

FARO TECHNOLOGIES INC  
Form 10-K  
February 25, 2015

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-K**

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

**For the fiscal year ended December 31, 2014**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 0-23081**

**FARO TECHNOLOGIES, INC.**

**(Exact name of Registrant as Specified in Its Charter)**

**Florida**  
**(State or Other Jurisdiction of**  
**Incorporation or Organization)**

**59-3157093**  
**(I.R.S. Employer**  
**Identification Number)**

**250 Technology Park, Lake Mary, FL**  
**(Address of Principal Executive Offices)**

**32746**  
**(Zip Code)**

**Registrant's telephone number, including area code: (407) 333-9911**

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
<b>Common Stock, par value \$.001</b>	<b>NASDAQ Global Select Market</b>

**Securities registered pursuant to Section 12(g) of the Act: None**

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

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

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  No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definite proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

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Non-accelerated filer  (Do not check if a smaller reporting company)  Smaller reporting company   
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the  
Act). Yes  No

The aggregate market value of the Registrant's common stock held by non-affiliates of the Registrant on June 27, 2014 (the last business day of the Registrant's most recently completed second fiscal quarter) was \$831,458,800.32 (based on the closing price of the Registrant's common stock on such date on the NASDAQ Global Select Market, and assuming solely for the purposes of this calculation that all directors and executive officers of the Registrant are affiliates.

As of February 10, 2015, there were outstanding 17,317,430 shares of the Registrant's common stock.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's proxy statement for the 2015 Annual Meeting of Shareholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

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## PART I

### CAUTIONARY STATEMENTS FOR FORWARD-LOOKING INFORMATION

Some of the statements made in this Annual Report on Form 10-K are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Statements that are not historical facts or that describe our plans, beliefs, goals, intentions, objectives, projections, expectations, assumptions, strategies, or future events are forward-looking statements. In addition, words such as may, might, would, will, will be, future, strategy, should, could, seek, expect, anticipate, intend, estimate, goal, objective, project, forecast, target, and similar words identify forward-looking statements.

Forward-looking statements are not guarantees of future performance and are subject to a number of known and unknown risks, uncertainties, and other factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements. Consequently, undue reliance should not be placed on these forward-looking statements. The Company does not intend to update any forward-looking statements, whether as a result of new information, future events, or otherwise, unless otherwise required by law. Important factors that could cause actual results to differ materially from those contemplated in such forward-looking statements include, among others, the following:

economic downturn in the manufacturing industry or the domestic and international economies in the regions of the world where the Company operates;

the Company's inability to further penetrate its customer base and target markets;

development by others of new or improved products, processes or technologies that make the Company's products less competitive or obsolete;

the Company's inability to maintain its technological advantage by developing new products and enhancing its existing products;

the Company's inability to successfully identify and acquire target companies or achieve expected benefits from acquisitions that are consummated;

the cyclical nature of the industries of the Company's customers and material adverse changes in its customers' access to liquidity and capital;

change in the potential for the computer-aided measurement (CAM2) market and the potential adoption rate for the Company's products, which are difficult to quantify and predict;

the Company's inability to protect its patents and other proprietary rights in the United States and foreign countries;

fluctuations in the Company's annual and quarterly operating results and the inability to achieve its financial operating targets as a result of a number of factors including, without limitation (i) litigation and regulatory action brought against the Company, (ii) quality issues with its products, (iii) excess or obsolete inventory, shrinkage or other inventory losses due to product obsolescence, scrap or material price changes, (iv) raw material price fluctuations and other inflationary pressures, (v) expansion of the Company's manufacturing capability, (vi) the size and timing of customer orders, (vii) the amount of time that it takes to fulfill orders and ship the Company's products, (viii) the length of the Company's sales cycle to new customers and the time and expense incurred in further

penetrating its existing customer base, (ix) increases in operating expenses required for product development and new product marketing, (x) costs associated with new product introductions, such as product development, marketing, assembly line start-up costs and low introductory period production volumes, (xi) the timing and market acceptance of new products and product enhancements, (xii) customer order deferrals in anticipation of new products and product enhancements, (xiii) the Company's success in its sales and marketing programs, (xiv) start-up costs associated with opening new sales offices outside of the United States, (xv) fluctuations in revenue without proportionate adjustments in fixed costs, (xvi) the efficiencies achieved in managing inventories and fixed assets, and (xvii) compliance with government regulations including health, safety, and environmental matters;

changes in gross margins due to changing mix of products sold and the different gross margins on different products and sales channels;

the Company's inability to successfully maintain the requirements of Restriction of use of Hazardous Substances ( RoHS2 ) and Waste Electrical and Electronic Equipment ( WEEE ) compliance in its products;

the inability of the Company's products to displace traditional measurement devices and attain broad market acceptance;

the impact of competitive products and pricing in the CAM2 market and the broader market for measurement and inspection devices;

the effects of increased competition as a result of consolidation in the CAM2 market;

risks associated with expanding international operations, such as fluctuations in currency exchange rates, difficulties in staffing and managing foreign operations, political and economic instability, compliance with import and export regulations, and the burdens and potential exposure of complying with a wide variety of U.S. and foreign laws and labor practices;

the loss of the Company's Chief Executive Officer or other key personnel;

difficulties in recruiting research and development engineers and application engineers;

the failure to effectively manage the effects of the Company's growth;

the impact of reductions or projected reductions in government spending, particularly in the defense sector;

variations in the Company's effective income tax rate and the difficulty in predicting the tax rate on a quarterly and annual basis;

the loss of key suppliers and the inability to find sufficient alternative suppliers in a reasonable period or on commercially reasonable terms;

the impact of disruption, delays, or deficiencies in the design or implementation of the Company's new global enterprise resource planning system;

the Company's ability to achieve and maintain profitability;

the effect of estimates and assumptions with respect to critical accounting policies and the impact of the adoption of recently issued accounting pronouncements;

the magnitude of increased warranty costs from new product introductions and enhancements to existing products;

the continuation of the Company's share repurchase program;



the sufficiency of the Company's working capital, cash flow from operations, and credit facility to fund its long-term liquidity requirements;

the impact of geographic changes in the manufacturing or sales of the Company's products on its tax rate; and

the Company's ability to comply with the requirements for favorable tax rates in foreign jurisdictions. as well as other risks and uncertainties discussed in Part I, Item 1A in this Annual Report on Form 10-K. Moreover, new risks and uncertainties emerge from time to time, and we undertake no obligation to update publicly or review the risks and uncertainties included in this Annual Report on Form 10-K, unless otherwise required by law.

#### **ITEM 1. BUSINESS.**

The Company was founded in 1982, and re-incorporated in Florida in 1992. The Company's worldwide headquarters are located at 250 Technology Park, Lake Mary, Florida 32746 and its telephone number is (407) 333-9911.

The Company designs, develops, manufactures, markets and supports software driven, three-dimensional (3-D) measurement, imaging and realization systems. The Company sells the majority of its products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building construction and law enforcement applications. The Company's FaroArm®, FARO Laser ScanArm®, FARO Gage, FARO Laser Tracker, FARO 3D Imager AMP, and their companion CAM2® software provide for Computer-Aided Design, or CAD, based inspection and/or factory-level statistical process control and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company's FARO Focus<sup>3D</sup> and FARO Freestyle<sup>3D</sup> laser scanners, and their companion SCENE and FARO forensic software, are utilized for a wide variety of 3-D modeling, documentation and high-density surveying applications, including in two of the Company's key vertical markets—architecture, engineering and construction (AEC) and law enforcement.

#### **Industry Background**

The Company believes four principal forces drive the need for its products and services: 1) the widespread use by manufacturers of CAD in product development, which shortens product cycles; 2) the adoption by manufacturers of quality standards such as Six Sigma and ISO-9001 (and its offshoot QS-9000), which stress the measurement of every step in a manufacturing process to reduce or eliminate defects; 3) the inability of traditional measurement devices to address many manufacturing problems such as throughput, efficiency, and accuracy, especially with respect to large components for products such as automobiles, aircraft, heavy duty construction equipment and factory retrofits; and 4) the growing demand to capture large volumes of three-dimensional data for modeling and analysis.

***CAD improves the manufacturing process.*** The creation of physical products involves the processes of design, engineering, production, and measurement and quality inspection. These basic processes have been profoundly affected by the computer hardware and software revolution that began in the 1980s. CAD software was developed to automate the design process, providing manufacturers with computerized 3-D design capability and shortening the time between design changes. Today, most manufacturers use some form of CAD software to create designs and engineering specifications for new products and to quantify and modify designs and specifications for existing products. While manufacturers



previously designed their products to remain in production for longer periods of time, current manufacturing practices must accommodate more frequent product introductions and modifications, while satisfying more stringent quality and safety standards. Assembly fixtures and measurement tools must be linked to the CAD design to enable production to keep up with the rate of design change.

***Quality standards dictate measurement to reduce defects.*** QS-9000 is the name given to the Quality System Requirements of the automotive industry developed by Chrysler, Ford, General Motors and major truck manufacturers. Companies registered under QS-9000 are considered to have higher standards and better quality products. Six Sigma is a set of quality standards that embodies the principles of total quality management, focused on measuring results and reducing product or service failure rates to 3.4 per million. All aspects of a Six Sigma company's infrastructure must be analyzed, and if necessary, restructured to increase revenues and raise customer satisfaction levels. The all-encompassing nature of these and other quality standards has resulted in manufacturers measuring every aspect of their process, including stages of product assembly that may never have been measured before, in part because of the lack of suitable measurement equipment.

***Traditional products do not measure up.*** A significant aspect of the manufacturing process entails measurement and quality inspection. Historically, manufacturers have measured and inspected products using hand-measurement tools such as scales, calipers, micrometers and plumb lines for simple measuring tasks, test (or check) fixtures for certain large manufactured products, and traditional (or fixed) coordinate measurement machines, or CMM, for objects that require higher precision measurement. However, the broader utility of each of these measurement methods is limited.

Although hand-measurement tools are often appropriate for simple geometric measurements, including hole diameters or length and width of a rectangular component, their use for complex part measurements, such as the fender of a car, is limited. Also, these devices do not allow for the measurements to be directly compared electronically to the CAD model of the part. Test fixtures (customized fixed tools used to make comparative measurements of complex production parts to master parts) are relatively expensive and must be reworked or discarded each time a dimensional change is made in the part being measured. In addition, these manual measuring devices do not permit the manufacturer to electronically compare the dimensions of an object with its CAD model.

Conventional CMMs are generally large, fixed-base machines that provide very high levels of precision and provide a link to the CAD model of the object being measured. However, fixed-base CMMs require that the object being measured be brought to the CMM and fit within the CMM's measurement grid. As manufactured subassemblies increase in size and become integrated into even larger assemblies, they become less transportable, thus diminishing the utility of a conventional CMM. Consequently, manufacturers must continue to use hand-measurement tools, or expensive customized test fixtures, to measure large or unconventionally shaped objects. In addition, some parts or assemblies are not easily accessible and cannot be measured using traditional devices.

***The market demands three-dimensional data.*** Various factors contribute to increased market demand for FARO products and services. Conventional surveying equipment is limited to single-point measurements and does not have the capacity to capture and analyze large volumes of three-dimensional data. As data requirements for construction, civil engineering and forensic inspection projects become more complex, single-point measurement devices will become increasingly more difficult to utilize in those applications.

Escalating global competition has created a demand for higher quality products with shorter life cycles. Customers require more rapid design, greater control of the manufacturing process, tools to compare components to their CAD specifications, the ability to precisely

measure components that cannot be measured or inspected by conventional devices, and the ability to capture and analyze large volumes of three-dimensional data. Moreover, they increasingly require measurement capabilities to be integrated into manufacturing processes and to be available on the factory floor. These changing demands have driven the demand for FARO's products and services.

### **FARO Products**

**FaroArm.** The FaroArm is a combination of a portable, six or seven-axis, articulated measurement arm, a computer, and CAM2 software programs, which are described below under "CAM2 Software".

***Articulated Arm*** The articulated arm is comprised of three major joints, each of which may consist of one, two or three axes of motion. The articulated arm is available in a variety of sizes, configurations and precision levels suitable for a broad range of applications. To take a measurement, the operator simply touches the object to be measured with a probe at the end of the arm and presses a button. Data can be captured at either individual points or a series of points. Optical encoders located at each of the joints of the arm measure the angles at those joints, and this rotational measurement data is transmitted to an on-board controller that converts the arm angles to precise locations in 3-D space using xyz position coordinates and ijk orientation coordinates.

***Computer*** The Company pre-installs its CAM2 software on either a notebook or desktop style computer or Microsoft Windows®-based Touch PC or Touch Pad, depending on the customer's need, and the measurement arm, computer and installed software are sold as a system. The Company purchases the computers sold with its products from various suppliers.

**FARO Laser ScanArm.** The FARO Laser ScanArm is a FaroArm equipped with a combination of a hard probe (like that in the FaroArm) and a non-contact laser line probe. This product provides the Company's customers the ability to measure products without touching them and offers a seven-axis contact/non-contact measurement device with a fully integrated laser scanner. The ScanArm is used for contact and non-contact measurement applications, including inspection, cloud-to-CAD comparison, rapid prototyping, reverse engineering and 3-D modeling.

**FARO Gage.** The FARO Gage is a smaller, higher-accuracy version of the FaroArm that is sold as a combination of an articulated arm device with a computer and software. The FARO Gage is also distinguished from the FaroArm by the special mounting features and software unique to the FARO Gage. The FARO Gage is targeted at machine tools and bench tops around machine tools, where basic measurements of smaller machined parts must be measured. The CAM2 FARO Gage software developed for this device, described below, features basic 2-D and 3-D measurements common to these applications.

**FARO Laser Tracker.** The FARO Laser Tracker combines a portable, large-volume laser measurement tool, a computer, and CAM2 software programs.

***Laser Tracker Vantage*** The FARO Laser Tracker Vantage utilizes an ultra-precise laser beam to measure objects of up to 260 feet. It enables manufacturing, engineering, and quality control professionals to measure and inspect large parts, machine tools and other large objects on-site and in-process. With its greater angular resolution, repeatability, and accuracy, the FARO Laser Tracker Vantage advances already-proven tracker technology. Among its many enhanced features is TruADM™, which improves upon existing Absolute Distance Measurement (ADM) technology by providing the time-saving ability to reacquire the laser beam

without the need to return to a known reference point or the need to hold the target stationary.

**Laser Tracker ION** The FARO Laser Tracker ION is an interferometer (IFM)-based measurement system that provides the high accuracy and range to complete measurement tasks, such as in-line measurements, high-speed dynamic measurements, or high-accuracy machine calibration. The FARO Laser Tracker ION features Dual Distancing Systems, enabling the Tracker to catch the beam in the air and set the distance instantly with Agile ADM.

**Computer** The FARO Laser Tracker includes a notebook or desktop style computer or Microsoft Windows -based Touch PC or Touch Pad, depending on the customer's requirements, that includes the pre-installed CAM2 Software.

**FARO 3D Imager AMP.** The FARO 3D Imager AMP is a high-performance non-contact 3-D Imager, capable of collecting millions of points to generate infinitely-focused fringe patterns. The FARO 3D Imager AMP creates a highly-accurate point cloud of objects in the AMP's field of view. This technology is used in quality control to improve product quality and reduce scrap, as well as for reverse engineering and rapid manufacturing.

**FARO Focus<sup>3D</sup>.** The FARO Focus<sup>3D</sup> utilizes laser technology to measure and collect a cloud of data points, allowing for the detailed and precise three-dimensional rendering of an object or an area as large as a factory. This technology is currently used for factory planning, facility life-cycle management, quality control, forensic analysis and capturing large volumes of three-dimensional data. The FARO Focus<sup>3D</sup> simplifies modeling, reduces project time and maintains or increases the accuracy of the image. The resulting data is used with major CAD systems or FARO's own proprietary SCENE software.

**FARO Freestyle<sup>3D</sup>.** The FARO Freestyle<sup>3D</sup>, which was released in January 2015, is a top-quality, high-precision, handheld scanner that quickly and reliably documents rooms, structures and objects in 3-D and creates high-definition point clouds. The applications of the FARO Freestyle<sup>3D</sup> include architecture, construction, industrial production and forensics. The FARO Freestyle<sup>3D</sup>'s durable carbon fiber design equips the user with a versatile and ergonomic tool for performing accurate scanning in confined spaces. The FARO Freestyle<sup>3D</sup> can be used independently or as a complement to the FARO Focus<sup>3D</sup>. The FARO Freestyle<sup>3D</sup> comes with two software applications in addition to FARO's proprietary SCENE software: SCENE Capture, which is installed on a tablet computer to record and visualize the capturing of 3-D data, and SCENE Process, which processes the captured 3-D data.

**FARO Software.** The Company provides a family of proprietary CAD-based measurement and laser scanner software used with the Company's measurement and scanning devices.

**CAM2 Measure 10** allows customers to complete measurement jobs quickly and gives customers the freedom to measure as required by the application. State-of-the-art functionalities improve every process where measuring is needed.

**FARO CAM2 Smartinspect** is the Company's CAM2 solution for measuring geometry and building dimensions. The software allows customers to quickly measure geometric features and report dimensions for control.

**FARO SCENE** software combines ease-of-use, networking, and an enhanced 3-D experience to deliver a complete scan processing solution. With SCENE, customers can display, analyze, administer and edit 3-D measurements in point clouds.

**FARO Forensics** software makes diagramming and pre-planning easier for law enforcement officers, firefighters and loss control engineers by allowing the users who need to draw site plans or crash or crime scene diagrams to be able to do so in a fast and efficient manner.

To support its product lines, the Company also offers extended warranties and comprehensive support, training and technology consulting services to its customers.

### **Customers**

The Company's sales are diversified across a broad number of over 15,000 customers worldwide in a range of end market applications. The FARO metrology product lines (e.g. Arm, Gage, Laser ScanArm, Laser Tracker, and Imager AMP) are purchased primarily by customers in the automotive and aerospace markets and a diverse array of manufacturing customers from small machine shops to large industrials. The Company's Focus<sup>3D</sup> and Freestyle<sup>3D</sup> product lines provide precise three-dimensional renderings primarily to architecture, engineering, construction, and law enforcement customers. The Company's ten largest customers by revenue represented an aggregate of approximately 3.3% of the Company's total sales in 2014. No customer represented more than 1.0% of the Company's sales in 2014.

### **Sales and Marketing**

The Company conducts its sales and marketing efforts on a decentralized basis in three main regions around the world: Americas, Europe/Africa and Asia-Pacific. The regional headquarters for the Americas is located in the Company's headquarters in Lake Mary, Florida; the Europe/Africa regional headquarters is located in Stuttgart, Germany; and the regional headquarters for the Asia-Pacific region is located in Singapore. At December 31, 2014, the Company employed 167, 157, and 166 sales and marketing specialists in the Americas, Europe/Africa, and Asia-Pacific regions, respectively. The Company sells most of its products through direct sales representation in the United States, Brazil, Mexico, Germany, Switzerland, United Kingdom, France, Italy, Singapore, Japan, China and India. The Company also sells its products through distributors, although this channel has historically represented a small percentage of total sales, and in 2014 represented 9.9% of total sales. Note 16 to the Company's Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K includes financial information about the Company's foreign and domestic operations.

The Company's sales and marketing efforts use a process of integrated lead qualification and sales demonstration. Once a customer opportunity is identified, the Company employs a team-based sales approach involving inside and outside sales personnel who are supported by application engineers. Each team has the ability to sell multiple product lines. The Company employs a variety of marketing techniques to promote brand awareness and customer identification.

### **Research and Development**

The Company believes that its future success depends, in part, on its ability to maintain technological leadership, which will require ongoing enhancements of its products and the development of new applications and products that provide 3-D measurement solutions. The field of 3-D measurement continues to expand, and new technologies and applications will be essential to competing in this market. Accordingly, the Company intends to continue to make substantial investments in the development of new technologies, the commercialization of new products that build on the Company's existing technological base and the enhancement and development of additional applications for its products.

