SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1998

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

FOR THE TRANSITION PERIOD FROM _____ TO _____.

COMMISSION FILE NUMBER 0-23081

FARO TECHNOLOGIES, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

FLORIDA	59-3157093
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NUMBER)
125 TECHNOLOGY PARK LAKE MARY, FLORIDA	32746
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE): (407) 333-9911

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS:	NAME OF EACH EXCHANGE ON WHICH REGISTERED:
NONE	NONE

SECURITIES TO BE REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
COMMON STOCK, PAR VALUE $.001

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

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

As of March 26, 1999, there were outstanding 11,343,461 shares of Common Stock. The aggregate market value of the voting stock held by nonaffiliates of the Registrant based on the last sale price reported on the Nasdaq National Market as of March 26, 1999 was $39,845,541.

DOCUMENTS INCORPORATED BY REFERENCE

DOCUMENTS	FORM 10-K REFERENCE
Portions of the Proxy Statement, dated April 2, 1999	Part III, Items 10-13

PART I

CAUTIONARY STATEMENTS FOR FORWARD-LOOKING INFORMATION

FARO Technologies, Inc. (the "Company") has made forward-looking statements in this document that are subject to risks and uncertainties. The statements contained in this report on Form 10-K that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding the Company's expectations, hopes, beliefs, intentions, or strategies regarding the future. Forward looking statements include statements regarding, among other things: (i) the potential loss of material customers; (ii) the failure to properly manage growth and successfully integrate acquired businesses; (iii) the Company's financing plans; (iv) trends affecting the Company's financial condition or results of operations; (v) the Company's growth and operating strategies; (vi) the ability to attract and

retain qualified sales, information services and management personnel; (vii) the impact of competition from new and existing competitors; (viii) the financial condition of the Company's clients; (ix) potential increases in the Company's costs; (x) the declaration and payment of dividends; (xi) the potential for unfavorable interpretation of existing government regulations or new government legislation; (xii) the ability of the Company and its significant suppliers and large customers to address the year 2000 Issue; and (xiii) the outcome of certain litigation involving the Company. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors. All forward-looking statements included in this document are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statement. Among the factors that could cause actual results to differ materially are the factors detailed in Items 1 through 3 and 7 of this report and the risks discussed under the caption "Risk Factors" included in the Company's filings under the Securities Act of 1933. Prospective investors should also consult the risks described from time to time in the Company's Reports on Form 10-Q, 8-K, 10-K and Annual Reports to Shareholders.

ITEM 1. BUSINESS.

INDUSTRY BACKGROUND

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

existing products. The benefits of CAD are significant. The CAD process offers a three-dimensional, highly-efficient and inherently flexible alternative to traditional design methods. Many manufacturers have also recently adopted computer-aided manufacturing ("CAM") technology, in which CAD data directs machines in the manufacturing process. CAM has further improved the efficiency and quality of the production of manufactured goods.

A significant aspect of the manufacturing process which traditionally has not benefitted from computer-aided technology is measurement and quality inspection. Historically, manufacturers have measured and inspected products using hand-measurement tools such as scales, calipers, micrometers and plumb lines for simple measuring tasks, test fixtures for certain large manufactured products and traditional coordinate measurement machines ("CMMs") for objects that require higher precision measurement. However, the broader utility of each of these measurement methods is limited. Although hand-measurement tools are often appropriate for simple measurements, their use for complex measurements is time-consuming and limited in adaptability. Test fixtures (customized fixed tools used to make comparative measurements of production parts to "master parts") are relatively expensive and must be reworked or discarded each time a dimensional change is made in the part being measured. In addition, these manual measuring devices do not permit the manufacturer to compare the dimensions of an object with its CAD model.

Conventional CMMs are generally large, fixed-base machines that provide very high levels of precision but have only recently begun to provide a link to the CAD model of the object being measured. Fixed-base CMM's require that the object being measured be brought to the CMM and that the object fit within the CMM's measurement grid. In addition, conventional CMMs generally operate in metrology laboratories or environmentally-stable quality inspection departments of manufacturing facilities rather than on the factory floor.

Isolation from the factory floor and the relatively small measurement grids of CMMs limit their utility to small, readily portable workpieces that require high levels of measurement precision. As manufactured subassemblies increase in size and become integrated into even larger assemblies, they become less transportable, thus diminishing the utility of a conventional CMM. Consequently, manufacturers must continue to use hand-measuring tools or expensive customized test fixtures to measure large or unconventionally shaped objects.

An increasingly competitive global marketplace has created a demand for higher quality products with shorter life cycles. While manufacturers previously designed their products to be in production for longer periods of time, current manufacturing practices must accommodate more frequent product introductions and modifications, while satisfying more stringent quality and safety standards. In most cases, only a relatively small percentage of the components of a manufactured product requires highly precise measurements (less than one-thousandth of an inch). Conventional CMMs provide manufacturers with very precise measurement capabilities and cost up to $2 million per unit. However, they are not responsive to manufacturers' increasing need for cost-effective intermediate precision measurement capabilities. The Company believes that a greater percentage of components

requires intermediate precision measurements (between one- and twenty-thousandths of an inch). In the absence of intermediate precision measuring systems, manufacturers often are unable to make appropriate measurements or part-to-CAD comparisons during the manufacturing process, resulting in decreased productivity, poor product quality and unacceptable levels of product rework and scrap. Manufacturers increasingly require more rapid design, greater control of the manufacturing process, tools to compare components to their CAD specifications and the ability to measure precisely components that cannot be measured or inspected by conventional CMMs. Moreover, they increasingly require measurement capabilities to be integrated into the manufacturing process and to be available on the factory floor.

