the Clarke Letter Agreement, 10,000 of these restricted stock units were subject to immediate vesting and the remaining 6,667 restricted stock units were forfeited. Therefore, the amount shown represents the aggregate grant date fair value of Mr. Clarke s 2012 equity award based on the stock price on March 8, 2012, plus the aggregate incremental fair value of the accelerated awards based on the stock price on the date of modification (September 28, 2012) computed in accordance with ASC 718.

(6) Also refer to the section entitled Certain Relationships below.

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Grants of Plan-Based Awards

The following table sets forth information regarding all plan-based awards granted to the Company s Named Executive Officers during the year ended December 31, 2012.

Name (a)	Type	Grant Date (b)	Approval Date(2)	Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1) Threshold ($) (c)	Target ($) (d)	Maximum ($) (e)	Estimated Future Payments Under Equity Incentive Plan Awards All other stock awards: number of shares of stock or units (#) (i)(3)	Grant Date Fair Value of Stock Awards ($)(l)(4)
Executive Officers								
John A. Roush	Bonus				525,000	945,000		
	Equity	3/8/2012	3/8/2012				91,304 (5)	1,049,996
Robert J. Buckley	Bonus				238,000	428,400		
	Equity	3/8/2012	3/8/2012				44,348 (5)	510,002
Jamie B. Bader	Bonus				91,620	164,700		
	Equity	3/8/2012	3/8/2012				16,957 (5)	195,006
Matthijs Glastra	Bonus				47,500	85,500		
	Equity	10/30/2012	9/5/2012				75,000 (6)	597,000
Deborah A. Mulryan	Bonus				85,400	153,300		
	Equity	3/8/2012	3/8/2012				10,217 (5)	117,496
Former Executive Officers								
David Clarke	Bonus				130,000	234,000		
	Equity	3/8/2012	3/8/2012				10,000 (5)	204,100(7)

(1) Amounts in these columns reflect aggregate threshold, target and maximum payout levels under the SMIP. Pursuant to the SMIP, each NEO has an established target bonus which is based on a percentage of the respective NEO s base salary. A target payout assumes a 100% payout of the target bonus based on 100% achievement of each of the respective components of the SMIP. A threshold payout assumes 0% payout for failure to attain each of the respective components of the SMIP. A maximum payout assumes a 200% payout for achievement of 150% or more of the Company Financial Objective, a 200% payout for achievement of 150% or more of the respective Group Financial Objective, as applicable, and a 100% payout for full achievement of the Non-Financial Objectives. See the section entitled Compensation Discussion and Analysis for the weightings of each of the performance metrics for each NEO. The target and maximum payout amounts for Mr. Glastra reflect participation only in three months of the second half of the SMIP plan, based on his offer letter, or 12.5% of the established annual target and maximum bonus potential. Further information regarding amounts earned is provided in the section entitled Compensation Discussion and Analysis . The actual amount earned is reported under the Non-Equity Incentive Plan Compensation column in the Summary Compensation Table.

(2) Approval Date for Messrs. Roush, Buckley, Bader and Clarke and Ms. Mulryan represents the date that the Board of Directors approved the granting of annual restricted stock units. Approval Date for Mr. Glastra represents the respective date that the Board of Directors or the Compensation Committee of the Board of Directors approved the respective terms of employment, including the grant of such awards.

(3)

The number of shares in this column represents restricted stock units granted in 2012. There were no performance-based awards under any equity incentive plan granted to the NEOs during the year ended December 31, 2012. With the exception of Mr. Glastra s award (described in footnote 6 below), the

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restricted stock units vest one-third annually on each of the first, second and third anniversaries of the date of grant, subject to continued employment on the date of vesting, and accelerated vesting under specified circumstances. Further information regarding accelerated vesting is provided in the section entitled Potential Payments Upon Termination or Change of Control .

(4) Grant date fair value of restricted stock units granted during the year ended December 31, 2012 was calculated by multiplying the number of restricted stock units granted by the closing market price of the Company s common stock on the date of grant.

(5) Represents the 2012 annual restricted stock units granted.

(6) Represents new hire restricted stock units granted pursuant to Mr. Glastra s employment agreement. These restricted stock units have three-year time based cliff vesting, with all of the grant vesting on the third anniversary of the grant date.

(7) Pursuant to the terms of the Clarke letter agreement, a portion of Mr. Clarke s unvested restricted stock units were accelerated. The restricted stock units accelerated were originally granted on March 31, 2011 and March 8, 2012 and were scheduled to vest in three equal annual installments on the anniversaries of the grant dates. The amount shown represents the aggregate grant date fair value of Mr. Clarke s 2012 equity award, plus the aggregate incremental fair value of the accelerated awards based on the closing market price on the date of modification.

Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table

The material terms of the equity and non-equity incentive plan compensation disclosed in the Summary Compensation Table and the 2012 Grants of Plan-based Awards Table are discussed above under the heading Compensation Discussion and Analysis , as well as in the footnotes to the applicable tables. The terms of the Clarke Separation Agreement are described under Potential Payments Upon Termination or Change of Control . Certain other elements of the Named Executive Officers compensation are provided for in their employment agreements and letters, described here.

John A. Roush

In accordance with the employment agreement entered into between the Company and Mr. Roush on November 16, 2010 (the CEO Employment Agreement), Mr. Roush became the Company s Chief Executive Officer on December 14, 2010. The initial term of Mr. Roush s employment expires on December 13, 2013 and will automatically be extended for successive one-year periods unless either the Company or Mr. Roush gives 90-days notice of non-extension to the other party. Pursuant to the CEO Employment Agreement, Mr. Roush received an initial base salary of $500,000 per year, subject to review and increase by the Company s Board of Directors. The employment agreement provides that Mr. Roush will be eligible to receive an annual performance-based cash bonus with respect to each year during the term with a minimum target of 85% of his annual base salary. In March 2012, Mr. Roush s annual base salary was increased to $525,000 and he became eligible to receive an annual performance-based cash bonus of 100% of his annual base salary. The CEO Employment Agreement provides that, beginning in 2012, Mr. Roush would be granted an annual equity compensation award with a value equal to 200% of his annual base salary each year. The CEO Employment Agreement also provides that the Company will provide Mr. Roush with term life insurance in a face amount equal to 400% of his annual base salary, subject to certain limitations. Additional discussion of certain termination obligations pursuant to the CEO Employment Agreement is provided in Potential Payments Upon Termination or Change of Control .

Robert J. Buckley

On February 10, 2011, the Company and Mr. Buckley entered into an employment agreement (the CFO Employment Agreement) providing for the employment of Mr. Buckley in an advisory capacity prior to March 31, 2011 and as the Company s Chief Financial Officer on and after March 31, 2011. The initial term of

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Mr. Buckley s employment expires on February 22, 2014 and will automatically be extended for successive one-year periods unless either the Company or Mr. Buckley gives 90-days notice of non-extension to the other party. Pursuant to the CFO Employment Agreement, Mr. Buckley received an initial base salary of $325,000 per year, subject to review and increase by the Company s Board of Directors. The employment agreement provides that Mr. Buckley will be eligible to receive an annual performance-based cash bonus with respect to each year during the term with a minimum target of 65% of his annual base salary. In March 2012, Mr. Buckley s annual base salary was increased to $340,000 and he became eligible to receive an annual performance-based cash bonus of 70% of his annual base salary. The CFO Employment Agreement provides that, beginning in 2012, Mr. Buckley would be granted an annual equity compensation award with a value equal to 150% of his annual base salary each year. The CFO Employment Agreement also provides that the Company will provide Mr. Buckley with term life insurance in a face amount equal to 400% of his annual base salary, subject to certain limitations. Additional discussion of certain termination obligations pursuant to the CFO Employment Agreement is provided in Potential Payments Upon Termination or Change of Control .

