FARO TECHNOLOGIES INC
Form 10-Q
August 01, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
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	59-3157093
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
250 Technology Park, Lake Mary, Florida	32746
(Address of Principal Executive Offices)	(Zip Code)

(407) 333-9911
(Registrant’s Telephone Number, including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨
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 x NO ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” “and emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)		o

Smaller reporting company

Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

There were 16,708,033 shares of the registrant’s common stock outstanding as of July 25, 2017.

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Quarterly Report on Form 10-Q
Quarter Ended June 30, 2017
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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	June 30, 2017 (unaudited)	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 117,594	$ 106,169
Short-term investments	21,970	42,942
Accounts receivable, net	58,805	61,364
Inventories, net	57,866	51,886
Prepaid expenses and other current assets	22,989	16,304
Total current assets	279,224	278,665
Property and equipment:		
Machinery and equipment	62,937	57,063
Furniture and fixtures	7,156	6,099
Leasehold improvements	19,400	18,778
Property and equipment, at cost	89,493	81,940
Less: accumulated depreciation and amortization	(57,138)	(50,262)
Property and equipment, net	32,355	31,678
Goodwill	51,417	46,744
Intangible assets, net	23,313	22,279
Service and sales demonstration inventory, net	35,259	29,136
Deferred income tax assets, net	14,442	14,307
Other long-term assets	1,058	905
Total assets	$ 437,068	$ 423,714
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 12,651	$ 11,126
Accrued liabilities	25,619	24,572
Income taxes payable	—	618
Current portion of unearned service revenues	29,358	27,422
Customer deposits	2,883	2,872
Total current liabilities	70,511	66,610
Unearned service revenues - less current portion	12,832	13,813
Deferred income tax liabilities	1,570	1,409
Other long-term liabilities	2,664	2,225
Total liabilities	87,577	84,057
Commitments and contingencies - See Note 16		
Shareholders' equity:		
Common stock - par value $.001, 50,000,000 shares authorized; 18,194,509 and 18,170,267 issued, respectively; 16,708,033 and 16,680,791 outstanding, respectively	18	18
Additional paid-in capital	216,511	212,602
Retained earnings	178,053	183,436
Accumulated other comprehensive loss	(13,262)	(24,561)
Common stock in treasury, at cost; 1,486,476 and 1,489,476 shares, respectively	(31,829)	(31,838)

Total shareholders’ equity	349,491	339,657
Total liabilities and shareholders’ equity	$ 437,068	$ 423,714

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

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(in thousands, except share and per share data)	Three Months Ended June 30, 2017	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	Six Months Ended June 30, 2016
Sales				
Product	$62,533	$ 61,640	$124,913	$120,952
Service	20,149	16,898	39,331	33,334
Total sales	82,682	78,538	164,244	154,286
Cost of Sales				
Product	24,455	25,062	51,513	49,058
Service	11,467	9,542	22,222	18,623
Total cost of sales (exclusive of depreciation and amortization, shown separately below)	35,922	34,604	73,735	67,681
Gross Profit	46,760	43,934	90,509	86,605
Operating Expenses:				
Selling and marketing	26,022	18,715	48,894	36,618
General and administrative	11,877	10,242	22,576	20,392
Depreciation and amortization	3,989	3,266	7,707	6,352
Research and development	9,045	7,214	17,511	14,416
Total operating expenses	50,933	39,437	96,688	77,778
(Loss) income from operations	(4,173)	4,497	(6,179)	8,827
Other (income) expense				
Interest income, net	(89)	(54)	(171)	(98)
Other expense, net	459	240	467	991
(Loss) income before income tax (benefit) expense	(4,543)	4,311	(6,475)	7,934
Income tax (benefit) expense	(918)	919	(1,389)	1,462
Net (loss) income	$(3,625)	$ 3,392	$(5,086)	$6,472
Net (loss) income per share - Basic	$(0.22)	$ 0.20	$(0.30)	$0.39
Net (loss) income per share - Diluted	$(0.22)	$ 0.20	$(0.30)	$0.39
Weighted average shares - Basic	16,700,718	16,659,115	16,692,500	16,634,323
Weighted average shares - Diluted	16,700,718	16,672,600	16,692,500	16,654,415