The Company's research and development efforts are directed primarily at enhancing the functional adaptability of its current products and developing new and innovative products that respond to specific requirements of the emerging market for 3-D measurement and





documentation systems. The Company's engineering development efforts will continue to focus on enhancing the mechanical hardware, electronics, and software in its existing products and developing new products for the CAM2 market. Research and development activities, especially with respect to new products and technologies, are subject to significant risks, and there can be no assurance that any of the Company's research and development activities will be completed successfully or on schedule, or, if completed, will be commercially accepted.

At December 31, 2014, the Company employed 156 scientists and technicians in its research and development efforts. Research and development expenses were approximately \$27.5 million in 2014, compared to \$22.4 million in 2013 and \$17.6 million in 2012.

### **Intellectual Property**

The Company holds or has pending approximately 800 patents in the United States and related patents worldwide, which generally expire on a rolling basis between 2015 and 2033. The Company also has 21 registered or pending trademarks in the United States and worldwide, which generally expire on a rolling basis between 2015 and 2024.

The Company's success and its ability to maintain its competitive position depends, in large part, on its ability to protect its intellectual property. The Company relies on a combination of contractual provisions and trade secret laws to protect its proprietary information. However, there can be no assurance that the steps taken by the Company to protect its trade secrets and proprietary information will be sufficient to prevent misappropriation of its proprietary information or preclude third-party development of similar intellectual property.

Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of the Company's products or to obtain and use information that the Company regards as proprietary. The Company intends to vigorously defend its proprietary rights against infringement by third parties. However, policing unauthorized use of the Company's products is difficult, particularly in foreign countries, and the Company may be unable to determine the extent, if any, to which unauthorized use of its products exists. In addition, the laws of some foreign countries do not protect the Company's proprietary rights to the same extent as the laws of the United States.

The Company does not believe that any of its products infringe on the proprietary rights of third parties. There can be no assurance, however, that third parties will not claim infringement by the Company with respect to current or future products. Any such claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require the Company to enter into royalty or licensing agreements, which could have a material adverse effect upon the Company's business, operating results and financial condition. In addition, such royalty or licensing agreements, if required, may not be available on terms acceptable to the Company, if at all.

### **Manufacturing and Assembly**

The Company manufactures its FaroArm, FARO Gage, FARO Laser ScanArm, FARO 3D Imager AMP and FARO Laser Tracker products in the Company's manufacturing facilities located in Florida and Pennsylvania for customer orders from the Americas, in its manufacturing facility located in Schaffhausen, Switzerland for customer orders from the Europe/Africa region, and in its manufacturing facility located in Singapore for customer orders from the Asia-Pacific region. The Company manufactures its FARO Focus<sup>3D</sup> and FARO Freestyle<sup>3D</sup> products in its facilities located in Schaffhausen, Switzerland and Stuttgart, Germany. In the fourth quarter of 2014, the Company relocated its facility in Kennett Square, Pennsylvania to a leased facility consisting of approximately 90,400 square feet in Exton, Pennsylvania.

The Company expects all its existing plants to have the production capacity necessary to support its volume requirements through 2015.

Manufacturing consists primarily of assembling and integrating components and subassemblies purchased from suppliers into finished products. The primary components, which include machined parts and electronic circuit boards, are produced by subcontractors according to the Company's specifications. All products are assembled, calibrated and tested for accuracy and functionality before shipment. The Company performs limited in-house circuit board assembly and component part machining. Typically, the Company enters into purchase commitments for manufacturing components to cover production requirements for 60 to 90 days.

The Company's manufacturing, engineering, and design headquarters have been registered to the ISO-9001 standard since July 1998. Semi-annual surveillance audits have documented continuous improvement to this multinational standard. Currently, the Company's manufacturing sites in Lake Mary, Florida; Stuttgart, Germany; Schaffhausen, Switzerland; and Singapore are jointly registered to ISO-9001 and ISO-17025. As a result of the Company's relocation of its Pennsylvania facility from Kennett Square to Exton, Pennsylvania, the ISO-9001 certification is being transitioned to the new facility. However, the Exton facility is registered to the ISO-17025 standard. In addition, the Company's service sites in the United States, Germany, Switzerland, India, Japan, China, Singapore, Mexico and Brazil have joint certification and accreditation to ISO-17025. The Company continues to examine its scope of registration as its business evolves and has chosen English as the standard business language for its operations.

The Company's efforts to register its manufacturing, engineering and design headquarters to the ISO-9001 standard in concert with the ISO9001:2008 Quality Management System Certification verifies the Company's commitment to quality through an internationally recognized standard. Additionally, the Company takes a global approach to ISO17025:2005 regarding the recognition of the Competence of Calibration and Testing Laboratories, seeking to have all locations registered with similar scopes of accreditation and capabilities for the products generated and serviced.

### **Competition**

The Company's measurement systems compete in the broad and highly competitive market for measurement devices for manufacturing and industrial applications, which, in addition to portable articulated arms, laser tracker, 3-D imaging and laser scanner products, consist of fixed-base CMMs, templates and go/no-go gages, check fixtures, handheld measurement tools, and various categories of surveying equipment. In the FARO Gage product line, the Company competes with a number of manufacturers of handheld measurement tools and fixed-base CMMs, including some large, well-established companies. In the FaroArm, FARO Laser ScanArm, FARO Laser Tracker, FARO Focus<sup>3D</sup> and FARO 3D Imager AMP product lines, the Company competes primarily with Hexagon Metrology, a division of Hexagon AB, and with Steinbichler Optotechink GmbH and GOM GmbH in the 3D Imager product lines. The Company also competes in these product lines with a number of other smaller competitors. The Company competes on the basis of technical innovation, product performance, quality and price with respect to all of its products.

The Company will be required to make continued investments in technology and product development to maintain and extend the technological advantage that it believes it currently has over its competition. However, the Company cannot be certain that its technology or its product development efforts will allow the Company to successfully compete as the industry evolves. As the market for the Company's measurement systems expands, additional competition may emerge and the Company's existing and future competitors may commit more resources to the markets in which the Company participates.

### **Government Regulation**

The Company's operations are subject to numerous governmental laws and regulations, including those governing antitrust and competition, the environment, import and export of products, currency conversions and repatriation, taxation of foreign earnings and earnings of expatriate personnel and use of local employees and suppliers. The Company's foreign operations are subject to the U.S. Foreign Corrupt Practices Act, or FCPA, and similar foreign anti-corruption laws, which makes illegal any payments to government officials or government employees that are intended to induce their influence to assist the Company or to gain any improper advantage for the Company. The Company operates in certain regions in the Middle East, Africa, and Asia-Pacific that are more prone to risk under these anti-corruption laws.

Manufacturers of electrical goods are subject to the European Union's RoHS2 and WEEE directives, which took effect during 2006. RoHS2 prohibits the use of lead, mercury and certain other specified substances in electronics products, and WEEE makes producers of electrical goods financially responsible for specified collection, recycling, treatment, and disposal of covered electronic products and components. Parallel initiatives are being proposed in other jurisdictions, including several states in the United States and China.

The Company currently holds WEEE registration and is in compliance with the directives of the European Union. Under the classification of Industrial Monitoring and Control Instruments, the Company's products have until July 22, 2017 to become compliant with the RoHS2 directive. Currently, only the FARO Laser Tracker ION does not meet the RoHS2 directive. However, if the Company is unable to bring the FARO Laser Tracker ION into compliance with the RoHS2 directive by July 22, 2017, it would be unable to sell the FARO Laser Tracker ION in European Union countries and China, and potentially in several states in the United States, which could have a material adverse effect on its sales and results of operations.

### **Backlog and Seasonality**

At December 31, 2014, the Company had orders representing approximately \$14.1 million in sales outstanding. The majority of these specific orders were shipped by February 19, 2015, and, as of February 19, 2015, the Company had orders representing approximately \$13.1 million in sales outstanding. The Company believes that substantially all of the outstanding sales orders as of February 19, 2015 will be shipped during 2015. At December 31, 2013 and 2012, the Company had orders representing approximately \$18.7 million and \$18.0 million in sales outstanding, respectively.

The Company typically experiences greater order volume during the fourth quarter as customers spend the remaining balances of their capital expenditures budgets.

### **Employees**

At December 31, 2014, the Company had 1,223 full-time employees, consisting of 490 sales and marketing professionals, 180 production staff, 156 research and development staff, 163 administrative staff, and 234 customer service/training/application engineering specialists. The Company is not a party to any collective bargaining agreements and believes its employee relations are satisfactory. Management believes that its future growth and success will depend in part on its ability to retain and continue to attract highly skilled personnel. The Company anticipates that it will be able to obtain the additional personnel required to satisfy its staffing requirements over the foreseeable future.

### **Geographic Information**

The Company has three reportable segments based upon geographic regions: Americas, Europe/Africa and Asia-Pacific. The Company develops, manufactures, markets, supports and sells CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software and three-dimensional documentation systems in each of these regions. These activities represent more than 99% of consolidated sales. The Company evaluates performance and allocates resources based upon profitable growth and assets deployed. Information regarding the Company's net sales, operating income, and long-lived assets by geographic region is set forth in Note 16 to the Consolidated Financial Statements under Part II, Item 8 to this Annual Report on Form 10-K.

### **Available Information**

The Company makes available, free of charge on its Internet website at <http://www.faro.com>, its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission, or the SEC. You can find these reports on the Company's website at [www.faro.com](http://www.faro.com) by first clicking "Investor Relations" and then "SEC Filings". The information on the Company's website is not a part of this Annual Report on Form 10-K.

These reports may also be obtained at the SEC's Public Reference Room at 100 F Street NE, Washington, DC 20549. Information on the operation of the Public Reference Room is available by calling the SEC at (800) SEC-0330. You may also access this information at the SEC's website at <http://www.sec.gov>. This site contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

### **ITEM 1A. RISK FACTORS.**

The statements under this heading describe the most significant risks to the Company's business identified by management and should be considered carefully in conjunction with the discussion in Management's Discussion and Analysis of Financial Condition and Results of Operations included in Part II, Item 7 of this Annual Report on Form 10-K and in the Company's Consolidated Financial Statements and notes thereto included in Part II, Item 8 of this Annual Report on Form 10-K.

Any of the following risks and uncertainties could materially and adversely affect our business, results of operations, liquidity, and financial condition. However, predicting or identifying all such risks and uncertainties is not possible. As a result, the following factors should not be considered to be a complete discussion of the Company's risks and uncertainties.

#### ***Competitors may develop products that make the Company's products obsolete or less competitive.***

The CAM2 market is characterized by rapid technological change. Competitors may develop new or improved products, processes or technologies that may make the Company's products obsolete or less competitive.

As a result, the Company's success depends, in part, on its ability to maintain its technological advantage by developing new products and applications and enhancing its existing products, which can be complex and time-consuming and require substantial investment by the Company. Significant delays in new product releases or difficulties in



developing new products could adversely affect the Company's business and results of operations. The Company can provide no assurance that it will be able to adapt to evolving markets and technologies or maintain its technological advantage.

***The Company's financial performance is dependent on the conditions of various industries, including the automotive, aerospace, and heavy equipment industries, which have from time to time experienced, and may again experience, significant disruptions in the economic environment.***

A significant portion of the Company's sales are to manufacturers in the automotive, aerospace, and heavy equipment industries. The Company is dependent upon the continued viability and financial stability of its customers in these industries, which are highly cyclical and dependent upon the general health of the economy and consumer spending.

***Reductions in defense spending could adversely affect the Company's business.***

Certain of the Company's customers operate in the defense sector and depend significantly on U.S. government spending. In August 2011, Congress enacted the Budget Control Act of 2011 which imposes spending caps and certain reductions in defense spending over the next ten years. Automatic spending reductions, referred to as sequestration, were implemented in March 2013. Ongoing budgetary discussions in the federal government may result in other cuts to defense spending. Reductions in defense spending that impact the aerospace and defense industries could have an adverse effect on the Company's results of operations.

***The buying process for most of the Company's customers for the its measurement products is highly decentralized and typically requires significant time and expense for the Company to further penetrate the potential market of a specific customer, which may delay the Company's ability to generate additional revenue.***

The Company's success depends, in part, on its ability to further penetrate its customer base. During 2014, approximately 63% of the Company's revenue was attributable to sales to its existing customers. If the Company is not able to continue to further penetrate its existing customer base, its sales growth may decline. However, most of the Company's customers have a decentralized buying process for measurement devices, and the Company must spend significant time and resources to increase revenues from a specific customer. For example, the Company may provide products to only one of its customer's manufacturing facilities or for a specific product line within a manufacturing facility. The Company cannot offer any assurance that it will be able to maintain or increase the amount of sales to its existing customers, which could adversely affect its financial results.

***The Company's ability to protect its patents and proprietary rights in the United States and foreign countries could adversely affect its revenues.***

The Company's success depends, in large part, on its ability to obtain and maintain patents and other proprietary right protection for its processes and products in the United States and other countries. The Company also relies upon trade secrets, technical know-how and continuing inventions to maintain its competitive position. The Company seeks to protect its technology and trade secrets, in part, by confidentiality agreements with its employees and contractors. However, the Company's employees may breach these agreements or the Company's trade secrets may otherwise become known or be independently discovered by inventors. If the Company is unable to obtain or maintain protection of its patents, trade secrets and other proprietary rights, it may not be able to prevent third parties from using its proprietary rights, which could have a material adverse effect on the Company's results of operations.

The Company's patent protection involves complex legal and technical questions. Its patents may be challenged, narrowed, invalidated or circumvented. Further, the Company may be able to protect its proprietary rights from infringement by third parties only to the extent that its proprietary processes and products are covered by valid and enforceable patents or are effectively maintained as trade secrets. Furthermore, others may independently develop similar or alternative technologies or design around the Company's patented technologies. Litigation or other proceedings to defend or enforce its intellectual property rights could require the Company to spend significant time and money, which could have an adverse impact on the Company's financial condition.

***Claims from others that the Company infringes their intellectual property rights may adversely affect its business and financial condition.***

From time to time, the Company receives notices from others claiming it infringes their intellectual property rights. Resolving these claims may require the Company to enter into royalty or licensing agreements on unfavorable terms, require it to stop selling or to redesign affected products, or require it to pay damages. In addition, from time to time, the Company is involved in intellectual property lawsuits. The Company could in the future incur judgments or enter into settlements of lawsuits and claims that could have a material adverse effect on the Company's financial condition. Any litigation or interference proceedings, regardless of their outcome, may be costly and may require significant time and attention of the Company's management and technical personnel.

***Product failures or product availability and performance issues could result in increased warranty costs, delays in new product introductions and enhancements and adversely affect the Company's business.***

The Company regularly introduces new products and enhances existing products. Failures in the Company's new or existing products could result in increased warranty costs, delays in new product introductions, and a loss of sales and customers and have an adverse effect on the Company's business and financial condition.

***The Company may not be able to achieve financial results within its target goals, and its operating results may fluctuate due to a number of factors, many of which are beyond its control.***

The Company's ability to achieve financial results that are within its goals is subject to a number of factors beyond its control. Moreover, the Company's annual and quarterly operating results have varied significantly in the past and likely will vary significantly in the future. Factors that cause the Company's financial results to fluctuate include, but are not limited to, the following:

adverse changes in the manufacturing industry and general economic conditions;

the effectiveness of sales promotions;

geographic expansion in the Asia-Pacific region and other regions;

training and ramp-up time for new sales people;

investments in strategic sales, product or other initiatives;



investments in technologies and new products and product enhancements, including costs associated with new development and product introductions and the timing and market acceptance of new products and product enhancements;

shrinkage or other inventory losses due to product obsolescence, scrap or material price changes;

expansion of the Company's manufacturing capability;

the size and timing of customer orders, many of which are received towards the end of the quarter;

the amount of time that it takes to fulfill orders and ship the Company's products;

the length of the Company's sales cycle to new customers;

customer order deferrals in anticipation of new products and product enhancements;

start-up costs and ramp-up time associated with opening new sales offices outside of the United States;

variations in the effective income tax rate and the difficulty in predicting the tax rate on a quarterly and annual basis; and

litigation and regulatory action brought against the Company.

Any one or a combination of these factors could adversely affect the Company's annual and quarterly operating results in the future and could cause it to fail to achieve its target financial results.

***The Company's growth depends on the ability of the Company's products to attain broad market acceptance.***

The market for traditional fixed-base CMMs, check fixtures, handheld measurement tools, and surveying equipment is mature. Part of the Company's strategy is to continue to displace these traditional measurement devices. Displacing traditional measurement devices and achieving broad market acceptance of the Company's products requires significant effort to convince customers to reevaluate their historical measurement procedures and methodologies.

The potential size and growth rate of the CAM2 market is uncertain and difficult to quantify. If the CAM2 market does not continue to expand or does not expand as quickly as the Company anticipates, it may not be able to grow its sales, which may affect its financial results.

The Company markets seven closely interdependent products (FaroArm, FARO Laser ScanArm, FARO Gage, FARO Laser Tracker, FARO 3D Imager AMP, FARO Focus<sup>3D</sup> and FARO Freestyle<sup>3D</sup>) and related software for use in measurement, inspection, and high density surveying applications. Substantially all of the Company's revenues are currently derived from sales of these products and software, and it plans to continue its business strategy of focusing on the software-driven, 3-D measurement and inspection market. Consequently, the Company's financial performance will depend in large part on computer-based measurement, inspection, and high density surveying products achieving broad market acceptance. If its products cannot attain broad market acceptance, the Company will not grow as anticipated and may be required to make increased expenditures on research and development for new applications or new products.



***The Company competes with manufacturers of measurement systems and traditional measurement devices, many of which have more resources than the Company and may develop new products and technologies.***

The broad market for measurement devices is highly competitive. In the FARO Gage product line, the Company competes with manufacturers of handheld measurement tools and fixed-base CMMs, including some large, well-established companies. In the FaroArm, FARO Laser ScanArm, FARO Laser Tracker, FARO Focus<sup>3D</sup> and FARO 3D Imager AMP product lines, the Company competes primarily with Hexagon Metrology, a division of Hexagon AB, and with Steinbichler Optotechink GmbH and GOM mbH in the 3D Imager product lines. The Company also competes in these product lines with a number of other smaller competitors. The Company competes on the basis of technical innovation, product performance, quality, and price with respect to all of its products.

The Company will be required to make continued investments in technology and product development to maintain the technological advantage that it believes it currently has over its competition. Some of the Company's competitors possess substantially greater financial, technical, and marketing resources than it possesses. Moreover, the Company cannot be certain that its technology or its product development efforts will allow it to successfully compete as the industry evolves. As the market for its measurement systems expands, additional competition may emerge and the Company's existing and future competitors may commit more resources to the markets in which the Company participates. The Company's results of operations could be adversely affected by pricing strategies pursued by competitors or technological or product developments by competitors.

***The Company derives a substantial part of its revenues from its international operations, which are subject to greater volatility and often require more management time and expense to achieve profitability than its domestic operations.***

The Company derives more than half of its revenues from international operations. The Company's international operations are subject to various risks, including:

difficulties in staffing and managing foreign operations;

political and economic instability;

unexpected changes in regulatory requirements and laws;

longer customer payment cycles and difficulty collecting accounts receivable;

compliance with export and import regulations and trade restrictions;

governmental restrictions on the transfer of funds to the Company from its operations outside the United States; and

burdens of complying with a wide variety of foreign laws and labor practices.

Several of the countries where the Company operates have emerging or developing economies, which may be subject to greater currency volatility, negative growth, high inflation, limited availability of foreign exchange and other risks. These factors may harm the Company's results of operations and any measures that it may implement to reduce the effect of volatile currencies and other risks of its international operations may not be effective.

***Because a significant portion of the Company's revenues and expenses are denominated in foreign currencies, the Company faces significant exposure to foreign exchange rate risk.***

The Company's results of operations are affected by fluctuations in exchange rates which can cause significant fluctuations in the Company's quarterly and annual results of operations. Fluctuations in exchange rates may have a material adverse effect on the Company's results of operations and financial condition, and could result in potentially significant foreign exchange gains and losses. To the extent that the percentage of its non-U.S. dollar revenues derived from international sales increases in the future, the Company's exposure to risks associated with fluctuations in foreign exchange rates will increase.