Jamie B. Bader

On July 25, 2011, the Company hired Mr. Bader as the Vice President, Group President of Precision Motion and Technologies business group and entered into an employment letter with him. Mr. Bader received an initial base salary of $300,000 per year. In March 2012, Mr. Bader s annual base salary was increased to $309,000. Pursuant to the employment letter, Mr. Bader is eligible to receive an annual performance-based cash bonus of 30% of his annual base salary. The employment letter provides that, beginning in 2012, Mr. Bader would be granted an annual equity compensation award with a value targeted at 65% of his annual base salary each year. The employment letter included severance provisions, but the Company entered into a Severance Agreement with Mr. Bader on August 15, 2012 that superseded such provisions. A summary of such agreement is provided in Potential Payments Upon Termination or Change of Control .

Matthijs Glastra

On October 15, 2012, the Company hired Mr. Glastra as the Vice President, Group President of the Laser Group. Pursuant to his employment letter, Mr. Glastra received an initial base salary of $380,000 per year and is eligible to receive an annual performance-based cash bonus of 50% of his annual base salary. On October 30, 2012, the Company granted Mr. Glastra 75,000 restricted stock units pursuant to the terms of his employment letter. The employment letter provides that, beginning in 2013, Mr. Glastra would be granted an annual equity compensation award with a value targeted at 40% of his annual base salary each year. Additional discussion of certain termination obligations pursuant to the employment letter entered into with Mr. Glastra is provided in Potential Payments Upon Termination or Change of Control .

Deborah A. Mulryan

On September 6, 2011, the Company hired Ms. Mulryan as the Vice President, Human Resources. Pursuant to her employment letter, Ms. Mulryan received an initial base salary of $235,000 per year. In March 2012, Ms. Mulryan became eligible to receive an annual performance-based cash bonus of 35% of her annual base salary. The employment letter provides that, beginning in 2012, Ms. Mulryan would be granted an annual equity compensation award with a value targeted at 50% of her annual base salary each year. The employment letter included severance provisions, but the Company entered into a Severance Agreement with Ms. Mulryan on August 15, 2012 that superseded such provisions. A summary of such agreement is provided in Potential Payments Upon Termination or Change of Control .

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Outstanding Equity Awards at Fiscal Year-End

The following table sets forth information regarding stock awards that have not yet vested for each of the Company s Named Executive Officers as of December 31, 2012.

		Stock Awards	
Name (a)	**Grant Date**	**Number of Shares or Units of Stock That Have Not Vested (#) (g)**	**Market Value of Shares or Units of Stock That Have Not Vested ($)(1) (h)**
Executive Officers			
John A. Roush	12/20/2010	111,112 (2)	962,230
	3/9/2011	88,890 (3)	769,787
	3/8/2012	91,304 (7)	790,693
Robert J. Buckley	2/22/2011	73,334 (4)	635,072
	3/9/2011	33,334 (3)	288,672
	3/8/2012	44,348 (7)	384,054
Jamie B. Bader	7/25/2011	25,000 (5)	216,500
	3/8/2012	16,957 (7)	146,848
Matthijs Glastra	10/30/2012	75,000 (8)	649,500
Deborah A. Mulryan	9/6/2011	13,334 (6)	115,472
	3/8/2012	10,217 (7)	88,479
Former Executive Officers			
David Clarke			

(1) Represents the product of the number of shares in column (g) and $8.66, the closing market price of the Company s common stock on the NASDAQ Global Select Market as of December 31, 2012.

(2) Represents time-based restricted stock units granted on December 20, 2010. Each restricted stock unit represents the right to receive one share of common stock upon vesting. These units are scheduled to vest on December 13, 2013, subject to continued employment on the date of vesting, and accelerated vesting under specified circumstances as described under Potential Payments Upon Termination or Change of Control.

(3) Represents time-based restricted stock units granted on March 9, 2011. Each restricted stock unit represents the right to receive one share of common stock upon vesting. These units were scheduled to vest in two equal annual installments on March 9, 2013 and March 9, 2014, subject to continued employment on the date of vesting, and accelerated vesting under specified circumstances as described under Potential Payments Upon Termination or Change of Control .

(4) Represents time-based restricted stock units granted on February 22, 2011. Each restricted stock unit represents the right to receive one share of common stock upon vesting. These units were scheduled to vest in two equal annual installments on February 22, 2013 and February 22, 2014, subject to continued employment on the date of vesting, and accelerated vesting under specified circumstances as

described under Potential Payments Upon Termination or Change of Control .

(5) Represents time-based restricted stock units granted on July 25, 2011. Each restricted stock unit represents the right to receive one share of common stock upon vesting. These units are scheduled to vest in two equal annual installments on July 25, 2013 and July 25, 2014, subject to continued employment on the date of vesting, and accelerated vesting under specified circumstances as described under Potential Payments Upon Termination or Change of Control .

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(6) Represents time-based restricted stock units granted on September 6, 2011. Each restricted stock unit represents the right to receive one share of common stock upon vesting. These units are scheduled to vest in two equal annual installments on September 6, 2013 and September 6, 2014, subject to continued employment on the date of vesting, and accelerated vesting under specified circumstances as described under Potential Payments Upon Termination or Change of Control .

(7) Represents time-based restricted stock units granted on March 8, 2012. Each restricted stock unit represents the right to receive one share of common stock upon vesting. These units were scheduled to vest in three equal annual installments on March 8, 2013, March 8, 2014 and March 8, 2015, subject to continued employment on the date of vesting, and accelerated vesting under specified circumstances as described under Potential Payments Upon Termination or Change of Control .

(8) Represents time-based cliff vesting restricted stock units granted on October 30, 2012. Each restricted stock unit represents the right to receive one share of common stock upon vesting. These units are scheduled to cliff vest on the third anniversary of the grant date on October 30, 2015, subject to continued employment on the date of vesting, and accelerated vesting under specified circumstances as described under Potential Payments Upon Termination or Change of Control .

Stock Vested

The following table sets forth information regarding all restricted stock awards that vested and the value realized upon vesting by each of the Company s Named Executive Officers during the year ended December 31, 2012.

	Stock Awards	
Name	**Number of Shares**	**Value Realized**
(a)	**Acquired on Vesting (#)(d)**	**on Vesting ($) (e)(1)**
Executive Officers		
John A. Roush	155,555	1,413,327
Robert J. Buckley	53,332	620,751
Jamie B. Bader	12,500	124,875
Matthijs Glastra		
Deborah A. Mulryan	6,666	61,927
Former Executive Officers		
David Clarke	13,333(2)	130,096

(1) Value realized on vesting is computed by multiplying the number of shares of stock vested by the closing market price of the Company s common stock on the applicable vesting date.

(2) The above vested shares for Mr. Clarke represent 3,333 shares that vested on March 31, 2012 and 10,000 shares that were subject to accelerated vesting upon Mr. Clarke s termination on September 28, 2012.

Stock Forfeited

The following restricted stock award previously granted to Mr. Clarke represents the only officer restricted stock award forfeited during the year ended December 31, 2012.

Grant Date	**Mr. Clarke**
March 8, 2012	6,667(1)

1 Mr. Clarke was granted 10,000 restricted stock units on March 8, 2012 of which 3,333 were subject to accelerated vesting and 6,667 shares were forfeited upon termination. The award was originally scheduled to vest in three equal annual installments on each of March 8, 2013, March 8, 2014 and March 8, 2015.

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Potential Payments upon Termination or Change of Control

The following table sets forth estimated compensation that the Company would be obligated to provide to each of the Company s Named Executive Officers upon termination of employment or change of control pursuant to the terms of individualized employment agreements or other contractual obligations. Further information regarding these agreements or other obligations is provided immediately following the table. Other than these agreements and obligations, there are no other plans or other contractual obligations triggered upon termination of employment or change of control related to the Company s Named Executive Officers. The amounts reflected in the following table assume that the termination of employment and/or, if applicable, change of control occurred on December 31, 2012.