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

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended		Six Months Ended	
(in thousands)	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Net (loss) income	$(3,625)	$3,392	$(5,086)	$6,472
Currency translation adjustments, net of income tax	7,140	(1,795)	11,299	4,826
Comprehensive income	$3,515	$1,597	$6,213	$11,298

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

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Six Months Ended	
(in thousands)	June 30, 2017	June 30, 2016
Cash flows from:		
Operating activities:		
Net (loss) income	$(5,086)	$6,472
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Depreciation and amortization	7,707	6,352
Stock-based compensation	3,195	2,731
Provision for bad debts	230	574
Loss on disposal of assets	122	305
Provision for excess and obsolete inventory	736	1,440
Deferred income tax expense (benefit)	168	(261)
Income tax benefit from exercise of stock options	—	(70)
Change in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	4,771	13,818
Inventories	(10,107)	(4,918)
Prepaid expenses and other current assets	(6,489)	2,115
(Decrease) increase in:		
Accounts payable and accrued liabilities	1,610	(1,596)
Income taxes payable	(590)	522
Customer deposits	(163)	(870)
Unearned service revenues	(472)	1,114
Net cash (used in) provided by operating activities	(4,368)	27,728
Investing activities:		
Proceeds from sale of short-term investments	21,000	—
Purchases of property and equipment	(3,669)	(2,580)
Payments for intangible assets	(645)	(712)
Acquisition of business	(5,496)	—
Net cash provided by (used in) investing activities	11,190	(3,292)
Financing activities:		
Payments on capital leases	(4)	(4)
Income tax benefit from exercise of stock options	—	70
Proceeds from issuance of stock, net	284	513
Net cash provided by financing activities	280	579
Effect of exchange rate changes on cash and cash equivalents	4,323	1,170
Increase in cash and cash equivalents	11,425	26,185
Cash and cash equivalents, beginning of period	106,169	107,356
Cash and cash equivalents, end of period	$117,594	$133,541

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
(in thousands, except share and per share data, or as otherwise noted)

NOTE 1 – DESCRIPTION OF BUSINESS

FARO Technologies, Inc. and its subsidiaries (collectively "FARO," the "Company," "us," "we" or "our") is a global technolo company that designs, develops, manufactures, markets and supports software driven, three-dimensional ("3D") measurement, imaging and realization systems. This technology permits high-precision 3D measurement, imaging and comparison of parts and complex structures within production and quality assurance processes. Our devices are used for inspection of components and assemblies, rapid prototyping, reverse engineering, documenting large volume or structures in 3D, surveying and construction, as well as for investigation and reconstruction of accident sites or crime scenes. We sell the majority of our products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building information modeling, construction, public safety forensics, cultural heritage and other applications. Our FaroArm®, FARO Laser ScanArm®, FARO Gage®, FARO Laser Tracker™, FARO Laser Projector, FARO Cobalt Array Imager, and their companion CAM2® and BuildIT software solutions, provide for Computer-Aided Design ("CAD") based inspection, factory-level statistical process control, high-density surveying and laser-guided assembly and production. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD and 3D software to improve productivity, enhance product quality, and decrease rework and scrap in the manufacturing process, mainly supporting applications in our Factory Metrology vertical. Our FARO Focus and FARO Scanner Freestyle^{3D}X laser scanners, and their companion SCENE, FARO PointSense, and FARO public safety forensics software offerings, are utilized for a wide variety of 3D modeling, documentation and high-density surveying applications in our Construction Building Information Modeling-Construction Information Management ("Construction BIM-CIM") and Public Safety Forensics verticals. Our FARO Laser ScanArm®, FARO Cobalt Array Imager, FARO Scanner Freestyle^{3D}X laser scanners and their companion SCENE software also enable a fully digital workflow used to capture real world geometry for the purpose of empowering design, enabling innovation, and speeding up the design cycle, supporting our Product Design vertical. FARO Visual Inspect™ enables large, complex 3D CAD data to be transferred to a tablet device and then used for mobile visualization and comparison to real world conditions, facilitating in-process inspection, assembly, guidance and positioning for applications in our Factory Metrology and Construction BIM-CIM verticals. Our line of galvanometer-based scan heads and laser scan controllers are used in a variety of laser applications and are integrated into larger components and systems.