FARO'S BUSINESS

The Company designs, develops, markets and supports portable, software-driven, 3-D measurement systems that are used in a broad range of manufacturing and industrial applications. In May 1998 the Company acquired CATS Computer Aided Technologies, GmbH ("CATS"), a German company which develops and markets CAD-based inspection and statistical process control ("SPC") software. The acquisition of CATS provides the Company with a stronger marketing presence in Europe, as well as an expanded software product line under the Company's AnthroCam/registered trademark/ product name. The Company's principal products are the FAROArm/registered trademark/ articulated measuring device and its multi-faceted AnthroCam/registered trademark/ software which provides for CAD-based inspection on portable and fixed-base CMMs, and factory-level statistical process control. Together, these products integrate the measurement and quality inspection function with CAD, CAM and computer-aided engineering ("CAE") technology to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company's products bring precision measurement, quality inspection and specification conformance capabilities, integrated with leading CAD software, to the factory floor. The Company is a pioneer in the development and marketing of 3-D measurement technology in manufacturing and industrial applications and currently holds or has pending 23 patents in the United States, 13 of which also are held or pending in other jurisdictions. The Company's products have been purchased by more than 1100 customers worldwide, ranging from small machine shops to such large manufacturing and industrial companies as General Motors, DaimlerChrysler, Ford, Boeing, Lockheed Martin, General Electric, Westinghouse Electric, Caterpillar and Komatsu Dresser.

FARO PRODUCTS

THE FAROARM/registered trademark/. The FAROArm/registered trademark/ is a portable, six-axis, instrumented, articulated device that approximates the range of motion and dexterity of the human arm. Each articulated arm is comprised of three major joints, each of which may consist of one, two or three axes of motion. The FAROArm/registered trademark/ is available in a variety of sizes, configurations and precision levels that are suitable for a broad range of applications. To take a measurement, the operator simply touches the object to be measured with a probe at the end of the arm and presses a button. Data can be captured as either individual points or a series of points.

Digital rotational transducers located at each of the joints of the arm measure the angles at those joints. This rotational measurement data is transmitted to an on-board controller that converts the arm angles to precise locations in 3-D space using "xyz" position coordinates and "ijk" orientation coordinates.

The FAROArm/registered trademark/ has been designed as an open architecture system. The communications parameters of the on-board processors have the ability to combine advanced sensing probes, integrate with conventional CMM software and communicate with different CAD software packages and a variety of computer operating systems. This open architecture is designed to provide for easy integration of the FAROArm/registered trademark/ into the manufacturing environment. The customer's ability to use an installed base of computing hardware and software further reduces the cost of installation and training while initiating the transition to the Company's preferred group of CAD-based products. To encourage integration of the FAROArm/registered trademark/ into the manufacturing environment, the Company provides a group of seamless interface drivers for leading CAD/CAM packages, including AutoCAD/registered trademark/, CADKey/registered trademark/ and SURFCAM/registered trademark/. The Company also provides a full serial communication command protocol to the FAROArm/registered trademark/ for customers who write their own interfaces.

The Company offers several models of the FAROArm/registered trademark/ under three product lines: the Gold Series, Silver Series and the Sterling Series.

GOLD SERIES. The Gold Series models are the Company's highest precision (P.001 to P.005 inches) measuring devices and are available in four, six, eight, ten and twelve foot measurement diameters. These models are used for factory floor inspection and fit checking applications requiring higher precision than the Silver Series. Depending on the component of the AnthroCam software, the Gold Series models are priced between $50,000 and $60,000 when sold as a turnkey system including hardware, computer and software and $45,000 without computer and software.

SILVER SERIES. The Silver Series models are the Company's intermediate precision (P.003 to P.007 inches) measuring devices and are available in eight and twelve foot measurement diameters. These models are most frequently used for factory floor inspection and fit-checking applications. Depending on the component of the AnthroCam software, the Silver Series models are priced at $40,000 and $50,000 when sold as a turnkey system including hardware, computer and AnthroCam/registered trademark/ software and $35,000 without computer and software.

STERLING SERIES. The Sterling Series models are the Company's lighter-weight, medium precision (P.002 to P.007 inches) measuring devices and are available in four, six, eight and ten foot measurement diameters. These models are most frequently used for applications that do not require high-level precision, such as 3-D modeling, mold production and reverse-engineering applications. Depending on the component of AnthroCam software, the Sterling Series models are priced between $30,000 and $40,000 when sold as a turnkey system including hardware, computer and AnthroCam/registered trademark/ software and $25,000 without computer and software.

ANTHROCAM/registered trademark/. AnthroCam is the Company's proprietary CAD-based measurement and statistical process control software. The AnthroCam product line includes six (6) software programs:

ANTHROCAM CAD ANALYZER/registered trademark/ allows users to convert very large, complex CAD files from engineering workstations into simpler graphical images which make them available on a personal computer level for numerous applications throughout the factory from assembly and inspection planning, to the creation of user or service manuals. AnthroCam CAD Analyzer/registered trademark/ sells for $6,500

ANTHROCAM DESIGN/registered trademark/ allows users to measure older parts without data files, or models of potential products and convert them into CAD files for manufacturing. It is built on the AutoCAD/registered trademark/ software development platform, which allows users to benefit from extensive hardware, software, interfacing and software support libraries and teaching products. AnthroCam Design/registered trademark/ is offered with the FAROArm/registered trademark/ and is also offered as an unbundled product. When unbundled from the FAROArm/registered trademark/, AnthroCam Design/registered trademark/ sells for $26,000.

ANTHROCAM MEASURE/registered trademark/ allows users to compare measurements of manufactured components or assemblies with the corresponding CAD data for the components or assemblies. AnthroCam Measure/registered trademark/ is offered with the FAROArm/registered trademark/ and is also offered as an unbundled product. When unbundled from the FAROArm/registered trademark/, AnthroCam Measure/registered trademark/ sells for $16,000.