***The Company is subject to the impact of governmental and other similar certification processes and regulations, which could adversely affect the Company's business and results of operations.***

The Company's operations are subject to numerous governmental laws and regulations, including those governing antitrust and competition, the environment, import and export of products, currency conversions and repatriation, taxation of foreign earnings and earnings of expatriate personnel and use of local employees and suppliers. An inability to comply with these regulations or obtain any necessary certifications in a timely manner could have an adverse effect on the Company's operating results.

Manufacturers of electrical goods are subject to the European Union's RoHS2 and WEEE directives, which took effect during 2006. RoHS2 prohibits the use of lead, mercury and certain other specified substances in electronics products, and WEEE makes producers of electrical goods financially responsible for specified collection, recycling, treatment, and disposal of covered electronic products and components. Parallel initiatives are being proposed in other jurisdictions, including several states in the United States and China.

The Company currently holds WEEE registration and is in compliance with the directives of the European Union. Under the classification of Industrial Monitoring and Control Instruments, the Company's products have until July 22, 2017 to become compliant with the RoHS2 directive. Currently, only the FARO Laser Tracker ION does not meet the RoHS2 directive. However, if the Company is unable to bring the FARO Laser Tracker ION into compliance with the RoHS2 directive by July 22, 2017, it would be unable to sell the FARO Laser Tracker ION in European Union countries and China, and potentially in several states in the United States, which could have a material adverse effect on its sales and results of operations.

***Any failure to comply with the Foreign Corrupt Practices Act or similar anti-corruption laws could subject the Company to fines and penalties.***

In 2012, the Company's monitorship expired pursuant to its settlement with the SEC and the Department of Justice, or DOJ, concerning certain payments made by the Company's China subsidiary that may have violated the Foreign Corrupt Practices Act, or the FCPA, and other applicable laws. The Company is, of course, still subject to such laws and has adopted and maintains a compliance plan designed to ensure compliance with these laws; however, in light of the Company's prior conduct, any future failure to comply with any such continuing obligations could result in the SEC and the DOJ aggressively seeking to impose penalties against the Company in the future. In addition, many countries in which the Company operates have increased regulation regarding anti-corruption practices generally. Compliance with such regulations could be costly and could adversely impact the Company's results of operations or delay entry into new markets.

***The Company may not be able to identify or consummate acquisitions or achieve expected benefits from acquisitions, which could harm its growth.***

The Company's growth strategy partly depends on its ability to obtain additional technologies, complementary product lines and sales channels through selective acquisitions



and strategic investments. The Company may not be able to identify and successfully negotiate suitable acquisitions, obtain financing for future acquisitions, if necessary, on satisfactory terms or otherwise complete acquisitions in the future. In the past, the Company has used its stock as consideration for acquisitions. The Company's common stock may not remain at a price at which it can be used as consideration for acquisitions without diluting the Company's existing shareholders, and potential acquisition candidates may not view the Company's stock attractively.

In addition, realization of the benefits of acquisitions often requires integration of some or all of the sales and marketing, distribution, manufacturing, engineering, software development, customer service, finance and administrative organizations of the acquired companies. The integration of acquisitions demands substantial attention from senior management and the management of the acquired companies. Any acquisition may be subject to a variety of risks and uncertainties including:

the inability to assimilate effectively the operations, products, technologies and personnel of the acquired companies (some of which may be located in diverse geographic regions);

the inability to maintain uniform standards, controls, procedures and policies;

the need or obligation to divest portions of the acquired companies; and

the potential impairment of relationships with customers.

The Company cannot offer any assurance that it will be able to identify or complete suitable acquisitions, integrate successfully any acquisitions, that any acquired companies will operate profitably, or that it will realize the expected synergies and other benefits from any acquisition.

***The Company may face difficulties managing the effects of its growth.***

If its business grows rapidly in the future, the Company expects it to result in:

increased complexity;

increased responsibility for existing and new management personnel; and

incremental strain on its operations and financial and management systems.

If the Company is not able to manage the effects of its future growth, its business, financial condition and operating results may be harmed.

***The Company's dependence on suppliers for materials could impair its ability to manufacture its products.***

Outside vendors provide key components used by the Company in the manufacture of its products. Any supply interruption in a limited source component would harm its ability to manufacture its products until a new source of supply is identified. In addition, an uncorrected defect or supplier's variation in a component, either known or



unknown to the Company, or incompatibility with its manufacturing processes could harm its ability to manufacture its products. The Company may not be able to find a sufficient alternative supplier in a reasonable period, or on commercially reasonable terms, if at all. If the Company fails to obtain a supplier for the manufacture of components of its potential products, it may experience delays or interruptions in its operations, which would adversely affect its business, results of operations and financial condition.

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***The disclosure requirements under the conflict minerals provisions of the Dodd-Frank Act could increase the Company's costs and limit the supply of certain metals used in its products and affect its reputation with customers and shareholders.***

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as amended, or the Dodd-Frank Act, the SEC adopted disclosure requirements, which became effective in 2014, for public companies using certain minerals and metals in their products. These minerals and metals are generally referred to as conflict minerals regardless of their country of origin. Under these rules, the Company is required to perform due diligence and disclose its efforts to prevent the sourcing of such conflict minerals from the Democratic Republic of Congo or adjoining countries. Conflict minerals are commonly used in the manufacture of electronics and may be incorporated in the Company's products. As a result of these new regulations, the Company has incurred, and expects to continue to incur, additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the conflict minerals used in the Company's products. These new requirements could also adversely affect the sourcing, availability and pricing of such minerals, and the pool of suppliers who provide conflict free metals may be limited. As a result, the Company or its suppliers may not be able to obtain materials necessary for production of the Company's products in sufficient quantities or at competitive prices. In addition, since the Company's supply chain is complex, it may not be able to sufficiently verify the origins of all metals used in its products and confirm that they are conflict free, which may adversely affect the Company's reputation.

***The Company's failure to attract and retain qualified personnel could lead to a loss of sales or decreased profitability.***

The Company may not be able to attract and retain sufficient qualified personnel to support its growth. In addition, the loss of the Company's Chief Executive Officer, or other key personnel, could adversely affect its sales, profitability or growth. Moreover, the Company continues to rely in part on equity awards to attract and retain qualified personnel, which may result in an increase in compensation expense.

***Risks generally associated with the Company's information systems could adversely affect the Company's business reputation and results of operations.***

The Company relies on its information systems to obtain, rapidly process, analyze and manage data to, among other things:

facilitate the purchase and distribution of thousands of inventory items;

receive, process and ship orders on a timely basis;

accurately bill and collect from customers;

process payments to suppliers and employees; and

summarize results and manage the Company's business.

The Company's primary and back-up computer systems are subject to damage or interruption from power outages, computer and telecommunication failures, computer viruses, security breaches, natural disasters and errors by

employees. Though losses arising from some of these issues would be covered by insurance, interruptions of the Company's critical business computer systems or failure of its back-up systems could lead to a loss of sales or decreased profitability.

A cyberattack or security breach of the Company's systems may compromise the confidentiality, integrity, or availability of the Company's internal data, the availability of the Company's products and websites designed to support the Company's customers, or the Company's customer data. Computer hackers, foreign governments or cyber terrorists may attempt to penetrate the Company's network security and the Company's website. Unauthorized access to the Company's proprietary business information or customer data may be obtained through break-ins, sabotage, or breach of our secure network by an unauthorized party, computer viruses, computer denial-of-service attacks, employee theft or misuse or other misconduct. Because the techniques used by computer programmers who may attempt to penetrate and sabotage the Company's network security or the Company's website change frequently and may not be recognized until launched against a target, the Company may be unable to anticipate these techniques. It is also possible that unauthorized access to customer data may be obtained through inadequate use of security controls by customers, suppliers or other vendors. Any security breach, cyberattack or cyber security breach, and any incident involving the misappropriation, loss or other unauthorized disclosure of, or access to, sensitive or confidential customer information, whether by the Company or by one of its vendors, could require the Company to expend significant resources to remediate any damage, interrupt its operations and damage its reputation, and could also result in regulatory enforcement actions, material fines and penalties, litigation or other actions which could have a material adverse effect on the Company's business, reputation and results of operations.

The Company is in the process of implementing a global enterprise resource planning, or ERP system, which is expected to be completed in phases over the next year. ERP implementations are complex and time-consuming projects that involve substantial expenditures on system software and implementation activities. During implementation, the Company may encounter difficulties in operating its business, which could disrupt operations, including the ability to timely ship customer orders, determine inventory requirements, manage the supply chain, and otherwise adequately service customers, and lead to increased costs and other difficulties. Any significant delays or disruptions during the implementation of the ERP could have a material adverse effect on the Company's results of operations and cash flows.

***The Company is subject to risks of natural disasters.***

The Company has manufacturing facilities in each of its regions. The occurrence of one or more natural disasters, such as tornadoes, hurricanes, earthquakes, floods and other forms of severe weather where the Company has a manufacturing facility could result in physical damage to, and complete or partial closure of, the Company's manufacturing facilities, which could adversely affect the Company's business, operations and financial performance. Interruptions in the Company's manufacturing operations or damage to its manufacturing facilities could reduce the Company's revenues and increase its costs and the extent of losses from natural disasters and severe weather will be a function of both the severity of the event and the total amount of insured exposure. Although the Company maintains insurance coverage, it can offer no assurance that its insurance coverage will be adequate to cover any losses or that it will be able to maintain insurance at a reasonable cost in the future. If losses from business interruption or property damage exceed the amounts for which the Company is insured, the Company's business, results of operations and financial condition could be adversely affected.

***The Company may experience volatility in its stock price.***

The price of the Company's common stock has been, and may continue to be, highly volatile in response to various factors, many of which are beyond its control, including:

fluctuations in demand for, and sales of, the Company's products or prolonged downturns in the industries that the Company serves;



actual or anticipated variations in quarterly or annual operating results;

general economic uncertainties;

speculation in the press or investment community; and

announcements of technological innovations or new products by the Company or its competitors.

The market price of the Company's common stock may also be affected by its inability to meet analyst and investor expectations and failure to achieve projected financial results. Any failure to meet such expectations or projected financial results, even if minor, could cause the market price of the Company's common stock to decline significantly. Volatility in its stock price may result in the inability of the Company's shareholders to sell their shares at or above the price at which they purchased them.

The Company's relatively small public float and daily trading volume have in the past caused, and may in the future result in, significant volatility in its stock price. At December 31, 2014, the Company had approximately 17.0 million shares outstanding held by non-affiliates. The Company's daily trading volume for the year ended December 31, 2014 averaged approximately 128,303 shares.

In addition, stock markets have generally experienced a high level of price and volume volatility, and the market prices of equity securities of many companies have experienced wide price fluctuations not necessarily related to the operating performance of such companies. These broad market fluctuations may adversely affect the market price of the Company's common stock. In the past, securities class action lawsuits frequently have been instituted against such companies following periods of volatility in the market price of such companies' securities. If any such litigation is instigated against the Company, it could result in substantial costs and a diversion of management's attention and resources, which could have a material adverse effect on its results of operations and financial condition.

***Anti-takeover provisions in the Company's articles of incorporation, its bylaws and provisions of Florida law could delay or prevent a change of control that you may favor.***

The Company's articles of incorporation, its bylaws and provisions of Florida law could make it more difficult for a third party to acquire the Company. Although the Company believes such provisions are appropriate to protect long-term value for its shareholders, these provisions could discourage potential takeover attempts and could adversely affect the market price of the Company's shares. Because of these provisions, you might not be able to receive a premium on your investment. These provisions include:

a limitation on shareholders' ability to call a special meeting of the Company's shareholders;

advance notice requirements to nominate directors for election to the Company's board of directors or to propose matters that can be acted on by shareholders at shareholder meetings;

the Company's classified board of directors, which means that approximately one-third of its directors are elected each year; and

the authority of the board of directors to issue, without shareholder approval, preferred stock with such terms as the board of directors may determine.

The provisions described above could delay or make more difficult transactions involving a change in control of the Company or its management.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.

**ITEM 2. PROPERTIES.**

**The Americas**

The Company's headquarters are located in a leased building in Lake Mary, Florida containing approximately 46,000 square feet. This facility houses the Company's sales, marketing, customer service/application operations and administrative staff. The Company's U.S. production, research and development, service operations and manufacturing are located in a leased building in Lake Mary, Florida consisting of approximately 35,000 square feet and a new leased facility consisting of approximately 90,400 square feet located in Exton, Pennsylvania containing research and development, manufacturing and service operations of the laser tracker and imager product lines. In the fourth quarter of 2014, the Company relocated to its Exton facility from its Kennett Square, Pennsylvania facility that consisted of two leased buildings totaling approximately 36,800 square feet.

**Europe/Africa**

The Company's European headquarters are located in a leased building in Stuttgart, Germany containing approximately 103,600 square feet. This facility houses the manufacturing, administration, sales, marketing and service management personnel for the Company's European operations. Additionally, the Company has a leased facility consisting of approximately 15,900 square feet located in Schaffhausen, Switzerland containing manufacturing operations for the Company's products shipped to customers in Europe and Africa.

**Asia-Pacific**

The Company's Asian headquarters are located in a leased building in Singapore containing approximately 22,000 square feet. This facility houses the administration, sales, marketing, production, service management personnel and manufacturing for the Company's Asia-Pacific operations. The Company's Japan headquarters are located in a leased building in Nagoya, Japan containing approximately 17,200 square feet. This facility houses the Company's Japan sales, marketing and service operations. The Company's China headquarters are located in a leased building in Shanghai, China containing approximately 25,500 square feet for sales, marketing and service operations.

The Company believes that its current facilities will be adequate for its foreseeable needs and that it will be able to locate suitable space for additional regional offices or enhanced production needs as necessary.

The information required by the remainder of this Item is incorporated herein by reference to Exhibit 99.1 to this Annual Report on Form 10-K.



**ITEM 3. LEGAL PROCEEDINGS.**

The Company is not involved in any legal proceedings other than routine litigation arising in the normal course of business, none of which the Company believes will have a material adverse effect on the Company's business, financial condition or results of operations.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.****Market Information and Holders**

The Company's common stock is listed and traded on the NASDAQ Global Select Market under the symbol "FARO".

The following table sets forth, for the periods indicated, the high and low sales prices of the Company's common stock as reported by the NASDAQ Stock Market:

	2014		2013	
	High	Low	High	Low
First Quarter	\$ 59.90	\$ 48.70	\$ 45.88	\$ 31.10
Second Quarter	54.84	39.75	43.98	32.50
Third Quarter	59.35	44.52	42.88	33.50
Fourth Quarter	65.63	47.31	60.91	38.56

As of February 10, 2015, the Company had 49 holders of record of common stock.

**Dividends**

The Company has not paid any cash dividends on its common stock to date. The Company expects to retain future earnings for use in operating and expanding its business and does not anticipate paying any cash dividends in the reasonably foreseeable future.

**Recent Sales of Unregistered Securities**

During the year ended December 31, 2014, the Company did not sell any equity securities that were not registered under the Securities Act.

**Purchases of Equity Securities**

On November 24, 2008, the Company's Board of Directors approved a \$30 million share repurchase program. Acquisitions for the share repurchase program will be made from time to time at prevailing prices, as permitted by securities laws and other legal requirements and subject to market conditions and other factors. The share repurchase program may be



discontinued at any time. There is no restriction date or other restriction governing the period over which the Company can repurchase shares under the program. The Company did not purchase any shares in the year ended December 31, 2014 under the repurchase program. As of December 31, 2014, the Company had \$21.1 million available for repurchase under this share repurchase program.

### **Performance Graph**

*The following performance graph and related information shall not be deemed soliciting material or to be filed with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or the Exchange Act, except to the extent that the Company specifically incorporates it by reference into such filing.*

The following line graph compares the cumulative five-year returns on the Company's common stock with (1) the cumulative returns of the NASDAQ Composite-Total Return and (2) the Morningstar Scientific & Technical Instruments Index.

For purposes of preparing the graph, we assumed that an investment of \$100 was made at market close on December 31, 2009, the last trading day before the beginning of the Company's fifth preceding fiscal year, with reinvestment of any dividends at the time they were paid. The Company did not pay any dividends during the period indicated.

The comparison in the graph below is based on historical data and is not necessarily indicative of future performance of the Company's common stock.

Company/Market/Peer Group	2009	2010	2011	2012	2013	2014
FARO Technologies, Inc.	\$ 100.00	\$ 153.17	\$ 214.55	\$ 166.42	\$ 271.92	\$ 292.35
NASDAQ Composite-Total Returns	\$ 100.00	\$ 118.02	\$ 117.04	\$ 137.47	\$ 192.62	\$ 221.02
Morningstar Scientific & Technical Instruments	\$ 100.00	\$ 129.77	\$ 129.89	\$ 151.89	\$ 192.23	\$ 201.65

**ITEM 6. SELECTED FINANCIAL DATA.**

in thousands, except share and per-share data	Year ended December 31,				
	2014	2013	2012	2011	2010
<b>Consolidated Statement of Operations Data:</b>					
Sales	\$ 341,826	\$ 291,784	\$ 273,395	\$ 254,164	\$ 191,775
Gross profit	188,914	161,893	149,619	143,689	113,398
Income from operations	37,340	30,154	31,554	32,858	16,927
Income before income tax expense	37,522	28,862	30,942	31,705	14,215
Net income	33,649	21,509	22,998	23,377	11,068
EBITDA (1)	44,862	35,835	37,786	38,353	20,470
Net income per common share:					
Basic	\$ 1.95	\$ 1.26	\$ 1.36	\$ 1.42	\$ 0.69
Diluted	\$ 1.93	\$ 1.25	\$ 1.34	\$ 1.39	\$ 0.68
Weighted average shares outstanding:					
Basic	17,247,727	17,087,104	16,910,830	16,503,773	16,153,831
Diluted	17,416,453	17,241,115	17,129,128	16,868,471	16,365,826

	As at December 31,				
	2014	2013	2012	2011	2010
<b>Consolidated Balance Sheet Data:</b>					
Working capital	\$ 273,352	\$ 263,166	\$ 232,396	\$ 197,539	\$ 162,814
Total assets	425,463	391,496	350,807	312,791	266,019
Total debt-capital leases	8	16	64	341	216
Total shareholders equity	343,854	315,950	282,736	247,898	212,477

**Notes to Selected Financial Data**

- (1) **EBITDA** represents earnings before interest, income taxes, depreciation, and amortization. EBITDA is a non-GAAP financial measure that is used by management to evaluate business performance in comparison to budgets, forecasts, and prior year financial results, providing a measure that management believes reflects the Company's core operating performance. The Company believes this will help investors perform trend analysis and better identify operating trends. EBITDA is useful for analytical purposes; however, it should not be considered an alternative to the Company's reported GAAP results, as there are limitations in using such financial measures. Furthermore, EBITDA measures shown for the Company may not be comparable to similarly titled measures used by other companies. The following table presents the reconciliation of net income reported in accordance with GAAP to EBITDA:

in thousands	Year ended December 31,				
	2014	2013	2012	2011	2010
Net income	\$ 33,649	\$ 21,509	\$ 22,998	\$ 23,377	\$ 11,068

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Add (deduct):

Interest expense	8	9	28	37	34
Interest income	(96)	(74)	(160)	(101)	(105)
Income taxes	3,873	7,353	7,944	8,328	3,147
Depreciation and amortization	7,428	7,038	6,976	6,712	6,326
<b>Total adjustments</b>	<b>11,213</b>	<b>14,326</b>	<b>14,788</b>	<b>14,976</b>	<b>9,402</b>
<b>EBITDA</b>	<b>\$ 44,862</b>	<b>\$ 35,835</b>	<b>\$ 37,786</b>	<b>\$ 38,353</b>	<b>\$ 20,470</b>

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

The following information should be read in conjunction with the Consolidated Financial Statements of the Company, including the notes thereto, included in Part II, Item 8 of this Annual Report on Form 10-K.

