HESKA CORP
Form 10-Q
August 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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, 2013

OR

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

For the transition period from _____ to _____

Commission file number: 000-22427

HESKA CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	77-0192527
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
3760 Rocky Mountain Avenue Loveland, Colorado (Address of principal executive offices)	80538 (Zip Code)

Registrant's telephone number, including area code: (970) 493-7272

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate 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 o

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

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

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

The number of shares of the Registrant's Public Common Stock outstanding at August 13, 2013 was 5,826,079.

TABLE OF CONTENTS

trademarks and trade names of other organizations.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(amounts in thousands except shares and per share amounts)
(unaudited)

ASSETS

	December 31, 2012	June 30, 2013
Current assets:		
Cash and cash equivalents	$ 5,784	$ 5,410
Accounts receivable, net of allowance for doubtful accounts of $155 and $214, respectively	11,044	8,393
Inventories, net	12,483	14,300
Deferred tax asset, current	1,130	238
Other current assets	2,514	1,055
Total current assets	32,955	29,396
Property and equipment, net	6,005	7,044
Note receivable – related party	—	1,379
Goodwill and other intangible assets	1,120	21,641
Deferred tax asset, net of current portion	26,746	29,215
Other long-term assets	—	70
Total assets	$ 66,826	$ 88,745
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,298	$ 5,721
Accrued liabilities	4,132	4,882
Current portion of deferred revenue	2,407	3,644
Line of credit	2,552	1,991
Other short-term borrowings, including current portion of long-term note payable	—	986
Total current liabilities	14,389	17,224
Long-term note payable, net of current portion	—	435
Deferred revenue, net of current portion, and other	3,575	9,405
Total liabilities	17,964	27,064
Commitments and contingencies		
Non-Controlling Interest	—	12,551
Public Common Stock subject to redemption	—	2,888
Stockholders' equity:		
Preferred stock, $.01 par value, 2,500,000 shares authorized; none issued or outstanding	—	—
	—	—

Common stock, $.01 par value, 7,500,000 shares authorized; none issued or outstanding		
Public common stock, $.01 par value, 7,500,000 shares authorized, 5,372,336 and 5,811,889 shares issued and outstanding, respectively	54	58
Additional paid-in capital	218,544	219,578
Accumulated other comprehensive income	296	216
Accumulated deficit	(170,032)	(173,610)
Total stockholders' equity	48,862	46,242
Total liabilities and stockholders' equity	$ 66,826	$ 88,745

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Revenue, net				
Core companion animal health	$ 15,701	$ 15,851	$ 32,281	$ 31,500
Other vaccines, pharmaceuticals and products	2,570	2,410	5,165	5,740
Total revenue, net	18,271	18,261	37,446	37,240
Cost of revenue	10,223	13,241	20,475	24,418
Gross profit	8,048	5,020	16,971	12,822
Operating expenses:				
Selling and marketing	4,751	4,838	9,639	9,963
Research and development	203	483	537	873
General and administrative	2,711	3,277	5,330	6,246
Total operating expenses	7,665	8,598	15,506	17,082
Operating income (loss)	383	(3,578)	1,465	(4,260)
Interest and other (income) expense, net	(57)	52	85	41
Income (loss) before income taxes	440	(3,630)	1,380	(4,301)
Income tax expense (benefit):				
Current tax expense	34	59	82	65
Deferred tax expense (benefit)	144	(1,222)	452	(1,547)
Total income tax expense (benefit)	178	(1,163)	534	(1,482)
Net income (loss)	$ 262	$ (2,467)	$ 846	$ (2,819)
Net income (loss) attributable to non-controlling interest	—	(239)	—	(205)
Net income (loss) attributable to Heska Corporation	$ 262	$ (2,228)	$ 846	$ (2,614)
Basic net income (loss) per share attributable to Heska Corporation	$ 0.05	$ (0.38)	$ 0.16	$ (0.46)
Diluted net income (loss) per share attributable to Heska Corporation	$ 0.05	$ (0.38)	$ 0.15	$ (0.46)
Weighted average outstanding shares used to compute basic net income (loss) per share attributable to Heska Corporation	5,327	5,804	5,296	5,676
Weighted average outstanding shares used to compute diluted net income (loss) per share attributable to Heska Corporation	5,583	5,804	5,517	5,676

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	Three Months Ended June 30		Six Months Ended June 30,	
	2012	2013	2012	2013
Net income (loss)	$ 262	$ (2,467)	$ 846	$ (2,819)
Other comprehensive income (expense):				
Foreign currency translation	(144)	13	(36)	(94)
Unrealized gain on available for sale investments	—	13	—	13
Comprehensive income (loss)	$ 118	$ (2,441)	$ 810	$ (2,900)
Comprehensive income (loss) attributable to non-controlling interest	$ —	$ (239)	$ —	$ (205)
Comprehensive income (loss) attributable to Heska Corporation	$ 118	$ (2,202)	$ 810	$ (2,695)

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30,	
	2012	2013
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net income (loss)	$ 846	$ (2,819)
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Depreciation and amortization	861	1,089
Deferred tax expense (benefit)	452	(1,547)
Stock-based compensation	181	231
Unrealized (gain) loss on foreign currency translation	(19)	(24)
Changes in operating assets and liabilities:		
Accounts receivable	(161)	3,157
Inventories	72	(1,143)
Other current assets	(379)	577
Other non-current assets	(92)	—
Accounts payable	(108)	(1,000)
Accrued liabilities	440	518
Deferred revenue and other liabilities	(23)	(102)
Net cash provided by (used in) operating activities	2,070	(1,063)
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:		
Investment in subsidiary	—	(3,019)
Purchase of property and equipment	(542)	(734)
Proceeds from disposition of property and equipment	—	5,020
Net cash provided by (used in) investing activities	(542)	1,267
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	295	111
Proceeds from (repayments of) line of credit borrowings, net	—	(561)
Proceeds from (repayments of) other debt	—	(105)
Dividends to shareholders	(532)	—
Net cash provided by (used in) financing activities	(237)	(555)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	1	(23)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,292	(374)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	6,332	5,784
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 7,624	$ 5,410
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Dividends payable	$ 534	$ —
Cash paid for interest	$ 56	$ 43
Non-cash transfer of inventory to property and equipment	$ 639	$ 787
Prepaid applied to acquisition of Heska Imaging	$ —	$ 1,000

See accompanying notes to condensed consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2013
(UNAUDITED)

1. ORGANIZATION AND BUSINESS

Heska Corporation ("Heska" or the "Company") develops, manufactures, markets, sells and supports veterinary products. Heska's core focus is on the canine and feline companion animal health markets.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements are the responsibility of the Company's management and have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the instructions to Form 10-Q and rules and regulations of the Securities and Exchange Commission (the "SEC"). The condensed consolidated balance sheet as of June 30, 2013, the condensed consolidated statements of operations for the three months and six months ended June 30, 2012 and 2013, the condensed consolidated statements of comprehensive income for the three months and six months ended June 30, 2012 and 2013 and the condensed consolidated statements of cash flows for the six months ended June 30, 2012 and 2013 are unaudited, but include, in the opinion of management, all adjustments (consisting of normal recurring adjustments) which the Company considers necessary for a fair presentation of its financial position, operating results and cash flows for the periods presented. All material intercompany transactions and balances have been eliminated in consolidation. Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in complete financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the SEC.

Results for any interim period are not necessarily indicative of results for any future interim period or for the entire year. The accompanying financial statements and related disclosures have been prepared with the presumption that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these financial statements should be read in conjunction with the audited financial statements and the related notes thereto for the year ended December 31, 2012, included in the Company's Annual Report on Form 10-K filed with the SEC on March 14, 2013.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenue and expense during the reported period. Actual results could differ from those estimates. Significant estimates are required when establishing the allowance for doubtful accounts and the provision for excess/obsolete inventory, in determining the period over which the Company's obligations are fulfilled under agreements to license product rights and/or technology rights, in determining the need for, and the amount of, a valuation allowance on certain deferred tax assets and in determining the need for, and the amount of, an accrued liability for future payments related to minimum purchase obligations the Company may make in order to maintain

certain product rights.

Inventories

Inventories are stated at the lower of cost or market using the first-in, first-out method. Inventory manufactured by the Company includes the cost of material, labor and overhead. If the cost of inventories exceeds estimated fair value, provisions are made to reduce the carrying value to estimated fair value.

Inventories, net consist of the following (in thousands):

	December 31, 2012	June 30, 2013
Raw materials	$ 5,275	$ 5,711
Work in process	3,342	2,548
Finished goods	4,671	7,797
Allowance for excess or obsolete inventory	(805)	(1,756)
	$ 12,483	$ 14,300

Basic and Diluted Net Income (Loss) Per Share

Basic net income (loss) per common share is computed using the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the sum of the weighted average number of shares of common stock outstanding, and, if not anti-dilutive, the effect of outstanding common stock equivalents (such as stock options and warrants) determined using the treasury stock method. For the three and six months ended June 30, 2012, the Company reported net income and therefore, dilutive common stock equivalent securities, as computed using the treasury method, were added to basic weighted average shares outstanding for the period to derive the weighted average shares for diluted earnings per share calculation. Common stock equivalent securities that were anti-dilutive for the three and six months ended June 30, 2012, and therefore excluded, were outstanding options to purchase 510,770 and 538,941 shares of common stock, respectively. These securities are anti-dilutive primarily due to exercise prices greater than the average trading price of the Company's common stock during the three and six months ended June 30, 2012. For the three and six months ended June 30, 2013, the Company reported a net loss and therefore all common stock equivalent securities would be anti-dilutive and were not included in the diluted earnings per share calculation for the period. Common stock equivalent securities that were anti-dilutive for the three months and six months ended June 30, 2013, and therefore excluded, were outstanding options to purchase 1,177,736 and 1,206,864 shares of common stock, respectively. These securities are anti-dilutive due to the Company’s net loss for the three and six months ended June 30, 2013.

3. ACQUISITION

Cuattro Veterinary USA, LLC

On February 24, 2013, the Company acquired a 54.6% interest in Cuattro Veterinary USA, LLC ("Cuattro Vet USA") for approximately $7.6 million in cash and stock, including more than $4 million in cash (the "Acquisition"). Immediately following and as a result of the transaction, former Cuattro Vet USA unit holders owned approximately 7.2% of the Company's Public Common Stock. The remaining minority position (45.4%) in Cuattro Vet USA is subject to purchase by Heska under performance-based puts and calls following calendar year 2015, 2016 and 2017. Since the exercise of any put option is out of the Company’s control, authoritative guidance requires the non-controlling interest, which includes the value of the put option, to be displayed outside of the equity section of the Company’s consolidated balance sheet. Should Heska undergo a change in control, as defined, prior to the end of

2017, Cuattro Vet USA minority unit holders will be entitled to sell their Cuattro Vet USA units to Heska at the highest call value they could have otherwise obtained. The Company's position in Cuattro Vet USA is subject to premium repurchase or discounted sale under calls and puts expiring 18 months following the closing of the transaction.

Cuattro Vet USA was subsequently renamed Heska Imaging US, LLC ("Heska Imaging") and markets, sells and supports digital radiography and ultrasound products along with embedded software and support, data hosting and other services.

Shawna M. Wilson, Clint Roth, DVM, Steven M. Asakowicz, Rodney A. Lippincott, Kevin S. Wilson and Cuattro, LLC own approximately 29.75%, 8.39%, 4.09%, 3.07%, 0.05% and 0.05% of Heska Imaging, respectively. Kevin S. Wilson is the President and Chief Operating Officer of the Company and the spouse of Shawna M. Wilson. Steven M. Asakowicz serves as Executive Vice President, Companion Animal Health Sales for the Company. Rodney A. Lippincott serves as Executive Vice President, Companion Animal Health Sales for the Company. Mr. Wilson, Mrs. Wilson and trusts for their children and family own a 100% interest in Cuattro, LLC.

The aggregate position in Heska Imaging of the unit holders who hold the 45.4% of Heska Imaging that Heska Corporation does not own (the “Put Value”) is being accreted to its estimated redemption value in accordance with Heska Imaging’s Operating Agreement. The adjustment to increase or decrease the Put Value to its expected redemption value each reporting period is recorded to retained earnings in accordance with United States Generally Accepted Accounting Principles.