ANTHROCAM AUTOMOTIVE/registered trademark/ also allows users to compare measurements of manufactured components with the corresponding CAD file. Unlike AnthroCam Measure/registered trademark/, AnthroCam Automotive/registered trademark/ is especially suited to the measurement of very large components with large CAD files, typical of those in the automotive industry. AnthroCam Automotive/registered trademark/ is offered with the FAROArm/registered trademark/ and is also offered as an unbundled product. When unbundled from the FAROArm/registered trademark/, AnthroCam Automotive/registered trademark/ sells for $20,000.

ANTHROCAM SPC GRAPH/registered trademark/ allows the user to organize and compare measurement results from the FAROArm in the form of pictures, tables, and charts, for the purpose of statistical process control. AnthroCam SPC Graph/registered trademark/ is tailored to an individual user. AnthroCam SPC Graph/registered trademark/ sells for $1,000.

ANTHROCAM SPC PROCESS/registered trademark/ allows for the collection, organization, and presentation of measurement data factory-wide. Not limited to measurements from the FAROArm/registered trademark/, AnthroCAM SPC Process/registered trademark/ accepts data from CMMs and other computer-based measurement devices from many different measurement applications along the production line. AnthroCam SPC Process/registered trademark/ sells for $90,000 per assembly line.

DEVELOPMENT OF A NEW TRADEMARK

In February 1999 the Company filed an application in the United States Patent and Trademark Office (the "Trademark Office") for the trademark CAM2. Upon initial acceptance

of the CAM2 trademark by the Trademark Office, the Company intends to rename its software family preface from AnthroCam/registered trademark/ to CAM2.

SPECIALTY PRODUCTS. The Company licenses and supports certain specialty products based on its articulated arm technology that are used in medical and multimedia applications. License and support fees from these products do not represent a significant portion of the Company's revenues and the Company does not intend to actively market these products.

The Company's products overcome many limitations of hand-measurement tools, test fixtures and conventional CMMs by incorporating the following features:

INTEGRATION WITH CAD TECHNOLOGY. The Company's products provide a bridge between the virtual 3-D world of the CAD process and the physical 3-D world of the factory floor. The interface to CAD allows manufacturers to integrate design, production and measurement and quality inspection processes on a common software platform. The Company believes that this integration creates significant savings by reducing the need for test fixtures and improves productivity by reducing production set-up times. Finally, the Company's integration with CAD technology significantly enhances product quality by maximizing the opportunities to make precise measurements based on engineering specifications within the manufacturing process.

SIX-AXIS ARTICULATING ARM. The FAROArm/registered trademark/ incorporates a six-axis instrumented, articulating device that approximates the range of motion and dexterity of the human arm. The flexibility of the FAROArm/registered trademark/ enables the user to measure complex shapes and ergonomic structures and to reach behind, underneath and into previously inaccessible spaces, such as interior surfaces of aircraft or automobiles. The flexibility of the FAROArm/registered trademark/ allows customers to measure more accurately and efficiently than previously possible.

PORTABILITY AND ADAPTABILITY. The FAROArm/registered trademark/ is lightweight, portable and designed for operation in the often harsh environments typical of manufacturing facilities. The FAROArm/registered trademark/ can be moved to multiple locations on the factory floor to measure large parts and assemblies that cannot be easily moved to a conventional CMM. This portability extends 3-D measurement to previously inaccessible areas of the factory floor and eliminates the travel time to and from quality inspection departments.

LEVELS OF PRECISION RESPONSIVE TO INDUSTRY NEEDS. The Company's products respond to manufacturers' need for intermediate levels of measurement precision. Although high levels of precision (less than one-thousandth of an inch) are required for certain manufacturing applications, the FAROArm/registered trademark/ satisfies the greater demand for measurements that require intermediate precision (one- to twenty-thousandths of an inch). The Company's products meet the precision measurement requirements of a substantial portion of products in the manufacturing process and address the underserved market for intermediate precision measurement systems.

BROAD AFFORDABILITY. The Company offers various models of the FAROArm/registered trademark/ ranging in price from $25,000 to $60,000, while conventional CMMs range in price from $20,000 to $2 million. The relatively low cost of the Company's products compared to conventional CMMs has afforded manufacturers the opportunity to introduce cost-effective measurement and quality inspection functions throughout the manufacturing process. Manufacturers are able to purchase multiple units to be used at different locations within a single manufacturing facility and to introduce measurement and quality inspection at additional points in the manufacturing process.

EASE OF USE. The Company's software products have been specifically designed to be used by production line personnel with minimal prior computer or CAD experience. The bundled hardware and software system is designed to require minimal training for production line personnel to reach proficiency with the product. To take a measurement, the operator simply touches the object to be measured with a probe at the end of the arm and presses a button. The FAROArm/registered trademark/ is also ergonomically designed to facilitate use in typical factory floor applications.

PAPERLESS DATA COLLECTION. The FAROArm/registered trademark/ allows for paperless data collection by a connected computer hosting related CAD application software. This function responds to current trends toward automated statistical process controls for facilitating data analysis. Paperless data collection improves productivity and eliminates the risk of error in transcribing the collected information.

OPEN ARCHITECTURE. The FAROArm/registered trademark/ and AnthroCam/registered trademark/ have been designed as an open architecture system, allowing the user to unbundle the hardware and software to interface the FAROArm/registered trademark/ with other CAD-based software packages and to interface AnthroCam/registered trademark/ with other 3-D measurement devices. In addition, the Company's software and hardware are built in accordance with computer and communications industry standards so that these products may be integrated with a broad range of application software packages.