We report our segment information in accordance with the provisions of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 280, Segment Reporting ("FASB ASC Topic 280"). During fiscal 2016, we evaluated our reportable segments based on our new internal management structure organized around operating activities and the changes implemented in connection with our initiatives to reorganize our business around certain vertical markets. We evaluate business performance based upon several metrics, using revenue growth and segment profit as the primary financial measures. As a result of this assessment, we now report our activities in the following three reportable segments:

- The Factory Metrology reporting segment provides solutions for manual and automated measurement and inspection in an industrial or manufacturing environment. Applications include alignment, part inspection, dimensional analysis, first article inspection, incoming and in-process inspection, machine calibration, non-contact inspection, robot calibration, tool building and set-up, and assembly guidance.
- The Construction BIM-CIM reporting segment provides solutions for as-built data capturing and 3D visualization in building information modeling and construction information management applications, allowing our customers in the architecture, engineering and construction markets to quickly and accurately extract two-dimensional ("2D") and 3D measurement points. Applications include as-built documentation, construction monitoring, surveying, asset and facility management, and heritage preservation.
- The Other reporting segment includes our Product Design, Public Safety Forensics and 3D Solutions operating segments. Our Product Design operating segment provides advanced 3D solutions to assist in the engineering or

design of a movable object, enabling a full digital workflow for applications that include reverse engineering and virtual simulation. Our Public Safety Forensics operating segment provides solutions to public safety officials and professionals to capture environmental or situational scenes in 2D and 3D for crime, crash and fire scene investigations and environmental safety evaluations. Our 3D Solutions operating segment provides solutions to customers who require customized 3D measurement and realization solutions not otherwise addressed by our off-the-shelf product offerings.

All operating segments that do not meet the criteria to be reportable segments are aggregated in the Other reporting segment and have been combined based on the aggregation criteria and quantitative thresholds in accordance with the provisions of FASB ASC Topic 280. There has been no change in our total consolidated financial condition or results of operations previously reported as a result of the change in our reportable segments. The amounts related to our segment information for the three and six months ended June 30, 2016 have been restated throughout this Quarterly Report on Form 10-Q to reflect the change in reporting segments. Each of our reporting segments employs consistent accounting policies. See Note 15 – Segment Reporting for further information.

NOTE 2 – PRINCIPLES OF CONSOLIDATION

Our condensed consolidated financial statements 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 our 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 loss. Foreign currency transaction gains and losses are included in income.

NOTE 3 – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements and notes thereto have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. These condensed consolidated financial statements include all normal recurring accruals and adjustments considered necessary by management for a fair presentation in conformity with U.S. GAAP. Preparing financial statements 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 materially from those estimates. The condensed consolidated results of operations for the six months ended June 30, 2017 are not necessarily indicative of results that may be expected for the year ending December 31, 2017 or any future interim period.

The information included in this Quarterly Report on Form 10-Q, including the interim condensed consolidated financial statements and the accompanying notes, should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. The accompanying December 31, 2016 condensed consolidated balance sheet has been derived from those audited consolidated financial statements.

NOTE 4 – RECLASSIFICATIONS

Certain prior period amounts have been reclassified in the accompanying condensed consolidated financial statements to conform to the current period presentation. For example, certain prior period stock compensation expenses were reclassified between cost of product sales, cost of service sales, selling and marketing, general and administrative, and research and development expenses in the accompanying condensed consolidated financial statements to reflect the appropriate departmental costs. In addition, other amounts have been reclassified in the accompanying condensed consolidated financial statements to conform to the current period presentation as a result of the adoption of various new accounting pronouncements. See Note 5 – Impact of Recently Issued Accounting Pronouncements for further details.

NOTE 5 – IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In January 2017, the FASB issued Accounting Standards Update (“ASU”) No. 2017-04, Intangible - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment (“ASU 2017-04”), which is intended to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under the current guidance, performance of Step 2 requires us to calculate the implied fair value of goodwill by following procedures that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Under the new guidance, we will perform our goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge will be recognized for the amount by which the carrying amount exceeds the reporting unit’s fair value up to the amount of the goodwill allocated to the reporting unit.