Name	Event	Salary ($)	Bonus ($)	Vesting of Outstanding Stock ($)	IRC Section 280G Gross-Up Payment ($)(7)	Total ($)
Executive Officers						
John A. Roush	Termination without cause or by employee for good reason	$787,500 (1) (18 months salary)	120,286 (2)	$1,637,588 (3) (4) (Immediate vesting of unvested CEO Sign-On RSUs; prorated vesting of unvested CEO 2011 and 2012 RSUs)		$2,545,374
	Termination without cause or by employee for good reason, within 12 months following a change of control	$1,050,000 (1) (200% annual base salary in a lump sum)	120,286 (2)	$2,522,705 (3) (5) (6) (Immediate vesting of unvested CEO Sign-On RSUs and CEO 2011 and 2012 RSUs)		$3,692,991
	Termination due to death or by Company due to disability		120,286 (2)	$2,522,705 (3) (5) (Immediate vesting of unvested CEO Sign-On RSUs and CEO 2011 and 2012 RSUs)		$2,642,991
	Change of control			$2,522,705 (3) (5) (6) (Immediate vesting of unvested CEO Sign-On RSUs and CEO 2011 and 2012 RSUs)		$2,522,705
Robert J. Buckley	Termination without cause or by employee for good reason	$510,000 (1) (18 months salary)	54,415 (2)	$911,962(8) (9) (Immediate vesting of unvested CFO Sign-On RSUs; prorated vesting of unvested CFO 2011 and 2012 RSUs)		$1,476,377
	Termination without cause or by employee for good reason, within 12 months following a change of control	$680,000 (1) (200% annual base salary in a	54,415 (2)	$1,307,788 (6) (8) (10) (Immediate vesting of unvested CFO Sign-On		$2,042,203

	lump sum)		RSUs and CFO 2011 and 2012 RSUs)	
Termination due to death or by Company due to disability		54,415 (2)	$1,307,788 (8) (10) (Immediate vesting of unvested CFO Sign-On RSUs and CFO 2011 and 2012 RSUs)	$1,362,203
Change of control			$1,307,788 (6), (8) (10) (Immediate vesting of unvested CFO Sign-On RSUs and CFO 2011 and 2012 RSUs)	$1,307,788

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Name	Event	Salary ($)	Bonus ($)	Vesting of Outstanding Stock ($)	IRC Section 280G Gross-Up Payment ($)(7)	Total ($)
Jamie B. Bader	Termination without cause	$309,000 (1) (12 months salary)				$309,000
	Termination by the Company or by employee for good reason, within 12 months following a change of control (11)	$463,500 (1) (18 months salary)		$363,348 (6)		$826,848
	Change of control			$363,348(6)		$363,348
Matthijs Glastra	Termination without cause	$380,000 (1) (12 months salary)		$38,970 (13) (Prorated vesting of unvested Glastra 2012 RSUs)		$418,970
	Termination by the Company without cause or by employee for good reason, within 12 months following a change of control (12)	$570,000 (1) (18 months salary)		$649,500 (6)		$1,219,500
	Change of control			$649,500 (6)		$649,500
Deborah A. Mulryan	Termination without cause	$250,000 (1) (12 months salary)				$250,000
	Termination by the Company without cause or by employee for good reason, within 12 months following a change of control (11)	$375,000 (1) (18 months salary)		$203,952 (6)		$578,952
	Change of control			$203,952 (6)		$203,952

(1) Amounts based on the respective executive s annual base salary for the year ended December 31, 2012.

(2) The amount to be paid is equal to the product of: (i) the amount of bonus that would have been payable if the executive had remained employed through the first day of the fiscal year following the fiscal year in which the date of termination occurs based on actual individual and Company performance goals in such year and (ii) the ratio of the number of days elapsed during the fiscal year in which such termination of employment occurs to 365 days. Amounts presented reflect the amounts earned in 2012 under the SMIP.

(3) CEO Sign-on RSUs represent the grant of 333,334 RSUs on December 20, 2010 and CEO 2011 and 2012 RSUs represent the grant of 133,334 and 91,304 RSUs on March 9, 2011 and March 8, 2012, respectively.

(4) Represents the outstanding number of unvested CEO Sign-on RSUs (111,111), plus the prorated portion of the unvested CEO 2011 and 2012 RSUs based on the ratio of the number of days of employment during the

applicable service-based vesting period to the total number of days of such service-based vesting period (53,334 unvested CEO 2011 RSUs and 24,652 unvested CEO 2012 RSUs), multiplied by $8.66, the closing market price of the Company s common stock as of December 31, 2012.

(5) Represents the outstanding number of unvested CEO Sign-on RSUs (111,111), plus the outstanding numbers of the CEO 2011 and 2012 RSUs (88,890 and 91,304, respectively), multiplied by $8.66, the closing market price of the Company s common stock as of December 31, 2012.

(6) Pursuant to the respective restricted stock unit award agreements, outstanding unvested restricted stock units will become fully vested and non-forfeitable immediately prior to and subject to consummation of a Change in Control (as defined in such agreements) regardless of termination of employment, if any, in connection therewith.

(7) The amounts payable to Messrs. Roush and Buckley upon a termination of employment following a change of control on December 31, 2012 would not have triggered parachute payment excise taxes. Consequently, no tax gross-up payment would have been payable to them.

(8) CFO Sign-on RSUs represent the grant of 110,000 RSUs on February 22, 2011 and CFO 2011 and 2012 RSUs represent the grant of 50,000 and 44,348 RSUs on March 9, 2011 and March 8, 2012, respectively.

(9) Represents the outstanding number of unvested CFO Sign-on RSUs (73,333), plus the prorated portion of the unvested CFO 2011 and 2012 RSUs based on the ratio of the number of days of employment during the applicable service-based vesting period to the total number of days of such service-based vesting period (20,000 unvested CFO 2011 RSUs and 11,974 unvested CFO 2012 RSUs), multiplied by $8.66, the closing market price of the Company s common stock as of December 31, 2012.

(10) Represents the outstanding number of unvested CFO Sign-on RSUs (73,333), plus outstanding numbers of unvested CFO 2011 and 2012 RSUs (33,333 and 44,348, respectively), multiplied by $8.66, the closing market price of the Company s common stock as of December 31, 2012.

(11) Pursuant to the Severance Agreements for Mr. Bader and Ms. Mulryan, Mr. Bader and Ms. Mulryan are entitled to severance equal to 18 months of base salary if there is a change of control of the Company and his or her employment is terminated by the Company without cause or by the executive for Good Reason (defined below) within 12 months after such change of control.

(12) Pursuant to the employment letter for Mr. Glastra, Mr. Glastra is entitled to severance equal to 18 months of base salary if there is a change of control of the Company and his employment is involuntarily terminated, or materially reduced in scope or if his place of work is moved more than 50 miles from the current Santa Clara, California location within 12 months after such change of control.

(13) Represents the prorated portion of the unvested 2012 Glastra RSUs based on the ratio of the number of days of employment during the applicable service-based vesting period to the total number of days of such service-based vesting period (4,500 unvested 2012 Glastra RSUs), multiplied by $8.66, the closing market price of the Company s common stock as of December 31, 2012.

Employment and Severance Agreements and Letters

Employment Agreement with Mr. Roush

On November 16, 2010, the Company and Mr. Roush entered into an employment agreement (as defined above, the CEO Employment Agreement). The initial term of the CEO Employment Agreement is a period of three years from December 13, 2010 through December 13, 2013, unless earlier terminated. The initial term will

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automatically renew for successive one year periods, unless either party gives notice of non-extension no later than 90 days prior to expiration of the then-applicable term. Pursuant to the terms of the CEO Employment Agreement, there are certain obligations of the Company that become due in the event of termination or change of control.

Upon termination of Mr. Roush s employment for any reason, Mr. Roush or Mr. Roush s estate is entitled to receive: (i) any portion of Mr. Roush s annual base salary through the date of termination not theretofore paid, (ii) any business expenses owed to Mr. Roush, (iii) any accrued, but unused vacation pay owed to Mr. Roush and (iv) any amount arising from Mr. Roush s participation in, or benefits under, any employee benefit plans, programs or arrangements (together referred to as CEO Accrued Amounts).