CUSTOMERS

The Company's products have been purchased by more than 1100 customers ranging from small machine shops to large manufacturing and industrial companies. The Company's ten largest customers by revenue represented an aggregate of 19% of the Company's total revenues in 1998. No customer represented 10.0% or more of the Company's sales in 1998. The following table illustrates, by vertical market, the Company's diverse customer base:

AEROSPACE	APPAREL AND FOOTWEAR	AUTOMOTIVE
Boeing	Nike	AO Smith
GE Aircraft Engines	Reebok	DaimlerChrysler
Lockheed Martin		General Motors
Nordam Repair Division		Samsung Motors
Northrop Grumman		HyundaiToyota
Orbital Sciences		Vehma International
Dee Howard		Johnson Controls
		Lear Corporation
		Porsche
		Ford
		Honda
BUSINESS AND CONSUMER MACHINES	ELECTRIC UTILITIES AND MANUFACTURERS	FARM/LAWN EQUIPMENT
Corning Asahi	General Electric	New Holland North America
Xerox	Southern California Edison	Toro
	Tennessee Valley Authority	
	Westinghouse Electric	
HEAVY EQUIPMENT MANUFACTURERS	PERSONAL ROAD/ WATER/ SNOW CRAFT	PLASTICS
Caterpillar	Harley Davidson	Able Design Plastics
Komatsu Dresser	Polaris Industries	Paramount Plastics
Champion Road Machinery		Thermoform Plastics
Texas Steel		

SALES AND MARKETING

The Company directs its sales and marketing efforts from its headquarters in Lake Mary, Florida. At December 31, 1998, the Company employed 68 sales professionals who operate from the Company's headquarters, seven domestic regional sales offices located in Charlotte, Chicago, Columbus (Ohio), Dallas, Detroit, Los Angeles and Seattle, four German regional sales offices in Stuttgart, Munich, Gladbeck and Hanover, and sales offices located in Coventry, United Kingdom, and suburban Paris, France. The Company also utilizes six domestic and 24 international distributors in territories where the Company does not have regional sales offices. See Footnote 13 to the Notes to Consolidated Financial Statements incorporated by reference herein from Item 8 hereof for financial information about the Company's foreign and domestic operations and export sales required by this Item.

The Company uses a process of integrated lead qualification and sales demonstration. Once a customer opportunity is identified, the Company employs a team-based sales approach involving inside and outside sales personnel who are supported by application engineers.

The Company employs a variety of marketing techniques, including direct mail, trade shows, and advertising in trade journals, and proactively seeks publicity opportunities for customer testimonials. Management believes that word-of-mouth advertising from the Company's existing customers provides an important marketing advantage. The Company also has a computerized sales and marketing software system with telemarketing, lead tracking and analysis, as well as customer support capabilities. Each of the Company's sales offices is linked electronically to the Company's headquarters.

In June 1996, the Company entered into an OEM agreement with Mitutoyo Corporation ("Mitutoyo"), a Japanese company that is the world's largest manufacturer of metrology tools. Mitutoyo markets the FAROArm/registered trademark/ in Japan under the name SPINARM/registered trademark/. The agreement, which grants Mitutoyo a non-exclusive right to sales in Japan, expires in June 1999 and is renewable for successive one-year terms.

In March 1999, the Company entered into an OEM agreement with Brown & Sharpe Manufacturing Company ("Brown & Sharpe"), a North Kingstown, Rhode Island company that is a world leader in the manufacture of traditional CMMs and other metrology products. Brown & Sharpe will market the FAROArm/registered trademark/ worldwide under the name GAGE 2000 A. The agreement, which grants Brown & Sharpe a non-exclusive right to sales worldwide, expires in March 2000, and is renewable for successive one-year terms.

RESEARCH AND DEVELOPMENT

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

The Company's research and development efforts are directed primarily at enhancing the technology of its current products and developing new and innovative products that respond to specific requirements of the emerging market for 3-D measurement systems. The Company's research and development efforts have been devoted primarily to mechanical hardware, electronics and software. The Company's acquisition of CATS resulted in the addition of 11 software developers to the research and development efforts. The Company's engineering development efforts will continue to focus on the FAROArm/registered trademark/ and the family of AnthroCam/registered trademark/ products. Significant efforts are also being directed toward the development of new measurement technologies and additional features for existing products. See "Technology."

At December 31, 1998, the Company employed 43 scientists and technicians in its research and development efforts. Research and development expenses were $2,587,000 in 1998 as compared to $1,076,000 in 1997 and $730,000 in 1996. Research and development activities, especially with respect to new products and technologies, are subject to significant risks, and there can be no assurance that any of the Company's research and development activities will be completed successfully or on schedule, or, if so completed, will be commercially accepted.

TECHNOLOGY

The primary measurement function of the FAROArm/registered trademark/ is to provide orientation and position information with respect to the probe at the end of the FAROArm/registered trademark/. This information is processed by software and can be compared to the desired dimensions of the CAD data of a production part or assembly to determine whether the measured data conforms to meet dimensional specifications.

To accomplish this measurement function, the FAROArm/registered trademark/ is designed as an articulated arm with six or seven joints. The arm consists of aluminum links and rotating joints that are combined in different lengths and configurations, resulting in human arm-like characteristics. Each joint is instrumented with a rotational transducer, a device used to measure rotation, which is based on optical digital technology. The position and orientation of the probe in three dimensions is determined by applying trigonometric calculations at each joint. The position of the end of a link of the arm can be determined by using the angle measured and the known length of the link. Through a complex summation of these calculations at each joint, the position and orientation of the probe is determined.