The new guidance also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform Step 2 of the goodwill impairment test if it fails the qualitative assessment. As a result, all reporting units will be subject to the same impairment assessment. We will still have the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary.

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ASU 2017-04 becomes effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted for annual or any interim goodwill impairment tests after January 1, 2017. The amendments in this ASU will be applied on a prospective basis. Disclosure of the nature and reason for the change in accounting principal is required upon transition. This disclosure is required in the first annual period and in the interim period within the first annual period when we initially adopt the amendments in this ASU. We do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business ("ASU 2017-01") in order to clarify the definition of a business and provide additional guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Currently, ASC Topic 805 recognizes three elements of a business: inputs, processes, and outputs. While an integrated set of assets and activities (collectively referred to as a "set") that is a business usually has outputs, outputs are not required to be present. Additionally, all the inputs and processes that a seller uses in operating a set are not required if market participants can acquire the set and continue to produce outputs. ASU 2017-01 provides a screen to determine when a set is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. If the screen is not met, the new guidance (1)requires that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) removes the evaluation of whether a market participant could replace missing elements. The new guidance provides a framework to assist entities in evaluating whether both an input and a substantive process are present. This framework includes two sets of criteria to consider that depend on whether a set has outputs. Although outputs are not required for a set to be a business, outputs generally are a key element of a business. ASU 2017-01 provides more stringent criteria for sets without outputs and more narrowly defines the term output.

ASU 2017-01 becomes effective for annual periods beginning after December 15, 2017, including interim periods within those periods, and will be applied prospectively commencing on the effective date. No disclosures are required at transition. Early application is permitted under certain circumstances. We do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory ("ASU 2016-16"), which removes the prohibition in ASC Topic 740, Income Taxes, against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. This ASU requires the tax effects of intercompany transactions, other than sales of inventory, to be recognized when the transfer occurs, instead of deferred until the transferred asset is sold to a third party or otherwise recovered through use of the asset. The new guidance must be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption and is effective for annual periods beginning after December 15, 2017, and interim periods therein, with early adoption permitted. We do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"), which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, and interim periods therein. Early adoption is permitted. We do not expect that the adoption of this guidance will have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02"), which is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 must be applied on a modified retrospective basis and is effective for fiscal years beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. We are currently evaluating the impact of adopting this standard on our consolidated financial statements and related disclosures.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers: (Topic 606) ("ASU 2014-09"), amending its accounting guidance related to revenue recognition. Under this ASU and subsequently issued amendments, 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. Additional disclosures are required to provide 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 ASU and subsequently issued amendments to it are effective for us on January 1, 2018 and permit the use of either the retrospective or cumulative-effect transition method.

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We currently plan to adopt this guidance utilizing the cumulative-effect transition method and plan to apply the cumulative-effect transition method only to contracts that are not completed as of the date of initial adoption, an option that is available under ASC Topic 606. We are continuing to evaluate the expected impact of the new revenue guidance contained in ASC Topic 606 on our consolidated financial statements. We currently expect to complete this assessment of the full financial impact of the new revenue recognition guidance during the second half of 2017.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”), simplifying several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 became effective for annual periods beginning after December 15, 2016, and interim periods therein (our fiscal year 2017). We adopted ASU 2016-09 effective January 1, 2017. Under the new guidance, excess tax benefits that were not previously recognized because the related tax deduction had not reduced current taxes payable are to be recorded on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period in which the new guidance is adopted. Historically, we recognized all excess tax benefits when an option was exercised or a share vested since we did not have a U.S. net operating loss carryforward. Therefore, no adjustment to retained earnings for prior excess tax benefits was required upon adoption.

Under the new guidance, all tax-related cash flows resulting from share-based payments are reported as operating activities in the statement of cash flows. This approach incorporates the net of the inflow and outflow from all tax-related cash flows resulting from share-based payments in the deferred income tax (benefit) expense line item and presents it along with other income tax cash flows as operating activities in the statement of cash flows. Effective January 1, 2017, we adopted this portion of the guidance on a prospective basis and therefore did not restate the prior period's condensed consolidated statement of cash flows.