If Mr. Roush s employment is terminated by the Company without Cause (as defined in the CEO Employment Agreement) or by Mr. Roush for Good Reason (as defined in the CEO Employment Agreement and which generally consists of (a) a material diminution in Mr. Roush s responsibilities, duties or authority or a material diminution in his title, (b) failure of the Company to make any material payment or provide any material benefit under the CEO Employment Agreement, (c) the Company s material breach of the CEO Employment Agreement or (d) a material relocation of Mr. Roush s place of employment), then in addition to the payment of the CEO Accrued Amounts, the Company will: (i) continue to pay Mr. Roush s annual base salary for 18 months in accordance with the Company s regular payroll practices; provided that if such termination occurs within 12 months after a Change in Control (as defined in the CEO Employment Agreement), then, in lieu of the foregoing annual base salary payments, the Company will pay Mr. Roush a lump sum equal to 200% of his annual base salary, (ii) pay Mr. Roush a pro rata portion of any performance-based cash bonus to which he would have been entitled had he remained employed by the Company and (iii) cause any unvested RSUs granted in connection with Mr. Roush s commencement of employment (the CEO Sign-On RSUs) to become fully vested, a pro rata portion of the equity awards granted to Mr. Roush in 2011 and 2012 (the CEO 2011 and 2012 RSUs) and a pro rata portion of any annual equity awards granted to Mr. Roush (the CEO Annual Equity Awards) subject to service-based vesting to become vested, and a pro rata portion of any CEO Annual Equity Awards subject to performance-based vesting to continue to be eligible to become vested in accordance with their terms based on actual performance; provided that if such termination occurs (x) while Mr. Roush is unable to engage in substantial gainful activity that may reasonably be expected to result in Disability (as defined in the CEO Employment Agreement), then the Company will cause the CEO Sign-On RSUs, the CEO 2011 and 2012 RSUs, and all CEO Annual Equity Awards subject to service-based vesting to be fully vested and all CEO Annual Equity Awards subject to performance-based vesting to continue to be eligible to become vested in accordance with their terms based on actual performance, and (y) within 12 months after a Change in Control, then the Company will cause all unvested equity awards held by Mr. Roush to become vested, deeming that the Company will attain target performance levels for purposes of awards subject to performance-based vesting.

If Mr. Roush s employment is terminated due to death or by the Company due to Disability, then in addition to the payment of the CEO Accrued Amounts, the Company will: (i) pay Mr. Roush a pro rata portion of any performance-based cash bonus to which he would have been entitled had he remained employed by the Company, (ii) cause any unvested CEO Sign-On RSUs, CEO 2011 and 2012 RSUs and CEO Annual Equity Awards subject to service-based vesting to become fully vested, and (iii) cause all CEO Annual Equity Awards subject to performance-based vesting to continue to be eligible to become vested in accordance with their terms based on actual performance.

Mr. Roush is also entitled to a tax gross-up in the event that any payments due to him pursuant to the CEO Employment Agreement or otherwise would be subject to an excise tax imposed by Sections 280G and 4999 of the Internal Revenue Code. The gross-up is intended to be of an amount necessary to place Mr. Roush in the same after-tax position as if no payments to him were subject to an excise tax under Sections 280G and 4999 of the Internal Revenue Code.

The severance payments and benefits provided for in the CEO Employment Agreement are subject to Mr. Roush s compliance with a non-competition and non-solicitation covenant through the date that is 18 months following termination and an indefinite confidentiality covenant, and no severance payments will be made or acceleration of vesting will occur following the date of any violation of any such covenants, unless Mr. Roush cures such violation within 30 days of written notice thereof.

The severance payments and benefits are also subject to Mr. Roush s execution of a release of claims against the Company.

Employment Agreement with Mr. Buckley

On February 10, 2011, the Company and Mr. Buckley entered into an employment agreement (as defined above the CFO Employment Agreement). The initial term of Mr. Buckley s employment (the Initial CFO Term) expires on February 22, 2014, unless earlier terminated. The initial term will automatically renew for successive one year periods, unless either party gives notice of non-extension no later than 90 days prior to expiration of the then-applicable term. Pursuant to the terms of the CFO Employment Agreement, there are certain obligations of the Company that become due in the event of termination or change of control.

Upon termination of Mr. Buckley s employment for any reason, Mr. Buckley or Mr. Buckley s estate is entitled to receive: (i) any portion of Mr. Buckley s annual base salary through the date of termination not theretofore paid, (ii) any business expenses owed to Mr. Buckley, (iii) any accrued, but unused vacation pay owed to Mr. Buckley and (iv) any amount arising from Mr. Buckley s participation in, or benefits under, any employee benefit plans, programs or arrangements (together referred to as CFO Accrued Amounts).

If Mr. Buckley s employment is terminated by the Company without Cause (as defined in the CFO Employment Agreement) or by Mr. Buckley for Good Reason (as defined in the CFO Employment Agreement and as described above for the CEO), then in addition to the payment of the CFO Accrued Amounts, the Company will: (i) continue to pay the annual base salary for 18 months in accordance with the Company s regular payroll practices; provided that if such termination occurs within 12 months after a Change in Control (as defined in the CFO Employment Agreement), then, in lieu of the foregoing annual base salary payments, the Company will pay Mr. Buckley a lump sum equal to 200% of his annual base salary, (ii) pay Mr. Buckley a pro rata portion of any performance-based cash bonus to which he would have been entitled had he remained employed by the Company and (iii) cause any unvested RSUs granted in connection with Mr. Buckley s commencement of employment (the CFO Sign-On RSUs) to become fully vested, the pro rata portion of the RSUs granted to Mr. Buckley in 2011 and 2012 (the CFO 2011 and 2012 RSUs) and a pro rata portion of any annual equity awards granted to Mr. Buckley (the CFO Annual Equity Awards) subject to service-based vesting to become vested, and the pro rata portion of any CFO Annual Equity Awards subject to performance-based vesting to continue to be eligible to become vested in accordance with their terms based on actual performance; provided that if such termination occurs while Mr. Buckley is unable to engage in substantial gainful activity that may reasonably be expected to result in Disability (as defined in the CFO Employment Agreement), then the Company will cause the CFO Sign-On RSUs, the CFO 2011 and 2012 RSUs, and all CFO Annual Equity Awards subject to service-based vesting to be fully vested and all CFO Annual Equity Awards subject to performance-based vesting to continue to be eligible to become vested in accordance with their terms based on actual performance.

If Mr. Buckley s employment is terminated due to death or by the Company due to Disability, then in addition to the payment of the CFO Accrued Amounts, the Company will: (i) pay Mr. Buckley a pro rata portion of any performance-based cash bonus to which he would have been entitled had he remained employed by the Company, (ii) cause any unvested CFO Sign-On RSUs, CFO 2011 and 2012 RSUs and CFO Annual Equity Awards subject to service-based vesting to become fully vested, and (iii) cause all CFO Annual Equity Awards subject to performance-based vesting to continue to be eligible to become vested in accordance with their terms based on actual performance.

Mr. Buckley is also entitled to a tax gross-up in the event that any payments due to him pursuant to the CFO Employment Agreement or otherwise would be subject to an excise tax imposed by Sections 280G and 4999 of the Internal Revenue Code. The gross-up is intended to be of an amount necessary to place Mr. Buckley in the same after-tax position as if no payments to him were subject to an excise tax under Sections 280G and 4999 of the Internal Revenue Code.

The severance payments and benefits provided for in the CFO Employment Agreement are subject to Mr. Buckley s compliance with a non-competition and non-solicitation covenant through the date that is 18 months following termination and an indefinite confidentiality covenant, and no severance payments will be made or acceleration of vesting will occur following the date of any violation of any such covenants, unless Mr. Buckley cures such violation within 30 days of written notice thereof.

The severance payments and benefits are also subject to Mr. Buckley s execution of a release of claims against the Company.