The Company's products are the result of a successful integration of state-of-the-art developments in mechanical and electronic hardware and applications software. The unique nature of the Company's technical developments is evidenced by the Company's numerous U.S. and international patents. The Company maintains low cost product design processes by retaining development responsibilities for all electronics, hardware and software.

MECHANICAL HARDWARE. The FAROArm/registered trademark/ is designed to function in diverse environments and under rigorous physical conditions. The arm monitors its temperature to adjust for environments ranging from -10 degrees to +50 degrees Celsius. The arm is constructed of pre-stressed precision bearings to resist shock loads. Low production costs are attained by the proprietary combination of reasonably priced electromechanical components accompanied by the optimization and on-board storage of calibration data. Many of the Company's innovations relate to the environmental adaptability of its products. Significant features include integrated counter-balancing, configuration convertibility and temperature compensation.

ELECTRONICS. The rotational information for each joint is processed by an on-board computer that is designed to handle complex analyses of joint data as well as communications with a variety of host computers. The Company's electronics are based on

digital signal processing and surface mount technologies. The Company's products meet all mandatory electronic safety requirements. Advanced circuit board development, surface mount production and automated testing methods are used to ensure low cost and high reliability.

SOFTWARE. AnthroCam/registered trademark/ is a Windows-based, 32-bit application family written for the most recent PC-based technology. AnthroCam/registered trademark/ has been entirely designed and programmed by the Company utilizing field input and industry wide beta site installations. AnthroCam CADanalyser/registered trademark/ is a family member for viewing, analyzing and browsing CAD files. AnthroCam Design/registered trademark/ is a family member primarily used for reverse engineering and is written as an AutoCAD runtime extension (ARX) that is the AutoCAD Application Programming Interface (API). Family member AnthroCam Measure/registered trademark/ is simplified version of Design for pure measurement applications written entirely on the ACIS CAD development platform. Family member AnthroCam Automotive/registered trademark/ is a measurement software designed for large CAD files and specific Automotive applications and is written using a proprietary graphics display engine. Family member AnthroCam SPC Process/registered trademark/ is designed for plant wide dimensional data acquisition and presentation in classical SPC (Statistical Process Control) formats for plant-wide quality control.

All the AnthroCam/registered trademark/ family members are written in the C++ development language using Microsoft Foundation Class (MFC) standards. The software fully implements UNICODE standards for worldwide translation allowing the Company to create foreign language versions to enter international markets more effectively. The software is developed with the cooperation of diverse user beta sites and a well developed system for tracking and implementing market demands.

INTELLECTUAL PROPERTY

The Company holds or has pending 23 patents in the United States, 13 of which are also held or pending in other jurisdictions. The Company also has 13 registered trademarks in the United States, 10 foreign registered trademarks, 10 trademark applications pending in the United States and 15 foreign trademark applications pending.

The Company relies on a combination of contractual provisions and trade secret laws to protect its proprietary information. There can be no assurance that the steps taken by the Company to protect its trade secrets and proprietary information will be sufficient to prevent misappropriation of its proprietary information or to preclude third-party development of similar intellectual property.

Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of the Company's products or to obtain and use information that the Company regards as proprietary. The Company intends to vigorously defend its proprietary rights against infringement by third parties. However, policing unauthorized use of the Company's products is difficult, particularly overseas, and the Company is unable to determine the extent to which piracy of its software products exists. In addition, the laws of

some foreign countries do not protect the Company's proprietary rights to the same extent as the laws of the United States.

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

MANUFACTURING AND ASSEMBLY

The Company manufactures its products primarily at its headquarters in Lake Mary, Florida. Manufacturing consists primarily of assembling components and subassemblies purchased from suppliers into finished products. The primary components, which include machined parts and electronic circuit boards, are produced by subcontractors according to the Company's specifications. All products are assembled, calibrated and finally tested for accuracy and functionality before shipment. In limited circumstances, the Company performs in-house circuit board assembly and part machining.

"Quality" has rapidly emerged as a new emphasis in commerce and industry, and is a significant factor in international trade. Various national and multinational standards have been developed in the quality systems arena for commercial and industrial use. On September 3, 1998 the Company announced that the Company's quality management system received ISO 9001 certification from Bureau Veritas Quality International, an international ISO auditor based in Jamestown, New York. The ISO 9000 series of quality assurance standards ("ISO 9000"), which is administered by the American National Standards Institute, was developed to bring together existing multinational standards and to provide consistence in quality and terminology. ISO 9000 Certification demonstrates that a company has implemented an adequate quality system for products and services it offers. By this, better internal commitment, as well as enhanced purchaser confidence, may be achieved.

COMPETITION

The broad market for measurement devices, which includes hand-measurement tools, test fixtures and conventional, fixed-base CMMs, is highly competitive. Manufacturers of hand-measurement tools and traditional CMMs include a significant number of well-established companies that are substantially larger and possess substantially greater financial, technical and marketing resources than the Company. There can be no assurance that these entities or others will not succeed in developing products or technologies that will directly compete with those of the Company. The market for measurement software to retrofit traditional CMMs, and for statistical process control is also highly competitive. The

Company will be required to make continued investments in technology and product development to maintain its technological advantage over its competition. There can be no assurance that the Company will have sufficient resources to make such investments or that the Company's product development efforts will be sufficient to allow the Company to compete successfully as the industry evolves. The Company's products compete on the basis of portability, accuracy, application features, ease-of-use, quality, price and technical support.

The Company's only significant direct competitor for its FAROArm/registered trademark/ and related software is a joint venture of Romer SRL (France) and Romer, Inc. (California). The Company is aware of a direct competitor in Germany, two direct competitors in Italy, and a new direct competitor in the United Kingdom, each of which the Company believes currently has negligible sales. The Company also has an established, indirect competitor in Japan that markets a measuring device that is mobile but not portable. There can be no assurance that such companies will not devote additional resources to the development and marketing of products that compete with those of the Company.