We also elected to account for forfeitures related to the service condition-based awards as they occur effective January 1, 2017, which is a change from previous guidance, which required an estimate of forfeitures. However, we continue to assess performance condition-based awards quarterly as required. In adopting the new policy using a modified retrospective approach, we assessed the cumulative effect adjustment and recorded to retained earnings the difference between the amount of compensation cost previously recorded and the amount that would have been recorded without assuming forfeitures. The cumulative effect adjustment recorded to retained earnings, net of income tax benefit, was not material.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes (“ASU 2015-17”), which requires that deferred tax liabilities and assets be classified as noncurrent in a classified balance sheet. ASU 2015-17 became effective for us on January 1, 2017. We adopted this guidance on a retrospective basis, which resulted in the reclassification of current deferred tax assets totaling approximately $7.6 million as of December 31, 2016 from current to non-current in these condensed consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory (“ASU 2015-11”), which changes the measurement principle for inventory from the lower of cost or market to the lower of cost or net realizable value. ASU 2015-11 defines net realizable value as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new guidance must be applied on a prospective basis and became effective for fiscal years beginning after December 15, 2016 (i.e., our fiscal year 2017), and interim periods within those years, with early adoption permitted. We adopted ASU 2015-11 effective January 1, 2017. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

NOTE 6 – STOCK-BASED COMPENSATION

Stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date and is recognized over the requisite service period.

We have three 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 “Board”). 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. In May 2014, our shareholders approved the 2014 Plan, authorizing us 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. We will not make any further grants under the 2004 Plan or the 2009 Plan.

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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, the non-employee directors are granted restricted shares with a value equal to $100,000 on the first business day following the annual meeting of shareholders, calculated using the closing price of our common stock on that day. In addition, the Lead Director is annually granted restricted shares with a value equal to $40,000 on the first business day following the annual meeting of shareholders, calculated using the closing price of our common stock on that day. The shares of restricted stock granted annually to our non-employee directors and our Lead Director 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. We record compensation cost associated with our restricted stock grants on a straight-line basis over the vesting term.

Annually, upon approval by our Compensation Committee, we grant stock options and restricted stock units to certain employees. We also grant stock options and restricted stock units to certain new employees throughout the year. The fair value of these stock-based awards is determined by using (a) the current market price of our common stock on the grant date in the case of restricted stock units or (b) the Black-Scholes option valuation model in the case of stock options.

Our annual grants in March 2017 and March 2016 consisted of stock options and restricted stock units that are subject to only time-based vesting. The number of stock options and/or restricted stock units granted was based on the employee's individual objectives, performance against operational metrics assigned to the employee and overall contribution over the last year. The stock options vest in three equal annual installments beginning one year after the grant date. The restricted stock unit awards vest in full on the three-year anniversary of the grant date. The fair value of these stock-based awards is determined by using (a) the Black-Scholes option valuation model in the case of stock options or (b) the current market price of our common stock on the grant date in the case of restricted stock units.

In 2015, we granted performance-based stock options and restricted stock units to certain executives. These awards vest in three annual installments beginning one year after the grant date if the applicable performance measures or strategic objectives are achieved. The related stock-based compensation expense is recognized over the requisite service period, taking into account the probability that we will satisfy the performance measures or strategic objectives. In addition to certain strategic objectives, the performance-based stock options and restricted stock units granted in 2015 are earned and vest based upon (1) our achievement of specified revenue and earnings per share targets, and (2) our total shareholder return ("TSR") relative to the TSR attained by companies within our defined peer group.

Due to the application of TSR to certain performance-based grants, the fair value of these awards is determined using the Monte Carlo Simulation valuation model. We expense these market condition awards over the three-year vesting period regardless of the value the award recipients ultimately receive. In February 2017, our Compensation Committee determined that 9,616 performance-based stock options and 300 restricted stock units were earned for the 2016 performance period and 19,362 stock options and 604 restricted stock units were unearned, as the required metrics were not achieved.