**Overview**

The Company designs, develops, manufactures, markets and supports software driven, three-dimensional (3-D) measurement, imaging and realization systems. The Company sells the majority of its products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building construction and law enforcement applications. The Company's FaroArm®, FARO Laser ScanArm®, FARO Gage, FARO Laser Tracker, FARO 3D Imager AMP, and their companion CAM2® software provide for Computer-Aided Design, or CAD, based inspection and/or factory-level statistical process control and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company's FARO Focus<sup>3D</sup> and FARO Freestyle<sup>3D</sup> laser scanners, and their companion SCENE and FARO forensic software, are utilized for a wide variety of 3-D modeling, documentation and high-density surveying applications, including in two of the Company's key vertical markets—architecture, engineering and construction (AEC) and law enforcement.

The Company derives revenues primarily from the sale of its measurement equipment and their related multi-faceted software programs. Revenue related to these products is generally recognized upon shipment. In addition, the Company sells extended warranties and training and technology consulting services relating to its products. The Company recognizes the revenue from extended warranties on a straight-line basis over the term of the warranty and revenue from training and technology consulting services when the services are provided. The Company also receives royalties from licensing agreements for its historical medical technology and recognizes the revenue from these royalties as licensees use the technology.

The Company operates in international markets throughout the world and maintains sales offices in the United States, Brazil, Mexico, France, Germany, United Kingdom, Japan, Spain, Italy, Turkey, China, South Korea, India, Poland, the Netherlands, Malaysia, Thailand, Singapore and Vietnam. The Company manages and reports its global sales in three regions: the Americas, Europe/Africa and Asia-Pacific.

The Company manufactures its FaroArm, FARO Laser ScanArm, FARO Gage, FARO Laser Tracker and FARO 3D Imager AMP products in its manufacturing facility located in Switzerland for customer orders from the Europe/Africa region, in its manufacturing facility located in Singapore for customer orders from the Asia-Pacific region, and in its manufacturing facilities located in Florida and Pennsylvania for customer orders from the Americas. The Company manufactures its FARO Focus<sup>3D</sup> and FARO Freestyle<sup>3D</sup> products in its facility located in Stuttgart, Germany. The Company expects all of its existing plants to have the production capacity necessary to support its volume requirements through 2015.

The Company accounts for wholly owned foreign subsidiaries in the currency of the respective foreign jurisdiction. Therefore, fluctuations in exchange rates may have an impact on the value of the intercompany account balances denominated in different currencies. The Company is aware of the availability of off-balance sheet financial instruments to hedge exposure to foreign currency exchange rates, including cross-currency swaps, forward contracts and foreign currency options. However, it does not use such instruments, and none were utilized in 2014, 2013 or 2012.

The Company has achieved continued sales and earnings growth over the last several years, with the exception of a loss in 2009, that resulted primarily from the decline of the global economy that year. The Company's historical sales and earnings growth were the result of a number of factors, including: continuing market demand for and acceptance of the Company's products; increased sales activity in part through additional sales staff worldwide, new products and product enhancements such as the FARO Edge Arm, FARO Laser ScanArm, FARO Focus<sup>3D</sup>, FARO Freestyle, and the effect of acquisitions. However, the Company's historical financial performance is not indicative of its future financial performance.

### **Results of Operations**

The following table sets forth, for the periods presented, the percentage of sales represented by certain items in the Company's consolidated statements of operations:

	<b>Years ended December 31,</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
<b>Statement of Operations Data:</b>			
Sales	100.0%	100.0%	100.0%
Cost of sales	44.7%	44.5%	45.3%
Gross margin	55.3%	55.5%	54.7%
<b>Operating expenses:</b>			
Selling and marketing	23.4%	24.6%	23.6%
General and administrative	10.7%	10.5%	10.6%
Depreciation and amortization	2.2%	2.4%	2.6%
Research and development	8.0%	7.7%	6.4%
Total operating expenses	44.3%	45.2%	43.2%
Income from operations	11.0%	10.3%	11.5%
Interest income	0.0%	0.0%	-0.1%
Other expense	0.0%	0.4%	0.3%
Interest expense	0.0%	0.0%	0.0%
Income before income tax expense	11.0%	9.9%	11.3%
Income tax expense	1.1%	2.5%	2.9%
Net Income	9.9%	7.4%	8.4%

### **2014 Compared to 2013**

*Sales.* Total sales increased \$50.0 million, or 17.2%, to \$341.8 million in the year ended December 31, 2014 from \$291.8 million for the year ended December 31, 2013. The Company's sales growth was primarily driven by strong year-over-year unit sales growth across all product lines, including Arm (comprising the FaroArm, FARO Laser ScanArm, and FARO Gage), Laser Tracker (comprising the FARO Laser Tracker Vantage and ION products) and Laser Scanner (FARO Focus<sup>3D</sup> product line) and across all geographic regions.





Arm sales growth of 18% was driven by an 11% increase in units sold and a higher average selling price due to the release of the Company's new Laser Line Probe HD for its FARO Laser ScanArm. The number of Laser Tracker units sold increased 16%; however the dollar amount of Laser Tracker sales grew 1% due to pricing pressures and the negative impact of foreign exchange rates. Sales of Laser Scanner grew 38% driven primarily by the continued adoption of the technology in the architecture, engineering, and construction (AEC), and law enforcement markets. Foreign exchange rates had a negative impact on sales of \$6.5 million for the year end December 31, 2014, primarily driven by the decline in the Euro and Yen. Product sales increased by \$45.3 million, or 19.0%, to \$284.1 million for the year ended December 31, 2014 from \$238.8 million in the year ended December 31, 2013, primarily reflecting the higher Laser Scanner and Arm sales described above. Service revenue increased by \$4.7 million, or 8.9%, to \$57.7 million for the year ended December 31, 2014 from \$53.0 million in the year ended December 31, 2013, primarily due to an increase in warranty revenue of \$3.0 million and customer service revenue of \$1.5 million, reflecting the higher unit sales year-over year.

Sales in the Americas region increased \$18.6 million, or 15.4%, to \$139.0 million for the year ended December 31, 2014 from \$120.4 million in the prior year period. Foreign exchange rates had a negative impact on sales of \$1.1 million, decreasing sales growth by 0.9 percentage points. Product sales in the Americas region increased by \$17.2 million, or 17.6%, to \$114.8 million for the year ended December 31, 2014 from \$97.6 million in the prior year, primarily driven by a 50% increase in Laser Scanner sales and a 14% growth in Arm sales. Service revenue in the Americas region increased by \$1.4 million, or 6.0%, to \$24.2 million for the year ended December 31, 2014 from \$22.8 million for the prior year, primarily due to an increase in customer service revenue of \$0.9 million and warranty revenue of \$0.8 million.

Sales in the Europe/Africa region increased \$16.7 million, or 16.2%, to \$120.1 million for the year ended December 31, 2014 from \$103.4 million in the year ended December 31, 2013. Foreign exchange rates had a negative impact on sales of \$1.8 million, decreasing sales growth by 1.7 percentage points. Product sales in the Europe/Africa region increased by \$13.7 million, or 16.6%, to \$96.4 million for the year ended December 31, 2014 from \$82.7 million in the prior year, primarily driven by a 29% increase in Laser Scanner sales and a 20% growth in Arm sales. Service revenue in the Europe/Africa region increased by \$3.0 million, or 14.8%, to \$23.7 million for the year ended December 31, 2014 from \$20.7 million in the prior year, primarily due to an increase in warranty revenue of \$2.0 million and customer service revenue of \$0.6 million.

Sales in the Asia-Pacific region increased \$14.7 million, or 21.7%, to \$82.7 million for the year ended December 31, 2014 from \$68.0 million in the year ended December 31, 2013. Foreign exchange rates had a negative impact on sales of \$3.6 million, decreasing sales growth by 5.4 percentage points. Product sales in the Asia-Pacific region increased by \$14.4 million, or 24.7%, to \$72.9 million for the year ended December 31, 2014 from \$58.5 million in the prior year, primarily driven by a 38% increase in Laser Scanner sales, a 25% growth in Laser Tracker sales, and a 20% growth in Arm sales. Service revenue in the Asia-Pacific region increased by \$0.3 million, or 3.3%, to \$9.8 million for the year ended December 31, 2014 from \$9.5 million in the prior year, primarily due to a modest increase in warranty and training revenue.

*Gross profit.* Gross profit increased by \$27.0 million, or 16.7%, to \$188.9 million for the year ended December 31, 2014 from \$161.9 million for the year ended December 31, 2013, driven by the increase in sales revenue. Foreign exchange rates had a negative impact on gross profit of \$2.2 million for the year ended December 31, 2014. Gross margin at 55.3% for the year ended December 31, 2014 was marginally lower than 55.5% for the year ended December 31, 2013. Gross margin from product revenue increased by 0.4 percentage points to 59.5% for the year ended December 31, 2014 from 59.1% for the year ended December 31,

2013, primarily as a result of lower manufacturing costs for the Company's Arm and Laser Tracker products and improved average selling prices for Arm products due to the release of the Company's new Laser Line Probe HD, partially offset by a less favorable overall sales mix with the strong year-over-year increase in units of Laser Scanners sold. This was partially offset by the impact of a write-off of primarily demonstration and service loaner inventory that became obsolete through release of new products totaling \$3.3 million, or a 1% impact on gross margin. Gross margin from service revenue decreased by 4.8 percentage points to 34.3% for the year ended December 31, 2014 from 39.1% for the year ended December 31, 2013, primarily due to an increase in headcount in customer service to support the growth in our product sales.

*Selling and Marketing Expenses.* Selling and marketing expenses increased by \$8.5 million, or 11.8%, to \$80.2 million for the year ended December 31, 2014 from \$71.7 million for the year ended December 31, 2013. The increase in selling and marketing expenses was primarily due to higher compensation costs of \$6.8 million, travel costs of \$0.6 million, advertising and trade show costs of \$0.7 million, and facility costs of \$0.4 million. The increase in compensation costs was driven by higher commissions, primarily reflecting the increase in sales volume in 2014, as well as an increase in headcount to support and contribute to increased demand and sales for the Company's products.

Worldwide sales and marketing headcount increased by 57, or 13.2%, to 490 at December 31, 2014 from 433 at December 31, 2013. Regionally, the Company's sales and marketing headcount increased by 31, or 22.8%, to 167 at December 31, 2014 from 136 at December 31, 2013 for the Americas; increased by 16, or 11.3%, to 157 at December 31, 2014 from 141 at December 31, 2013 in Europe/Africa; and increased by 10, or 6.4%, in Asia-Pacific to 166 at December 31, 2014 from 156 at December 31, 2013.

In 2014, the Company further leveraged its sales and marketing organization as, selling and marketing expenses decreased to 23.4% of sales in the year ended December 31, 2014 from 24.6% of sales in the year ended December 31, 2013. Regionally, selling and marketing expenses were 20.8% of sales in the Americas for the year ended December 31, 2014 compared to 21.4% of sales in the year ended December 31, 2013; 27.3% of sales for Europe/Africa for the year ended December 31, 2014 compared to 28.8% of sales in the prior year; and 22.3% of sales for Asia-Pacific for the year ended December 31, 2014 compared to 23.6% of sales in the prior year.

*General and administrative expenses.* General and administrative expenses increased by \$5.9 million, or 19.2%, to \$36.5 million, for the year ended December 31, 2014 from \$30.6 million in the year ended December 31, 2013, primarily due to higher compensation costs of \$4.0 million reflecting higher headcount and an increase in the Company's consulting and advisory services of \$1.9 million relating primarily to a new ERP system implementation and strategic planning initiatives. General and administrative expenses as a percentage of sales increased to 10.7% for the year ended December 31, 2014 from 10.5% for the year ended December 31, 2013.

*Depreciation and amortization expenses.* Depreciation and amortization expenses increased by \$0.4 million, or 5.5%, to \$7.4 million for the year ended December 31, 2014 from \$7.0 million in the year ended December 31, 2013, primarily due to the start of depreciation for the ERP system.

*Research and development expenses.* In 2014, the Company increased its investment in Research and Development to accelerate new product development by increasing engineering headcount by 17. As a result, research and development expenses increased \$5.1 million, or 22.7%, to \$27.5 million for the year ended December 31, 2014 from \$22.4 million for the year ended December 31, 2013. Research and development expenses as a percentage of sales increased to 8.0% for the year ended December 31, 2014 from 7.7% for the year ended December 31, 2013.

*Other (income) expense.* Other (income) expense decreased by \$1.5 million to \$0.2 million of income for the year ended December 31, 2014, from expense of \$1.3 million for the year ended December 31, 2013, primarily as a result of foreign exchange transaction gains resulting from changes in foreign exchange rates on the value of current intercompany account balances of the Company's subsidiaries denominated in different currencies.

*Income tax expense.* Income tax expense decreased by \$3.5 million to \$3.9 million for the year ended December 31, 2014 from \$7.4 million for the year ended December 31, 2013, primarily due to a discrete tax benefit of \$4.5 million recorded in the third quarter of 2014 due to a reduction in the valuation allowance partially offset by higher pre-tax income. The valuation allowance was originally established against net operating losses in certain foreign subsidiaries. During 2014, these foreign subsidiaries demonstrated a pattern of profitability that resulted in the Company concluding that the valuation allowance should be reversed. The Company's effective tax rate decreased to 10.3% for the year ended December 31, 2014 compared to 25.5% for the year ended December 31, 2013, primarily due to the discrete tax benefit. The Company's effective tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company's effective tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction.

*Net income.* Net income increased by \$12.1 million to \$33.6 million for the year ended December 31, 2014 from \$21.5 million for the year ended December 31, 2013 as a result of the factors described above. Foreign exchange rates had a negative impact on net income of \$0.9 million for the year ended December 31, 2014.

*EBITDA (Non-GAAP).* Earnings before interest, income taxes, depreciation, and amortization (EBITDA) increased by \$9.1 million to \$44.9 million for the year ended December 31, 2014 from \$35.8 million for the year ended December 31, 2013, primarily as a result of strong year-over-year sales growth, partially offset by headcount growth and increased investment in research and development. Foreign exchange rates had a negative impact on EBITDA of \$1.0 million for the year ended December 31, 2014. EBITDA is not intended to be an alternative to any measure calculated in accordance with GAAP. Rather, EBITDA is used by management and is provided to further aid the Company's investors in understanding and evaluating the Company's core operating performance. A more detailed description of the rationales for utilizing EBITDA and a reconciliation of net income to EBITDA is included in Part II, Item 6 of this Annual Report on Form 10-K.

#### 2013 Compared to 2012

*Sales.* Total sales increased \$18.4 million, or 6.7%, to \$291.8 million in the year ended December 31, 2013 from \$273.4 million for the year ended December 31, 2012. This increase resulted primarily from an increase in worldwide demand for the Company's products and services. Product sales increased by \$10.9 million, or 4.8%, to \$238.8 million for the year ended December 31, 2013 from \$227.9 million in the year ended December 31, 2012. Service revenue increased by \$7.5 million, or 16.4%, to \$53.0 million for the year ended December 31, 2013 from \$45.5 million in the year ended December 31, 2012 primarily due to an increase in warranty revenue.

Sales in the Americas region increased \$11.8 million, or 10.9%, to \$120.4 million for the year ended December 31, 2013 from \$108.6 million in the prior year period. Product sales in the Americas region increased by \$8.6 million, or 9.6%, to \$97.6 million for the year ended

December 31, 2013 from \$89.0 million in the prior year. Service revenue in the Americas region increased by \$3.2 million, or 16.5%, to \$22.8 million for the year ended December 31, 2013 from \$19.6 million for the prior year, primarily due to an increase in warranty revenue.

Sales in the Europe/Africa region increased \$3.3 million, or 3.3%, to \$103.4 million for the year ended December 31, 2013 from \$100.1 million in the year ended December 31, 2012. Product sales in the Europe/Africa region decreased by \$0.3 million, or 0.4%, to \$82.7 million for the year ended December 31, 2013 from \$83.1 million in the prior year. Service revenue in the Europe/Africa region increased by \$3.7 million, or 21.4%, to \$20.7 million for the year ended December 31, 2013 from \$17.0 million in the prior year, primarily due to an increase in warranty revenue.

Sales in the Asia-Pacific region increased \$3.3 million, or 5.0%, to \$68.0 million for the year ended December 31, 2013 from \$64.7 million in the year ended December 31, 2012. Product sales in the Asia-Pacific region increased by \$2.7 million, or 4.8%, to \$58.5 million for the year ended December 31, 2013 from \$55.8 million in the prior year. Service revenue in the Asia-Pacific region increased by \$0.6 million, or 6.6%, to \$9.5 million for the year ended December 31, 2013 from \$8.9 million in the prior year, primarily due to an increase in customer service revenue.

*Gross profit.* Gross profit increased by \$12.3 million, or 8.2%, to \$161.9 million for the year ended December 31, 2013 from \$149.6 million for the year ended December 31, 2012. Gross margin increased to 55.5% for the year ended December 31, 2013 from 54.7% for the year ended December 31, 2012. The increase in gross margin was primarily due to an increase in gross margin from service revenues to 39.1% for the year ended December 31, 2013 compared to 34.8% for the prior year as a result of an increase in higher margin warranty sales, and an increase in gross margin from product sales to 59.1% in the year ended December 31, 2013 from 58.7% in the prior year, primarily as a result of lower manufacturing costs, offset by lower average selling prices.

*Selling and Marketing Expenses.* Selling and marketing expenses increased by \$7.3 million, or 11.2%, to \$71.7 million for the year ended December 31, 2013 from \$64.4 million for the year ended December 31, 2012. This increase was primarily due to an increase in commissions and compensation expense of \$4.9 million, an increase in travel expenses of \$1.4 million, and an increase in marketing and advertising expenses of \$0.3 million.

Worldwide sales and marketing headcount increased by 68, or 18.6%, to 433 at December 31, 2013 from 365 at December 31, 2012. Regionally, the Company's sales and marketing headcount increased by 28, or 25.9%, to 136 at December 31, 2013 from 108 at December 31, 2012 for the Americas; increased by 18, or 14.6%, to 141 at December 31, 2013 from 123 at December 31, 2012 in Europe/Africa; and increased by 22, or 16.4%, in Asia-Pacific to 156 at December 31, 2013 from 134 at December 31, 2012.

As a percentage of sales, selling expenses increased to 24.6% of sales in the year ended December 31, 2013 from 23.6% of sales in the year ended December 31, 2012. Regionally, selling expenses were 21.4% of sales in the Americas for the year ended December 31, 2013 compared to 20.0% of sales in the year ended December 31, 2012; 28.8% of sales for Europe/Africa for the year ended December 31, 2013 compared to 26.4% of sales in the prior year; and 23.6% of sales for Asia-Pacific for the year ended December 31, 2013 compared to 25.1% of sales in the prior year.

*General and administrative expenses.* General and administrative expenses increased by \$1.5 million to \$30.6 million, or 5.3%, for the year ended December 31, 2013 from \$29.1 million in the year ended December 31, 2012, primarily due to an increase in compensation of \$1.8 million, bad debt expense of \$1.2 million, recruiting costs of \$1.0 million, and travel costs of \$0.2 million, partially offset by a decrease of \$2.9 million in professional fees related

to patent litigation and the FCPA matter. General and administrative expenses as a percentage of sales decreased to 10.5% for the year ended December 31, 2013 from 10.6% for the year ended December 31, 2012.

*Depreciation and amortization expenses.* Depreciation and amortization expenses remained flat at \$7.0 million for the years ended December 31, 2013 and December 31, 2012.

*Research and development expenses.* Research and development expenses increased \$4.8 million, or 27.5%, to \$22.4 million for the year ended December 31, 2013 from \$17.6 million for the year ended December 31, 2012, primarily due to an increase in compensation of \$2.5 million, subcontractor expenses of \$1.6 million, and material expenses of \$0.6 million. Research and development expenses as a percentage of sales increased to 7.7% for the year ended December 31, 2013 from 6.4% for the year ended December 31, 2012.

*Other (income) expense.* Other (income) expense increased by \$0.7 million to \$1.3 million of expense for the year ended December 31, 2013, from expense of \$0.6 million for the year ended December 31, 2012, primarily as a result of an increase in foreign exchange transaction losses resulting from changes in foreign exchange rates on the value of current intercompany account balances of the Company's subsidiaries denominated in different currencies.