The Company accounted for the acquisition pursuant to ASC No. 805, "Business Combinations." Accordingly, it recorded assets acquired, liabilities assumed and non-controlling interests at their fair values. The following summarizes the aggregate consideration paid by the Company and the allocation of the purchase price based on current estimates as the Company continues to gather information to evaluate the appropriate accounting result (in thousands):

Consideration	
Cash	$ 4,073
Stock	3,571
Total	$ 7,644
Inventories	$ 1,466
Note from Cuattro Veterinary, LLC, due March 15, 2016	1,360
Other tangible assets	1,278
Intangible assets	688
Goodwill	19,994
Notes payable and other borrowings	(1,527)
Accounts payable	(1,424)
Other assumed liabilities	(2,399)
	$ 19,436
Non-controlling interest	(11,792)
Total	$ 7,644

Intangible assets and their amortization periods are as follows:

	Useful Life (in years)	Fair Value
Trade name	2.75	$ 688
		$ 688

Cuattro Vet USA generated net revenue of $4.6 million and net loss of $450 thousand, inclusive of net loss of $205 thousand attributable to non-controlling interest, for the period from February 24, 2013 to June 30, 2013. The following unaudited pro forma financial information presents the combined results of the Company and Cuattro Vet USA as if the Acquisition had closed on January 1, 2012.

	Six Months Ended June 30,	
	2012	2013
Revenue, net	$ 40,951	$38,140
Net income (loss) attributable to Heska Corporation	535	(3,010)
Basic earnings (loss) per share attributable to Heska Corporation	$ 0.09	$ (0.53)
Diluted earnings (loss) per share attributable to Heska Corporation	0.09	(0.53)

4. CAPITAL STOCK

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model, with the following weighted average assumptions for options granted in the three and six months ended June 30, 2012 and 2013.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Risk-free interest rate	0.35%	0.46%	0.37%	0.50%
Expected lives	2.8 years	3.4 years	2.8 years	3.4 years
Expected volatility	65%	52%	65%	52%
Expected dividend yield	3.23%	0%	3.25%	0%

A summary of the Company's stock option plans, excluding options to purchase fractional shares resulting from the Company's December 2010 1-for-10 reverse stock split is as follows:

	Year Ended December 31, 2012		Six Months Ended June 30, 2013	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at beginning of period	1,448,675	$ 10.425	1,245,161	$ 11.054
Granted at market	137,950	$ 9.534	60,730	$ 8.337
Cancelled	(118,330)	$ 11.373	(153,810)	$ 11.383
Exercised	(223,134)	$ 5.863	(19,107)	$ 6.286
Outstanding at end of period	1,245,161	$ 11.054	1,132,974	$ 10.944

Exercisable at end of period	971,029	$ 12.129	911,549	$ 11.761

The estimated fair value of stock options granted during the six months ended June 30, 2013 and 2012 was computed to be approximately $506 thousand and $155 thousand, respectively. The amount is amortized ratably over the vesting period of the options. The per share weighted average estimated fair value of options granted during the six months ended June 30, 2013 and 2012 was computed to be approximately $3.12 and $4.40, respectively. The total intrinsic value of options exercised during the six months ended June 30, 2013 and 2012 was approximately $30 thousand and $990 thousand, respectively. The cash proceeds from options exercised during the six months ended June 30, 2013 and 2012 were approximately $66 thousand and $231 thousand, respectively.

The following table summarizes information about stock options outstanding and exercisable at June 30, 2013, excluding outstanding options to purchase an aggregate of 81.6 fractional shares resulting from the Company's December 2010 1-for-10 reverse stock split with a weighted average remaining contractual life of 1.69 years, a weighted average exercise price of $14.41 and exercise prices ranging from $4.40 to $31.50. The Company intends to issue whole shares only from option exercises.

	Options Outstanding			Options Exercisable	
Exercise Prices	Number of Options Outstanding at June 30, 2013	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Number of Options Exercisable at June 30, 2013	Weighted Average Exercise Price
$ 2.70 - $ 6.76	238,489	5.58	$ 5.112	201,328	$ 5.120
$ 6.77 - $ 8.55	276,232	8.16	$ 7.875	104,202	$ 7.723
$ 8.56 - $12.40	216,009	3.57	$ 9.644	203,775	$ 9.635
$12.41 - $17.17	222,136	2.41	$14.313	222,136	$14.313
$17.18 - $31.50	180,108	2.13	$20.779	180,108	$20.779
$ 2.70 - $31.50	1,132,974	4.66	$10.944	911,549	$11.761

As of June 30, 2013, there was approximately $624 thousand of total unrecognized compensation cost related to outstanding stock options. That cost is expected to be recognized over a weighted average period of 2.0 years, with approximately $149 thousand to be recognized in the six months ending December 31, 2013 and all the cost to be recognized as of May 2017, assuming all options vest according to the vesting schedules in place at June 30, 2013. As of June 30, 2013, the aggregate intrinsic value of outstanding options was approximately $424 thousand and the aggregate intrinsic value of exercisable options was approximately $356 thousand.

5. SEGMENT REPORTING

The Company is comprised of two reportable segments, Core Companion Animal Health ("CCA") and Other Vaccines, Pharmaceuticals and Products ("OVP"). The CCA segment includes diagnostic instruments and supplies as well as single use diagnostic and other tests, pharmaceuticals and vaccines, primarily for canine and feline use. The CCA segment also includes digital radiography and ultrasound products along with embedded software and support, data hosting and other services from Heska Imaging after February 24, 2013. These products are sold directly by the Company as well as through other distribution relationships. CCA segment products manufactured at the Des Moines, Iowa production facility included in our OVP segment's assets are transferred at cost and are not recorded as revenue for our OVP segment. The OVP segment includes private label vaccine and pharmaceutical production, primarily for cattle, but also for other animals including small mammals and fish. All OVP products are sold by third parties under third-party labels.

Summarized financial information concerning the Company's reportable segments is shown in the following table (in thousands):

	Core Companion Animal Health	Other Vaccines, Pharmaceuticals and Products	Total
Six Months Ended June 30, 2012:			
Total revenue	$ 32,281	$ 5,165	$ 37,446
Operating income (loss)	1,009	456	1,465
Interest expense	47	12	59
Total assets	52,041	11,145	63,186
Net assets	40,167	8,597	48,764
Capital expenditures	235	307	542
Depreciation and amortization	409	452	861
Six Months Ended June 30, 2013:			
Total revenue	$ 31,500	$ 5,740	$ 37,240
Operating income (loss)	(4,191)	(69)	(4,260)
Interest expense	128	19	147
Total assets	78,161	10,584	88,745
Net assets	38,078	8,164	46,242
Capital expenditures	361	373	734
Depreciation and amortization	696	393	1,089

	Core Companion Animal Health	Other Vaccines, Pharmaceuticals and Products	Total
Three Months Ended June 30, 2012:			
Total revenue	$ 15,701	$ 2,570	$ 18,271
Operating income (loss)	464	(81)	383
Interest expense	23	6	29
Total assets	52,041	11,145	63,186
Net assets	40,167	8,597	48,764
Capital expenditures	53	218	271
Depreciation and amortization	220	228	448
Three Months Ended June 30, 2013:			
Total revenue	$ 15,851	$ 2,410	$ 18,261
Operating income (loss)	(3,098)	(480)	(3,578)
Interest expense	77	13	90
Total assets	78,161	10,584	88,745
Net assets	38,078	8,164	46,242
Capital expenditures	52	365	417

Depreciation and amortization	417	198	615

Item 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with "Selected Consolidated Financial Data" and the Unaudited Condensed Consolidated Financial Statements and related Notes included in Part I Item 1 of this Form 10-Q.

This discussion contains forward-looking statements that involve risks and uncertainties. Such statements, which include statements concerning future revenue sources and concentration, gross profit margins, selling and marketing expenses, general and administrative expenses, research and development expenses, capital resources, capital expenditures and additional financings or borrowings, are subject to risks and uncertainties, including, but not limited to, those discussed below and elsewhere in this Form 10-Q, particularly in Part II Item 1A. "Risk Factors," that could cause actual results to differ materially from those projected. The forward-looking statements set forth in this Form 10-Q are as of the close of business on August 13, 2013, and we do not intend to update this forward-looking information.

Overview

We develop, manufacture, market, sell and support veterinary products. Our business is comprised of two reportable segments, Core Companion Animal Health ("CCA"), which represented 85% of our revenue for the twelve months ended June 30, 2013 assuming we had consolidated Heska Imaging for the entire period (which we define as "Pro forma LTM") and Other Vaccines, Pharmaceuticals and Products ("OVP"), which represented 15% of Pro forma LTM revenue.

The CCA segment includes in-clinic blood testing and other non-imaging instruments and supplies, imaging hardware, software and services as well as single use diagnostic and other tests, pharmaceuticals and vaccines, primarily for canine and feline use.

Blood testing and other non-imaging instruments and supplies represented approximately 39% of our Pro forma LTM revenue. Many products in this area involve placing an instrument in the field and generating future revenue from consumables, including items such as supplies and service, as that instrument is used. Approximately 29% of our Pro forma LTM revenue resulted from the sale of such consumables to an installed base of instruments and approximately 10% of our Pro forma LTM revenue was from new hardware sales. A loss of or disruption in supply of consumables we are selling to an installed base of instruments could substantially harm our business. All of our blood testing and other non-imaging instruments and supplies are supplied by third parties, who typically own the product rights and supply the product to us under marketing and/or distribution agreements. In many cases, we have collaborated with a third party to adapt a human instrument for veterinary use. Major products in this area include our chemistry instruments, our hematology instruments and our blood gas instruments and their affiliated operating consumables. Revenue from products in these three areas, including revenues from consumables, represented approximately 35% of our Pro forma LTM revenue.

Imaging hardware, software and services represented approximately 15% of Pro forma LTM revenue. Digital radiography is the largest product offering in this area, which also includes ultrasound instruments. Digital radiography solutions typically consist of a combination of hardware and software placed with a customer, often combined with an ongoing service and support contract. It has been our experience that most of the economic benefit is generated at the time of sale in this area, in contrast to the blood testing category discussed above where ongoing consumable revenue is often a larger component of economic value.

Other CCA revenue, including single use diagnostic and other tests, pharmaceuticals and vaccines as well as research and development, licensing and royalty revenue, represented approximately 31% of our Pro forma LTM revenue. Since items in this area are often single use by their nature, our typical aim is to build customer satisfaction and loyalty for each product, generate repeat annual sales from existing customers and expand our customer base in the future. Products in this area are both supplied by third parties and provided by us. Major products in this area include our heartworm diagnostic tests, our heartworm preventives, our allergy test kits, our

allergy immunotherapy and our allergy diagnostic tests. Combined revenue from heartworm-related products and allergy-related products represented 27% of our Pro forma LTM revenue.

We consider the CCA segment to be our core business and devote most of our management time and other resources to improving the prospects for this segment. Maintaining a continuing, reliable and economic supply of products we currently obtain from third parties is critical to our success in this area. Virtually all of our sales and marketing expenses occur in the CCA segment. The majority of our research and development spending is dedicated to this segment as well.

All our CCA products are ultimately sold primarily to or through veterinarians. In many cases, veterinarians will mark up their costs to the end user. The acceptance of our products by veterinarians is critical to our success. CCA products are sold directly to end users by us as well as through distribution relationships, such as our corporate agreement with Intervet Inc., formerly known as Schering-Plough Animal Health Corporation ("Merck Animal Health"), a unit of Merck & Co., Inc., the sale of kits to conduct blood testing to third-party veterinary diagnostic laboratories and independent third-party distributors. Revenue from direct sales and distribution relationships represented approximately 71% and 29%, respectively, of CCA Pro forma LTM revenue.

We intend to sustain profitability over the long term through a combination of revenue growth, gross margin improvement and expense control. Accordingly, we closely monitor revenue growth trends in our CCA segment. Pro forma LTM revenue in this segment increased 4% as compared to Pro forma revenue for the twelve months ended June 30, 2012 assuming we had consolidated Heska Imaging for the entire period. We believe poor economic conditions over the past several years have impacted our revenue as, for example, veterinarians have continued to delay or defer capital expenditures on new diagnostic instrumentation.

The OVP segment includes our 168,000 square foot USDA- and FDA-licensed production facility in Des Moines, Iowa. We view this facility as an asset which could allow us to control our cost of goods on any vaccines and pharmaceuticals that we may commercialize in the future. We have increased integrating this facility with our operations elsewhere. For example, virtually all our U.S. inventory, excluding Heska Imaging, is now stored at this facility and fulfillment logistics are managed there. CCA segment products manufactured at this facility are transferred at cost and are not recorded as revenue for our OVP segment. We view OVP reported revenue as revenue primarily to cover the overhead costs of the facility and to generate incremental cash flow to fund our CCA segment.