The Black-Scholes option valuation model incorporates assumptions as to stock price volatility, the expected life of options or awards, a risk-free interest rate and dividend yield. The weighted-average grant-date fair value of the stock options that were granted during the six months ended June 30, 2017 and June 30, 2016 and valued using the Black-Scholes option valuation model was $14.51 and $12.37 per option, respectively. For stock options granted during the six months ended June 30, 2017 and June 30, 2016 valued using the Black-Scholes option valuation model, we used the following assumptions:

	Six Months Ended	
	June 30, 2017	June 30, 2016
Risk-free interest rate	1.88% - 2.02%	1.06% - 1.21%
Expected dividend yield	— %	— %
Expected term of option	5 years	4 years

Expected volatility	45.2 %	46.7% - 47%
Weighted-average expected volatility	45.2 %	46.7 %

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 the 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 during the six months ended June 30, 2017 follows:

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	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value as of June 30, 2017
Outstanding at January 1, 2017	1,090,160	$ 48.02		
Granted	267,039	34.79		
Forfeited or expired	(25,988)	59.97		
Exercised	(11,401)	24.93		
Unearned performance-based options	(19,362)	47.33		
Outstanding at June 30, 2017	1,300,448	$ 45.34	4.5	$ 2,119
Options exercisable at June 30, 2017	966,617	$ 42.78	3.3	$ 538

The total intrinsic value of stock options exercised during each of the three months ended June 30, 2017 and June 30, 2016 was less than $0.1 million. For the six months ended June 30, 2017 and June 30, 2016, the total intrinsic value of stock options exercised in the respective period was $0.1 million and $1.7 million.

The fair value of stock options vested during each of the three months ended June 30, 2017 and June 30, 2016 was less than $0.1 million. The fair value of stock options vested during the six months ended June 30, 2017 and June 30, 2016 was $2.9 million and $3.4 million, respectively.

The following table summarizes the restricted stock and restricted stock unit activity and weighted average grant-date fair values for the six months ended June 30, 2017:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at January 1, 2017	150,682	$ 33.39
Granted	152,207	35.42
Forfeited	(21,101)	33.65
Vested	(10,682)	33.50
Unearned performance-based awards	(604)	52.83
Non-vested at June 30, 2017	270,502	$ 34.47

We recorded total stock-based compensation expense of $1.8 million and $1.2 million for the three months ended June 30, 2017 and June 30, 2016, respectively, and $3.2 million and $2.7 million for the six months ended June 30, 2017 and June 30, 2016, respectively.

As of June 30, 2017, there was $13.4 million of 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 2.2 years.

NOTE 7 – CASH AND CASH EQUIVALENTS

We consider cash on hand and all short-term, highly liquid investments that have original maturities of three months or less at the time of purchase to be cash and cash equivalents.

NOTE 8 – SHORT TERM INVESTMENTS

Short-term investments at June 30, 2017 consisted of U.S Treasury Bills totaling $22.0 million that mature through September 14, 2017. Short-term investments at December 31, 2016 consisted of U.S. Treasury Bills totaling $42.9 million that matured through June 15, 2017. 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, which approximates fair value. The fair value of the U.S. Treasury Bills at June 30, 2017 and December 31, 2016 were classed as Level 1, as they are traded with sufficient frequency and volume to enable us to obtain pricing information on an ongoing basis. For further discussion of fair value, refer to Note 14 – Fair Value of Financial Instruments.

NOTE 9 – ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

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	As of June 30, 2017	As of December 31, 2016
Accounts receivable	$60,720	$ 63,193
Allowance for doubtful accounts	(1,915)	(1,829)
Total	$58,805	$ 61,364

NOTE 10 – INVENTORIES

Inventories are stated at the lower of cost or net realizable value using the first-in first-out (FIFO) method. We have three principal categories of inventory: 1) manufactured product to be sold; 2) sales demonstration inventory - completed product used to support our sales force and demonstrations; and 3) service inventory - completed product and parts used to support our service department. Shipping and handling costs are classified as a component of cost of sales in our condensed consolidated statements of operations.

Sales demonstration inventory is held by our sales representatives for up to three years, at which time it would be refurbished and transferred to finished goods as used equipment, stated at the lower of cost or net realizable value. Management expects these refurbished units to remain in finished goods inventory and to be sold within 12 months at prices that may produce reduced gross margins.