Severance Agreement with Mr. Bader

Pursuant to a severance agreement dated August 15, 2012 entered into between the Company and Mr. Bader (the Bader Severance Agreement), there are certain obligations of the Company that become due in the event of termination or change of control. If Mr. Bader s employment with the Company is terminated by the Company without Cause (as defined in the Bader Severance Agreement), at any time other than during the first 12 months following a change of control of the Company, the Company will pay Mr. Bader a severance benefit in the amount of 100% of his base salary, payable over 12 months. In addition, if, during the 12-month period immediately following a change of control, Mr. Bader s employment is terminated by the Company without Cause or he terminates his employment for Good Reason (which is defined in the agreement and includes a material diminution in the nature or scope of his responsibilities, duty or authority or a material change in the geographic location at which he must perform services more than 50 miles from the Bedford, Massachusetts metropolitan area), the Company will pay Mr. Bader a severance benefit in the amount of 150% of his annual base salary, payable over 18 months. The Bader Severance Agreement provides that, to the extent Mr. Bader s payments would otherwise be subject to the excise tax imposed by Sections 280G and 4999 of the Internal Revenue Code, his payments will be reduced to an amount one dollar less than the minimum amount that, when combined with any other of his benefits considered parachute payments, would subject him to the excise tax. The severance payments and benefits are also subject to Mr. Bader s execution of a release of claims against the Company.

Mr. Bader was also provided with a one-time grant of 37,500 restricted stock units upon hire that will fully vest in the event of a change of control of the Company.

Upon hire, Mr. Bader was required to sign an Invention Assignment and Non-compete Agreement, which includes a non-competition covenant and a non-solicitation covenant that apply through the first anniversary of termination of employment, as well as an indefinite confidentiality covenant.

Employment Letter with Mr. Glastra

Pursuant to an employment letter dated August 24, 2012 entered into between the Company and Mr. Glastra (the Glastra Employment Letter), there are certain obligations of the Company that become due in the event of termination or change of control. If Mr. Glastra s employment with the Company is involuntarily terminated by the Company, other than for Cause (as defined in the Glastra Employment Letter), Mr. Glastra will be eligible for a severance benefit in the amount of 12 months of base salary. In addition, if there is a change of control of the Company, and Mr. Glastra s employment is involuntarily terminated by the Company or materially reduced in scope or if his place of work is moved more than 50 miles from the current Santa Clara, California location, within 12 months after such change of control, Mr. Glastra will be eligible for a severance benefit in the amount of 18 months of base salary and pro rata vesting of his equity awards in the year of termination.

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The Glastra Employment Letter also provided Mr. Glastra with a one-time grant of 75,000 restricted stock units upon hire (the Glastra 2012 RSUs) that will fully vest in the event of a change of control of the Company.

Upon hire, Mr. Glastra was required to sign an Invention Assignment and Non-compete Agreement, which includes a non-competition covenant that applies during the term of employment and a non-solicitation covenant that applies through the first anniversary of termination of employment, as well as an indefinite confidentiality covenant.

Severance Agreement with Ms. Mulryan

Pursuant to a severance agreement dated August 15, 2012 entered into between the Company and Ms. Mulryan (the Mulryan Severance Agreement), there are certain obligations of the Company that become due in the event of termination or change of control. If Ms. Mulryan s employment with the Company is terminated by the Company without Cause (as defined in the Mulryan Severance Agreement), at any time other than during the first 12 months following a change of control of the Company, the Company will pay Ms. Mulryan a severance benefit in the amount of 100% of her base salary, payable over 12 months. In addition, if, during the 12-month period immediately following a change of control, Ms. Mulryan s employment is terminated by the Company without Cause or she terminates her employment for Good Reason (which is defined in the agreement and includes a material diminution in the nature or scope of her responsibilities, duty or authority or a material change in the geographic location at which she must perform services more than 50 miles from the Bedford, Massachusetts metropolitan area), the Company will pay Ms. Mulryan a severance benefit in the amount of 150% of her annual base salary, payable over 18 months. The Mulryan Severance Agreement provides that, to the extent Ms. Mulryan s payments would otherwise be subject to the excise tax imposed by Sections 280G and 4999 of the Internal Revenue Code, her payments will be reduced to an amount one dollar less than the minimum amount that, when combined with any other of her benefits considered parachute payments, would subject her to the excise tax. The severance payments and benefits are also subject to Ms. Mulryan s execution of a release of claims against the Company.

Ms. Mulryan was granted 20,000 restricted stock units upon hire that will fully vest in the event of a change of control of the Company.

Upon hire, Ms. Mulryan was required to sign an Invention Assignment and Non-compete Agreement, which includes a non- competition covenant and a non-solicitation covenant that apply through the first anniversary of termination of employment, as well as an indefinite confidentiality covenant.

Severance Agreement with Mr. Clarke

Mr. Clarke s employment with the Company terminated effective September 28, 2012. The Company entered into the Clarke Letter Agreement as of September 4, 2012. Pursuant to the Clarke Letter Agreement, Mr. Clarke executed a release in favor of the Company in exchange for certain separation benefits. More specifically, the Clarke Letter Agreement provided for payment of the following benefits:

- 12 months of salary continuation, $260,000, to be paid in accordance with the Company s normal bi-weekly payroll practices;

- Cash payment of $130,000, payable in two installments (of $78,000 and $52,000, respectively) at the same time Mr. Clarke would have been entitled to receive a bonus in respect to the second half of 2012 and the first half of 2013 had he remained employed by the Company;

- Continued group medical and dental coverage, at the Company s sole expense, during the period beginning on September 29, 2012 and ending on the earlier of September 28, 2013 and the date on which Mr. Clarke first becomes eligible for medical and dental coverage from a new employer or service recipient; and

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6,667 restricted stock units awarded to Mr. Clarke on March 31, 2011 and 3,333 restricted stock units awarded to Mr. Clarke on March 8, 2012 became vested on the September 28, 2012 termination date. All other unvested restricted stock units awarded to Mr. Clarke were automatically forfeited as of the termination date.

The Clarke Letter Agreement provides that Mr. Clarke s severance benefits are contingent on his compliance with the restrictive covenants set forth in the RSU Agreements that he signed, including one-year post-termination non-competition and non-solicitation covenants and an indefinite confidentiality covenant.

Equity Awards

Pursuant to the restricted stock unit award agreements under the Company s 2010 Incentive Award Plan, all outstanding restricted stock units held by the named executive officers on the date of a Change in Control (as defined in the plan) will vest upon such Change in Control, subject to the executive s continued employment through the date of such Change in Control.

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DIRECTOR COMPENSATION

In general, the Company uses a combination of cash and equity-based compensation to attract and retain candidates to serve on the Company s Board of Directors. The Company does not compensate directors who are also employees for their service on the Board of Directors. Accordingly, during the year ended December 31, 2012, Mr. Roush, who served as the Company s Chief Executive Officer, did not receive any compensation for his service on the Board of Directors. The Board of Director compensation is overseen by the Nominating and Corporate Governance Committee rather than the Compensation Committee, which focuses on employee compensation. The Nominating and Corporate Governance Committee periodically reviews its cash and equity-based compensation for non-employee directors and makes recommendations to the Board of Directors for any adjustments.

The Board of Directors approved the following compensation for non-employee directors:

Each non-employee member of the Board of Directors will receive an annual retainer in the amount of $125,000.

The Chairperson of the Audit Committee will receive an additional annual retainer in the amount of $15,000.

The Chairpersons of the Compensation Committee and the Nominating and Corporate Governance Committee will each receive an additional annual retainer in the amount of $10,000 (unless any such Chairperson is also serving as non-executive Chairperson of the Board of Directors).

The non-executive Chairperson of the Board of Directors will receive an additional annual retainer in the amount of $125,000. Fifty percent of the foregoing non-employee director compensation will be paid in the form of cash and the remaining fifty percent of such compensation will be payable in the form of deferred stock units, which will be convertible into shares of the Company s common stock upon a holder s termination of directorship with the Company.

As of the end of the Company s fiscal year ended December 31, 2012, each director was also a party to an indemnification agreement with the Company. Such indemnification agreements generally provide, among other things, that each director shall be indemnified to the fullest extent permitted by applicable law against all expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred by such director in connection with any proceeding by reason of his or her relationship with the Company. In addition, such indemnification agreements provide for the advancement of expenses incurred by such director in connection with any proceeding covered by such indemnification agreements, subject to the conditions set forth therein and to the extent such advancement is not prohibited by law.