Our OVP segment includes private label vaccine and pharmaceutical production, primarily for cattle but also for other animals such as small mammals. All OVP products are sold by third parties under third-party labels.

We developed a line of bovine vaccines that are licensed by the USDA. We have an agreement with a distributor, Agri Laboratories, Ltd., ("AgriLabs"), for the marketing and sale of certain of these vaccines which are sold primarily under the Titanium® and MasterGuard® brands which are registered trademarks of AgriLabs. This agreement generates a significant portion of our OVP segment's revenue. Our OVP segment also produces vaccines and pharmaceuticals for other third parties.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon the consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenue and expense during the periods. These estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. We have identified those critical accounting policies used in reporting our

financial position and results of operations based upon a consideration of those accounting policies that involve the most complex or subjective decisions or assessment. We consider the following to be our critical policies.

Revenue Recognition

We generate our revenue through the sale of products, as well as through licensing of technology product rights, royalties and sponsored research and development. Our policy is to recognize revenue when the applicable revenue recognition criteria have been met, which generally include the following:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services rendered;
- Price is fixed or determinable; and
- Collectability is reasonably assured.

Revenue from the sale of products is recognized after both the goods are shipped to the customer and acceptance has been received, if required, with an appropriate provision for estimated returns and allowances. We do not permit general returns of products sold. Certain of our products have expiration dates. Our policy is to exchange certain outdated, expired product with the same product. We record an accrual for the estimated cost of replacing the expired product expected to be returned in the future, based on our historical experience, adjusted for any known factors that reasonably could be expected to change historical patterns, such as regulatory actions which allow us to extend the shelf lives of our products. Revenue from both direct sales to veterinarians and sales to independent third-party distributors are generally recognized when goods are shipped. Our products are shipped complete and ready to use by the customer. The terms of the customer arrangements generally pass title and risk of ownership to the customer at the time of shipment. Certain customer arrangements provide for acceptance provisions. Revenue for these arrangements is not recognized until the acceptance has been received or the acceptance period has lapsed. We reduce our revenue by the estimated cost of any rebates, allowances or similar programs, which are used as promotional programs.

Recording revenue from the sale of products involves the use of estimates and management judgment. We must make a determination at the time of sale whether the customer has the ability to make payments in accordance with arrangements. While we do utilize past payment history, and, to the extent available for new customers, public credit information in making our assessment, the determination of whether collectability is reasonably assured is ultimately a judgment decision that must be made by management. We must also make estimates regarding our future obligation relating to returns, rebates, allowances and similar other programs.

License revenue under arrangements to sell or license product rights or technology rights is recognized as obligations under the agreement are satisfied, which generally occurs over a period of time. Generally, licensing revenue is deferred and recognized over the estimated life of the related agreements, products, patents or technology. Nonrefundable licensing fees, marketing rights and milestone payments received under contractual arrangements are deferred and recognized over the remaining contractual term using the straight-line method.

Recording revenue from license arrangements involves the use of estimates. The primary estimate made by management is determining the useful life of the related agreement, product, patent or technology. We evaluate all of our licensing arrangements by estimating the useful life of either the product or the technology, the length of the agreement or the legal patent life and defer the revenue for recognition over the appropriate period.

Occasionally we enter into arrangements that include multiple elements. Such arrangements may include the licensing of technology and manufacturing of product. In these situations we must determine whether the various elements meet the criteria to be accounted for as separate elements. If the elements cannot be separated, revenue is recognized once revenue recognition criteria for the entire arrangement have been met or over the period that the Company's obligations to the customer are fulfilled, as appropriate. If the elements are determined to be separable, the revenue is allocated to the separate elements based on relative fair value and recognized separately for each element when

the applicable revenue recognition criteria have been met. In accounting for these multiple element arrangements, we must make determinations about whether elements can be accounted for separately and make estimates regarding their relative fair values.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts receivable based on client-specific allowances, as well as a general allowance. Specific allowances are maintained for clients which are determined to have a high degree of collectability risk based on such factors, among others, as: (i) the aging of the accounts receivable balance; (ii) the client's past payment history; (iii) a deterioration in the client's financial condition, evidenced by weak financial condition and/or continued poor operating results, reduced credit ratings, and/or a bankruptcy filing. In addition to the specific allowance, the Company maintains a general allowance for credit risk in its accounts receivable which is not covered by a specific allowance. The general allowance is established based on such factors, among others, as: (i) the total balance of the outstanding accounts receivable, including considerations of the aging categories of those accounts receivable; (ii) past history of uncollectable accounts receivable write-offs; and (iii) the overall creditworthiness of the client base. A considerable amount of judgment is required in assessing the realizability of accounts receivable. Should any of the factors considered in determining the adequacy of the overall allowance change, an adjustment to the provision for doubtful accounts receivable may be necessary.

Inventories

Inventories are stated at the lower of cost or market, cost being determined on the first-in, first-out method. Inventories are written down if the estimated net realizable value of an inventory item is less than its recorded value. We review the carrying cost of our inventories by product each quarter to determine the adequacy of our reserves for excess/obsolescence inventory. In accounting for inventories we must make estimates regarding the estimated net realizable value of our inventory. This estimate is based, in part, on our forecasts of future sales and shelf life of product.

Deferred Tax Assets – Valuation Allowance

Our deferred tax assets, such as a domestic Net Operating Loss ("NOL"), are reduced by an offsetting valuation allowance based on judgmental assessment of available evidence if we are unable to conclude that it is more likely than not that some or all of the related deferred tax assets will be realized. If we are able to conclude it is more likely than not that we will realize a future benefit from a deferred tax asset, we will reduce the related valuation allowance by an amount equal to the estimated quantity of income taxes we would pay in cash if we were not to utilize the deferred tax asset in the future. The first time this occurs in a given jurisdiction, it will result in a net deferred tax asset on our balance sheet and an income tax benefit of equal magnitude in our statement of operations in the period we make the determination. In future periods, we will then recognize as income tax expense the estimated quantity of income taxes we would have paid in cash had we not utilized the related deferred tax asset. The corresponding journal entry will be a reduction of our deferred tax asset. If there is a change regarding our tax position in the future, we will make a corresponding adjustment to the related valuation allowance. For example, if we were to conclude we were not more likely than not to utilize deferred tax assets recognized on our balance sheet, we would increase the valuation allowance affiliated with these deferred tax assets and recognize an income tax expense of an equal magnitude in our statement of operations.

Results of Operations

Revenue

Total revenue was $37.2 million for the six months ended June 30, 2013, a decline of 1% as compared to $37.4 million in the corresponding period in 2012. Total revenue was $18.3 million for the three months ended June 30, 2013, a slight decline as compared to the corresponding period in 2012.

Revenue from our CCA segment was $31.5 million for the six months ended June 30, 2013, a decrease of 2% as compared to $32.3 million for the corresponding period in 2012. Lower revenue from sales of our heartworm diagnostic tests, both internationally and domestically, our heartworm preventive, our international allergy business products, our instrument consumables and our hematology instruments were key factors in the decline. This was somewhat offset by $4.6 million in revenue from Heska Imaging, which represents the revenue from sales after our acquisition of Heska Imaging on February 24, 2013. Revenue from our CCA segment was $15.9 million for the three months ended June 30, 2013, an increase of 1% as compared to $15.7 million for the corresponding period in 2012. The impact of $2.7 million in revenue from Heska Imaging was the largest factor in the increase. Increased revenue from international sales of our heartworm diagnostic tests also contributed to the increase. This was somewhat offset by lower revenue from sales of our heartworm preventive, our heartworm diagnostic tests domestically, our international allergy business, our instrument consumables and our hematology instruments. A large distributor of our products sold more instrument consumables and domestic heartworm diagnostic tests, respectively, than such distributor purchased from us in both the first half and second quarter of 2013, which was a factor in the decline in both product areas in both time periods. We believe purchases by end users of our instrument consumables increased in the six months and three months ended June 30, 2013 as compared to the prior year period but the reverse was true for financial reporting purposes due to the distributor's ordering pattern. Similarly, we believe unit purchases by end users of our heartworm diagnostic tests increased slightly in the six months ended June 30, 2013 as compared to the prior year period but declined for financial reporting purposes due to the distributor's ordering pattern. We believe this distributor's ordering pattern will normalize in the near future. The market for heartworm diagnostic tests remains highly competitive and we experienced lower average selling prices in this area in the six months and three months ended June 30, 2013 as compared to the prior year period, which contributed to the revenue decline in this area. We also believe unit purchases by end users of our heartworm diagnostic tests decreased in the three months ended June 30, 2013. We believe there are similar competitive pressures in Japan, our largest international market for heartworm diagnostic tests. We lost a large customer in our international allergy business which was a factor in the revenue decline in this area for the six months and three months ended June 30, 2013.

Revenue from our OVP segment was $5.7 million for the six months ended June 30, 2013, an increase of 11% as compared to $5.2 million in the corresponding period in 2012. Increased sales of cattle products for international distribution and sales to a new customer, somewhat offset by lower sales of cattle vaccines under our contract with AgriLabs, contributed to the increase. Revenue from our OVP segment was $2.4 million for the three months ended June 30, 2013, a decrease of 6% as compared to $2.6 million in the corresponding period in 2012. Lower sales of cattle vaccines under our contract with AgriLabs was a factor in the decrease.

Cost of Revenue

Cost of revenue totaled $24.4 million for the six months ended June 30, 2013, an increase of $3.9 million or 19% as compared to $20.5 million for the corresponding period in 2012. Gross profit decreased by $4.1 million to $12.8 million for the six months ended June 30, 2013 as compared to $17.0 million in the prior year period. Gross profit for the six months ended June 30, 2013 includes $1.4 million in gross profit from Heska Imaging. Gross Margin, i.e. gross profit divided by total revenue, decreased to 34.4% for the six months ended June 30, 2013 from 45.3% in the prior year period. At June 30, 2013, we recognized a reserve (the "Roche Reserve") related to an anticipated agreement (the "Roche Agreement") with Roche Diagnostics Corporation ("Roche") related to our blood gas analyzers under which we would be relieved of any minimum purchase obligations other than the Roche Agreement and Roche would be obligated to supply us with consumables and spare parts for a shortened period of time. The Roche Reserve recognized as of June 30, 2013 was $1.1 million, as follows: $600 thousand recognized in cost of revenue related to required purchase of new instruments under the Roche Agreement, $168 thousand recognized in cost of revenue related to instruments already in inventory and accelerated depreciation on service units, $13 thousand recognized in sales and marketing expenses related to accelerated depreciation on demonstration units, $99 thousand recognized in research and development expenses related to the purchase of research and development equipment required under the Roche Agreement we would not have otherwise purchased and $243 thousand recognized in

general and administrative expenses related to other anticipated costs related to the Roche Agreement. In addition, at June 30, 2013, we recognized a reserve (the "SpotChem Reserve") related to consumable and accessory inventory which we now do not expect to sell. The SpotChem Reserve recognized as of June 30, 2013 was $453 thousand, was recognized in cost of

revenue and the related inventory was for use in a previously sold chemistry instrument. The Roche Reserve and the SpotChem Reserve, as well as a shift in product mix to relatively lower margin product areas was a factor in the decline in Gross Margin for the six months ended June 30, 2013 as compared to the prior year period.

Cost of revenue totaled $13.2 million for the three months ended June 30, 2013, an increase of $3.0 million or 30% as compared to $10.2 million for the corresponding period in 2012. Gross profit decreased by $3.0 million to $5.0 million for the three months ended June 30, 2013 as compared to $8.0 million in the prior year period. Gross profit for the three months ended June 30, 2013 includes $691 thousand in gross profit from Heska Imaging. Gross Margin, i.e. gross profit divided by total revenue, decreased to 27.5% for the three months ended June 30, 2013 from 44.0% in the prior year period. The Roche Reserve and the SpotChem Reserve, as well as a shift in product mix to relatively lower margin product areas were factors in the decline.

Operating Expenses

Total operating expenses increased 10% to $17.1 million in the six months ended June 30, 2013 from $15.5 million in the prior year period. Total operating expenses increased 12% to $8.6 million in the three months ended June 30, 2013 from $7.7 million in the prior year period.

Selling and marketing expenses increased 3% to $10.0 million in the six months ended June 30, 2013 as compared to $9.6 million in the corresponding period in 2012. Heska Imaging sales and marketing expense of $1.2 million recognized in the six months ended June 30, 2013 but not the prior year period was a key factor in the increase. This was somewhat offset by lower spending on salaries and travel for members of our salesforce. Selling and marketing expenses were $4.8 million in the three months ended June 30, 2013, a slight increase as compared to the corresponding period in 2012. Heska Imaging sales and marketing expense of $762 thousand recognized in the three months ended June 30, 2013 but not the prior year period was a key factor in the increase. This was somewhat offset by lower spending on salaries and travel for members of our salesforce.