*Income tax expense.* Income tax expense decreased by \$0.5 million to \$7.4 million for the year ended December 31, 2013 from \$7.9 million for the year ended December 31, 2012, primarily due to a decrease in pretax income. The Company's effective tax rate decreased to 25.5% for the year ended December 31, 2013 compared to 25.7% for the year ended December 31, 2012 and included a reduction in the income tax rates of 0.8% and 1.5% related to the tax benefit of the exercise of employee stock options in the years ended December 31, 2013 and 2012, respectively. The effective tax rate for the year ended December 31, 2013 also included the discrete tax benefit of 1.5% related to the retroactive legislative reinstatement on January 2, 2013 of the Research and Development tax credit for the year ended December 31, 2012, which is required to be included in the period the reinstatement was enacted into law. The Company's tax rate continued to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company's tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction.

*Net income.* Net income decreased by \$1.5 million to \$21.5 million for the year ended December 31, 2013 from \$23.0 million for the year ended December 31, 2012 as a result of the factors described above.

*EBITDA (Non-GAAP).* EBITDA decreased by \$2.0 million to \$35.8 million for the year ended December 31, 2013 from \$37.8 million for the year ended December 31, 2012, primarily due to an unfavorable impact of \$1.7 million from the change in foreign exchange rates and higher investment in research and development spending, partially offset by modest sales growth. EBITDA is not intended to be an alternative to any measure calculated in accordance with GAAP. Rather, EBITDA is used by management and is provided to further aid the Company's investors in understanding and evaluating the Company's core operating performance. A more detailed description of the rationales for utilizing EBITDA and a reconciliation of net income to EBITDA is included in Part II, Item 6 of this Annual Report on Form 10-K.

**Liquidity and Capital Resources**

Cash and cash equivalents decreased by \$15.3 million to \$109.3 million at December 31, 2014 from \$124.6 million at December 31, 2013. The decrease in cash and cash equivalents was primarily due to an increase in accounts receivable and inventory as a result of the Company's sales growth, partially offset by higher net income in 2014. Also impacting the comparison was \$18.7 million in capital expenditures mainly reflecting the Company's investment in the new facility in Exton, Pennsylvania and ERP implementation.

Of the Company's cash and cash equivalents, \$58.9 million was held by foreign subsidiaries. The Company's current intent is to indefinitely reinvest these funds in its foreign operations, as the cash is needed to fund on-going operations. In the event circumstances change, leading to the conclusion that these funds will not be indefinitely reinvested, the Company would need to provide at that time for the income taxes that would be triggered upon their repatriation.

The Company has an undrawn \$30 million under a credit facility it entered into on July 11, 2006. The terms of the loan arrangement was most recently amended on March 15, 2012. Loans under the Amended and Restated Loan Agreement, as amended, bear interest at the rate of LIBOR plus a fixed percentage between 1.50% and 2.00% and require the Company to maintain a minimum cash balance of \$25 million and tangible net worth measured at the end of each of the Company's fiscal quarters. As of December 31, 2014, the Company was in compliance with all of the covenants under the Amended and Restated Loan Agreement, as amended. The term of the Amended and Restated Loan Agreement, as amended, expires on March 31, 2015. The Company does not expect to renew the agreement.

On December 21, 2012, the Company filed a shelf registration statement on Form S-3 with the SEC registering shares of common stock, preferred stock, and warrants to purchase common and preferred stock, either individually or in units, with a proposed maximum aggregate offering price of \$250 million. The registration statement was declared effective on January 7, 2013. The proceeds from any offerings with respect to this shelf registration statement, if any, would be used for either repayment or refinancing of debt, acquisition of additional businesses or technologies or for working capital and general corporate purposes.

The Company believes that its working capital, anticipated cash flow from operations, and credit facility will be sufficient to fund its long-term liquidity requirements for the foreseeable future.

The Company has no off balance sheet arrangements.

**Contractual Obligations and Commercial Commitments**

The Company is party to capital leases on equipment with an initial term of 36 to 60 months and other non-cancelable operating leases. These obligations are presented below as of December 31, 2014 (dollars in thousands):

<b>Contractual Obligations</b>	<b>Total</b>	<b>Payments Due by Period</b>			
		<b>&lt; 1 Year</b>	<b>1-3 Years</b>	<b>3-5 Years</b>	<b>&gt; 5 Years</b>
Operating lease obligations	\$ 26,799	\$ 6,668	\$ 8,961	\$ 4,829	\$ 6,341
Capital lease obligations	8	8			\$
Purchase obligations	14,776	14,776			
<b>Total</b>	<b>\$ 41,583</b>	<b>\$ 21,452</b>	<b>\$ 8,961</b>	<b>\$ 4,829</b>	<b>\$ 6,341</b>

The Company enters into purchase commitments for products and services in the ordinary course of business. These purchases generally cover production requirements for 60

to 90 days. The Company has a \$0.3 million liability for unrecognized tax benefits that is excluded from the contractual obligations table due to the uncertainty of the period of settlement, if any, with the respective taxing authorities.

### **Inflation**

Inflation did not have a material impact on the Company's results of operations in recent years, and the Company does not expect inflation to have a material impact on its operations in 2015.

### **Critical Accounting Policies**

The preparation of the Company's consolidated financial statements requires the Company's management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, as well as disclosure of contingent assets and liabilities. The Company bases its estimates on historical experience, along with various other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Some of these judgments can be subjective and complex and, consequently, actual results may differ from these estimates under different assumptions or conditions. While for any given estimate or assumption made by the Company's management there may be other estimates or assumptions that are reasonable, the Company believes that, given the current facts and circumstances, it is unlikely that applying any such other reasonable estimate or assumption would materially impact the financial statements.

In response to the SEC's financial reporting release, FR-60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies," the Company has selected its critical accounting policies for purposes of explaining the methodology used in its calculation, in addition to any inherent uncertainties pertaining to the possible effects on its financial condition. The critical policies discussed below are the Company's processes of recognizing revenue, the reserve for excess and obsolete inventory, income taxes, the reserve for warranties and goodwill impairment. These policies affect current assets and operating results and are therefore critical in assessing the Company's financial and operating status. These policies involve certain assumptions that, if incorrect, could have an adverse impact on the Company's operations and financial position.

### **Revenue Recognition**

Revenue is recognized when the price is fixed, collectability is reasonably assured, the title and risks and rewards of ownership have passed to the customer and the earnings process is complete. Revenue related to the Company's measurement, imaging, and realization equipment and related software is generally recognized upon shipment, as the Company considers the earnings process complete as of the shipping date. Fees billed to customers associated with the distribution of products are classified as revenue. The Company warrants its products against defects in design, materials and workmanship for one year. A provision for estimated future costs relating to warranty expense is recorded when products are shipped. The Company separately sells extended warranties. Extended warranty revenues are recognized on a straight-line basis over the term of the warranty. Costs relating to extended warranties are recognized as incurred. Revenue from sales of software only is recognized when no further significant production, modification or customization of the software is required and when the following criteria are met: persuasive evidence of a sales agreement exists, delivery has occurred, and the sales price is fixed or determinable and deemed collectible. Revenues resulting from sales of comprehensive support, training and technology consulting services are recognized as such services are performed and are deferred when billed in advance of the performance of services. Revenue from the licensing agreements for the use of the Company's technology for medical applications is generally recognized as licensees use





the technology. Amounts representing royalties for the current year and not received as of year-end are estimated as due based on historical data and recognized in the current year. Revenues are presented net of sales-related taxes.

#### Reserve for Excess and Obsolete Inventory

Since the value of inventory that will ultimately be realized cannot be known with exact certainty, the Company relies upon both past sales history and future sales forecasts to provide a basis for the determination of the reserve. Inventory is considered potentially obsolete if the Company has withdrawn those products from the market or had no sales of the product for the past 12 months and has no sales forecasted for the next 12 months. Inventory is considered potentially excess if the quantity on hand exceeds 12 months of expected remaining usage. The resulting obsolete and excess parts are then reviewed to determine if a substitute usage or a future need exists. Items without an identified current or future usage are reserved in an amount equal to 100% of the FIFO cost of such inventory. The Company's products are subject to changes in technologies that may make certain of its products or their components obsolete or less competitive, which may increase its historical provisions to the reserve.

#### Income Taxes

The Company reviews its deferred tax assets on a regular basis to evaluate their recoverability based upon expected future reversals of deferred tax liabilities, projections of future taxable income over a two-year period, and tax planning strategies that it might employ to utilize such assets, including net operating loss carryforwards. Based on the positive and negative evidence of recoverability, the Company establishes a valuation allowance against the net deferred assets of a taxing jurisdiction in which it operates, unless it is more likely than not that it will recover such assets through the above means. In the future, the Company's evaluation of the need for the valuation allowance will be significantly influenced by its ability to achieve profitability and its ability to predict and achieve future projections of taxable income over at least a two-year period.

Significant judgment is required in determining the Company's worldwide provision for income taxes. In the ordinary course of operating a global business, there are many transactions for which the ultimate tax outcome is uncertain. The Company establishes provisions for income taxes when, despite the belief that tax positions are fully supportable, there remain certain positions that do not meet the minimum probability threshold as described by Accounting Standards Codification Topic 740, Income Taxes, which is a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority. In the ordinary course of business, the Company and its subsidiaries are examined by various federal, state, and foreign tax authorities. The Company regularly assesses the potential outcomes of these examinations and any future examinations for the current or prior years in determining the adequacy of its provision for income taxes. The Company assesses the likelihood and amount of potential adjustments and adjusts the income tax provision, the current tax liability and deferred taxes in the period in which the facts that gave rise to a revision become known.

#### Reserve for Warranties

The Company establishes at the time of sale a liability for the one year warranty included with the initial purchase price of equipment, based upon an estimate of the repair expenses likely to be incurred for the warranty period. The warranty period is measured in installation-months for each major product group. The warranty reserve is included in accrued

liabilities in the accompanying consolidated balance sheets. The warranty expense is estimated by applying the actual total repair expenses for each product group in the prior period and determining a rate of repair expense per installation-month. This repair rate is multiplied by the number of installation-months of warranty for each product group to determine the provision for warranty expenses for the period. The Company evaluates its exposure to warranty costs at the end of each period using the estimated expense per installation-month for each major product group, the number of units remaining under warranty and the remaining number of months each unit will be under warranty. The Company has a history of new product introductions and enhancements to existing products, which may result in unforeseen issues that increase its warranty costs. While such expenses have historically been within expectations, the Company cannot guarantee this will continue in the future.

### Goodwill Impairment

Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. Goodwill is not amortized but is tested for impairment at least annually. The Company performs its annual review in the fourth quarter of each year, or more frequently if indicators of potential impairment exist, to determine if the carrying value of the recorded goodwill is impaired. If an asset is impaired, the difference between the value of the asset reflected in the financial statements and its current fair value is recognized as an expense in the period in which the impairment occurs.

Each period, and for any of its reporting units, the Company can elect to initially perform a qualitative assessment to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If the Company believes, as a result of its qualitative assessment, that it is not more likely than not that the fair value of a reporting unit containing goodwill is less than its carrying amount, then the first and second steps of the quantitative goodwill impairment test are unnecessary. If the Company elects to bypass the qualitative assessment option, or if the qualitative assessment was performed and resulted in the Company being unable to conclude that it is not more likely than not that the fair value of a reporting unit containing goodwill is less than its carrying amount, the Company will perform the two-step quantitative goodwill impairment test. The Company performs the first step of the two-step quantitative goodwill impairment test by calculating the fair value of the reporting unit using a discounted cash flow method, and then comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of the reporting unit exceeds its fair value, the Company performs the second step of the quantitative goodwill impairment test to measure the amount of the impairment loss, if any. Management has concluded there was no goodwill impairment for the years ended December 31, 2014, 2013 and 2012.

### Stock-Based Compensation

The Company measures compensation cost for stock-based awards at fair value and recognizes compensation over the service period for awards expected to vest. The Company uses the Black-Scholes option-pricing model to value stock options, which requires the input of assumptions, including dividend yield, risk-free interest rate, the estimated length of time employees will retain their vested stock options before exercising them (expected term) and the estimated volatility of the Company's common stock price over the expected term. Furthermore, in calculating compensation expense for these awards, the Company is also required to estimate the extent to which options will be forfeited prior to vesting (forfeitures). Many factors are considered when estimating expected forfeitures, including types of awards, employee class and historical experience. To the extent actual results or updated estimates differ from current estimates, such amounts are recorded as a cumulative adjustment to the previously recorded amounts.

Impact of Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board ( FASB ) issued an amendment to its accounting guidance related to revenue recognition. The amendment was the result of a joint project between the FASB and the International Accounting Standards Board ( IASB ) to clarify the principles for recognizing revenue and to develop common revenue standards for U.S. GAAP and International Financial Reporting Standards. To meet those objectives, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers: Topic 606* ( ASU 2014-09 ). ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The Company will adopt ASU 2014-09 in reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the impact of adopting this pronouncement on its consolidated financial statements.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

**Foreign Exchange Exposure**

The Company conducts a significant portion of its business outside the United States. At present, 64% of its revenues are invoiced, and a significant portion of its operating expenses paid, in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on the Company's results of operations and financial condition and could specifically result in foreign exchange gains and losses. The impact of future exchange rate fluctuations on the results of the Company's operations cannot be accurately predicted due to the Company's constantly changing exposure to various currencies, the fact that all foreign currencies do not react in the same manner in relation to the U.S. dollar and the number of currencies involved, although the Company's most significant exposures are to the euro, Swiss franc, Japanese yen, and Brazilian real. To the extent that the percentage of its non-U.S. dollar revenues derived from international sales increases in the future, the Company's exposure to risks associated with fluctuations in foreign exchange rates may increase. The Company is aware of the availability of off-balance sheet financial instruments to hedge exposure to foreign currency exchange rates, including cross-currency swaps, forward contracts and foreign currency options. However, it does not regularly use such instruments, and none were utilized in 2014, 2013 or 2012.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**  
**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

FARO Technologies, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of FARO Technologies, Inc. (a Florida corporation) and subsidiaries (the Company) as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FARO Technologies Inc. and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2014, based on criteria established in the 2013 *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 25, 2015 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Orlando, Florida

February 25, 2015

**FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)	December 31, 2014	December 31, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 109,289	\$ 124,630
Short-term investments	64,995	64,994
Accounts receivable, net	83,959	66,309
Inventories, net	59,334	48,940
Deferred income taxes, net	5,936	4,601
Prepaid expenses and other current assets	17,021	14,645
<b>Total current assets</b>	<b>340,534</b>	<b>324,119</b>
Property and equipment:		
Machinery and equipment	45,254	36,924
Furniture and fixtures	6,156	6,888
Leasehold improvements	19,676	11,765
Property and equipment at cost	71,086	55,577
Less: accumulated depreciation and amortization	(41,741)	(39,126)
Property and equipment, net	29,345	16,451
Goodwill	19,205	19,358
Intangible assets, net	9,109	8,112
Service inventory	20,646	19,033
Deferred income taxes, net	6,624	4,423
<b>Total assets</b>	<b>\$ 425,463</b>	<b>\$ 391,496</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 15,437	\$ 14,881
Accrued liabilities	26,127	20,141
Income taxes payable		1,690
Current portion of unearned service revenues	23,572	21,331
Customer deposits	2,046	2,910
<b>Total current liabilities</b>	<b>67,182</b>	<b>60,953</b>
Unearned service revenues - less current portion	13,799	13,414
Deferred income tax liability		1,171
Other long-term liabilities	628	8
<b>Total liabilities</b>	<b>81,609</b>	<b>75,546</b>

Commitments and contingencies - See Note 12

Shareholders' equity:		
Preferred stock - par value \$0.01, 10,000,000 shares authorized; none issued		
Common stock - par value \$.001, 50,000,000 shares authorized; 17,997,665 and 17,868,372 issued; 17,317,430 and 17,188,137 outstanding, respectively	18	18
Additional paid-in capital	200,090	191,874
Retained earnings	159,516	125,867
Accumulated other comprehensive (loss) income	(6,695)	7,266
Common stock in treasury, at cost - 680,235 shares	(9,075)	(9,075)
 Total shareholders' equity	 343,854	 315,950
 Total liabilities and shareholders' equity	 \$ 425,463	 \$ 391,496

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

**FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except share and per share data)	Years ended December 31,		
	2014	2013	2012
<b>SALES</b>			
Product	\$ 284,147	\$ 238,841	\$ 227,905
Service	57,679	52,943	45,490
Total sales	341,826	291,784	273,395
<b>COST OF SALES</b>			
Product	114,994	97,630	94,103
Service	37,918	32,261	29,673
Total cost of sales (exclusive of depreciation and amortization, shown separately below)	152,912	129,891	123,776
<b>GROSS PROFIT</b>	<b>188,914</b>	<b>161,893</b>	<b>149,619</b>
<b>OPERATING EXPENSES</b>			
Selling and marketing	80,157	71,689	64,446
General and administrative	36,479	30,600	29,065
Depreciation and amortization	7,428	7,038	6,976
Research and development	27,510	22,412	17,578
Total operating expenses	151,574	131,739	118,065
<b>INCOME FROM OPERATIONS</b>	<b>37,340</b>	<b>30,154</b>	<b>31,554</b>
<b>OTHER (INCOME) EXPENSE</b>			
Interest income	(96)	(74)	(160)
Other (income) expense, net	(94)	1,357	744
Interest expense	8	9	28
<b>INCOME BEFORE INCOME TAX EXPENSE</b>	<b>37,522</b>	<b>28,862</b>	<b>30,942</b>
<b>INCOME TAX EXPENSE</b>	<b>3,873</b>	<b>7,353</b>	<b>7,944</b>
<b>NET INCOME</b>	<b>\$ 33,649</b>	<b>\$ 21,509</b>	<b>\$ 22,998</b>
<b>NET INCOME PER SHARE - BASIC</b>	<b>\$ 1.95</b>	<b>\$ 1.26</b>	<b>\$ 1.36</b>
<b>NET INCOME PER SHARE - DILUTED</b>	<b>\$ 1.93</b>	<b>\$ 1.25</b>	<b>\$ 1.34</b>
Weighted average shares - Basic	17,247,727	17,087,104	16,910,830



Weighted average shares - Diluted	17,416,453	17,241,115	17,129,128
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The accompanying notes are an integral part of these consolidated financial statements.

**FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(in thousands)	Years ended December 31,		
	2014	2013	2012
Net income	\$ 33,649	\$ 21,509	\$ 22,998
Currency translation adjustments, net of tax	(13,961)	925	525
Comprehensive income	\$ 19,688	\$ 22,434	\$ 23,523

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

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY****FOR THE YEARS ENDED DECEMBER 31, 2014, 2013, AND 2012**

(in thousands except share data)	Common Stock		Additional	Retained	Accumulated	Common	Total
	Shares	Amounts	Paid-in		Other		
			Capital	Earnings	Comprehensive	Treasury	
					Income		
					(Loss)		
BALANCE JANUARY 1, 2012	16,700,875	\$ 17	\$ 169,780	\$ 81,360	\$ 5,816	\$ (9,075)	\$ 247,898
Net income				22,998			22,998
Currency translation adjustment, net of tax					525		525
Restricted stock issued and stock based compensation under incentive plans	14,339		4,018				4,018
Stock options exercised	258,430	1	6,161				6,162
Income tax benefit from exercise of stock options			1,135				1,135
BALANCE DECEMBER 31, 2012	16,973,644	\$ 18	\$ 181,094	\$ 104,358	\$ 6,341	\$ (9,075)	\$ 282,736
Net income				21,509			21,509
Currency translation adjustment, net of tax					925		925
Restricted stock issued and stock based compensation under incentive plans	17,441		4,367				4,367
Stock options exercised	197,052		5,444				5,444
Income tax benefit from exercise of stock options			969				969
BALANCE DECEMBER 31, 2013	17,188,137	\$ 18	\$ 191,874	\$ 125,867	\$ 7,266	\$ (9,075)	\$ 315,950
Net income				33,649			33,649
Currency translation adjustment, net of tax					(13,961)		(13,961)
Restricted stock issued and stock based compensation under incentive plans	24,588		4,678				4,678
Stock options exercised	104,705		3,369				3,369
Income tax benefit from exercise of stock options			169				169

BALANCE DECEMBER 31, 2014	17,317,430	\$ 18	\$ 200,090	\$ 159,516	\$ (6,695)	\$ (9,075)	\$ 343,854
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The accompanying notes are an integral part of these consolidated financial statements.