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Director Compensation Table

The following table sets forth information regarding the compensation earned during the fiscal year ended December 31, 2012 by the Company s non-employee directors.

Name (a)	Fees Earned or Paid in Cash ($)(1) (b)	Stock Awards ($)(2)(3)(4) (c)	Total ($) (h)
Directors			
Stephen W. Bershad	125,000	131,843	256,843
Eugene I. Davis	33,750	71,203	104,953
Dennis J. Fortino	65,233	68,699	133,932
K. Peter Heiland	15,625	65,927	81,552
Ira J. Lamel	70,000	73,836	143,836
Byron O. Pond	31,250	65,927	97,177
Harry L. Bosco	34,168	34,591	68,759
Dominic A. Romeo	34,168	34,591	68,759
Thomas N. Secor	34,168	34,591	68,759

(1) All fees earned by the Company s Board of Directors during the year ended December 31, 2012 were paid in full prior to December 31, 2012.

(2) Amounts shown do not reflect compensation actually received. Rather, amounts shown represent the aggregate grant date fair value of these awards determined in accordance with ASC 718. The deferred stock units granted by the Company were fully vested on the grant date and the associated expense was recognized in full on the grant date in accordance with ASC 718. For further discussion regarding the assumptions used in the estimation of the fair value of the awards and details regarding the associated calculation of compensation cost related thereto, refer to Note 11 to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

(3) All awards were granted at the closing price of the Company s common stock on the NASDAQ Global Select Market on the date of grant. The amounts represent the aggregate grant date fair value associated with the respective annual deferred stock unit award granted to each director on January 1, 2012 and July 2, 2012 of $10.79 and $11.60, respectively, per share. However, in accordance with the compensation arrangement with the Board of Directors, the number of deferred stock units granted on January 1, 2012 was determined based on the closing price of the Company s common stock as of the last day of the preceding fiscal year, December 31, 2011, $10.23 per share. The number of deferred stock units granted on July 2, 2012 was determined based on the closing price of the Company s common stock as of June 29, 2012, $11.46 per share. Because the stock price on the date of grant is greater than the stock price on the date the number of shares to be granted was determined, the value of the stock awards granted in 2012 is greater than 50% of the respective total compensation.

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(4) The Company had the following awards outstanding to directors as of December 31, 2012:

Name	Deferred Stock Units[1] (#)
Stephen W. Bershad	47,183
Harry L. Bosco	2,982
Dennis J. Fortino	23,832
Ira J. Lamel	26,423
Dominic A. Romeo	2,982
Thomas N. Secor	2,982
Total	**106,384**

(1) Represents all deferred stock units granted to the directors as of December 31, 2012. Such deferred stock units were fully vested on the date of grant and will convert into an equal number of shares of the Company s common stock as of the date the respective director ceases his membership on the Board of Directors. Includes the following:

Grant Date	Mr. Bershad	Mr. Fortino	Mr. Lamel	Messrs. Bosco, Romeo and Secor
September 2, 2010	23,149	11,575	12,963	
February 15, 2011	11,815	5,908	6,617	
January 1, 2012	12,219	6,110	6,843	
July 2, 2012		239		2,982
Total	47,183	23,832	26,423	2,982

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SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding the beneficial ownership of the Company s common shares for: (1) each person (or group of affiliated persons) who is known by the Company to own beneficially more than 5% of the Company s outstanding common shares; (2) each of the Company s current directors; (3) each of the Company s current Named Executive Officers; and (4) all current directors and executive officers of the Company as a group. The beneficial ownership of common shares with respect to our 5% shareholders is based on information available to the Company as of April 15, 2013, and with respect to our directors, Named Executive Officers and directors and officers as a group is as of March 15, 2013.

Beneficial ownership is determined in accordance with SEC rules and includes voting or investment power with respect to securities. Except as indicated by the footnotes below, the Company believes, based on the information furnished to it, that the persons and entities named in the table below have sole voting and investment power with respect to all common shares that they beneficially own, subject to applicable community property laws. All rights to acquire common shares within 60 days of March 15, 2013 are deemed to be outstanding and beneficially owned by the persons holding those rights for the purpose of computing the number of shares beneficially owned and the percentage ownership of that person. They are not, however, deemed to be outstanding and beneficially owned for the purpose of computing the percentage ownership of any other person.

Percentage ownership of outstanding shares is based on 33,920,454 common shares outstanding as of March 15, 2013.

Name and Address of Beneficial Owner (1)	Amount and Nature of Beneficial Ownership (2)	Percentage of Common Shares
5% Shareholders		
Investment Counselors of Maryland (3)	1,788,000	5.3%
803 Cathedral Street		
Baltimore, MD 21201		
Directors and Executive Officers		
Stephen W. Bershad (4)	3,164,693	9.3%
Harry L. Bosco (5)	10,200	*
Dennis J. Fortino (5)	31,627	*
Ira J. Lamel (5)	34,507	*
Dominic A. Romeo (5)	10,200	*
John A. Roush (6)	222,358	*
Thomas N. Secor (5)	10,200	*
Robert J. Buckley (7)	81,581	*
Jamie B. Bader (8)	12,046	*
Matthijs Glastra (9)		*
Deborah A. Mulryan (10)	6,666	*
All Directors and executive officers as a group (11 persons) (11)	3,584,078	10.57%

* Represents less than 1% of the outstanding common shares.

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(1) Unless otherwise indicated, the address of each shareholder is c/o GSI Group, Inc., 125 Middlesex Turnpike, Bedford, Massachusetts 01730.

(2) The information provided in this table is based on the Company s records, information supplied to the Company by its executive officers, directors and principal stockholders and information contained in Schedules 13D and 13G filed with the SEC.

(3) Pursuant to a Schedule 13G filed with the SEC on February 7, 2013, Investment Counselors of Maryland, LLC may be deemed to beneficially own 1,788,000 common shares of the Company. Investment Counselors of Maryland, LLC has sole dispositive power over all 1,788,000 shares, sole voting power over 1,225,000 shares, and shared voting power over 563,000 shares.

(4) Mr. Bershad is the Chairman of the Board of Directors of the Company. Mr. Bershad owns 938,416 common shares directly. Mr. Bershad is deemed a beneficial owner of 2,164,658 common shares as the trustee of various grantor related annuity trusts that were established for the benefit of his daughters. Mr. Bershad retains sole voting and dispositive power over the shares held in the trusts. On August 8, 2012, Mr. Bershad gifted 1,020,408 shares of Common Stock to his daughters for estate planning purposes, transferring beneficial ownership of these shares to his daughters. Mr. Bershad s direct ownership includes 61,618 deferred stock units that are fully vested and will convert into shares of common stock upon the date Mr. Bershad ceases to be a director of the Company. Mr. Bershad does not have voting rights or the right to receive dividends on these deferred stock units until they are converted to common shares.

(5) Mr. Bosco, Mr. Fortino, Mr. Lamel, Mr. Romeo and Mr. Secor are members of the Board of Directors of the Company. The respective amounts represent deferred stock units that are fully vested and will convert into shares of common stock upon the date each respective director ceases to be a director of the Company. The directors do not have voting rights or the right to receive dividends on the respective deferred stock units until they are converted to common shares.

(6) Excludes 328,083 unvested restricted stock units, which are subject to a risk of forfeiture in favor of the Company. Each restricted stock unit represents the right to receive one common share of the Company upon vesting. Mr. Roush does not have voting rights or the right to receive dividends until vested.

(7) Excludes 137,133 unvested restricted stock units, which are subject to a risk of forfeiture in favor of the Company. Each restricted stock unit represents the right to receive one common share of the Company upon vesting. Mr. Buckley does not have voting rights or the right to receive dividends until vested.