Research and development expenses were $873 thousand and included $66 thousand in expense from Heska Imaging in the six months ended June 30, 2013, an increase of $336 thousand as compared to $537 thousand in the corresponding period in 2012. The largest factor in the change was a reserve for equipment that had been previously used in a project that was recently discontinued. Expenses related to the Roche Reserve were another factor. Research and development expenses were $483 thousand and included $50 thousand in expense from Heska Imaging in the three months ended June 30, 2013, an increase of $280 thousand as compared to $203 thousand in the corresponding period in 2012. Expenses related to the Roche Reserve as well as the recognition of costs related to other research and development projects were other factors in the increase.

General and administrative expenses were $6.2 million and included approximately $510 thousand in expense from Heska Imaging in the six months ended June 30, 2013, up 17% from $5.3 million in the prior year period. In addition to expenses from and related to the acquisition of Heska Imaging, severance expenses related to the termination of certain employees and expenses related to the Roche Reserve were key factors in the increase. These were somewhat offset by lower legal expenses and expenses related to arbitration matters. General and administrative expenses were $3.3 million and included approximately $357 thousand in expense from Heska Imaging in the three months ended June 30, 2013, up 21% from $2.7 million in the prior year period. In addition to Heska Imaging, severance expenses related to the termination of certain employees and expenses related to the Roche Reserve were key factors in the increase. These were somewhat offset by lower legal expenses and expenses related to arbitration matters.

Interest and Other (Income) Expense, Net

Interest and other (income) expense, net was $41 thousand of expense in the six months ended June 30, 2013, a decrease of $44 thousand as compared to $85 thousand of expense in the prior year period. This line item can be

broken into two components: net interest expense or income and foreign currency gains or losses. In the six months ended June 30, 2013, net interest expense was $92 thousand as opposed to $16 thousand in interest income in the prior year period. The increase in interest expense was primarily related to interest on debts at Heska Imaging, which was included in the six months ended June 30, 2013 but not the prior year period as Heska Imaging was not consolidated in the prior year period. The decrease in interest income related to interest

recognized on overdue receivables from a customer in the 2012 period but not the 2013 period. A net foreign currency gain of $52 thousand was recognized in the six months ended June 30, 2013, as opposed to a net foreign currency loss of $101 thousand in the prior year period. Interest and other (income) expense, net was $52 thousand of expense in the three months ended June 30, 2013, a change of $109 thousand as compared to $57 thousand of income in the prior year period. In the three months ended June 30, 2013, net interest expense was $61 thousand as opposed to $34 thousand in interest income in the prior year period. The increase in interest expense was primarily related to interest on debts at Heska Imaging, which were included in the three months ended June 30, 2013 but not the prior year period as Heska Imaging was not consolidated in the prior year period. The decrease in interest income related to interest recognized on overdue receivables from a customer in the 2012 period but not the 2013 period. A net foreign currency gain of $9 thousand was recognized in the three months ended June 30, 2013, as opposed to a net foreign currency gain of $23 thousand in the prior year period.

Income Tax Expense

We recognized an income tax benefit of $1.5 million in the six months ended June 30, 2013, a $2.0 million increase as compared to a tax expense of $534 thousand in the prior year period. We recognized an income tax benefit of $1.2 million in the three months ended June 30, 2013, a $1.3 million increase as compared to a tax expense of $178 thousand in the prior year period. The change is due to income before income taxes in the 2012 period as opposed to a loss before income taxes in the 2013 period.

Current tax expense was $65 thousand in the six months ended June 30, 2013, a decline of $17 thousand as compared to $82 thousand in the prior year period. Current tax expense was $59 thousand in the three months ended June 30, 2013, an increase of $25 thousand as compared to $34 thousand in the prior year period. The current tax expense in the 2013 period was related to estimated alternative minimum tax payments and our Swiss subsidiary. The decline in current tax expense is due to domestic income before income taxes in the 2012 period as opposed to a domestic loss before income taxes in the 2013 period. Current tax expense represents taxes we are expected to pay in cash as a result of a given period's operations.

For the six months ended June 30, 2013, deferred tax benefit was $1.5 million, a $2.0 million change from $452 thousand in tax expense in the prior year period. For the three months ended June 30, 2013, deferred tax benefit was $1.2 million, a $1.4 million change from $144 thousand in tax expense in the prior year period. The change is due to income before income taxes in the 2012 period as opposed to a loss before income taxes in the 2013 period.

Net Income (Loss)

Net loss was $2.8 million in the six months ended June 30, 2013, a decrease of approximately $3.7 million compared to $846 thousand net income in the prior year period. Net loss was $2.5 million in the three months ended June 30, 2013, a decrease of approximately $2.7 million compared to $262 thousand net income in the prior year period. The change in both cases was primarily due to lower Gross Margin and higher operating expense.

Net Income (Loss) attributable to Heska Corporation

Net loss attributable to Heska Corporation was $2.6 million in the six months ended June 30, 2013, a decrease of approximately $3.5 million compared to $846 thousand net income in the prior year period. Net loss attributable to Heska Corporation was $2.2 million in the three months ended June 30, 2013, a decrease of approximately $2.5 million compared to $262 thousand net income in the prior year period. The difference between this line item and "Net Income (Loss)" above is the net income or loss attributable to the minority interest in Heska Imaging, which was a loss of $205 thousand in the six months ended June 30, 2013 and $239 thousand in the three months ended June 30, 2013. There were no corresponding entries in periods ending in 2012 as Heska Imaging was not consolidated into our financial statements until February 24, 2013.

Liquidity and Capital Resources

We have incurred net cumulative negative cash flow from operations since our inception in 1988. For the six months ended June 30, 2013, we had net loss of $2.8 million. During the six months ended June 30, 2013, our operations used cash of approximately $1.1 million. At June 30, 2013, we had $5.4 million of cash and cash equivalents, $12.2 million of working capital, and $2.0 million of outstanding borrowings under our revolving line of credit, discussed below.

Net cash used in operating activities was approximately $1.1 million for the six months ended June 30, 2013 as compared to $2.1 million of cash provided by operating activities in the prior year period, a change of approximately $3.1 million. Major factors in the decline were a $3.7 million change in net loss, an affiliated $2.0 million decrease in cash provided due to deferred tax effects, $1.2 million increase in cash used from inventory as we are carrying a relatively higher level of inventory in the 2013 period as opposed to the 2012 period and an $892 thousand greater cash usage in accounts payable. This was somewhat offset by a $3.3 million increase in cash provided by accounts receivable as a large order that had shipped in the fourth quarter of 2012 was paid for in the first quarter of 2013 as compared to relatively lower sales in the fourth quarter of 2011 and relatively higher sales in the first quarter of 2012 which led to greater cash usage by accounts receivable in the 2012 period as compared to the 2013 period, and a $956 thousand increase in cash provided by other current assets where a greater utilization of previously paid funds occurred.

Net cash flows provided by investing activities were $1.3 million in the six months ended June 30, 2013, an increase of approximately $1.8 million compared to $542 thousand used during the corresponding period in 2012. The major factor in the increase was $5.0 million of proceeds from disposition of property, including non-core vaccine-related intellectual property, which occurred in the 2013 period, but not the 2012 period. This was somewhat offset by $3.0 million in cash paid as part of the acquisition of Heska Imaging in February 2013 as well as an increase of $192 thousand in capital expenditures in the 2013 period as opposed to the 2012 period.

Net cash flows used in financing activities were $555 thousand during the six months ended June 30, 2013, a $318 thousand change as compared to $237 thousand used in financing activities in the prior year period. In the 2013 period, we repaid $561 thousand under our asset-based revolving line of credit with Wells Fargo Bank, National Association ("Wells Fargo") and Heska Imaging made $105 thousand in net repayments of other debts with no cash outflows related to the payment of dividends. In the 2012 period, we paid $532 thousand in dividends with no repayments of debt. The cash outflows related to financing were somewhat offset by proceeds from the issuance of common stock of $111 thousand in the 2013 period and $295 thousand in the 2012 period.

At June 30, 2013, Heska Corporation had lent Heska Imaging $126 thousand, including accrued interest, and subsequent to June 30, 2013, Heska Corporation lent Heska Imaging an additional $500 thousand, all of which is currently outstanding and which eliminates upon consolidation of our financial statements. These debts accrue interest at the same interest rate as Heska Corporation pays under its asset-based revolving line of credit with Wells Fargo, with the proceeds to be used to pay off other debt.

At June 30, 2013, we had a $1.4 million note receivable from Cuattro Veterinary, LLC. The note is to pay interest at the same interest rate as Heska Corporation pays under its asset-based revolving line of credit with Wells Fargo and is due on March 15, 2016. Cuattro Veterinary, LLC sells the same digital radiography solutions outside the United States that Heska Imaging sells in the United States. The note is listed on our balance sheet as a note receivable – related party as Kevin S. Wilson, our President and Chief Operating Officer, Mrs. Wilson and trusts for their children and family hold a majority interest in Cuattro Veterinary, LLC. This note was held by Heska Imaging at the time of our acquisition of Heska Imaging on February 24, 2013.

At June 30, 2013, we had a $15.0 million asset-based revolving line of credit with Wells Fargo which had a maturity date of December 31, 2013 as part of our credit and security agreement with Wells Fargo. At June 30, 2013, we had $2.0 million in outstanding borrowings under this line of credit. Our ability to borrow under this facility varies based upon available cash, eligible accounts receivable and eligible inventory. On June 30, 2013, interest on borrowings due was to be charged at a stated rate of three month LIBOR plus 3.75% and payable monthly. We are required to comply with various financial and non-financial covenants, and we have made

various representations and warranties under our agreement with Wells Fargo. Among the financial covenants is a requirement to maintain a minimum liquidity (cash plus excess borrowing base) of $1.5 million. Additional requirements include covenants for minimum capital monthly and minimum net income quarterly. Failure to comply with any of the covenants, representations or warranties could result in our being in default on the loan and could cause all outstanding amounts payable to Wells Fargo to become immediately due and payable or impact our ability to borrow under the agreement. We failed to comply with the net income covenant as of June 30, 2013, for which we obtained a waiver and subsequently negotiated new covenants as well as an extension of our asset-based revolving line of credit with Wells Fargo to December 31, 2015. As part of this agreement, interest on borrowings due is to be charged at a stated rate of three month LIBOR plus 3.75% and payable monthly starting on July 1, 2013. At June 30, 2013, we had $6.2 million of borrowing capacity based upon eligible accounts receivable and eligible inventory under our revolving line of credit.

At June 30, 2013, we had other borrowings outstanding totaling $1.4 million, all of which were obligations of Heska Imaging, as follows. We had $564 thousand outstanding on loan from De Lage Landen Financial Services, Inc. ("DLL"). The note bears an interest rate of 6% and is due in monthly payments of $13 thousand through June 2017. The note may be prepaid prior to maturity, but is subject to a surcharge in such a circumstance. $129 thousand of principal associated with this note is listed as short term on our balance sheet as it is due within a year. We also had $348 thousand in additional short term debt from DLL as of June 30, 2013 related to Heska Imaging's leasing activities. In addition, we had a $509 thousand principal, short term demand, non-interest bearing note from Esaote North America, Inc. which was collateralized by certain items in our ultrasound inventory. The note from Esaote North America, Inc. was repaid in full in July 2013.

At June 30, 2013, our balance sheet included $12.6 million in non-controlling interest. This represents the value of the aggregate position in Heska Imaging of the unit holders of the 45.4% of Heska Imaging we do not own (the "Imaging Minority"). We estimated a weighted average valuation for this position and are accreting to this value over a three year period using a weighted average cost of capital of 18.65%. The cost of capital assumptions was provided to us by a third party with expertise in estimating such items. The accretion is to be recorded as a credit which will tend to increase this entry over time, with the corresponding debit to directly reduce retained earnings. We intend to evaluate the value of this position every reporting period and adjust our accretion accordingly if necessary.

At June 30, 2013, our balance sheet included $2.9 million in Public Common Stock subject to redemption. This represents the stock we issued to acquire our position in Heska Imaging, which may be used to meet the purchase obligation if a Cuattro 12-month Call Option or a Cuattro 18-month Call Option is exercised under the Amended and Restated Operating Agreement of Heska Imaging (the "Operating Agreement"). We intend to mark this line item to market every reporting period with the corresponding debit or credit taken directly to additional paid-in-capital.