The worldwide trend toward CAD-based factory floor metrology has resulted in the introduction of CAD-based inspection software and statistical process control for conventional CMMs by most of the large CMM manufacturers. Certain CMM manufacturers are miniaturizing, and in some cases increasing the mobility of, their conventional CMMs. Nonetheless, these CMMs still have small measurement volumes, lack the adaptability typical of portable, articulated arm measurement devices and lose accuracy outside the controlled environment of the metrology lab.

BACKLOG

At December 31, 1998, the Company had orders representing $844,000 in sales. All outstanding orders at December 31, 1998 were shipped by March 3, 1999.

EMPLOYEES

At December 31, 1998, the Company had 190 full-time employees, consisting of 68 sales/application engineering staff, 36 production staff, 43 research and development staff, 33 administrative staff, and 10 customer service specialists. None of the Company's employees is represented by a labor organization, and the Company is not a party to any collective bargaining agreements. The Company believes its employee relations are good. Management believes that its future growth and success will depend in part on its ability to retain and continue to attract highly skilled personnel. The Company anticipates that it will obtain the additional personnel required to satisfy the staffing requirements caused by its planned expansion over the next 12 months.

EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of the Company, as well as certain key employees, and their ages, are as follows:

NAME	AGE	PRINCIPAL POSITION
EXECUTIVE OFFICERS:		
Simon Raab	45	Chairman of the Board, Chief Executive Officer, and President
Gregory A. Fraser	44	Chief Financial Officer, Executive Vice President, Secretary, and Treasurer
KEY EMPLOYEES:		
Ali S. Sajedi	38	Chief Engineer

SIMON RAAB, PH.D., a co-founder of the Company, has served as the Chairman of the Board, Chief Executive Officer and a director of the Company since its inception in 1982 and as President since 1986. Mr. Raab holds a Ph.D. in Mechanical Engineering from McGill University, Montreal, Canada, a Masters of Engineering Physics from Cornell University and a Bachelor of Science in Physics with a minor in Biophysics from the University of Waterloo, Canada.

GREGORY A. FRASER, PH.D., a co-founder of the Company, has served as Chief Financial Officer and Executive Vice President since May 1997 and as Secretary, Treasurer and a director of the Company since its inception in 1982. Mr. Fraser holds a Ph.D. in Mechanical Engineering from McGill University, Montreal, Canada, a Masters of Theoretical and Applied Mechanics from Northwestern University and a Bachelor of Science and Bachelor of Mechanical Engineering from Northwestern University.

ALI S. SAJEDI has been Chief Engineer for the Company since its inception in 1982. Mr. Sajedi has been responsible for implementation of research and development plans and for production oversight of the Company's self-managed production team. Mr. Sajedi holds a Bachelor of Mechanical Engineering from McGill University.

ITEM 2. PROPERTIES.

The Company's headquarters and principal operations are located in a leased building in Lake Mary, Florida containing approximately 35,000 square feet. The Company's European headquarters are located in a leased building in Karlsruhe, Germany containing approximately 4,400 square feet. The Company has a combined sales and research and development facility which is located in a leased building in Aveiro, Portugal containing approximately 2,800 square feet. The Company believes that its current facilities will be adequate for its foreseeable needs and that it will be able to locate suitable space for additional regional offices as those needs develop.

In addition, the Company has seven sales offices in the United States and six sales offices in Europe. All of the offices comprising the sales offices are leased by the Company.

The information required by the remainder of this Item is incorporated herein by reference to Exhibit 99.1 attached hereto.

ITEM 3. LEGAL PROCEEDINGS.

On April 2, 1998 the Company filed an action for declaratory judgement action against Kosaka Laboratory Ltd. of Tokyo, Japan (Civil Action No. 98-381-CIV-ORL-19A in the Federal Court for the Middle District of Florida). The Company seeks to have the Court declare its rights with regard to Kosaka's U.S. Patent number 4,430,796 regarding a method of measuring an object using, for example, a coordinate measuring machine (CMM), when an object is larger than the coordinate system physically measurable by the CMM. Over the past one to two years, the Company and Kosaka have sought to resolve this matter in an amicable manner. However, Kosaka has persisted in its erroneous claims that its patent is infringed by the Company, and has threatened to file suit if the Company did not pay a relatively large licensing fee. In order to make it clear to the market that the Company does not infringe the patent, the Company decided to file the above mentioned action. The Company strongly believes that the outcome to this declaratory judgement action will be favorable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of security holders during the last quarter of calendar 1998.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The Company's Common Stock, par value $.001 per share, began trading on the NASDAQ Stock Market on September 18, 1997, under the symbol FARO. Before that date, there was no established public trading market for the Common Stock. The following table sets forth the high and low sale price of the Company's Common Stock since its initial public offering:

	1997	
	HIGH	LOW
September 18-30	18-1/8	15-3/8
Fourth Quarter	18	11-5/8

	1998	
	HIGH	LOW
First Quarter	14-1/2	10
Second Quarter	12-1/2	9-1/4
Third Quarter	11-3/8	2-3/8
Fourth Quarter	4-1/16	2-3/8

The Company has not paid any cash dividends on its Common Stock to date. The payment of dividends, if any in the future is within the discretion of the Board of Directors and will depend on the Company's earnings, its capital requirements and financial condition, and may be restricted by future credit arrangements entered into by the Company. The Company expects to retain future earnings for use in operating and expanding its business and does not anticipate paying any cash dividends in the reasonably foreseeable future. As of March 26, 1999, there were approximately 59 holders of record of Common Stock.