(8) Excludes 57,253 unvested restricted stock units, which are subject to a risk of forfeiture in favor of the Company. Each restricted stock unit represents the right to receive one common share of the Company upon vesting. Mr. Bader does not have voting rights or the right to receive dividends until vested.

(9) Excludes 90,542 unvested restricted stock units, which are subject to a risk of forfeiture in favor of the Company. Each restricted stock unit represents the right to receive one common share of the Company upon vesting. Mr. Glastra does not have voting rights or the right to receive dividends until vested.

(10) Excludes 32,927 unvested restricted stock units, which are subject to a risk of forfeiture in favor of the Company. Each restricted stock unit represents the right to receive one common share of the Company upon vesting. Ms. Mulryan does not have voting rights or the right to receive dividends until vested.

(11)

Excludes 645,939 unvested restricted stock units, which are subject to a risk of forfeiture in favor of the Company. Each restricted stock unit represents the right to receive one common share of the Company upon vesting.

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EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information regarding the Company s common shares that may be issued upon the exercise of rights under all of its existing equity compensation plans as of December 31, 2012:

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Rights	Weighted-Average Exercise Price of Outstanding Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in First Column)
Equity Compensation Plans approved by security holders			
2010 Incentive Award Plan	856,583 (1)		1,575,926
Equity Compensation Plans not approved by security holders	53,208 (2)		

(1) Includes 803,407 unvested restricted stock units outstanding as of December 31, 2012 and 53,176 fully vested deferred stock units granted to the members of the Company s Board of Directors which will convert into shares of common stock as of the date the respective director ceases to be a director of the Company. These awards were granted pursuant to the 2010 Incentive Award Plan which was approved by the Company s shareholders in November 2010.

(2) Represents deferred stock unit awards granted to the members of the Company s Board of Directors, which are fully vested as of December 31, 2012 and will convert into shares of common stock as of the date the respective director ceases to be a director of the Company. These awards were granted pursuant to standalone award agreements outside of an equity compensation plan.

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CERTAIN RELATIONSHIPS

The Company s written Code of Ethics and Business Conduct sets forth the general principle that the Company s directors, officers and employees must act in the best interests of the Company and must refrain from engaging in any activity that presents a conflict of interest or having a personal interest that presents a conflict of interest. The Code of Ethics and Business Conduct generally provides that a conflict of interest occurs when an individual s personal interest interferes, or appears to interfere, with those of the Company. There may be times when a commercial relationship involving the Company s directors, officers or employees or their family members is beneficial to the Company and is not likely to raise material conflict of interest issues, but those situations should be disclosed to the Company for further review. The Company s policy is to review periodically, but not less than annually, all related party transactions for potential conflict of interest situations. The Company s corporate staff is primarily responsible for monitoring and obtaining information from the directors and officers with respect to related party transactions and for then determining, based on the facts and circumstances, whether the Company or a related party has a direct or indirect material interest in the transaction. If deemed necessary, the Audit Committee of the Board of Directors may review certain related party transactions to determine if any transaction creates a conflict of interest.

David Clarke was an executive officer and vice president of the Company and served as Vice President, Group President of Laser Products business group from May 9, 2011 until September 28, 2012. Mr. Clarke also served as the President of Synrad, Inc., a subsidiary of the Company. Mr. Clarke is related by marriage to Jenifer Bunis, who served as Vice President and General Manager of Synrad prior to October 19, 2012, when she terminated her employment with Synrad. Ms. Bunis reported to Mr. Clarke in her role at Synrad. During the year ended December 31, 2012, Ms. Bunis earned approximately $172,000 in compensation from the Company, including base salary of approximately $146,000, non-equity incentive plan compensation of approximately $22,000, defined contribution plan match of approximately $4,000 time-based restricted stock units with an aggregate grant date value determined in accordance with ASC 718 of approximately $59,800, which were forfeited due to Ms. Bunis termination.

As previously reported on the Company s Current Report on Form 8-K, filed with the SEC on July 23, 2010, the Company entered into a Registration Rights Agreement (the Registration Rights Agreement) with certain holders of the Company s prepetition notes. One of the Company s shareholder s that formerly beneficially owned over 5% of the Company s common shares, Liberty Harbor Master Fund I, LP., is party to the Registration Rights Agreement. The Registration Rights Agreement provides that, from the time the Company became current in its reporting obligations under the Securities Exchange Act of 1934 (the Exchange Act) and for as long as it remains a public company with shares registered under the Exchange Act, the parties to the Registration Rights Agreement that collectively own at least 30% of the registrable securities have a right to twice demand the registration of their registrable securities on a registration statement. The registration may be a shelf registration, filed with the SEC on an underwritten or non-underwritten basis. In addition, the parties to the Registration Rights Agreement have unlimited piggyback registration rights.

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OTHER MATTERS

Performance Graph

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

	December 31, 2007	December 31, 2008	December 31, 2009	December 31, 2010	December 31, 2011	December 31, 2012
GSI Group Inc.	$ 95.36	$ 5.88	$ 8.98	$ 36.39	$ 35.19	$ 31.24
NASDAQ Composite Index	$ 109.81	$ 65.29	$ 93.95	$ 109.84	$ 107.86	$ 113.85
S&P Technology	$ 112.14	$ 63.44	$ 96.04	$ 105.32	$ 100.67	$ 102.92

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Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires the officers, directors and persons who own more than 10% of our common shares to file reports of ownership and changes in ownership with the SEC. These officers, directors and 10% shareholders are also required by SEC rules to furnish the Company with copies of all Section 16(a) reports they file. Based solely on a review of copies of Forms 3, 4 or 5 filed by the Company on behalf of its directors and officers or otherwise provided to the Company, the Company believes that during and with respect to the year ended December 31, 2012, its officers, directors and greater than 10% shareholders complied with all applicable Section 16(a) filing requirements.

Directors and Officers Liability Insurance

At December 31, 2012, the Company maintained an entity and director and officers liability insurance policy in the aggregate principal amount of $20 million plus $10 million of additional A-side coverage for non-indemnifiable claims for current officers and directors. The policy is subject to a $350,000 deductible for each indemnifiable loss and a $750,000 deductible for each merger objection related loss. For claims that are not indemnifiable, there is no deductible. The Company is obligated to pay all deductibles. The policy expires in July 2013. The annual premium for this policy was approximately $272,000. This policy does not cover any actions or claims that occurred prior to July 23, 2010.

Additionally, as of December 31, 2012, the Company maintained a policy for former officers and directors in the aggregate principal amount of $20 million and $17 million of additional A-side coverage for non-indemnifiable claims. The policy is subject to a $250,000 deductible per loss for securities claims and $500,000 for all other claims that are indemnifiable by the Company. For claims that are not indemnifiable, there is no deductible. The Company is obligated to pay all deductibles. The policy expires in July 2016. The premium for the six-year policy was approximately $389,000.

Indebtedness of Directors and Officers

Since the beginning of the year ended December 31, 2012, there has been no indebtedness to the Company by any director or officer or the family members or associates of any such person, other than amounts owing for purchases, subject to usual trade terms, for ordinary travel and expense advances and for other transactions in the ordinary course of business.

Shareholder Proposals for the 2014 Annual Meeting

Shareholder proposals intended for inclusion in next year s management proxy circular pursuant to SEC Rule 14a-8 for the 2014 annual meeting of shareholders must be received at the Company s principal executive offices on or before December 25, 2013. Unless otherwise required by law, shareholder proposals received after this date will not be included in next year s management proxy circular. Shareholder proposals not intended for inclusion in next year s management proxy circular or notice of meeting, but which instead are sought to be presented directly at next year s annual meeting, will be considered untimely if received later than March 10, 2014. Proxies will confer discretionary authority with respect to such untimely proposals. In order to curtail controversy as to the date upon which such written notice is received by the Company, it is suggested that such notice be submitted by Certified Mail, Return Receipt Requested.

In the event the date of the 2014 annual meeting of shareholders is changed by more than 30 days from the date of the 2013 Annual Meeting, the Company will inform shareholders of such change and will indicate the new dates by which shareholder proposals must be received.