Our financial plan for 2013 indicates that our available cash and cash equivalents, together with cash from operations and borrowings expected to be available under our revolving line of credit, will be sufficient to fund our operations through 2013 and into 2014. However, our actual results may differ from this plan, and we may be required to consider alternative strategies. We may be required to raise additional capital in the future. If necessary, we expect to raise these additional funds through the sale of equity securities or the issuance of new term debt secured by the same assets as the term loans which were fully repaid in 2010. There is no guarantee that additional capital will be available from these sources on acceptable terms, if at all, and certain of these sources may require approval by existing lenders. See "Risk Factors" in Item 1A of this Form 10-Q for a discussion of some of the factors that affect our capital raising alternatives.

Under the Operating Agreement, should Heska Imaging meet certain performance criteria, the Imaging Minority has been granted a put option to sell us some or all of the Imaging Minority's remaining 45.4% position in Heska Imaging following the audit of our financial statements in 2015, 2016 and 2017. Furthermore, should Heska Imaging meet certain performance criteria, and the Imaging Minority fail to exercise an applicable put to sell us all of the Imaging

Minority's position in Heska Imaging following the audit of our financial statements in 2015, 2016 and 2017, we would have a call option to purchase all, but not less than all, of the Imaging Minority's position in Heska Imaging.

We believe it is likely that Heska Imaging will meet the required performance criteria for its 2015 highest strike put in 2015. In this case, the Imaging Minority would be granted a put following our 2015 audit which could require us to deliver up to $17.0 million, as well as 25% of Heska Imaging's cash, to purchase the 45.4% of Heska Imaging we do not own. If this put is not exercised in full, we would have a call option to purchase all, but not less than all, of the Imaging Minority's position in Heska Imaging for $19.6 million, as well as 25% of Heska Imaging's cash. In both cases, while we have the right to deliver up to 55% of the consideration in our Public Common Stock under certain circumstances, such stock is to be valued based on 90% of market value (the "Delivery Stock Value") and is limited to approximately 650 thousand shares in any case. If the Delivery Stock Value is less than the market value of our stock at the time of the Acquisition, we do not have the right to deliver any Public Common Stock as consideration.

If Heska Imaging meets the required performance criteria for its 2015 highest strike put in 2015, we anticipate that either the Imaging Minority will exercise its put or we will desire to exercise our call, or perhaps both, following our 2015 audit in 2016. While we intend to meet this payment obligation with funds provided by our ongoing operations and assets, likely supplemented by debt financing and potentially with equity financing, there can be no assurance our results will unfold according to our expectations. This potential payment obligation in 2016 is an important consideration for us in our cash management decisions.

We would consider acquisitions if we felt they were consistent with our strategic direction. We paid $1.6 million in dividends in 2012, and while we may consider paying dividends again in the long term, we do not anticipate the payment of any further dividends for the foreseeable future. We conducted an odd lot tender offer in 2012 which could have led to the repurchase of approximately $400 thousand of our stock if all eligible holders had chosen to participate, and while we may consider stock repurchase alternatives again in the long term, we do not anticipate any stock repurchases in the foreseeable future.

Recent Accounting Pronouncements

None.

Item 3.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact the financial position, results of operations or cash flows due to adverse changes in financial and commodity market prices and rates. We are exposed to market risk in the areas of changes in United States and foreign interest rates and changes in foreign currency exchange rates as measured against the United States dollar and against other foreign currencies. These exposures are directly related to our normal operating and funding activities.

Interest Rate Risk

At June 30, 2013, there was $2.0 million in debt outstanding on our line of credit with Wells Fargo and we had $1.4 million in additional borrowings. We also had approximately $5.4 million of cash and cash equivalents at June 30, 2013, the majority of which was invested in liquid accounts. We had no interest rate hedge transactions in place on June 30, 2013. We completed an interest rate risk sensitivity analysis based on the above and an assumed one percentage point increase/decrease in interest rates. If market rates increase/decrease by one percentage point and such changes were reflected in all our investments, we would experience an increase/decrease in annual net interest expense of approximately $34 thousand based on our outstanding balances as of June 30, 2013.

Foreign Currency Risk

Our investment in foreign assets consists primarily of our investment in our European subsidiary. Foreign currency risk may impact our results of operations. In cases where we purchase inventory in one currency and sell corresponding products in another, our gross margin percentage is typically at risk based on foreign currency exchange rates. In addition, in cases where we may be generating operating income in foreign currencies, the magnitude of such operating income when translated into U.S. dollars will be at risk based on foreign currency exchange rates. Our agreements with customers and suppliers vary significantly in regard to the existence and extent of currency adjustment and other currency risk sharing provisions. We had no foreign currency hedge transactions in place on June 30, 2013.

We have a wholly-owned subsidiary in Switzerland which uses the Swiss Franc as its functional currency. We purchase inventory in foreign currencies, primarily Japanese Yen and Euros, and sell corresponding products in U.S. dollars. We also sell products in foreign currencies, primarily Japanese Yen and Euros, where our inventory costs are in U.S. dollars. Based on our results of operations for the most recent twelve months, if foreign currency exchange rates were to strengthen/weaken by 25% against the dollar, we would expect a resulting pre-tax loss/gain of approximately $292 thousand.

Item 4.

CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures. Our management, with the participation of our chief executive officer and our chief financial officer, evaluated the effectiveness of our disclosure controls and procedures, as defined by Rule 13a-15 of the Exchange Act, as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our chief executive officer and our chief financial officer have concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit 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 our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Control over Financial Reporting. There was no change in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may be involved in litigation relating to claims arising out of our operations. As of June 30, 2013, we were not a party to any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on our business, financial condition or operating results.

Item 1A. Risk Factors

Our future operating results may vary substantially from period to period due to a number of factors, many of which are beyond our control. The following discussion highlights some of these factors and the possible impact of these factors on future results of operations. The risks and uncertainties described below are not the only ones we face. Additional risks or uncertainties not presently known to us or that we deem to be currently immaterial also may impair our business operations. If any of the following factors actually occur, our business, financial condition or results of operations could be harmed. In that case, the price of our Public Common Stock could decline and you could experience losses on your investment.

Our February 2013 acquisition of a 54.6% majority interest (the "Acquisition") in Cuattro Veterinary USA, LLC, which has been renamed Heska Imaging US, LLC, is subject to various puts and calls and other provisions which could be detrimental to the interests of our shareholders.

Under the Operating Agreement for up to 18 months following the Acquisition, the Imaging Minority may repurchase our 54.6% interest in Heska Imaging at a premium to our Acquisition purchase price under a call option we have granted the Imaging Minority. Through the first year anniversary of the Acquisition, such repurchase may be made at 1.3 times our purchase price and following the first year anniversary of the Acquisition and through the 18-month anniversary of the Acquisition, such repurchase may be made at 1.45 times our purchase price. Furthermore, the Imaging Minority may deliver any Heska shares resulting from and held since the Acquisition as consideration, with such shares to be valued based on market value, although not less than $5 per share. Should the Imaging Minority exercise this call, it could be significantly disruptive to our business and if Heska Imaging represents a significant portion of our revenue and earnings at the time of such exercise, our stock price could decline significantly following such exercise. Furthermore, should Heska stock have appreciated significantly, the Imaging Minority might not have to repay some or all of the cash we paid in the Acquisition, or even deliver all the shares we issued in the Acquisition. In addition, if our stock price has declined below $5 per share prior to the time of exercise, we may not realize the full economic premium (either 1.3 or 1.45), or any premium, anticipated in the repurchase. In addition, should our stock price decline enough, we could be placed in a position where the repurchase is at an economic discount to our purchase price.

Under the Operating Agreement, should Heska Imaging meet certain performance criteria, the Imaging Minority has been granted a put option to sell us some or all of the Imaging Minority's position in Heska Imaging following the audit of our financial statements in 2015, 2016 and 2017. Based on Heska Imaging's current ownership position, this put option could require us to deliver either up to $17.0 million following calendar year 2015, $25.5 million following calendar year 2016 or $36.9 million following calendar year 2017 as well as 25% of Heska Imaging's cash (any applicable payment in aggregate to be defined as the "Put Payment") to acquire the outstanding minority interest in Heska Imaging. While we have the right to deliver up to 55% of the consideration in our Public Common Stock under certain circumstances, such stock is to be valued based on 90% of market value (the "Delivery Stock Value") and is limited to approximately 650 thousand shares in any case. If the Delivery Stock Value is less than the market value of our Public Common Stock at the time of the Acquisition, we do not have the right to deliver any Public Common

Stock as consideration. Cash required under any Put Payment could put a significant strain on our financial position or require us to raise additional capital. There is no guarantee that additional capital will be available in such a circumstance on reasonable terms, if at all. We may be unable to obtain debt financing, the public markets may be unreceptive to equity financing and we may not be able to obtain financing from other alternative sources, such as private equity. Any debt financing, if available, may include restrictive covenants and high interest rates and any equity financing would likely be dilutive to stockholders in this scenario. If additional funds are required and are not available, it would likely have a material adverse effect on our business, financial condition and our ability to continue as a going concern.

Under the Operating Agreement, should Heska Imaging meet certain performance criteria, and the Imaging Minority fail to exercise an applicable put to sell us all of the Imaging Minority's position in Heska Imaging following the audit of our financial statements in 2015, 2016 and 2017, we would have a call option to purchase all, but not less than all, of the Imaging Minority's position in Heska Imaging. Based on Heska Imaging's current ownership position, exercising this call option could require us to deliver up to $19.6 million following calendar year 2015, $29.4 million following calendar year 2016 or $42.4 million following calendar year 2017 as well as 25% of Heska Imaging's cash (any applicable payment in aggregate to be defined as the "Call Payment") to acquire the outstanding minority interest in Heska Imaging. While we have the right to deliver up to 55% of the consideration in our Public Common Stock under certain circumstances, such stock is to be valued based on 90% of market value (the "Delivery Stock Value") and is limited to approximately 650 thousand shares in any case. If the Delivery Stock Value is less than the market value of our stock at the time of the Acquisition, we do not have the right to deliver any Public Common Stock as consideration. If we believe it is desirable to exercise any one of these calls, cash required under the Call Payment could put a significant strain on our financial position or require us to raise additional capital. There is no guarantee that additional capital will be available in such a circumstance on reasonable terms, if at all. If we believe it is desirable to exercise any such call, determine we are unable to economically finance the Call Payment and do not exercise the call as a result, we could be subject to a more expensive Put Payment less than a year in the future. In this circumstance, unless there is a significant change in our financial position or market conditions, such a Put Payment could have a material adverse effect on our business, financial condition and our ability to continue as a going concern.

Under and as defined in the Operating Agreement, should we undergo a change in control prior to the end of 2017, the Imaging Minority will be entitled to sell their Heska Imaging units to us for cash at the highest call value they otherwise could have obtained (the "Change in Control Payment"). If Heska Imaging meets certain minimum performance criteria, this will be $42.4 million as well as 25% of Heska Imaging's cash until at least the end of 2015. The Change in Control Payment may materially decrease the interest of third parties in acquiring the Company or a majority of the Company's shares, which could otherwise have occurred at a significant premium to the Company's then current market price for the benefit of some or all of our shareholders. This could make some investors less likely to buy and hold our stock.

Under the terms of the Operating Agreement, Heska Imaging will be managed by a three-person board of managers, two of which are to be appointed by Heska Corporation and one of which is to be appointed by Kevin S. Wilson, who has been Heska Corporation's President and Chief Operating Officer since the Acquisition closing and is a founder of Heska Imaging. The current board of managers consists of Robert B. Grieve, Ph.D., Heska Corporation's Chairman and Chief Executive Officer, Mr. Wilson and Jason A. Napolitano, Heska Corporation's Executive Vice President, Chief Financial Officer and Secretary. Until the earlier of (1) our acquiring 100% of the units of Heska Imaging pursuant to the puts and/or calls discussed above or (2) the sixth anniversary of the acquisition, Heska Imaging may only take the following actions, among others, by unanimous consent of the board of managers: (i) issue securities, (ii) incur, guarantee, prepay, refinance, renew, modify or extend debt, (iii) enter into material contracts, (iv) hire or terminate an officer or amend the terms of their employment, (v) make a distribution other than a tax or liquidation distribution, (vi) enter into a material acquisition or disposition arrangement or a merger, (vii) lease or acquire an interest in real property, (viii) convert or reorganize Heska Imaging, or (ix) amend its certificate of formation or the Heska Imaging Agreement. This unanimous consent provision may hinder our ability to optimize the value of its investment in Heska Imaging in certain circumstances.