**FARO TECHNOLOGIES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)	Years Ended December 31,		
	2014	2013	2012
<b>CASH FLOWS FROM:</b>			
<b>OPERATING ACTIVITIES:</b>			
Net income	\$ 33,649	\$ 21,509	\$ 22,998
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	7,428	7,038	6,976
Compensation for stock options and restricted stock units	4,678	4,367	4,018
(Net recovery of) provision for bad debts	(306)	1,001	(23)
Write-down of inventories	3,272	1,167	1,978
Deferred income tax (benefit) expense	(4,707)	645	(2,016)
Income tax benefit from exercise of stock options	(169)	(969)	(1,135)
Change in operating assets and liabilities:			
Decrease (increase) in:			
Accounts receivable	(24,587)	(4,053)	(4,840)
Inventories	(21,995)	(1,286)	(2,822)
Prepaid expenses and other current assets	(3,501)	(3,346)	(1,870)
(Decrease) increase in:			
Accounts payable and accrued liabilities	8,867	6,108	(3,079)
Income taxes payable	(1,560)	(2,028)	3,497
Customer deposits	(724)	353	(1,374)
Unearned service revenues	5,313	3,772	5,565
<b>Net cash provided by operating activities</b>	<b>5,658</b>	<b>34,278</b>	<b>27,873</b>
<b>INVESTING ACTIVITIES:</b>			
Purchases of property and equipment	(18,722)	(4,350)	(3,843)
Payments for intangible assets	(1,221)	(2,204)	(1,361)
Purchase of business acquired	(1,150)		
<b>Net cash used in investing activities</b>	<b>(21,093)</b>	<b>(6,554)</b>	<b>(5,204)</b>
<b>FINANCING ACTIVITIES:</b>			
Payments on capital leases	(8)	(93)	(132)
Income tax benefit from exercise of stock options	169	969	1,135
Proceeds from issuance of stock, net	3,369	5,444	6,162
<b>Net cash provided by financing activities</b>	<b>3,530</b>	<b>6,320</b>	<b>7,165</b>
	(3,436)	(2,647)	(1,141)

EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS

(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(15,341)	31,397	28,693
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	124,630	93,233	64,540
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 109,289	\$ 124,630	\$ 93,233

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

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**FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**YEARS ENDED DECEMBER 31, 2014, 2013 and 2012**

(in thousands, except share and per share data or as otherwise noted)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Description of Business** FARO Technologies, Inc. and its subsidiaries (collectively the Company or FARO) designs, develops, manufactures, markets and supports software driven, three-dimensional (3-D) measurement, imaging and realization systems. The Company sells the majority of its products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building construction and law enforcement applications. The Company's FaroArm®, FARO Laser ScanArm®, FARO Gage, FARO Laser Tracker, FARO 3D Imager AMP, and their companion CAM2® software provide for Computer-Aided Design, or CAD, based inspection and/or factory-level statistical process control and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company's FARO Focus<sup>3D</sup> and FARO Freestyle<sup>3D</sup> laser scanners, and their companion SCENE and FARO forensic software, are utilized for a wide variety of 3-D modeling, documentation and high-density surveying applications, including in two of the Company's key vertical markets—architecture, engineering and construction (AEC) and law enforcement.

**Principles of Consolidation** The consolidated financial statements of the Company include the accounts of FARO Technologies, Inc. and its subsidiaries, all of which are wholly owned. All intercompany transactions and balances have been eliminated. The financial statements of the Company's foreign subsidiaries are translated into U.S. dollars using exchange rates in effect at period-end for assets and liabilities and average exchange rates during each reporting period for results of operations. Adjustments resulting from financial statement translations are reflected as a separate component of accumulated other comprehensive income. Foreign currency transaction gains and losses are included in income.

**Revenue Recognition, Product Warranty and Extended Warranty Contracts** Revenue is recognized when the price is fixed, collectability is reasonably assured, the title and risks and rewards of ownership have passed to the customer and the earnings process is complete. Revenue related to the Company's measurement, imaging, and realization equipment and related software is generally recognized upon shipment, as the Company considers the earnings process complete as of the shipping date. Fees billed to customers associated with the distribution of products are classified as revenue. The Company warrants its products against defects in design, materials and workmanship for one year. A provision for estimated future costs relating to warranty expense is recorded when products are shipped. The Company separately sells extended warranties. Extended warranty revenues are recognized on a straight-line basis over the term of the warranty. Costs relating to extended warranties are recognized as incurred. Revenue from sales of software only is recognized when no further significant production, modification or customization of the software is required and when the following criteria are met: persuasive evidence of a sales agreement exists, delivery has occurred, and the sales price is fixed or determinable and deemed collectible. Revenues resulting from sales of comprehensive support, training and technology consulting services are recognized as such services are performed and are deferred when billed in advance of the performance of services. Revenue from the licensing agreements for the use of the Company's technology for medical applications is generally recognized as licensees use the technology.





Amounts representing royalties for the current year and not received as of year-end are estimated as due based on historical data and recognized in the current year. Revenues are presented net of sales-related taxes.

**Cash and Cash Equivalents** The Company considers cash on hand and amounts on deposit with financial institutions with maturities of three months or less when purchased to be cash and cash equivalents. The Company had deposits with foreign banks totaling \$58.9 million and \$66.9 million as of December 31, 2014 and 2013, respectively. The Company does not presently intend to repatriate those funds. (See Note 11, *Income Taxes*).

**Accounts Receivable and Related Allowance for Doubtful Accounts** Credit is extended to customers based on an evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are generally due within 30 to 90 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due. The Company makes judgments as to the collectability of accounts receivable based on historical trends and future expectations. Management estimates an allowance for doubtful accounts, which adjusts gross trade accounts receivable to its net realizable value. The allowance for doubtful accounts is based on an analysis of all receivables for possible impairment issues and historical write-off percentages. The Company writes off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. The Company does not generally charge interest on past due receivables.

**Inventories** Inventories are stated at the lower of cost or net realizable value using the first-in first-out (FIFO) method. Shipping and handling costs are classified as a component of cost of sales in the consolidated statements of operations. Sales demonstration inventory is comprised of measuring, imaging, and realization devices utilized by sales representatives to present the Company's products to customers. Management expects these products to remain in sales demonstration inventory for approximately 12 months and are subsequently sold at prices that produce slightly reduced gross margins. Service inventory is comprised of inventory that is not expected to be sold within twelve months, such as training and loaned equipment.

**Reserve for Excess and Obsolete Inventory** Since the value of inventory that will ultimately be realized cannot be known with exact certainty, the Company relies upon both past sales history and future sales forecasts to provide a basis for the determination of the reserve. Inventory is considered potentially obsolete if the Company has withdrawn those products from the market or had no sales of the product for the past 12 months and has no sales forecasted for the next 12 months. Inventory is considered potentially excess if the quantity on hand exceeds 12 months of expected remaining usage. The resulting obsolete and excess parts are then reviewed to determine if a substitute usage or a future need exists. Items without an identified current or future usage are reserved in an amount equal to 100% of the FIFO cost of such inventory. The Company's products are subject to changes in technologies that may make certain of its products or their components obsolete or less competitive, which may increase its historical provisions to the reserve.

**Property and Equipment** Property and equipment purchases exceeding a thousand dollars are capitalized and recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the various classes of assets as follows:

Machinery and equipment	2 to 5 years
Furniture and fixtures	3 to 10 years

Leasehold improvements are amortized on a straight-line basis over the lesser of the life of the asset or the remaining term of the lease.

Depreciation expense was \$6,171, \$5,825 and \$5,769 in 2014, 2013 and 2012, respectively. Accelerated methods of depreciation are used for income tax purposes in contrast to book purposes, and as a result, appropriate provisions are made for the related deferred income taxes.

**Goodwill and Intangibles** Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. The Company does not amortize goodwill; however, performs an annual review in the fourth quarter of each year, or more frequently if indicators of potential impairment exist, to determine if the carrying value of the recorded goodwill or indefinite lived intangible assets is impaired. If an asset is impaired, the difference between the value of the asset reflected in the financial statements and its current fair value is recognized as an expense in the period in which the impairment occurs.

Each period, and for any of its reporting units, the Company can elect to initially perform a qualitative assessment to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If the Company believes, as a result of its qualitative assessment, that it is not more likely than not that the fair value of a reporting unit containing goodwill is less than its carrying amount, then the first and second steps of the quantitative goodwill impairment test are unnecessary. If the Company elects to bypass the qualitative assessment option, or if the qualitative assessment was performed and resulted in the Company being unable to conclude that it is not more likely than not that the fair value of a reporting unit containing goodwill is greater than its carrying amount, the Company will perform the two-step quantitative goodwill impairment test. The Company performs the first step of the two-step quantitative goodwill impairment test by calculating the fair value of the reporting unit using a discounted cash flow method, and then comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of the reporting unit exceeds its fair value, the Company performs the second step of the quantitative goodwill impairment test to measure the amount of the impairment loss, if any. Management has concluded there was no goodwill impairment for the years ended December 31, 2014, 2013 and 2012.

Other intangible assets principally include patents, existing product technology and customer relationships that arose in connection with the Company's acquisitions of CAD Zone, iQvolution AG and Dimensional Photonics International. Other intangible assets are recorded at fair value at the date of acquisition and are amortized over their estimated useful lives of 3 to 20 years. As of December 31, 2014, there were no indefinite-lived intangible assets.

Product technology and patents are recorded at cost. Amortization is computed using the straight-line method over the lives of the patents of 17 to 20 years.

The weighted-average amortization period for all the Company's intangible assets is nine years.

**Long-Lived Assets** Long-lived assets, other than goodwill, are evaluated for impairment when events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Management has concluded that there were no indications of impairment of these assets during the years ended December 31, 2014, 2013 and 2012.

**Research and Development** Research and development costs incurred in the discovery of new knowledge and the resulting translation of this new knowledge into plans and designs for new products, prior to the attainment of the related products' technological feasibility, are recorded as expenses in the period incurred.

**Reserve for Warranties** The Company establishes at the time of sale a liability for the one year warranty included with the initial purchase price of equipment, based upon an estimate of the repair expenses likely to be incurred for the warranty period. The warranty period is measured in installation-months for each major product group. The warranty reserve is included in accrued liabilities in the accompanying consolidated balance sheets. The warranty expense is estimated by applying the actual total repair expenses for each product group in the prior period and determining a rate of repair expense per installation-month. This repair rate is multiplied by the number of installation-months of warranty for each product group to determine the provision for warranty expenses for the period. The Company evaluates its exposure to warranty costs at the end of each period using the estimated expense per installation-month for each major product group, the number of units remaining under warranty and the remaining number of months each unit will be under warranty. The Company has a history of new product introductions and enhancements to existing products, which may result in unforeseen issues that increase its warranty costs. While such expenses have historically been within expectations, the Company cannot guarantee this will continue in the future.

**Income Taxes** The Company reviews its deferred tax assets on a regular basis to evaluate their recoverability based upon expected future reversals of deferred tax assets and liabilities, projections of future taxable income, and tax planning strategies that the Company might employ to utilize such assets, including net operating loss carryforwards. Based on the positive and negative evidence for recoverability, the Company establishes a valuation allowance against the net deferred tax assets of a taxing jurisdiction in which the Company operates unless it is more likely than not that the Company will recover such assets through the above means. In the future, the Company's evaluation of the need for the valuation allowance will be significantly influenced by the Company's ability to achieve profitability and the Company's ability to predict and achieve future projections of taxable income over at least a two-year period.

The Company recognizes tax benefits related to uncertain tax positions only if it is more likely than not that the tax position will be sustained upon examination by taxing authorities. For those positions where it is more likely than not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. In the ordinary course of business, the Company and its subsidiaries are examined by various federal, state, and foreign tax authorities. The Company regularly assesses the potential outcomes of these examinations and any future examinations for the current or prior years in determining the adequacy of its provision for income taxes.

**Fair Value of Financial Instruments** The Company's financial instruments include cash and cash equivalents, short-term investments, accounts receivable and accounts payable and accrued liabilities.

In accordance with the requirements of the Fair Value Measurements and Disclosures Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), the Company groups its financial assets and liabilities measured at fair value on a recurring basis in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 - Valuation is based upon quoted market price for identical instruments traded in active markets.

Level 2 - Valuation is based on quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 - Valuation is generated from model-based techniques that use significant assumptions not observable in the market. Valuation techniques include use of discounted cash flow models and similar techniques.

In accordance with the requirements of the Fair Value Measurements and Disclosures Topic of the FASB ASC, it is the Company's policy to use observable inputs whenever reasonably practicable in order to minimize the use of unobservable inputs when developing fair value measurements. When available, the Company uses quoted market prices to measure fair value. If market prices are not available, the fair value measurement is based on models that use primarily market based parameters including interest rate yield curves, option volatilities and currency rates. In certain cases, where market rate assumptions are not available, the Company is required to make judgments about assumptions market participants would use to estimate the fair value of a financial instrument. Changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values.

*Cash, cash equivalents and short-term investments* - Included in cash and cash equivalents and short-term investments in the accompanying consolidated balance sheets are deposits with financial institutions and six-month U.S. Treasury Bills. The fair values of these assets are based on Level 1 inputs in the fair value hierarchy. Due to their short-term nature, the carrying amounts of such financial instruments approximate their fair values.

*Accounts receivable, accounts payable and accrued liabilities* - The recorded amounts of these financial instruments approximate their fair value because of the short-maturities of these instruments.

**Earnings Per Share** Basic earnings per share (EPS) is computed by dividing earnings available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS includes the effect of all potentially dilutive common shares by applying the treasury stock method. A reconciliation of the number of common shares used in calculation of basic and diluted EPS is presented in Note 14, *Earnings Per Share*.

**Accounting for Stock-Based Compensation** The Company has several stock-based employee and director compensation plans, which are described more fully in Note 13, *Stock Compensation Plans*. The Company records compensation expense using the applicable accounting guidance for share-based payments related to stock options, restricted stock, and performance share awards granted to directors and employees.

Compensation cost for share-based awards is recorded on a straight line basis over the required service period. The fair value of the stock option grants is estimated using the Black-Scholes option-pricing model, which requires the input of assumptions, including dividend yield, risk-free interest rate, the estimated length of time employees will retain their stock options before exercising them (expected term) and the estimated volatility of the Company's common stock price over the expected term. These assumptions are generally based on historical averages of the Company. Furthermore, in calculating compensation expense for these awards, the Company is also required to estimate the extent to which options will be forfeited prior to vesting. Many factors are considered when estimating expected forfeitures, including types of awards, employee class and historical experience. To the extent actual results or updated estimates of forfeiture differ from current estimates, such amounts are

recorded as a cumulative adjustment to the previously recorded amounts. Compensation expense associated with restricted stock and performance share awards are equal to the market value of the Company's common stock determined by the closing price on the date of grant and is recorded pro rata over the required service period. For those awards with performance criteria, the expense is recorded based on an assessment of achieving the criteria.

**Concentration of Credit Risk** Financial instruments that expose the Company to concentrations of credit risk consist principally of short-term investments and operating demand deposit accounts. The Company's policy is to place its operating demand deposit accounts with high credit quality financial institutions, the balances of which at times may exceed federally insured limits. The Company continually monitors its banking relationships and believes it is not exposed to any significant credit risk on its operating demand deposit accounts.

**Estimates** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ( U.S. GAAP ) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Impact of Recently Issued Accounting Standards** In May 2014, the FASB issued an amendment to its accounting guidance related to revenue recognition. The amendment was the result of a joint project between the FASB and the International Accounting Standards Board ( IASB ) to clarify the principles for recognizing revenue and to develop common revenue standards for U.S. GAAP and International Financial Reporting Standards. To meet those objectives, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers: Topic 606* ( ASU 2014-09 ). ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. The Company will adopt ASU 2014-09 in reporting periods beginning after December 15, 2016. Early adoption is not permitted. The Company is currently evaluating the impact of adopting this pronouncement on its consolidated financial statements.

**Reclassifications** Certain prior year amounts have been reclassified in the accompanying consolidated financial statements to conform to current year presentation.

## 2. SUPPLEMENTAL CASH FLOW INFORMATION

Selected cash payments and non-cash activities were as follows:

	Years ended December 31,		
	2014	2013	2012
Cash paid for interest	\$ 7	\$ 8	\$ 28
Cash paid for income taxes	10,844	10,286	5,256

**3. ALLOWANCE FOR DOUBTFUL ACCOUNTS**

Activity in the allowance for doubtful accounts was as follows:

	Years ended December 31,		
	2014	2013	2012
Balance, beginning of year	\$ 3,686	\$ 3,780	\$ 4,585
Provision (net of recovery)	(306)	1,001	(23)
Amounts written off, net of recoveries	(1,536)	(1,095)	(782)
Balance, end of year	\$ 1,844	\$ 3,686	\$ 3,780

**4. SHORT-TERM INVESTMENTS**

Short-term investments of \$65.0 million at December 31, 2014 and 2013 were comprised of U.S. Treasury Bills that mature through June 11, 2015. The interest rate on the U.S. Treasury Bills is less than one percent. The investments are classified as held-to-maturity and recorded at cost plus accrued interest. The fair value of the U.S. Treasury Bills at December 31, 2014 and 2013 approximated cost. For further discussion of fair value, refer to the fair value of financial instruments section of Note 1, *Summary of Significant Accounting Policies*.

**5. INVENTORIES**

Inventories consist of the following:

	As of December 31, 2014	As of December 31, 2013
Raw materials	\$ 27,058	\$ 22,562
Finished goods	13,075	6,833
Sales demonstration inventory	19,201	19,545
Inventories, net	\$ 59,334	\$ 48,940
Service inventory	\$ 20,646	\$ 19,033

**6. GOODWILL**

The Company's goodwill at December 31, 2014 and 2013 is related to its previous acquisitions of four businesses. The Company evaluates each reporting unit's fair value as compared to its carrying value on December 31 of each year or more frequently if events or changes in circumstances indicate that the carrying value may exceed the fair value. The Company first performs a qualitative assessment to determine whether it is necessary to perform the two-step goodwill impairment test. If Step 1 of the quantitative goodwill impairment test is performed, the fair value of a reporting unit is measured using a discounted cash flow model incorporating discount rates commensurate with the risks involved for each reporting unit. The key assumptions used in the discounted cash flow model include discount

rates, growth rates, cash flow projections and terminal value rates. These rates are susceptible to change and require significant management judgment. Impairments to goodwill are charged against earnings in the period the impairment is identified. The Company has two reporting units for which goodwill was tested on December 31, 2014: the Americas Region, and the Europe/Africa Region, as shown in the table below. As of December 31, 2014 and 2013, the Company did not have any goodwill that was identified as impaired. The decrease in goodwill in 2014 related to changes in foreign exchange rates, partially offset by goodwill resulting from an acquisition completed in 2014. Changes in goodwill of \$0.5 million in 2013 were due to adjustments for changes in foreign exchange rates.