Service inventory is used to provide a temporary replacement product to a customer covered by a premium warranty when the customer’s unit requires service or repair and as training equipment. Service inventory is available for sale; however, management does not expect service inventory to be sold within 12 months and, as such, classifies this inventory as a long-term asset. Service inventory that we utilize for training or repairs and which we deem as no longer available for sale is transferred to fixed assets at the lower of cost or net realizable value and depreciated over the remaining life, typically three years.

Inventories consist of the following:

	As of June 30, 2017	As of December 31, 2016
Raw materials	$44,489	$ 36,760
Finished goods	13,377	15,126
Inventories, net	$57,866	$ 51,886
Service and sales demonstration inventory, net	$35,259	$ 29,136

NOTE 11 – EARNINGS PER SHARE

Basic earnings per share is computed by dividing net (loss) or income by the weighted average number of shares outstanding. Diluted earnings per share is computed by also considering the impact of potential common stock on both net income and the weighted average number of shares outstanding. Our potential common stock consists of employee and director stock options, restricted stock units and performance-based awards. Our potential common stock is included in the diluted earnings per share calculation when doing so would not be anti-dilutive. Performance-based awards are included in the computation of diluted earnings per share only to the extent that the underlying performance conditions (and any applicable market condition) (i) are satisfied as of the end of the reporting period or (ii) would be considered satisfied if the end of the reporting period were the end of the related contingency period and the result would be dilutive under the treasury stock method. When we report a net loss, which we did for the three months ended June 30, 2017 and for the six months ended June 30, 2017, the calculation of diluted net loss per share excludes our potential common stock, as the effect would be anti-dilutive.

For the three and six months ended June 30, 2017, there were approximately 1,265,885 and 1,221,308 shares, respectively, issuable upon the exercise of options and the contingent vesting of performance-based awards that were excluded from the dilutive calculations, as they were anti-dilutive. For the three and six months ended June 30, 2016, there were approximately 1,046,201 and 1,075,373, respectively, additional shares issuable upon the exercise of options and the contingent vesting of performance-based awards that were excluded from the dilutive calculations, as

they were anti-dilutive.
A reconciliation of the number of common shares used in the calculation of basic and diluted earnings per share (“EPS”) is presented below:

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	Three Months Ended			
	June 30, 2017		June 30, 2016	
	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	16,700,718	$ (0.22)	16,659,115	$ 0.20
Effect of dilutive securities	—	—	13,485	—
Diluted EPS	16,700,718	$ (0.22)	16,672,600	$ 0.20

	Six months ended			
	June 30, 2017		June 30, 2016	
	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	16,692,500	$ (0.30)	16,634,323	$ 0.39
Effect of dilutive securities	—	—	20,092	—
Diluted EPS	16,692,500	$ (0.30)	16,654,415	$ 0.39

NOTE 12 – ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	As of June 30, 2017	As of December 31, 2016
Accrued compensation and benefits	$14,336	$ 13,649
Accrued warranties	2,570	2,594
Professional and legal fees	1,784	1,775
Taxes other than income	3,517	4,026
Other accrued liabilities	3,412	2,528
	$25,619	$ 24,572

Activity related to accrued warranties was as follows:

	Six Months Ended	
	June 30, 2017	June 30, 2016
Balance, beginning of period	$2,594	$2,309
Provision for warranty expense	1,824	1,335
Fulfillment of warranty obligations	(1,848)	(1,244)
Balance, end of period	$2,570	$2,400

NOTE 13 – INCOME TAXES

For the three months ended June 30, 2017, we recorded an income tax benefit of $0.9 million compared with income tax expense of $0.9 million for the three months ended June 30, 2016. This change of $1.8 million was due to a pretax loss during the second quarter of 2017 compared to pretax income in the same period of 2016. Our effective tax rate was 20.2% for the three months ended June 30, 2017 compared with 21.3% in the prior year period. The decrease in our effective tax rate was primarily due to a shift in the geographic mix of pretax income expected for the full year 2017. For the six months ended June 30, 2017, we recorded an income tax benefit of $1.4 million compared with income tax expense of $1.5 million for the six months ended June 30, 2016. This change of $2.9 million was due to a pretax loss during the six months ended June 30, 2017 compared to pretax income in the same period of 2016. Our effective tax rate increased by 3.1 percentage points to 21.5% for the six months ended June 30, 2017 from 18.4% for the same period of 2016. The increase was primarily driven by the shift in the geographic mix of pretax income. Our effective tax rate continued to be lower than the statutory tax rate in the United States, mainly due to our global footprint in foreign jurisdictions with lower tax rates. However, our effective tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of our products and the resulting effect on taxable income in each jurisdiction.