Mr. Wilson's employment agreement with us requires that he devote 80% of his working hours' attention, skills, time and business efforts to Heska Corporation. However, Mr. Wilson has business interests in Cuattro, LLC, Cuattro Software, LLC, Cuattro Medical, LLC and Cuattro Veterinary, LLC which may require a portion of his time, resources and attention in the remaining 20% of his working hours. If Mr. Wilson is distracted by these or other business interests, he may not contribute as much as he otherwise would have to enhancing our business, to the detriment of our shareholder value. In addition, including shares held by Mrs. Wilson and by trusts for the benefit of

Mr. and Mrs. Wilson's children and family, Mr. Wilson also owns a 100% interest in Cuattro, LLC, the largest supplier to Heska Imaging. While the terms of both the Amended and Restated Master License Agreement and the Supply Agreement between Heska Imaging and Cuattro, LLC were negotiated at arm's length as part of the Acquisition, Mr. Wilson has an interest in these agreements and any time and resources devoted to

monitoring and overseeing this relationship may prevent us from deploying such time and resources on more productive matters.

Mrs. Wilson, Mr. Asakowicz, Mr. Lippincott, Mr. Wilson and Cuattro, LLC own approximately 29.75%, 4.09%, 3.07%, 0.05% and 0.05% of Heska Imaging, respectively, are each a member of Heska Imaging, and each have an interest in the puts and calls discussed above. If Mr. Wilson, Mr. Asakowicz or Mr. Lippincott is distracted by these holdings or interests, they may not contribute as much as they otherwise would have to enhancing our business, to the detriment of our shareholder value. While the Operating Agreement was negotiated at arm's length as part of the Acquisition, and requires that none of the members shall cause Heska Imaging to operate its business in any manner other than the ordinary course of business, any time and resources devoted to monitoring and overseeing this relationship may prevent us from deploying such time and resources on more productive matters.

In addition, like any acquisition, if Heska Imaging significantly underperforms our financial expectations, it may serve to diminish rather than enhance shareholder value.

We may not be able to continue to achieve sustained profitability or increase profitability on a quarterly or annual basis.

Prior to 2005, we incurred net losses on an annual basis since our inception in 1988 and, as of December 31, 2012, we had an accumulated deficit of $170.0 million. We have achieved only two quarters with income before income taxes greater than $1.5 million. Accordingly, relatively small differences in our performance metrics may cause us to generate an operating or net loss in future periods. Our ability to continue to be profitable in future periods will depend, in part, on our ability to increase sales in our CCA segment, including maintaining and growing our installed base of instruments and related consumables, to maintain or increase gross margins and to limit the increase in our operating expenses to a reasonable level as well as avoid or effectively manage any unanticipated issues. We may not be able to generate, sustain or increase profitability on a quarterly or annual basis. If we cannot achieve or sustain profitability for an extended period, we may not be able to fund our expected cash needs, including the repayment of debt as it comes due, or continue our operations.

We operate in a highly competitive industry, which could render our products obsolete or substantially limit the volume of products that we sell. This would limit our ability to compete and maintain sustained profitability.

The market in which we compete is intensely competitive. Our competitors include independent animal health companies and major pharmaceutical companies that have animal health divisions. We also compete with independent, third-party distributors, including distributors who sell products under their own private labels. In the point-of-care diagnostic testing market, our major competitors include IDEXX, Abaxis, Inc. ("Abaxis"), and Synbiotics Corporation ("Synbiotics"), a unit of Zoetis Inc. ("Zoetis"). The products manufactured by our OVP segment for sale by third parties compete with similar products offered by a number of other companies, some of which have substantially greater financial, technical, research and other resources than us and may have more established marketing, sales, distribution and service organizations than those of our OVP segment's customers. Competitors may have facilities with similar capabilities to our OVP segment, which they may operate and sell at a lower unit price to customers than our OVP segment does, which could cause us to lose customers. Companies with a significant presence in the companion animal health market, such as Bayer AG, CEVA Santé Animale, Eli Lilly and Company, Merck & Co., Inc. ("Merck"), Novartis AG, sanofi-aventis, Vétoquinol S.A., Virbac S.A. and Zoetis may be marketing or developing products that compete with our products or would compete with them if developed. These and other competitors and potential competitors may have substantially greater financial, technical, research and other resources and larger, more established marketing, sales and service organizations than we do. Our competitors may offer broader product lines and have greater name recognition than we do. For example, if Zoetis devotes its significant commercial and financial resources to growing Synbiotics' market share, our sales could suffer significantly. Our competitors may also develop or market technologies or

products that are more effective or commercially attractive than our current or future products or that would render our technologies and products obsolete. Further, additional competition could come from new entrants to the animal health care market. Moreover, we may not have the financial resources, technical expertise or marketing, sales or support capabilities to compete successfully. We believe that currently one of our largest competitors, IDEXX, in

effect prohibits all of its distributors except one from selling certain competitive products, including our blood testing instruments and heartworm diagnostic tests. Another of our competitors, Abaxis, recently launched a veterinary diagnostic laboratory offering which may serve to intensify competition and lower our margins.

If we fail to compete successfully, our ability to achieve sustained profitability will be limited and sustained profitability, or profitability at all, may not be possible.

We may be unable to market and sell our products successfully.

We may not develop and maintain marketing and/or sales capabilities successfully, and we may not be able to make arrangements with third parties to perform these activities on satisfactory terms. If our marketing and sales strategy is unsuccessful, our ability to sell our products will be negatively impacted and our revenues will decrease. This could result in the loss of distribution rights for products or failure to gain access to new products and could cause damage to our reputation and adversely affect our business and future prospects.

We believe the recent worldwide economic weakness has had a negative effect on our business, and this may continue in the future. This is particularly notable in the sale of new instruments, which is a capital expenditure many, if not most, veterinarians may choose to defer in times of perceived economic weakness. Even if the overall economy begins to grow in the future, there may be a lag before veterinarians display confidence such growth will continue and return to historical capital expenditure purchasing patterns. As the vast majority of cash flow to veterinarians ultimately is funded by pet owners without private insurance or government support, our business may be more susceptible to severe economic downturns than other health care businesses which rely less on individual consumers.

The market for companion animal healthcare products is highly fragmented. Because our CCA proprietary products are generally available only to veterinarians or by prescription and our medical instruments require technical training to operate, we ultimately sell all our CCA products primarily to or through veterinarians. The acceptance of our products by veterinarians is critical to our success. Changes in our ability to obtain or maintain such acceptance or changes in veterinary medical practice could significantly decrease our anticipated sales.

We believe that currently one of our largest competitors, IDEXX Laboratories, Inc. ("IDEXX"), in effect prohibits all of its distributors except for MWI Veterinary Supply, Inc. ("MWI") from selling certain competitive products, including our blood testing instruments and heartworm diagnostic tests. This situation may hinder our ability to sell and market our products if these distributors are increasingly successful. While we have an agreement with MWI to sell our blood testing instruments and heartworm diagnostic tests, there can be no assurance this agreement will prove to be ultimately successful in enhancing our profitability or market presence.

We have historically not consistently generated positive cash flow from operations, may need additional capital and any required capital may not be available on reasonable terms or at all.

If our actual performance deviates from our operating plan, we may be required to raise additional capital in the future. If necessary, we expect to raise these additional funds by borrowing under our revolving line of credit, the sale of equity securities or the issuance of new term debt secured by the same assets as the term loans which we fully repaid in 2010. There is no guarantee that additional capital will be available from these sources on reasonable terms, if at all, and certain of these sources may require approval by existing lenders. Funds we expect to be available under our existing revolving line of credit may not be available and other lenders could refuse to provide us with additional debt financing. The public markets may be unreceptive to equity financings and we may not be able to obtain additional private equity or debt financing. Any equity financing would likely be dilutive to stockholders and additional debt financing, if available, may include restrictive covenants and increased interest rates that would limit our currently planned operations and strategies. We believe the credit markets are particularly restrictive and it may be more difficult to obtain funding versus recent history. Furthermore, even if additional capital is available, it may

not be of the magnitude required to meet our needs under these or other scenarios. If additional funds are required and are not available, it would likely have a material adverse effect on our business, financial condition and our ability to continue as a going concern.

The loss of significant customers who, for example, are historically large purchasers or who are considered leaders in their field could damage our business and financial results.

Revenue from Merck entities, including Merck Animal Health, represented approximately 10% and 11% of our consolidated revenue for the three months and six months ended June 30, 2013, respectively as well as 13% and 11% for the three and six months ended June 30, 2012, respectively. No other single customer accounted for more than 10% of our consolidated revenue for the three months and six months ended June 30, 2013 nor the three months and six months ended June 30, 2012. No single customer accounted for more than 10% of our consolidated accounts receivable at June 30, 2013 and June 30, 2012.

The loss of significant customers who, for example, are historically large purchasers or who are considered leaders in their field could damage our business and financial results.

We rely substantially on third-party suppliers. The loss of products or delays in product availability from one or more third-party suppliers could substantially harm our business.

To be successful, we must contract for the supply of, or manufacture ourselves, current and future products of appropriate quantity, quality and cost. Such products must be available on a timely basis and be in compliance with any regulatory requirements. Similarly, we must provide ourselves, or contract for the supply of certain services. Such services must be provided in a timely and appropriate manner. Failure to do any of the above could substantially harm our business.

We rely on third-party suppliers to manufacture those products we do not manufacture ourselves and to provide services we do not provide ourselves. Proprietary products provided by these suppliers represent a majority of our revenue. We currently rely on these suppliers for our veterinary instruments and consumable supplies for these instruments, for key components of our point-of-care diagnostic tests as well as for the manufacture of other products.

The loss of access to products from one or more suppliers could have a significant, negative impact on our business. Major suppliers who sell us proprietary products which are responsible for more than 5% of our Pro forma LTM revenue are Boule Medical AB, Cuattro, LLC, FUJIFILM Corporation and Quidel Corporation. None of these suppliers sold us proprietary products which were responsible for more than 25% of our Pro forma LTM revenue, although the proprietary products of one of these suppliers was responsible for more than 20% of our Pro forma LTM revenue and two of the three others were responsible for more than 10% of our Pro forma LTM revenue. We often purchase products from our suppliers under agreements that are of limited duration or potentially can be terminated on an annual basis. In the case of our major veterinary blood testing instruments and our digital radiography solutions we are typically entitled to non-exclusive access to consumable supplies, or ongoing non-exclusive access to products and services to meet the needs of an existing customer base, respectively, for a defined period upon expiration of exclusive rights, which could subject us to competitive pressures in the period of non-exclusive access. Although we believe we will be able to maintain supply of our major product and service offerings in the near future, there can be no assurance that our suppliers will meet their obligations under any agreements we may have in place with them or that we will be able to compel them to do so. Risks of relying on suppliers include:

- Inability to meet minimum obligations. Current agreements, or agreements we may negotiate in the future, may commit us to certain minimum purchase or other spending obligations. It is possible we will not be able to create the market demand to meet such obligations, which could create a drain on our financial resources and liquidity. Some such agreements may require minimum purchases and/or sales to maintain product rights and we may be significantly harmed if we are unable to meet such requirements and lose product rights.

- Loss of exclusivity. In the case of our blood testing instruments, if we are entitled to non-exclusive access to consumable supplies for a defined period upon expiration of exclusive rights, we may face increased competition

from a third party with similar non-exclusive access or our former supplier, which could cause us to lose customers and/or significantly decrease our margins and could significantly affect our financial results. In addition, current agreements, or agreements we may negotiate in the future, with suppliers may require us to meet minimum annual sales levels to maintain our position as the exclusive distributor of these products. We may not meet these minimum sales levels and maintain exclusivity over the distribution and sale of these products. If we are not the exclusive distributor of these products, competition may increase significantly, reducing our revenues and/or decreasing our margins.

- Changes in economics. An underlying change in the economics with a supplier, such as a large price increase or new requirement of large minimum purchase amounts, could have a significant, adverse effect on our business, particularly if we are unable to identify and implement an alternative source of supply in a timely manner.

- The loss of product rights upon expiration or termination of an existing agreement. Unless we are able to find an alternate supply of a similar product, we would not be able to continue to offer our customers the same breadth of products and our sales and operating results would likely suffer. In the case of an instrument supplier, we could also potentially suffer the loss of sales of consumable supplies, which would be significant in cases where we have built a significant installed base, further harming our sales prospects and opportunities. Even if we were able to find an alternate supply for a product to which we lost rights, we would likely face increased competition from the product whose rights we lost being marketed by a third party or the former supplier and it may take us additional time and expense to gain the necessary approvals and launch an alternative product.