December 31, 2014	Beginning Balance	Additions	Foreign Currency Translation	Ending Balance
Americas Region	\$ 6,994	\$ 1,372	\$	\$ 8,366
Europe/Africa region	12,364		(1,525)	10,839
Asia-Pacific Region				
Total	\$ 19,358	\$ 1,372	\$ (1,525)	\$ 19,205

December 31, 2013	Beginning Balance	Additions	Foreign Currency Translation	Ending Balance
Americas Region	\$ 6,994	\$	\$	\$ 6,994
Europe/Africa region	11,822		542	12,364
Asia-Pacific Region				
Total	\$ 18,816	\$	\$ 542	\$ 19,358

## 7. INTANGIBLE ASSETS

Intangible assets consist of the following:

	As of December 31, 2014		
	Carrying Value	Accumulated Amortization	Net Intangible
Amortizable intangible assets:			
Product technology	\$ 9,065	\$ 8,215	\$ 850
Patents	12,169	4,621	7,548
Other	8,010	7,299	711
Total	\$ 29,244	\$ 20,135	\$ 9,109

	As of December 31, 2013		
	Carrying Value	Accumulated Amortization	Net Intangible
Amortizable intangible assets:			
Product technology	\$ 10,917	\$ 9,710	\$ 1,207
Patents	10,599	4,118	6,481
Other	8,028	7,604	424
Total	\$ 29,544	\$ 21,432	\$ 8,112





Amortization expense was \$1,257, \$1,213 and \$1,207 in 2014, 2013 and 2012, respectively. The estimated amortization expense for each of the years 2015 through 2019 and thereafter is as follows:

Years ending December 31,	Amount
2015	\$ 1,355
2016	1,159
2017	1,084
2018	982
2019	798
Thereafter	3,731
	\$ 9,109

## 8. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	As of December 31,	
	2014	2013
Accrued compensation and benefits	\$ 17,544	\$ 11,591
Accrued warranties	2,719	2,364
Professional and legal fees	1,475	1,203
Other accrued liabilities	4,389	4,983
	\$ 26,127	\$ 20,141

Activity related to accrued warranties was as follows:

	Years ended December 31,		
	2014	2013	2012
Balance, beginning of year	\$ 2,364	\$ 2,359	\$ 2,365
Provision for warranty expense	3,848	3,541	3,071
Fulfillment of warranty obligations	(3,493)	(3,536)	(3,077)
Balance, end of year	\$ 2,719	\$ 2,364	\$ 2,359

## 9. LINE OF CREDIT

On July 11, 2006, the Company entered into a loan agreement providing for an available line of credit of \$30.0 million, which was most recently amended on March 15, 2012. Loans under the Amended and Restated Loan Agreement, as amended, bear interest at the rate of LIBOR plus a fixed percentage between 1.50% and 2.00% and

require the Company to maintain a minimum cash balance of \$25 million and tangible net worth measured at the end of each of the Company's fiscal quarters. As of December 31, 2014, the Company was in compliance with all of the covenants under the Amended and Restated Loan Agreement, as amended. The term of the Amended and Restated Loan Agreement, as amended, expires on March 31, 2015. The Company has not drawn on this line of credit in 2014, 2013 or 2012.

**10. OTHER (INCOME) EXPENSE, NET**

Other (income) expense, net consists of the following:

	Years ended December 31,		
	2014	2013	2012
Foreign exchange transaction (gains) losses	\$ (103)	\$ 1,307	\$ 642
Other	9	50	102
<b>Total other (income) expense, net</b>	<b>\$ (94)</b>	<b>\$ 1,357</b>	<b>\$ 744</b>

**11. INCOME TAXES**

Income before income tax expense consists of the following:

	Years ended December 31,		
	2014	2013	2012
Domestic	\$ 12,877	\$ 14,842	\$ 8,310
Foreign	24,645	14,020	22,632
<b>Income before income taxes</b>	<b>\$ 37,522</b>	<b>\$ 28,862</b>	<b>\$ 30,942</b>

The components of the income tax expense (benefit) for income taxes are as follows:

	Years ended December 31,		
	2014	2013	2012
<b>Current:</b>			
Federal	\$ 3,780	\$ 4,859	\$ 4,418
State	367	472	429
Foreign	4,433	3,751	5,537
<b>Current income tax expense</b>	<b>8,580</b>	<b>9,082</b>	<b>10,384</b>
<b>Deferred:</b>			
Federal	306	(1,105)	(1,871)
State	30	(108)	(183)
Foreign	(5,043)	(516)	(386)
<b>Deferred income tax benefit</b>	<b>(4,707)</b>	<b>(1,729)</b>	<b>(2,440)</b>
<b>Income tax expense</b>	<b>\$ 3,873</b>	<b>\$ 7,353</b>	<b>\$ 7,944</b>



Income tax expense (benefit) for the years ended December 31, 2014, 2013 and 2012 differ from the amount computed by applying the federal statutory corporate rate to income before income taxes. The differences are recorded as follows:

	Years ended December 31,		
	2014	2013	2012
Tax expense (benefit) at statutory rate of 34%	\$ 12,757	\$ 9,813	\$ 10,521
State income taxes, net of federal benefit	425	490	274
Foreign tax rate difference	(2,917)	(1,345)	(2,549)
Research and development credit	(583)	(957)	
Change in valuation allowance	(5,392)	(187)	3
Equity based compensation	880	(212)	(225)
Manufacturing credit	(721)	(249)	(139)
Other	(576)		59
<b>Total income tax expense</b>	<b>\$ 3,873</b>	<b>\$ 7,353</b>	<b>\$ 7,944</b>

The components of the Company's net deferred income tax asset and liabilities are as follows:

	As of December 31,	
	2014	2013
<b>Net deferred income tax asset - Current</b>		
Warranty cost	\$ 404	\$ 348
Bad debt reserve	30	73
Inventory reserve	512	253
Unearned service revenue	3,474	2,992
Other, net	1,516	935
<b>Net deferred income tax asset - Current</b>	<b>\$ 5,936</b>	<b>\$ 4,601</b>
<b>Net deferred income tax asset - Non-current</b>		
Depreciation	\$ (3,059)	\$ (1,559)
Goodwill amortization	(2,007)	(1,841)
Product design costs	(136)	(259)
Employee stock options	2,756	3,021
Unearned service revenue	1,649	1,654
Loss carryforwards	9,240	10,252
<b>Deferred income tax asset - Non-current</b>	<b>8,443</b>	<b>11,268</b>
Valuation Allowance	(1,819)	(6,845)
<b>Net deferred income tax asset - Non-current</b>	<b>\$ 6,624</b>	<b>\$ 4,423</b>
<b>Net deferred income tax liability - Non-current</b>		

Intangible assets	\$	\$ (1,171)
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The effective income tax rate for 2014, 2013, and 2012 includes a reduction in the statutory corporate tax rates for the Company's operations in Switzerland. The favorable tax rate ruling requires the Company to maintain a certain level of manufacturing operations in Switzerland. The aggregate dollar effect of this favorable tax rate was approximately \$1.9 million, or \$0.11 per share, in the year ended December 31, 2014, \$1.5 million, or \$0.09 per share, in the year ended December 31, 2013, and \$0.9 million, or \$0.05 per share, in the year ended December 31, 2012.

At December 31, 2014 and 2013, the Company's domestic entities had deferred income tax assets in the amount of \$5.2 million and \$5.5 million, respectively. At December 31, 2014 and 2013, the Company's foreign subsidiaries had deferred tax assets primarily relating to net operating losses, some of which expire in the next 5 to 15 years and others which can be carried forward indefinitely, of \$9.2 million and \$10.3 million, respectively. The valuation allowance for deferred tax assets as of December 31, 2014 and 2013 was \$1.8 million and \$6.8 million, respectively. The net change in the total valuation allowance for each of years ended December 31, 2014, 2013 and 2012, was a decrease of \$5.0 million, a decrease of \$0.2 million and an increase of \$3.0 thousand, respectively. During the year ended December 31, 2014, the Company identified certain immaterial errors related to deferred tax assets and the related valuation allowance. As a result, the Company decreased deferred tax assets and the related valuation allowance by \$4.7 million each to correct the gross-up error. The above table has been adjusted to reflect this adjustment. The Company believes this error is not material to the consolidated financial statements of any prior interim or annual periods and that the correction of the error was not material to the Company's 2014 consolidated financial statements.

The valuation allowance as of December 31, 2014 and 2013 was primarily related to foreign net operating loss carryforwards that, in the judgment of management, were not more likely than not to be realized. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. Management considers the scheduled reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), projected taxable income, and tax-planning strategies in making this assessment. In 2014, certain foreign subsidiaries which had previously generated losses, established a pattern of profitability which resulted in the Company concluding that the valuation allowance should be reversed based on the assessment previously described. As a result, the Company recorded a \$4.5 million discrete tax adjustment during the third quarter of 2014. The remaining changes impacting the valuation allowance for the year ended December 31, 2014 related to changes in foreign currency.

The Company has not recognized any U.S. tax expense on undistributed international earnings, as it intends to reinvest the earnings outside the U.S. for the foreseeable future. The Company's net undistributed international earnings were approximately \$106.2 million and \$78.2 million at December 31, 2014 and 2013, respectively.

Significant judgment is required in determining the Company's worldwide provision for income taxes. In the ordinary course of a global business, there are many transactions for which the ultimate tax outcome is uncertain. The Company reviews its tax contingencies on a regular basis and makes appropriate accruals as necessary.

As of December 31, 2014 and 2013, the Company's gross unrecognized tax benefits totaled \$0.3 million, which includes approximately \$0.03 million of interest and penalties. The Company estimates that the unrecognized tax benefits will not change significantly within the next year.



A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	Years ended December 31,		
	2014	2013	2012
Balance at January 1,	\$ 265	\$ 265	\$ 265
Additions based on tax positions related to the current year			
Additions for tax positions of prior years			
Reductions for tax positions of prior years			
Settlements			
Balance at December 31,	\$ 265	\$ 265	\$ 265

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The table below summarizes the open tax years and ongoing tax examinations in major jurisdictions as of December 31, 2014:

Jurisdiction	Open Years	Examination in Process
United States - Federal Income Tax	2010-2014	N/A
United States - various states	2010-2014	N/A
Germany	2009-2014	2010-2011
Switzerland	2013	N/A
Singapore	2010-2014	N/A

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in tax expense. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$0.3 million. FARO does not currently anticipate that the total amount of unrecognized tax benefits will result in material changes to its financial position. The Company is subject to income taxes at the federal, state and foreign country level. The Company's tax returns are subject to examination at the U.S. federal level from 2010 forward and at the state level subject to a three to four year statute of limitations. In September 2013, the U.S. Internal Revenue Service issued new regulations for capitalizing and deducting costs incurred to acquire, produce, or improve tangible property. The Company adopted these new regulations as of January 1, 2014, and it did not have a material effect on its consolidated financial statements.

## 12. COMMITMENTS AND CONTINGENCIES

**Leases** The Company leases buildings and equipment under non-cancellable operating leases through 2024. The following is a schedule of future minimum lease payments required under non-cancelable operating leases with initial terms in excess of one year, in effect at December 31, 2014:

Years ending December 31,	Amount
2015	\$ 6,668
2016	5,740

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2017	3,221
2018	2,621
2019	2,208
Thereafter	6,341
<b>Total future minimum lease payments</b>	<b>\$ 26,799</b>

Rent expense for 2014, 2013, and 2012 was \$6,119, \$5,227 and \$4,917, respectively.

**Patent Matters** On July 11, 2008, Metris USA, Inc. and its affiliates, Metris N.V., Metris IPR N.V. and 3-D Scanners Ltd., filed a complaint against the Company for patent infringement in the U.S. District Court for the District of Massachusetts (the Massachusetts Court ) concerning U.S. Patent Nos. 6,611,617 and 7,313,264 (hereinafter, the patents-in-suit ). Following an acquisition by Nikon Corporation in late 2009, Metris USA, Inc. subsequently changed its name to Nikon Metrology, Inc., Metris N.V. changed its name to Nikon Metrology NV, and Metris IPR N.V. was dissolved and merged into Nikon Metrology NV. We refer to each of Nikon Metrology, Inc., Nikon Metrology NV, and 3-D Scanners Ltd. as Plaintiffs or Nikon .

The Company responded to the complaint with counterclaims alleging that the patents-in-suit, which are generally directed to laser scanning devices, are invalid, non-infringed, and unenforceable due to fraud during prosecution of the patents in the U.S. Patent and Trademark Office. On August 31, 2009, the Massachusetts Court granted the Company's motion to add counterclaims and defenses for violation of federal and state antitrust and unfair competition laws based on the alleged knowing assertion of invalid and fraudulent patents. The Company also filed an amended counterclaim to add the Plaintiff's parent company, Nikon Corporation, as a counterclaim defendant.

On July 14, 2010, the Company filed a motion for summary judgment of non-infringement of both patents-in-suit. On August 31, 2010, Nikon filed a motion for summary judgment against the Company's counterclaims for antitrust violations and unfair trade practices.

On September 19, 2011, the Massachusetts Court ruled that the Company did not infringe U.S. Patent No. 6,611,617. The Massachusetts Court also granted Nikon's motion for summary judgment on the Company's counterclaims for anti-trust violations and unfair trade practices. The Massachusetts Court denied the Company's motion for summary judgment of non-infringement of U.S. Patent No. 7,313,264. The effect of the ruling was to reduce or eliminate the Company's exposure with respect to claims associated with U.S. Patent No. 6,611,617, while the patent dispute with respect to U.S. Patent No. 7,313,264 continued.

On August 10, 2012, following a two-week jury trial on the remaining claims related to U.S. Patent No. 7,313,264, the jury determined the asserted patent claims were invalid, and on August 13, 2012, the Massachusetts Court entered judgment for the Company. The Massachusetts Court sustained this verdict on January 23, 2013, denying all post-trial motions except the Company's motion for attorneys' fees. On February 21, 2013, the Massachusetts Court stayed the Company's motion for attorneys' fees pending resolution of any appeals to the U.S. Federal Circuit.

On March 20, 2013, the Massachusetts Court entered Final Judgment in the Company's favor, awarding the Company its costs. On April 10, 2013, the Company filed a notice of appeal to the U.S. Federal Circuit with respect to the Massachusetts Court's failure to address the inequitable conduct by the inventor and related patent misuse and anti-trust issues.

On July 10, 2013, the matter was settled with no impact to the Company's financial statements.

### 13. STOCK COMPENSATION PLANS

The Company has five compensation plans that provide for the granting of stock options and other share-based awards to key employees and non-employee members of the Board of Directors. The 1997 Employee Stock Option Plan (1997 Plan) provided for granting incentive stock options and nonqualified stock options to officers and key employees of the Company. The 1997 Non-employee Director Stock Option Plan provided for granting nonqualified stock options and formula options to non-employee directors. The 2004 Equity Incentive Plan (2004 Plan), the 2009 Equity Incentive Plan (2009 Plan), and the 2014 Equity Incentive Plan (2014 Plan) provide for granting options, restricted stock, restricted stock units or stock appreciation rights to employees and non-employee directors.

The Company was authorized to grant awards for up to 1,400,000 shares of common stock under the 1997 Plan, of which no options remain outstanding. The Company was also authorized to grant awards for up to 250,000 shares of common stock under the 1997 Non-employee Director Stock Option Plan, of which no options remain outstanding. The Company was authorized to grant awards for up to 1,750,000 shares of common stock under the 2004 Plan, of which 120,988 options are currently outstanding at exercise prices between \$13.04 and \$31.06. The Company was also authorized to grant awards for up to 1,781,546 shares of common stock under the 2009 Plan, as well as any shares underlying awards outstanding under the 2004 Plan as of the effective date of the 2009 Plan that thereafter terminated or expired unexercised or were canceled, forfeited or lapsed for any reason. There are 768,941 options currently outstanding under the 2009 Plan at exercise prices between \$24.30 and \$57.54. The options outstanding under the 2004 Plan and the 2009 Plan have a 10-year term (7 years on grants beginning in 2010) and vest over a 3-year period.

In May 2014, the Company's shareholders approved the 2014 Plan authorizing the Company to grant awards for up to 1,974,543 shares of common stock, as well as any shares underlying awards outstanding under the 2004 Plan and 2009 Plan as of the effective date of the 2014 Plan that thereafter terminate or expire unexercised or are canceled, forfeited or lapse for any reason. There are 8,500 options currently outstanding under the 2014 Plan at exercise prices between \$46.40 and \$51.75. The options outstanding under the 2014 Plan have a 7-year term and vest over a 3-year period. The Company will not make any further grants under the 1997 Plan, the 1997 Non-employee Director Stock Option Plan, the 2004 Plan or the 2009 Plan.

Prior to 2009, upon election to the Board, each non-employee director was granted 3,400 restricted shares of common stock that vested ratably over three years. On the day following the Annual Meeting of Shareholders, each non-employee director, other than a non-employee director who received the initial equity grant in that same year, was granted 2,200 restricted shares of common stock that vested ratably over three years.

Prior to 2013, upon election to the Board, each non-employee director received an initial equity grant of shares of restricted common stock with a value equal to \$100,000, calculated using the closing share price on the date of the non-employee director's election to the Board. The initial restricted stock grant vests on the third anniversary of the grant date, subject to the non-employee director's continued membership on the Board. Annually on the first business day following the annual meeting of shareholders, each non-employee director was granted restricted shares of common stock with a value equal to \$70,000, calculated as of the closing

share price on that day. The shares of restricted stock vest on the day prior to the following year's annual meeting date, subject to the non-employee director's continued membership on the Board.

Beginning in 2013, upon election to the Board, each non-employee director receives an initial equity grant of shares of restricted common stock with a value equal to \$100,000, calculated using the closing share price on the date of the non-employee director's election to the Board. The initial restricted stock grant vests on the third anniversary of the grant date, subject to the non-employee director's continued membership on the Board. Annually on the first business day following the annual meeting of shareholders, each non-employee director is granted restricted shares of common stock with a value equal to \$80,000, calculated as of the closing share price on that day. The shares of restricted stock vest on the day prior to the following year's annual meeting date, subject to a non-employee director's continued membership on the Board. The Company records compensation cost associated with its restricted stock unit grants on a straight-line basis over the vesting term.

Compensation costs charged to operations associated with the Company's stock incentive plans were \$4,678, \$4,409 and \$4,080 in 2014, 2013 and 2012, respectively.

The Company used the Black-Scholes option-pricing model to determine the fair value of stock option grants made using the following assumptions:

	Years Ended December 31,		
	2014	2013	2012
Risk-free interest rate	0.95% - 1.32%	0.55% - 1.03%	0.50% - 0.66%
Expected dividend yield	0%	0%	0%
Expected option life	3-4 years	4 years	4 years
Expected volatility	42.5% - 45.4%	46.1% - 48.4%	50.4% - 50.7%
Weighted-average expected volatility	42.6%	48.2%	50.7%

Historical information was the primary basis for the selection of the expected dividend yield, expected volatility and the expected lives of the options. The risk-free interest rate was based on yields of U.S. zero coupon issues and U.S. Treasury issues, with a term equal to the expected life of the option being valued.

A summary of stock option activity and weighted average exercise prices follows:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value as of December 31, 2014
Outstanding at January 1, 2014	814,291	\$ 39.56		
Granted	248,388	56.81		
Forfeited	(59,545)	43.47		
Exercised	(104,705)	35.48		
Outstanding at December 31, 2014	898,429	\$ 44.40	4.3	\$ 16,427

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Options exercisable at December 31, 2014	446,760	\$	36.78	2.9	\$	11,569
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The weighted-average grant-date fair value of the stock options granted during the years ended December 31, 2014, 2013 and 2012 were \$19.38, \$14.41 and \$22.28, respectively. The aggregate intrinsic value of stock options exercised during the years ended December 31, 2014, 2013 and 2012 was \$2.2 million, \$3.7 million and \$7.1 million, respectively. The total fair value of stock options using the Black-Scholes option pricing model vested during the years ended December 31, 2014, 2013 and 2012 was \$3.7 million, \$3.3 million and \$1.7 million, respectively.

The following table summarizes the restricted stock activity and weighted average grant-date fair values for the year ended December 31, 2014:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at January 1, 2014	31,448	\$ 41.39
Granted	13,706	43.43
Forfeited		
Vested	(31,199)	41.31
Non-vested at December 31, 2014	13,955	\$ 43.57

As of December 31, 2014, there was \$5.2 million in total unrecognized stock-based compensation expense related to non-vested stock-based compensation arrangements. The expense is expected to be recognized over a weighted average period of 1.8 years.

#### 14. EARNINGS PER SHARE

Basic earnings per share information is calculated by dividing net income by the weighted average number of shares outstanding. Diluted earnings per share information is calculated by also considering the impact of potential common stock on both net income and the weighted average number of shares outstanding. The Company's potential common stock consists of employee and director stock options, restricted stock, and performance share awards. Performance share awards are included in the diluted earnings per share calculation when the performance criteria are achieved. The Company's potential common stock is excluded from the basic earnings per share calculation and is included in the diluted earnings per share calculation when doing so would not be anti-dilutive. For the years ended December 31, 2014, 2013 and 2012, the Company did not have any outstanding performance share awards.