Householding

The Company s 2012 Annual Report, including audited financial statements for the fiscal year ended December 31, 2012, is being mailed to you along with this management proxy circular. In order to reduce

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printing and postage costs, Broadridge Investor Communication Services has undertaken an effort to deliver only one annual report and one management proxy circular to multiple shareholders sharing an address. This delivery method, called householding, is not being used, however, if Broadridge has received contrary instructions from one or more of the shareholders sharing an address. If your household has received only one annual report and one management proxy circular, the Company will promptly deliver a separate copy of the annual report and the management proxy circular to any shareholder who sends a written request to GSI Group Inc., 125 Middlesex Turnpike, Bedford, Massachusetts 01730, USA, Attention: Investor Relations or who calls our Investor Relations staff at 781-266-5137.

You can also notify Broadridge that you would like to receive separate copies of the Company s annual report and management proxy circular in the future by writing or calling your bank or broker. Even if your household has received only one annual report and one management proxy circular, a separate proxy form or voting instruction form, as applicable, should have been provided for each shareholder account. Each proxy form or voting instruction form, as applicable, should be signed, dated, and returned in the enclosed self-addressed envelope. If your household has received multiple copies of the Company s annual report and management proxy circular, you can request the delivery of single copies in the future by completing the enclosed consent, if applicable, or writing or calling Broadridge directly.

Information Concerning the Company

You may obtain the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2012, the Company s 2012 audited consolidated financial statements, and additional copies of this document on the Company s Web site at http://www.gsig.com, or by writing to or calling Investor Relations, GSI Group Inc., 125 Middlesex Turnpike, Bedford, Massachusetts 01730, USA, or 781-266-5137. You may also obtain such documents and additional information about the Company on SEDAR at www.sedar.com or on EDGAR at www.sec.gov. This information is not incorporated by reference into this management proxy circular.

Other Business

The Board of Directors knows of no business to be brought before the annual meeting other than as described in this management proxy circular. If other matters properly come before the shareholders at the meeting, it is the intention of the persons named on the proxy form to vote the shares represented thereby on such matters in accordance with their judgment.

Directors Approval

The contents and the sending of this management proxy circular have been approved by the Company s Board of Directors.

By Order of the Board of Directors

John A. Roush

Chief Executive Officer

Bedford, Massachusetts

April 19, 2013

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GSI GROUP INC.

9th Floor, 100 University Avenue

Toronto, Ontario M5J 2Y1

www.computershare.com

MR SAM SAMPLE

123 SAMPLES STREET

Security Class COMMON

SAMPLETOWN SS X9X 9X9

Holder Account Number

C1234567890 X X X

Fold

This Form of Proxy is solicited by and on behalf of the Board of Directors of GSI Group Inc.

Notes to proxy

1. **Every holder has the right to appoint some other person or company of their choice, who need not be a holder, to attend and act on their behalf at the meeting or any continuation, adjournment or postponement thereof. If you wish to appoint a person or company other than the persons whose names are printed herein, please insert the name of your chosen proxyholder in the space provided (see reverse).**

2. If the securities are registered in the name of more than one owner (for example, joint ownership, trustees, executors, etc.), then all those registered should sign this proxy. If you are voting on behalf of a corporation or another individual you must sign this proxy with signing capacity stated, and you may be required to provide documentation evidencing your power to sign this proxy.

3. This proxy should be signed in the exact manner as the name(s) appear(s) on the proxy.

4. If this proxy is not dated, it will be deemed to bear the date on which it is mailed by Management to the holder.

5. **The securities represented by this proxy will be voted as directed by the holder, however, if such a direction is not made in respect of any matter, this proxy will be voted by the designated officers FOR each of the nominees for Director in Proposal 1, FOR Proposal 2, 1 YEAR for Proposal 3, and FOR Proposal 4.**

6. The securities represented by this proxy will be voted in favour or withheld from voting or voted against each of the matters described herein, as applicable, in accordance with the instructions of the holder, on any ballot that may be called for and, if the holder has specified a choice with respect to any matter to be acted on, the securities will be voted accordingly.

7. This proxy confers discretionary authority in respect of amendments to or variations of matters identified in the notice of meeting and such other matters that may properly come before the meeting or any continuation, adjournment or postponement thereof. The Board of Directors, at present, knows of no such amendments, variations or other matters to be presented at the meeting.

8. This proxy should be read in conjunction with the accompanying documentation provided by Management. Fold

Proxies submitted must be received by 2:00 pm, Eastern Time, on May 13, 2013.

VOTE USING THE TELEPHONE OR INTERNET 24 HOURS A DAY 7 DAYS A WEEK!

Call the number listed BELOW from a touch tone telephone.

1-866-732-VOTE (8683) Toll Free

Go to the following web site: www.investorvote.com

Smartphone?

Scan the QR code to vote now.

If you vote by telephone or the Internet, DO NOT mail back this proxy.

Voting by mail may be the only method for securities held in the name of a corporation or securities being voted on behalf of another individual.

Voting by mail or by Internet are the only methods by which a holder may appoint a person as proxyholder other than the Management nominees named on the reverse of this proxy. Instead of mailing this proxy, you may choose one of the two voting methods outlined above to vote this proxy.

To vote by telephone or the Internet, you will need to provide your CONTROL NUMBER listed below.

CONTROL NUMBER 123456789012345

00YR6B CPUQC01.E.INT/000001/i1234

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MR SAM SAMPLE

C1234567890

XXX 123

Appointment of Proxyholder

The undersigned shareholder of GSI Group Inc. (the Company) hereby appoints Robert Buckley, Chief Financial Officer or, failing him, John A. Roush, Chief Executive Officer

OR

Print the name of the person you are appointing if this person is someone other than the designated officers listed herein.

as my/our proxyholder with full power of substitution and to attend, act and to vote for and on behalf of the shareholder in accordance with the following direction and in their discretion with respect to amendments to or variations of matters identified in the notice of meeting and such other matters that may properly come before the Annual General Meeting of Shareholders to be held at Latham & Watkins LLP, 885 Third Avenue, New York, New York, 10022-4834 on Wednesday, May 15, 2013 at 2:00 p.m. ET and at any continuation, adjournment or postponement thereof.

VOTING RECOMMENDATIONS ARE INDICATED BY HIGHLIGHTED TEXT OVER THE BOXES.

1. Election of Directors

	For	Withhold		For	Withhold		For	Withhold
01. Stephen W. Bershad	¨	¨	02. Harry L. Bosco	¨	¨	03. Dennis J. Fortino	¨	¨
04. Ira J. Lamel	¨	¨	05. Dominic A. Romeo	¨	¨	06. John A. Roush	¨	¨
07. Thomas N. Secor	¨	¨						

Fold

	For	Against	Abstain
2. Advisory Vote on the Company s Executive Compensation	¨	¨	¨

	1 Year	2 Years	3 Years	Abstain
3. Advisory Vote on the Frequency of Future Advisory Votes on Executive Compensation	¨	¨	¨	¨

	For	Against	Abstain
4. Appointment of Auditors To appoint PricewaterhouseCoopers LLP as the Company s independent registered public accounting firm to serve until the 2014 annual meeting of shareholders.	¨	¨	¨

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Authorized Signature(s) **This section must be completed for your instructions to be executed.**	**Signature(s)**	**Date**
I/We authorize you to act in accordance with my/our instructions set out above. I/We hereby revoke any proxy previously given with respect to the Meeting. **If no voting instructions are indicated above, this Proxy will be voted by the designated officers FOR each of the nominees for Director in Proposal 1, FOR Proposal 2, 1 YEAR for Proposal 3 and FOR Proposal 4.**		DD/MM/YY

Interim Financial Statements Mark this box if you would like to receive Interim Financial Statements and accompanying Management s Discussion and Analysis by mail. ..

Annual Financial Statements Mark this box if you would NOT like to receive the Annual Financial Statements and accompanying Management s Discussion and Analysis by mail. ..

If you are not mailing back your proxy, you may register online to receive the above financial report(s) by mail at www.computershare.com/mailinglist.

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