- High switching costs. In our blood testing instrument products we could face significant competition and lose all or some of the consumable revenues from the installed base of those instruments if we were to switch to a competitive instrument. If we need to change to other commercial manufacturing contractors for certain of our regulated products, additional regulatory licenses or approvals generally must be obtained for these contractors prior to our use. This would require new testing and compliance inspections prior to sale thus resulting in potential delays. Any new manufacturer would have to be educated in, or develop, substantially equivalent processes necessary for the production of our products. We likely would have to train our sales force, distribution network employees and customer support organization on the new product and spend significant funds marketing the new product to our customer base.

- The involuntary or voluntary discontinuation of a product line. Unless we are able to find an alternate supply of a similar product in this or similar circumstances with any product, we would not be able to continue to offer our customers the same breadth of products and our sales would likely suffer. Even if we are able to identify an alternate supply, it may take us additional time and expense to gain the necessary approvals and launch an alternative product, especially if the product is discontinued unexpectedly.

- Inconsistent or inadequate quality control. We may not be able to control or adequately monitor the quality of products we receive from our suppliers. Poor quality items could damage our reputation with our customers.

- Limited capacity or ability to scale capacity. If market demand for our products increases suddenly, our current suppliers might not be able to fulfill our commercial needs, which would require us to seek new manufacturing arrangements and may result in substantial delays in meeting market demand. If we consistently generate more demand for a product than a given supplier is capable of handling, it could lead to large backorders and potentially lost sales to competitive products that are readily available. This could require us to seek or fund new sources of supply, which may be difficult to find or under terms that are less advantageous if available.

- Regulatory risk. Our manufacturing facility and those of some of our third-party suppliers are subject to ongoing periodic unannounced inspection by regulatory authorities, including the FDA, USDA and other federal, state and foreign agencies for compliance with strictly enforced Good Manufacturing Practices, regulations and similar foreign standards. We do not have control over our suppliers' compliance with these regulations and standards. Regulatory violations could potentially lead to interruptions in supply that could cause us to lose sales to readily available competitive products.

- Developmental delays. We may experience delays in the scale-up quantities needed for product development that could delay regulatory submissions and commercialization of our products in development, causing us to miss key opportunities.

- Limited intellectual property rights. We typically do not have intellectual property rights, or may have to share intellectual property rights, to the products supplied by third parties and any improvements to the manufacturing processes or new manufacturing processes for these products.

Potential problems with suppliers such as those discussed above could substantially decrease sales, lead to higher costs and/or damage our reputation with our customers due to factors such as poor quality goods or delays in order fulfillment, resulting in our being unable to sell our products effectively and substantially harm our business.

If the third parties to whom we granted substantial marketing rights for certain of our existing products or future products under development are not successful in marketing those products, then our sales and financial position may suffer.

Our agreements with our corporate marketing partners generally contain no or small minimum purchase requirements in order for them to maintain their exclusive marketing rights. We are party to an agreement with Merck Animal Health, which grants Merck Animal Health exclusive distribution and marketing rights for our canine heartworm preventive product, TRI-HEART Plus Chewable Tablets, ultimately sold to or through veterinarians in the United States. Novartis Agro K.K., Tokyo ("Novartis Japan") markets and distributes our SOLO STEP CH heartworm test in Japan under an exclusive arrangement. AgriLabs has the non-exclusive right to sell certain of our bovine vaccines in the United States, Africa and Mexico and currently generates the majority of our sales of those vaccines in those territories. One or more of these marketing partners may not devote sufficient resources to marketing our products and our sales and financial position could suffer significantly as a result. Revenue from Merck entities, including Merck Animal Health, represented 9% of our Pro forma LTM revenue. If Merck Animal Health personnel fail to market, sell and support our heartworm preventive sufficiently, our sales could decline significantly. Furthermore, there may be nothing to prevent these partners from pursuing alternative technologies or products that may compete with our products in current or future agreements. For example, we believe a unit of Merck has obtained FDA approval for a canine heartworm preventive product with additional claims compared with our TRI-HEART Plus Chewable Tablets, which we believe is not currently being marketed actively. Should Merck decide to emphasize sales and marketing efforts of this product rather than our TRI-HEART Plus Chewable Tablets or cancel our agreement regarding canine heartworm preventive distribution and marketing, our sales could decline significantly. In the future, third-party marketing assistance may not be available on reasonable terms, if at all. If any of these events occur, we may not be able to maintain our current market share or commercialize our products and our sales will decline accordingly.

We depend on key personnel for our future success. If we lose our key personnel or are unable to attract and retain additional personnel, we may be unable to achieve our goals.

Our future success is substantially dependent on the efforts of our senior management and other key personnel. The loss of the services of members of our senior management or other key personnel may significantly delay or prevent the achievement of our business objectives. Although we have an employment agreement with many of these individuals, all are at-will employees, which means that either the employee or Heska may terminate employment at any time without prior notice. If we lose the services of, or fail to recruit, key personnel, the growth of our business could be substantially impaired. We do not maintain key person life insurance for any of our senior management or key personnel.

Our future revenues depend on successful product development, commercialization and/or market acceptance, any of which can be slower than we expect or may not occur.

The product development and regulatory approval process for many of our potential products is extensive and may take substantially longer than we anticipate. Research projects may fail. New products that we may be developing for the veterinary marketplace may not perform consistent with our expectations. Because we have limited resources to devote to product development and commercialization, any delay in the development of one product or reallocation of resources to product development efforts that prove unsuccessful may delay or

jeopardize the development of other product candidates. If we fail to successfully develop new products and bring them to market in a timely manner, our ability to generate additional revenue will decrease.

Even if we are successful in the development of a product or obtain rights to a product from a third-party supplier, we may experience delays or shortfalls in commercialization and/or market acceptance of the product. For example, veterinarians may be slow to adopt a product or there may be delays in producing large volumes of a product. The former is particularly likely where there is no comparable product available or historical use of such a product. The ultimate adoption of a new product by veterinarians, the rate of such adoption and the extent veterinarians choose to integrate such a product into their practice are all important factors in the economic success of one of our new products and are factors that we do not control to a large extent. If our products do not achieve a significant level of market acceptance, demand for our products will not develop as expected and our revenues will be lower than we anticipate. For example, our VitalPath Blood Gas and Electrolyte Analyzer generated less revenue than we anticipated following its launch in May 2010 as placements of this product with customers have not occurred as we expected.

Many of our expenses are fixed and if factors beyond our control cause our revenue to fluctuate, this fluctuation could cause greater than expected losses, cash flow and liquidity shortfalls.

We believe that our future operating results will fluctuate on a quarterly basis due to a variety of factors which are generally beyond our control, including:

- supply of products from third-party suppliers or termination, cancelation or expiration of such relationships;
- competition and pricing pressures from competitive products;
- the introduction of new products or services by our competitors or by us;
- large customers failing to purchase at historical levels;
- fundamental shifts in market demand;
- manufacturing delays;
- shipment problems;
- information technology problems, which may prevent us from conducting our business effectively, or at all, and may also raise our costs;
- regulatory and other delays in product development;
- product recalls or other issues which may raise our costs;
- changes in our reputation and/or market acceptance of our current or new products; and
- changes in the mix of products sold.

We have high operating expenses, including those related to personnel. Many of these expenses are fixed in the short term and may increase over the course of the coming year. If any of the factors listed above cause our revenues to decline, our operating results could be substantially harmed.

Our stock price has historically experienced high volatility, and could do so in the future, including experiencing a material price decline resulting from a large sale in a short period of time. In addition, our Public Common Stock has certain transfer restrictions which could reduce trading liquidity from what it otherwise would have been and have other undesired effects. Our recently completed 1-for-10 reverse stock split could also reduce liquidity in our stock.

According to the latest available filings with the SEC of which we are aware, we have two shareholders who control more than 5% of our shares outstanding: one holds approximately 9% of our shares outstanding and the other holds approximately 6% of our shares outstanding. Should either of these shareholders or another relatively large shareholder decide to sell a large number of shares in a short period of time, it could lead to an excess supply of our shares available for sale and correspondingly result in a significant decline in our stock price. For example, we had a shareholder who held over 16% of our shares outstanding as of September 30, 2011 sell all of its holdings in our stock

on or before December 7, 2011 – and we believe this contributed to a corresponding decline in our stock price during this period.

The securities markets have experienced significant price and volume fluctuations and the market prices of securities of many microcap and smallcap companies have in the past been, and can in the future be expected to

be, especially volatile. During the twelve months ended June 30, 2013, our closing stock price has ranged from a low of $6.89 to a high of $11.20. Fluctuations in the trading price or liquidity of our Public Common Stock may adversely affect our ability to raise capital through future equity financings. Factors that may have a significant impact on the market price and marketability of our Public Common Stock include:

- stock sales by large stockholders or by insiders;
- changes in the outlook for our business;
- our quarterly operating results, including as compared to expected revenue or earnings and in comparison to historical results;
- termination, cancellation or expiration of our third-party supplier relationships;
- announcements of technological innovations or new products by our competitors or by us;
- litigation;
- regulatory developments, including delays in product introductions;
- developments or disputes concerning patents or proprietary rights;
- availability of our revolving line of credit and compliance with debt covenants;
- releases of reports by securities analysts;
- economic and other external factors; and
- general market conditions.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted. If a securities class action suit is filed against us, it is likely we would incur substantial legal fees and our management's attention and resources would be diverted from operating our business in order to respond to the litigation.

On May 4, 2010, our shareholders approved an amendment (the "Amendment") to our Restated Certificate of Incorporation. The Amendment places restrictions on the transfer of our stock that could adversely affect our ability to use our domestic Federal Net Operating Loss carryforward ("NOL"). In particular, the Amendment prevents the transfer of shares without the approval of our Board of Directors if, as a consequence, an individual, entity or groups of individuals or entities would become a 5-percent holder under Section 382 of the Internal Revenue Code of 1986, as amended, and the related Treasury regulations, and also prevents any existing 5-percent holder from increasing his or her ownership position in the Company without the approval of our Board of Directors. This may cause certain individuals or entities who may have otherwise been willing and able to bid on our stock to not do so, reducing the class of potential acquirers and trading liquidity from what it otherwise might have been. The Amendment could also have an adverse impact on the value of our stock if certain buyers who would otherwise have purchased our stock, including buyers who may not be comfortable owning stock with transfer restrictions, do not purchase our stock as a result of the Amendment. In addition, because some corporate takeovers occur through the acquirer's purchase, in the public market or otherwise, of sufficient shares to give it control of a company, any provision that restricts the transfer of shares can have the effect of preventing a takeover. The Amendment could discourage or otherwise prevent accumulations of substantial blocks of shares in which our stockholders might receive a substantial premium above market value and might tend to insulate management and the Board of Directors against the possibility of removal to a greater degree than had the Amendment not passed.

We completed a 1-for-10 reverse stock split effective December 30, 2010. The liquidity of our Public Common Stock could be adversely affected by the reduced number of shares resulting from the reverse stock split. Our reverse stock split may have left certain stockholders with one or more "odd lots", which are stock holdings in fewer than 100 shares of Public Common Stock. These odd lots may be more difficult to sell and may incur higher brokerage commissions when sold than shares of our Public Common Stock in multiples of 100, reducing liquidity. Furthermore, due to the increased price per share following our 1-for-10 reverse stock split, certain smaller investors may be unwilling or unable to purchase shares of our Public Common Stock, also reducing liquidity.

We often depend on third parties for products we intend to introduce in the future. If our current relationships and collaborations are not successful, we may not be able to introduce the products we intend to in the future.

We are often dependent on third parties and collaborative partners to successfully and timely perform research and development activities to successfully develop new products. For example, we jointly developed point-of-care diagnostic products with Quidel. In other cases, we have discussed Heska marketing in the veterinary market an instrument being developed by a third party for use in the human health care market. In the future, one or more of these third parties or collaborative partners may not complete research and development activities in a timely fashion, or at all. Even if these third parties are successful in their research and development activities, we may not be able to come to an economic agreement with them. If these third parties or collaborative partners fail to complete research and development activities, fail to complete them in a timely fashion, or if we are unable to negotiate economic agreements with such third parties or collaborative partners, our ability to introduce new products will be impacted negatively and our revenues may decline. For example, we have experienced delays compared to our expectations in our development of products in collaboration with Rapid Diagnostek, Inc.

We may face costly legal disputes, including related to our intellectual property or technology or that of our suppliers or collaborators.