A reconciliation of the number of common shares used in the calculation of basic and diluted earnings per share (EPS) is presented below:

	2014		Years Ended December 31, 2013		2012	
	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	17,247,727	\$ 1.95	17,087,104	\$ 1.26	16,910,830	\$ 1.36
Effect of dilutive securities	168,726	(0.02)	154,011	(0.01)	218,298	(0.02)

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Diluted EPS	17,416,453	\$ 1.93	17,241,115	\$ 1.25	17,129,128	\$ 1.34
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Securities excluded from the determination of weighted average shares for the calculation of diluted EPS, as they were antidilutive

520,739

403,649

238,266



**15. EMPLOYEE RETIREMENT BENEFIT PLAN**

The Company maintains a 401(k) defined contribution retirement plan for its eligible U.S. employees. The Company terminated matching contributions on April 18, 2009 and reinstated them on March 1, 2011. Costs charged to operations in connection with the 401(k) plan during 2014, 2013, and 2012 aggregated \$1,127, \$934, and \$876, respectively.

**16. SEGMENT REPORTING**

The Company has three reportable segments based upon geographic regions: Americas, Europe/Africa and Asia-Pacific. The Company includes costs related to Corporate in its Americas region. The Company does not incur research and development expenses in its Asia-Pacific region.

The Company develops, manufactures, markets, supports and sells CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software, and three-dimensional documentation systems in each of these regions. These activities represent more than 99% of consolidated sales. The Company evaluates performance and allocates resources based upon profitable growth and assets deployed.

The following table presents information about the Company's reportable segments:

	As of and for the Years Ended December 31,		
	2014	2013	2012
<b>Americas Region</b>			
Net sales to external customers	\$ 138,968	\$ 120,435	\$ 108,616
Depreciation and amortization	3,989	4,012	4,294
Operating income	7,490	6,270	2,949
Long-lived assets	37,013	23,791	21,775
Capital expenditures	12,347	3,563	1,435
Total assets	222,273	201,679	179,594
<b>Europe/Africa Region</b>			
Net sales to external customers	\$ 120,179	\$ 103,415	\$ 100,111
Depreciation and amortization	2,090	1,880	1,658
Operating income	8,811	6,417	10,703
Long-lived assets	17,599	17,409	16,871
Capital expenditures	4,799	1,558	1,672
Total assets	124,535	122,197	110,152
<b>Asia-Pacific Region</b>			
Net sales to external customers	\$ 82,679	\$ 67,934	\$ 64,668
Depreciation and amortization	1,349	1,146	1,024
Operating income	21,039	17,467	17,902
Long-lived assets	3,047	2,721	2,562
Capital expenditures	1,576	1,319	1,565
Total assets	78,655	67,620	61,061
<b>Totals</b>			
Net sales to external customers	\$ 341,826	\$ 291,784	\$ 273,395
Depreciation and amortization	7,428	7,038	6,976
Operating income	37,340	30,154	31,554
Long-lived assets	57,659	43,921	41,208
Capital expenditures	18,722	6,440	4,672
Total assets	425,463	391,496	350,807

The geographical sales information presented above represents sales to customers located in each respective region, whereas the long-lived assets information represents assets held in the respective regions. There were no customers that individually accounted for 10% or more of total consolidated revenue.

Net sales to external customers is based upon the geographic location of the customer.

	For the Years Ended December 31,		
	2014	2013	2012
<b>Net sales to external customers</b>			
United States	\$ 124,851	\$ 109,757	\$ 97,912
Americas-Other	14,117	10,678	10,704
Germany	50,437	42,471	42,413
Europe-Other	69,742	60,944	57,698

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Japan	32,531	23,795	25,553
Asia-Other	50,148	44,139	39,115
	\$ 341,826	\$ 291,784	\$ 273,395

Long lived assets consist primarily of property, plant, and equipment, goodwill, and intangible assets, and are attributed to the geographic area in which they are located or originated.

Long-Lived Assets	As of December 31,		
	2014	2013	2012
United States	\$ 35,900	\$ 22,720	\$ 20,824
Americas-Other	1,113	1,071	951
Germany	17,351	17,294	16,630
Europe-Other	248	115	241
Japan	599	434	576
Asia-Other	2,448	2,287	1,986
	\$ 57,659	\$ 43,921	\$ 41,208

## 17. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Quarter ended	March 29, 2014	June 28, 2014	September 27, 2014	December 31, 2014
Sales	\$ 73,374	\$ 82,060	\$ 82,239	\$ 104,153
Gross profit	40,083	45,517	46,041	57,273
Net income	4,976	6,328	11,223	11,122
Net income per share:				
Basic	\$ 0.29	\$ 0.37	\$ 0.65	\$ 0.64
Diluted	\$ 0.29	\$ 0.36	\$ 0.64	\$ 0.64

  

Quarter ended	March 30, 2013	June 29, 2013	September 28, 2013	December 31, 2013
Sales	\$ 65,370	\$ 68,329	\$ 68,190	\$ 89,895
Gross profit	36,825	36,926	38,821	49,321
Net income	4,574	3,631	5,042	8,262
Net income per share:				
Basic	\$ 0.27	\$ 0.21	\$ 0.29	\$ 0.48
Diluted	\$ 0.27	\$ 0.21	\$ 0.29	\$ 0.48

## 18. SUBSEQUENT EVENTS

On February 5, 2015, the Company announced the acquisition of ARAS 360 Technologies Inc. (ARAS), a privately held company for \$7.7 million in cash, and up to an additional \$4.0 million in contingent consideration that may be earned over a two-year period. ARAS is a global leader in the development of accident and crime reconstruction, simulation and animation software, headquartered in Kamloops, British Columbia. The acquisition is expected to complement the Company's portfolio within the law enforcement market. The Company is in the process of allocating the purchase price to the acquired assets and liabilities based upon their estimated fair values as of the date of closing. The results of ARAS' operations were not included in the Company's consolidated financial statements as of or for the year ended December 31, 2014.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**ITEM 9A. CONTROLS AND PROCEDURES.**

**Evaluation of Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, the Company's management carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer and its Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures, as defined by Rule 13a-15(e) under the Exchange Act, were effective as of December 31, 2014.

**Changes in Internal Control Over Financial Reporting**

FARO is implementing SAP, a new enterprise resource planning ( ERP ) system, to support and enhance the Company's operations and financial reporting. SAP is expected to significantly impact the Company's business, financial transaction and reporting processes. SAP is being implemented in phases, beginning with the Americas region, which implementation commenced at the start of the fourth quarter of 2014. The implementation is expected to continue in 2015 in the Europe/Africa region followed by the Asia-Pacific region. The implementation of a new worldwide ERP system affects the processes that constitute the Company's internal control over financial reporting and will require continued testing for effectiveness as the implementation progresses.

There were no other changes in the Company's internal control over financial reporting during the fourth quarter ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Management's Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act). Internal control over financial reporting is the process designed under the Chief Executive Officer's and the Chief Financial Officer's supervision, and effected by the Company's Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States.

Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company conducted an

evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2014, as required by Exchange Act Rule 13a-15(c). In making this assessment, the Company used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in *Internal Control - Integrated Framework* (2013 framework). Based on the Company's assessment under the framework in *Internal Control - Integrated Framework* (2013 framework), management concluded that the Company's internal control over financial reporting was effective as of December 31, 2014 to provide reasonable assurance of meeting its objectives.

There are inherent limitations in the effectiveness of internal control over financial reporting, including the possibility that misstatements may not be prevented or detected. Accordingly, an effective control system, no matter how well designed and operated, can provide only reasonable assurance of achieving the designed control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Grant Thornton LLP, the independent registered public accounting firm that audited the Company's consolidated financial statements and internal control over financial reporting, has issued an attestation report on the Company's internal control over financial reporting as of December 31, 2014, which appears below.

FARO Technologies, Inc.

Lake Mary, Florida

February 25, 2015

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

FARO Technologies, Inc. and Subsidiaries

We have audited the internal control over financial reporting of FARO Technologies, Inc. (a Florida corporation) and subsidiaries (the Company) as of December 31, 2014, based on criteria established in the 2013 *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in the 2013 *Internal Control Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended December 31, 2014, and our report dated February 25, 2015 expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP

Orlando, Florida

February 25, 2015



**ITEM 9B. OTHER INFORMATION**

None

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

The information required by this Item with respect to directors and executive officers is incorporated herein by reference from the information under the captions Election of Directors and Executive Officers contained in the Company's definitive proxy statement for its 2015 Annual Meeting of Shareholders, which the Company refers to as the Proxy Statement.

The information required by this Item regarding compliance with Section 16(a) of the Exchange Act appears under the heading Section 16(a) Beneficial Ownership Reporting Compliance in the Proxy Statement and is incorporated herein by reference.

The information required by this Item with respect to corporate governance and the Company's Code of Conduct is incorporated herein by reference from the information contained in the Proxy Statement under the heading Corporate Governance and Board Matters .

**ITEM 11. EXECUTIVE COMPENSATION.**

The information required by this Item regarding executive compensation is incorporated herein by reference from the information contained in the Proxy Statement under the captions Executive Compensation and 2014 Director Compensation .

The information required by this Item regarding Compensation Committee interlocks and insider participation is incorporated herein by reference from the information contained in the Proxy Statement under the heading Corporate Governance and Board Matters .

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

The information required by this Item regarding security ownership of certain beneficial owners and management and related stockholder matters is incorporated herein by reference from the information contained in the Proxy Statement under the captions Security Ownership of Certain Beneficial Owners and Management and Equity Compensation Plan Information .

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

The information required by this Item about certain relationships and related transactions appears under the heading Certain Relationships and Related Transactions in the Proxy Statement and is incorporated herein by reference.

The information required by this Item regarding director independence is incorporated herein by reference from the information contained in the Proxy Statement under the heading Corporate Governance and Board Matters .



**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.**

The information required by this Item about principal accountant fees and services as well as related pre-approval policies appears under the heading "Independent Public Accountants" in the Proxy Statement and is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.**

**(a) Documents Filed as Part of this Report.** The following documents are filed as part of this Annual Report on Form 10-K:

**(1) Consolidated Financial Statements.** Included in Part II, Item 8 are the consolidated financial statements, the notes thereto and the report of the Independent Registered Public Accounting Firm.

**(2) Exhibits.** The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Annual Report on Form 10-K.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

**FARO TECHNOLOGIES, INC.**

Date: February 25, 2015

By: /s/ Peter G. Abram  
Peter G. Abram, Senior Vice President and Chief  
Financial Officer

(Duly Authorized Officer and Principal Financial  
Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. Each person whose signature appears below constitutes and appoints JAY W. FREELAND his true and lawful attorney-in-fact and agent, with full power of substitution and revocation, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this report and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or either of them, may lawfully do or cause to be done by virtue hereof.

Signature	Title	Date
/s/ Simon Raab Simon Raab	Chairman of the Board and Director	February 25, 2015
/s/ Jay W. Freeland Jay W. Freeland	President and Chief Executive Officer (Principal Executive Officer) and Director	February 25, 2015
/s/ Peter G. Abram  Peter G. Abram	Senior Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	February 25, 2015
/s/ John Caldwell  John Caldwell	Director	February 25, 2015
/s/ Lynn Brubaker  Lynn Brubaker	Director	February 25, 2015
/s/ Stephen R. Cole	Director	February 25, 2015

Stephen R. Cole

/s/ Marvin Sambur                      Director

February 25,  
2015

Marvin Sambur

/s/ John Donofrio                      Director

February 25,  
2015

John Donofrio

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**EXHIBIT INDEX**

Exhibit No.	Description
3.1	Articles of Incorporation, as amended (Filed as Exhibit 3.1 to Registrant's Registration Statement on Form S-1 filed August 6, 1997, No. 333-32983, and incorporated herein by reference)
3.2	Amended and Restated Bylaws (Filed as Exhibit 3.1 to Registrant's Current Report on Form 8-K, filed February 3, 2010, and incorporated herein by reference, SEC File No. 000-23081)
4.1	Specimen Stock Certificate (Filed as Exhibit 4.1 to Registrant's Registration Statement on Form S-1/A filed September 10, 1997, No. 333-32983, and incorporated herein by reference)
10.1	1997 Amended and Restated Employee Stock Option Plan (Filed as Exhibit 4.2 to Registrant's Registration Statement on Form S-8, No. 333-125021, and incorporated herein by reference)*
10.2	Amended and Restated 2004 Equity Incentive Plan (Filed as Exhibit 10.1 to Registrant's Form 8-K filed November 24, 2008, and incorporated herein by reference, SEC File No. 000-23081)*
10.3	Amendment to Amended and Restated 2004 Equity Incentive Plan (Filed as Exhibit 10.3 to Registrant's Form 8-K, filed April 8, 2009, and incorporated herein by reference, SEC File No. 000-23081)*
10.4	1997 Non-Employee Director Stock Option Plan (Filed as Exhibit 10.3 to Registrant's Registration Statement on Form S-1 filed August 6, 1997, No. 333-32983, and incorporated herein by reference)*
10.5	2009 Equity Incentive Plan (Filed as Appendix A to Registrant's Definitive Proxy Statement on Schedule 14A filed April 15, 2009, and incorporated herein by reference, SEC File No. 000-23081)*
10.6	First Amendment to the 2009 Equity Incentive Plan (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed April 15, 2011, and incorporated herein by reference)*
10.7	2014 Incentive Plan (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed June 3, 2014, and incorporated herein by reference)*
10.8	Summary of Director Compensation Program (Filed as Exhibit 10.8 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2013 and incorporated herein by reference)*
10.9	Form of Patent and Confidentiality Agreement between FARO Technologies, Inc. and each of its employees (Filed as Exhibit 10.10 to Registrant's Registration Statement on Form S-1, filed August 6, 1997, No. 333-32983, and incorporated herein by reference)
10.10	Form of Restricted Stock Grant Agreement under the 2004 Equity Incentive Plan (Filed as Exhibit 10.7 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2006 and incorporated herein by reference, SEC File No. 000-23801)*
10.11	Form of Restricted Stock Unit Grant Agreement under the 2004 Equity Incentive Plan (Filed as Exhibit 10.8 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2006 and incorporated herein by reference, SEC File No. 000-23801)*
10.12	Form of Stock Option Grant Agreement under the 2004 Equity Incentive Plan (Filed as Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 29, 2008 and incorporated herein by reference, SEC File No. 000-23801)*
10.13	Amended and Restated Loan Agreement, dated as of July 11, 2006, between FARO Technologies, Inc. and SunTrust Bank (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed July 17, 2006 and

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incorporated herein by reference, SEC File No. 000-23801)

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- 10.14 First Amendment to Amended and Restated Loan Agreement, dated November 21, 2008, between FARO Technologies, Inc. and SunTrust Bank (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed November 24, 2008, and incorporated herein by reference, SEC File No. 000-23801)
  - 10.15 Second Amendment to Amended and Restated Loan Agreement, dated April 22, 2009, between FARO Technologies, Inc. and SunTrust Bank (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed April 24, 2009, and incorporated herein by reference, SEC File No. 000-23801)
  - 10.16 Third Amendment to Amended and Restated Loan Agreement, dated June 18, 2009, between FARO Technologies, Inc. and SunTrust Bank (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed June 22, 2009, and incorporated herein by reference, SEC File No. 000-23801)
  - 10.17 Fourth Amendment to Amended and Restated Loan Agreement, dated March 15, 2012, between FARO Technologies, Inc. and SunTrust Bank (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed March 19, 2012 and incorporated herein by reference)
  - 10.18 Amended and Restated Employment Agreement, dated November 7, 2008, by and between FARO Technologies, Inc. and Jay Freeland (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed November 14, 2008, and incorporated herein by reference, SEC File No. 000-23801)\*
  - 10.19 Amendment to Amended and Restated Employment Agreement, dated April 2, 2009, by and between FARO Technologies, Inc. and Jay Freeland (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed April 8, 2009, and incorporated herein by reference, SEC File No. 000-23801)\*
  - 10.20 Amendment No. 2 to Amended and Restated Employment Agreement, dated December 14, 2010, by and between FARO Technologies, Inc. and Jay Freeland (Filed as Exhibit 10.17 to the Registrant's Annual Report on Form 10-K, for the year ended December 31, 2010 and incorporated herein by reference, SEC File No. 000-23801)\*
  - 10.21 Amended and Restated Employment Agreement dated November 7, 2008, by and between FARO Technologies, Inc. and Keith Bair (Filed as Exhibit 10.2 to Registrant's Current Report on Form 8-K filed November 14, 2008 and incorporated herein by reference, SEC File No. 000-23801)\*
  - 10.22 Amendment to Amended and Restated Employment Agreement, dated April 2, 2009, by and between FARO Technologies, Inc. and Keith S. Bair (Filed as Exhibit 10.2 to Registrant's Current Report on Form 8-K, filed April 8, 2009, and incorporated herein by reference, SEC File No. 000-23801)\*
  - 10.23 Amendment No. 2 to Amended and Restated Employment Agreement, dated December 14, 2010, by and between FARO Technologies, Inc. and Keith Bair (Filed as Exhibit 10.18 to the Registrant's Annual Report on Form 10-K, for the year ended December 31, 2010 and incorporated herein by reference)\*
  - 10.24 Managing Director's Service Agreement, dated October 11, 2012, between FARO Europe GmbH & Co. KG and Ralf Drews (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed October 16, 2012 and incorporated herein by reference)\*
  - 10.25 Employment Agreement between FARO Technologies, Inc. and Kathleen Hall, dated as of July 15, 2013 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed July 17, 2013 and incorporated herein by reference)\*



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- 10.26 FARO Technologies, Inc. Change in Control Severance Policy (Filed as Exhibit 10.3 to Registrant's Current Report on Form 8-K, filed November 7, 2008, and incorporated herein by reference, SEC File No. 000-23801)\*
  - 10.27 Amendment to FARO Technologies, Inc. Change in Control Severance Policy, dated April 9, 2010 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed April 15, 2010, and incorporated herein by reference)\*
  - 10.28 Amendment to FARO Technologies, Inc. Change in Control Severance Policy, dated December 14, 2010 (Filed as Exhibit 10.21 to the Registrant's Annual Report on Form 10-K, for the year ended December 31, 2010 and incorporated herein by reference)\*
  - 10.29 Lease Agreement dated September 26, 2007, by and between FARO Technologies, Inc. and Sun Life Assurance Company of Canada (Filed as Exhibit 10.15 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2007 and incorporated herein by reference, SEC File No. 000-23801)
  - 10.30 First Amendment to Lease Agreement, dated October 1, 2009, by and between FARO Technologies, Inc. and Sun Life Assurance Company of Canada (Filed as Exhibit 10.27 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2009 and incorporated herein by reference, SEC File No. 000-23801)
  - 10.31 Amended and Restated Lease Agreement, dated October 1, 2009, by and between FARO Technologies, Inc. and Emma Investments, LLC (Filed as Exhibit 10.26 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2009 and incorporated herein by reference, SEC File No. 000-23801)
  - 10.32 First Amendment to Amended and Restated Lease Agreement between Emma Investments, LLC and FARO Technologies, Inc., dated as of May 14, 2014 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed May 16, 2014 and incorporated herein by reference)
  - 10.33 Agreement of Lease (Amendment and Restatement) between 290 National Road Limited Partnership and FARO Technologies, Inc., dated as of September 9, 2014 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed September 12, 2014 and incorporated herein by reference)
  - 10.34 Employment Agreement between FARO Technologies, Inc. and Peter G. Abram, dated March 7, 2014 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed March 10, 2014 and incorporated herein by reference)\*
  - 21.1 List of Subsidiaries
  - 23.1 Consent of Grant Thornton LLP
  - 24.1 Power of Attorney relating to subsequent amendments (included on the signature page(s) of this report).
  - 31-A Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - 31-B Certification of the Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - 32-A Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32-B Certification of the Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  
99.1 Properties

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Calculation Linkbase

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Labels Linkbase Document

101.PRE XBRL Taxonomy Presentation Linkbase Document

\* Indicates management contracts and compensatory plans and arrangements