On August 10, 1998 the prospectus comprising part of the Company's Registration Statement on Form S-1, File No. 333-57395, was declared effective by the Securities and Exchange Commission. Common Stock was the only class of securities registered. Of the 343,750 shares registered, none had been sold as at March 26, 1999.

On August 26, 1998 the Board of Directors authorized the officers of the Company, without further approval of the Board, to purchase in the open market, up to a maximum of one million shares of the Company's Common Stock. During the period August 26, 1998 to December 31, 1998 the Company purchased 40,000 shares of Common Stock in the open market.

ITEM 6. SELECTED FINANCIAL DATA.

SELECTED CONSOLIDATED FINANCIAL DATA

The following is a summary of selected financial data of the Company and its subsidiaries as of and for each of the five years ended December 31, 1998. The historical consolidated financial data has been derived from the historical financial statements of the Company. These data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's Consolidated Financial Statements appearing elsewhere in this document.

Year ended December 31,	1998	1997	1996	1995	1994
STATEMENT OF OPERATIONS DATA:					
Sales	$ 27,514,699	$23,516,385	$14,656,337	$9,862,242	$4,508,837
Cost of sales	11,291,313	9,610,838	6,486,268	4,987,779	2,222,085
Gross Profit	16,223,386	13,905,547	8,170,069	4,874,463	2,286,752
Operating expenses:					
Selling	9,960,914	5,676,113	3,731,762	2,008,301	1,569,014
General and administrative	3,161,599	1,519,657	744,206	503,184	521,040
Depreciation and amortization	2,816,135	293,996	230,799	341,494	270,615
Research and development	2,587,181	1,075,505	730,124	363,871	173,400
Employee stock options	172,164	408,000	23,100	106,700	--
Purchased in-process research and development costs	3,210,000	--	--	--	--
Total operating expenses	21,907,993	8,973,271	5,459,991	3,323,550	2,534,069
(Loss) income from operations	(5,684,607)	4,932,276	2,710,078	1,550,913	(247,317)
Interest income	1,077,713	442,444	--	--	--
Other income	139,355	57,308	25,145	62,212	11,706
Interest expense	(13,023)	(110,768)	(212,669)	(355,468)	(192,543)
Income (loss) before income taxes	(4,480,562)	5,321,260	2,522,554	1,257,657	(428,154)
Income tax expense (benefit)	450,532	2,114,630	1,115,892	(342,000)	--
Net income (loss)	$ (4,931,094)	$ 3,206,630	$ 1,406,662	$1,599,657	$ (428,154)
Net income (loss) per common share:					
Basic	$ (0.46)	$ 0.41	$ 0.20	$ 0.23	$ (0.06)
Assuming dilution	$ (0.46)	$ 0.39	$ 0.19	$ 0.22	$ (0.06)
Weighted-average common Share outstanding:					
Basic	10,632,708	7,831,715	7,000,000	7,000,000	7,000,000
Assuming dilution	10,728,783	8,189,048	7,349,041	7,166,739	7,149,690

At December 31,	1998	1997	1996	1995	1994
CONSOLIDATED BALANCE SHEET DATA:					
Working capital	$30,997,769	$37,277,545	$3,832,424	$1,321,517	$ (718,564)
Total assets	49,120,147	41,192,333	7,815,668	5,479,698	4,229,551
Total debt	333,554	--	1,501,267	2,200,000	2,925,000
Total shareholders' equity	45,375,391	38,939,411	3,773,699	2,343,937	637,580

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

THE FOLLOWING INFORMATION SHOULD BE READ IN CONJUNCTION WITH THE CONSOLIDATED FINANCIAL STATEMENTS OF THE COMPANY, INCLUDING THE NOTES THERETO, INCLUDED ELSEWHERE IN THIS DOCUMENT.

OVERVIEW

The Company designs, develops, markets and supports portable, software-driven, 3-D measurement systems that are used in a broad range of manufacturing and industrial applications. In May 1998 the Company acquired CATS Computer Aided Technologies, GmbH ("CATS"), a German company which develops and markets CAD-based inspection and statistical process control ("SPC") software. The Company's principal products are the FAROArm/registered trademark/ articulated measuring device and its multi-faceted AnthroCam/registered trademark/ software which provides for CAD-based inspection on portable and fixed-base CMMs, and factory-level statistical process control. Together, these products integrate the measurement and quality inspection function with CAD, CAM and computer-aided engineering ("CAE") technology to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company's products bring precision measurement, quality inspection and specification conformance capabilities, integrated with leading CAD software, to the factory floor. The Company is a pioneer in the development and marketing of 3-D measurement technology in manufacturing and industrial applications and currently holds or has pending 23 patents in the United States, 13 of which also are held or pending in other jurisdictions. The Company's products have been purchased by more than 1,100 customers worldwide, ranging from small machine shops to such large manufacturing and industrial companies as General Motors, DaimlerChrysler, Ford, Boeing, Lockheed Martin, General Electric, Westinghouse Electric, Caterpillar and Komatsu Dresser.

From its inception in 1982 through 1992, the Company focused on providing computerized, 3-D measurement devices to the orthopedic and neurosurgical markets. During this period, the company introduced a knee laxity measurement device, a diagnostic tool for measuring posture, scoliosis and back flexibility, and a surgical guidance device utilizing a six-axis articulated arm.

In 1992, in an effort to capitalize on a demand for 3-D portable measurement tools for the factory floor, the Company made a strategic decision to target its core measurement technology to the manufacturing and industrial markets. In order to focus on manufacturing and industrial applications of its technology, the Company phased out the direct sale of its medical products and entered into licensing agreements with two major neurosurgical companies for its medical technology. In 1995, the Company made a strategic decision to target international markets. The Company established sales offices in France and Germany in 1996 and Great Britain in 1997. International sales represented 26.1% of sales in 1996 and 35.0% of sales in 1997, and 57% of sales in 1998.