We may face legal disputes related to our business. Even if meritless, these disputes may require significant expenditures on our part and could entail a significant distraction to members of our management team or other key employees. We may have to use legal means to collect payment for goods shipped to third parties. A legal dispute leading to an unfavorable ruling or settlement could have significant material adverse consequences on our business.

We may become subject to patent infringement claims and litigation in the United States or other countries or interference proceedings conducted in the United States Patent and Trademark Office, or USPTO, to determine the priority of inventions. The defense and prosecution of intellectual property suits, USPTO interference proceedings and related legal and administrative proceedings are likely to be costly, time-consuming and distracting. As is typical in our industry, from time to time we and our collaborators and suppliers have received, and may in the future receive, notices from third parties claiming infringement and invitations to take licenses under third-party patents. Any legal action against us or our collaborators or suppliers may require us or our collaborators or suppliers to obtain one or more licenses in order to market or manufacture affected products or services. However, we or our collaborators or suppliers may not be able to obtain licenses for technology patented by others on commercially reasonable terms, or at all, may not be able to develop alternative approaches if unable to obtain licenses or current and future licenses may not be adequate, any of which could substantially harm our business.

We may also need to pursue litigation to enforce any patents issued to us or our collaborative partners, to protect trade secrets or know-how owned by us or our collaborative partners, or to determine the enforceability, scope and validity of the proprietary rights of others. Any litigation or interference proceedings will likely result in substantial expense to us and significant diversion of the efforts of our technical and management personnel. Any adverse determination in litigation or interference proceedings could subject us to significant liabilities to third parties. Further, as a result of litigation or other proceedings, we may be required to seek licenses from third parties which may not be available on commercially reasonable terms, if at all.

If we are unable to maintain various financial and other covenants required by our credit facility agreement we will be unable to borrow any funds under the agreement and fund our operations.

Under our credit and security agreement with Wells Fargo, we are required to comply with various financial and non-financial covenants in order to borrow under the agreement. The availability of borrowings under this agreement

may be important to continue to fund our operations. Among the financial covenants is a requirement to maintain minimum liquidity (cash plus excess borrowing base) of $1.5 million. Additional requirements include covenants for minimum capital monthly and minimum net income quarterly. Although we believe we will be able to maintain compliance with all these covenants and any covenants we may negotiate in the future, there can be no assurance thereof. We have not always been able to maintain compliance with all

covenants under our credit and security agreement with Wells Fargo. For example, we failed to comply with the net income covenant as of June 30, 2013, for which we obtained a waiver and subsequently negotiated new covenants. Although Wells Fargo granted us a waiver of non-compliance in each case, there can be no assurance we will be able to obtain similar waivers or other modifications if needed in the future on economic terms, if at all. Failure to comply with any of the covenants, representations or warranties, or failure to modify them to allow future compliance, could result in our being in default and could cause all outstanding borrowings under our credit and security agreement to become immediately due and payable, or impact our ability to borrow under the agreement. In addition, Wells Fargo has discretion in setting the advance rates which we may borrow against eligible assets. We may need to rely on available borrowings under the credit and security agreement to fund our operations in the future. If we are unable to borrow funds under this agreement, we will need to raise additional capital from other sources to continue our operations, which capital may not be available on acceptable terms, or at all.

Interpretation of existing legislation, regulations and rules, including financial accounting standards, or implementation of future legislation, regulations and rules could cause our costs to increase or could harm us in other ways.

We prepare our financial statements in conformance with United States generally accepted accounting principles, or GAAP. These accounting principles are established by and are subject to interpretation by the SEC, the Financial Accounting Standards Board ("FASB") and others who interpret and create accounting policies. A change in those policies can have a significant effect on our reported results and may affect our reporting of transactions completed before a change is made effective. Such changes may adversely affect our reported financial results, the way we conduct our business or have a negative impact on us if we fail to track such changes. For example, we have found FASB's recent decision to codify the accounting standards has made it more difficult to research complex accounting matters, increasing the risk we will fail to account consistent with FASB rules in the future. Similarly, changes in the underlying circumstances which we apply given accounting standards and principles may affect our results of operations and have a negative impact on us.

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") has increased our required administrative actions and expenses as a public company since its enactment. The general and administrative costs of complying with Sarbanes-Oxley will depend on how it is interpreted over time. Of particular concern are the level of standards for internal control evaluation and reporting adopted under Section 404 of Sarbanes-Oxley. If our regulators and/or auditors adopt or interpret more stringent standards than we anticipate, we and/or our auditors may be unable to conclude that our internal controls over financial reporting are designed and operating effectively, which could adversely affect investor confidence in our financial statements. Even if we and our auditors are able to conclude that our internal controls over financial reporting are designed and operating effectively in such a circumstance, our general and administrative costs are likely to increase. In addition, if our stock market value increases to a certain level on June 30, 2014, we will be required to have our independent registered public accountant conduct an audit of our internal controls, which would increase our general and administrative costs. Similarly, we are required to comply with the SEC's mandate to provide interactive data using the eXtensible Business Reporting Language as an exhibit to certain SEC filings in 2013. Compliance with this mandate has required a significant time investment, which has and may in the future preclude some of our employees from spending time on more productive matters. In addition, actions by other entities, such as enhanced rules to maintain our listing on the Nasdaq Capital Market, could also increase our general and administrative costs or have other adverse effects on us, as could further legislative, regulatory or rule-making action or more stringent interpretations of existing legislation, regulations and rules.

Obtaining and maintaining regulatory approvals in order to market our products may be costly and delay the marketing and sales of our products. Failure to meet all regulatory requirements could cause significant losses from affected inventory and the loss of market share.

Many of the products we develop, market or manufacture may subject us to extensive regulation by one or more of the USDA, the FDA, the EPA and foreign and other regulatory authorities. These regulations govern, among other things, the development, testing, manufacturing, labeling, storage, pre-market approval, advertising, promotion and sale of some of our products. Satisfaction of these requirements can take several years and time needed to satisfy them may vary substantially, based on the type, complexity and novelty of the product. The

decision by a regulatory authority to regulate a currently non-regulated product or product area could significantly impact our revenue and have a corresponding adverse impact on our financial performance and position while we attempt to comply with the new regulation, if such compliance is possible at all.

The effect of government regulation may be to delay or to prevent marketing of our products for a considerable period of time and to impose costly procedures upon our activities. We have experienced in the past, and may experience in the future, difficulties that could delay or prevent us from obtaining the regulatory approval or license necessary to introduce or market our products. Such delays in approval may cause us to forego a significant portion of a new product's sales in its first year due to seasonality and advanced booking periods associated with certain products. Regulatory approval of our products may also impose limitations on the indicated or intended uses for which our products may be marketed. Difficulties in making established products to all regulatory specifications may lead to significant losses related to affected inventory as well as market share. For instance, in 2010 we discovered we had produced a significant level of cattle vaccine product in our OVP segment which conformed to regulatory specifications for safety, potency and efficacy but not purity. We did not ship any related cattle vaccine product in the three months ended June 30, 2010 as we investigated and worked to resolve the situation. There can be no assurance that our efforts at remediation to ensure this or similar problems will not recur in the future will be successful or that the USDA will not suspend our ability to produce these, similar or other products for an extended time at some point in the future.

Among the conditions for certain regulatory approvals is the requirement that our facilities and/or the facilities of our third-party manufacturers conform to current Good Manufacturing Practices and other requirements. If any regulatory authority determines that our manufacturing facilities or those of our third-party manufacturers do not conform to appropriate manufacturing requirements, we or the manufacturers of our products may be subject to sanctions, including, but not limited to, warning letters, manufacturing suspensions, product recalls or seizures, injunctions, refusal to permit products to be imported into or exported out of the United States, refusals of regulatory authorities to grant approval or to allow us to enter into government supply contracts, withdrawals of previously approved marketing applications, civil fines and criminal prosecutions. In addition, certain of our agreements may require us to pay penalties if we are unable to supply products, including for failure to maintain regulatory approvals. Any of these events, alone or in unison, could damage our business.

Our Public Common Stock is listed on the Nasdaq Capital Market and we may not be able to maintain that listing, which may make it more difficult for you to sell your shares. In addition, we have less than 300 record holders, which would allow us to terminate voluntarily the registration of our common stock with the SEC and after which we would no longer be eligible to maintain the listing of our Public Common Stock on the Nasdaq Capital Market.

Our Public Common Stock is listed on the Nasdaq Capital Market. The Nasdaq has several quantitative and qualitative requirements companies must comply with to maintain this listing, including a $1.00 minimum bid price. We completed a 1-for-10 reverse stock split effective December 30, 2010 in order to resolve an ongoing minimum bid price deficiency. While we believe we are currently in compliance with all Nasdaq requirements, there can be no assurance we will continue to meet Nasdaq listing requirements including the minimum bid price, that Nasdaq will interpret these requirements in the same manner we do if we believe we meet the requirements, or that Nasdaq will not change such requirements or add new requirements to include requirements we do not meet in the future. If we are delisted from the Nasdaq Capital Market, our Public Common Stock may be considered a penny stock under the regulations of the SEC and would therefore be subject to rules that impose additional sales practice requirements on broker-dealers who sell our securities. The additional burdens imposed upon broker-dealers may discourage broker-dealers from effecting transactions in our Public Common Stock, which could severely limit market liquidity of the Public Common Stock and any stockholder's ability to sell our securities in the secondary market. This lack of liquidity would also likely make it more difficult for us to raise capital in the future.

We have less than 300 recordholders as of our latest information, a fact which would make us eligible to terminate voluntarily the registration of our common stock with the SEC and therefore suspend our reporting obligations with the SEC under the Exchange Act and become a non-reporting company. If we were to cease reporting with the SEC, we would no longer be eligible to maintain the listing of our common stock on the

Nasdaq Stock Market, which we would expect to materially adversely affect the liquidity and market price for our common stock.

We may face product returns and product liability litigation in excess of, or not covered by, our insurance coverage or indemnities and/or warranties from our suppliers. If we become subject to product liability claims resulting from defects in our products, we may fail to achieve market acceptance of our products and our sales could substantially decline.

The testing, manufacturing and marketing of our current products as well as those currently under development entail an inherent risk of product liability claims and associated adverse publicity. Following the introduction of a product, adverse side effects may be discovered. Adverse publicity regarding such effects could affect sales of our other products for an indeterminate time period. To date, we have not experienced any material product liability claims, but any claim arising in the future could substantially harm our business. Potential product liability claims may exceed the amount of our insurance coverage or may be excluded from coverage under the terms of the policy. We may not be able to continue to obtain adequate insurance at a reasonable cost, if at all. In the event that we are held liable for a claim against which we are not indemnified or for damages exceeding the $10 million limit of our insurance coverage or which results in significant adverse publicity against us, we may lose revenue, be required to make substantial payments which could exceed our financial capacity and/or lose or fail to achieve market acceptance.

We may be held liable for the release of hazardous materials, which could result in extensive clean-up costs or otherwise harm our business.

Certain of our products and development programs produced at our Des Moines, Iowa facility involve the controlled use of hazardous and biohazardous materials, including chemicals and infectious disease agents. Although we believe that our safety procedures for handling and disposing of such materials comply with the standards prescribed by applicable local, state and federal regulations, we cannot eliminate the risk of accidental contamination or injury from these materials. In the event of such an accident, we could be held liable for any fines, penalties, remediation costs or other damages that result. Our liability for the release of hazardous materials could exceed our resources, which could lead to a shutdown of our operations, significant remediation costs and potential legal liability. In addition, we may incur substantial costs to comply with environmental regulations if we choose to expand our manufacturing capacity.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Removed and Reserved

None.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits

Number	Description
10.1*	Eighth Amendment to Supply and Distribution Agreement between Heska Corporation and Boule Medical AB, dated May 28, 2013.
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS**	XBRL Instance Document.
101.SCH**	XBRL Taxonomy Extension Schema Document.
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document.
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document.
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document.

* Confidential portions of this agreement have been omitted pursuant to a request for confidential treatment filed separately with the Securities and Exchange Commission.

** Furnished electronically with this report

HESKA CORPORATION

SIGNATURES

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

HESKA CORPORATION

Date:	August 14, 2013	By	/s/ Robert B. Grieve ROBERT B. GRIEVE Chairman of the Board and Chief Executive Officer (on behalf of the Registrant and as the Registrant's Principal Executive Officer)
Date:	August 14, 2013	By	/s/ Jason A. Napolitano JASON A. NAPOLITANO Executive Vice President and Chief Financial Officer (on behalf of the Registrant and as the Registrant's Principal Financial Officer)

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