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NOTE 14 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Our financial instruments include cash and cash equivalents, short-term investments, accounts receivable, customer deposits, accounts payable and accrued liabilities. The carrying amounts of such financial instruments approximate their fair value due to the short-term nature of these instruments.

Assets and liabilities measured at fair value on a recurring basis are categorized in the tables below based upon the lowest level of significant input to the valuations:

	As of June 30, 2017		
	Level 1	Level 2	Level 3
Assets:			
Short-term investments (1)	$21,970	$ —	$ —
Total	$21,970	$ —	$ —
Liabilities:			
Contingent consideration (2)	$ —	$ —	$2,100
Total	$ —	$ —	$2,100

	As of December 31, 2016		
	Level 1	Level 2	Level 3
Assets:			
Short-term investments (1)	$42,942	$ —	$ —
Total	$42,942	$ —	$ —
Liabilities:			
Contingent consideration (2)	$ —	$ —	$2,100
Total	$ —	$ —	$2,100

(1) Short-term investments in the accompanying consolidated balance sheets are six-month U.S. Treasury Bills. The fair values of these assets are based on Level 1 inputs in the fair value hierarchy.

(2) Contingent consideration liability represents arrangements to pay the former owners of certain companies we acquired. The remaining undiscounted maximum payment under the arrangements is $6.1 million. We estimated the fair value of the contingent consideration using a Monte Carlo Simulation, which is based on significant inputs, primarily forecasted future results of the acquired businesses not observable in the market, and thus represents a Level 3 measure. During the six months ended June 30, 2017, we made no payments as part of these arrangements. During the six months ended June 30, 2016, we paid $0.1 million as part of these arrangements.

NOTE 15 – SEGMENT REPORTING

We have three reportable segments; Factory Metrology, Construction BIM-CIM, and Other. These segments are based upon the vertical markets that we currently serve. Business activities that do not meet the criteria to be reportable segments are aggregated in the Other category.

We develop, manufacture, market, support and sell CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software and three-dimensional documentation systems in each of these reportable segments. These activities represent more than 99% of consolidated sales.

Our Chief Operating Decision Maker (CODM), our Chief Executive Officer, evaluates segment performance and allocates resources based upon profitable growth. We use segment profit to evaluate the performance of our reportable segments. Segment profit is calculated as gross profit, net of selling and marketing expenses, for the reporting segment. Our definition of segment profit may not be comparable to similarly-titled measures reported by other companies.

Our segment structure presented below represents a change from geographic segments due to the reorganization which took place in the year ended December 31, 2016. The amounts for the three and six months ended June 30, 2016 have been restated to reflect the change in reporting segments. Each of our segments employs consistent accounting

policies.
The following tables present information about our reportable segments, including a reconciliation of total segment profit to (Loss) Income from Operations included in the condensed consolidated statements of operations for the three and six months ended June 30, 2017 and 2016:

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Three Months Ended June 30, 2017	Factory Metrology	Construction BIM-CIM	Other	Total
Total sales	$ 57,209	$ 18,859	$ 6,614	$ 82,682
Segment profit (loss)	$ 16,696	$ 4,314	$ (272)	$ 20,738
General and administrative				11,877
Depreciation and amortization				3,989
Research and development				9,045
Loss from operations				$ (4,173)

Three Months Ended June 30, 2016	Factory Metrology	Construction BIM-CIM	Other	Total
Total sales	$ 56,151	$ 16,659	$ 5,728	$ 78,538
Segment profit	$ 18,559	$ 4,284	$ 2,376	$ 25,219
General and administrative				10,242
Depreciation and amortization				3,266
Research and development				7,214
Income from operations				$ 4,497

Six Months Ended June 30, 2017	Factory Metrology	Construction BIM-CIM	Other	Total
Total sales	$ 114,190	$ 37,800	$ 12,254	$ 164,244