The Company derives revenues primarily from the sale of the FAROArm/registered trademark/, its six-axis articulated measuring device, and its multi-faceted AnthroCam/registered trademark/ software. Revenue related to these products is recognized upon shipment.

Revenue growth has resulted from increased unit sales due to an expanded sales effort that included the addition of sales personnel at existing offices, the opening of new sales offices, expanded promotional efforts and the acquisition of CATS. In September 1998 the Company announced the introduction of a new product line consisting of two additional FAROArm models, and the addition of 3 new software components to the AnthroCam family, from the CATS acquisition.

In addition to providing a one-year basic warranty without additional charge, the Company offers its customers one, two and three-year extended maintenance contracts, which include on-line help services, software upgrades and hardware warranties. In addition, the Company sells training and technology consulting services relating to its products. The Company recognizes the revenue from extended maintenance contracts proportionately as costs are projected to be incurred.

Cost of sales consists primarily of material, production overhead and labor. Selling expenses consist primarily of salaries and commissions to sales and marketing personnel, and promotion, advertising, travel and telecommunications. General and administrative expenses consist primarily of salaries for administrative personnel, rent, utilities and professional and legal expenses. Research and development expenses represent salaries, equipment and third-party services.

Accounting for wholly-owned foreign subsidiaries is maintained in the currency of the respective foreign jurisdiction and, therefore, fluctuations in exchange rates may have an impact on intercompany accounts reflected in the Company's consolidated financial statements. Although the Company has not historically engaged in any hedging transactions to limit risks of currency fluctuations, it intends to do so in the future.

RESULTS OF OPERATIONS

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

	Year Ended December 31,		
	1998	1997	1996
STATEMENT OF OPERATIONS DATA:			
Sales	100.0%	100.0%	100.0%
Cost of sales	41.0	40.9	44.3
Gross profit	59.0	59.1	55.7
Operating expenses:			
Selling	36.2	24.1	25.5
General and administrative	11.5	6.5	5.1
Depreciation and amortization	10.2	1.3	1.6
Research and development	9.4	4.6	5.0
Employee stock options	0.6	1.7	0.2
Total operating expenses	79.6	38.2	37.4
(Loss) income from operations	(20.7)	20.9	18.3
Interest Income	3.9	1.9	-
Other income	0.5	0.2	0.2
Interest expense	--	(0.5)	(1.5)
(Loss) income before income taxes	(16.3)	22.5	17.0
Income tax expense	1.6	9.0	7.6
Net (loss) income	(17.9)%	13.5%	9.4%

1998 COMPARED TO 1997

SALES. Sales increased $4.0 million, or 17.0%, from $23.5 million in 1997 to $27.5 million in 1998. The increase was a result of increases in sales in Europe ($5.4 million) and Canada ($634,000), offset by decreases in sales in Asia ($992,000) and the United States ($841,000).

GROSS PROFIT. Gross profit increased $2.3 million, or 16.7%, from $13.9 million in 1997 to $16.2 million in 1998. This increase was a result of a proportional increase in sales in 1998, at a gross margin of 59.0%, virtually unchanged from 59.1% in 1997.

SELLING EXPENSES. Selling expenses increased $4.3 million, or 75.5%, from $5.7 million in 1997 to $10.0 million in 1998. This increase was primarily the result of a 100% increase in the number of sales and marketing staff, and their resulting sales activities. The number of sales and marketing employees grew from 34 at December 31, 1997 to 68 at December 31, 1998. The cost per sales employee was higher in 1998 in part as a result of the greater proportion (primarily as a result of the CATS acquisition) of European employees and the higher cost of payroll benefits and travel costs in Europe.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses increased $1.6 million, or 108.0% from $1.5 million in 1997, to $3.2 million in 1998. This increase resulted primarily from the increased number of administrative personnel both at the Company's headquarters and from the acquisition of CATS.

DEPRECIATION AND AMORTIZATION EXPENSES. Depreciation and amortization expenses increased $2.5 million or 857.9%, from $294,000 in 1997 to $2.8 million in 1998. This increase was primarily due to $2.2 million in amortization expenses related to the intangible assets associated with the Company's acquisition of CATS.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses increased $1.5 million, or 140.6%, from $1.1 million in 1997 to $2.6 million in 1998. This increase was a result of an increase in the number of research and development employees from 14 at December 31, 1997 to 43 at December 31, 1998.

EMPLOYEE STOCK OPTIONS. Employee stock option expenses decreased $236,000, or 57.8%, from $408,000 in 1997 to $172,000 in 1998. This decrease was a result of a reduction in the amortized deferred compensation expense relating to stock options issued in 1995 and 1997. For all options issued in 1998, no compensation expense was recorded, as the exercise price of the options was equal to the market price at the day of the grant.

IN-PROCESS RESEARCH AND DEVELOPMENT RESULTING FROM ACQUISITION. On May 15, 1998 the Company acquired CATS for $5 million and 916,668 of the Company's common stock and the assumption of certain liabilities. The $3.2 million portion of the purchase price that was attributed to in process research and development and was expensed immediately.

INTEREST INCOME. Interest income increased $635,000 or 143.6%, from $442,000 in 1997 to $1.1 million in 1998. This increase was a result of a full year of interest in 1998 on the remaining portion of the proceeds from the Company's initial public offering in September 1997, compared to approximately three months of interest on the portion of these proceeds which were invested in 1997.

INCOME TAX EXPENSE. Income tax expense decreased $1.7 million or 78.7% from $2.1 million in 1997 to $451,000 in 1998. The income tax provision in 1998 results primarily from the Company's U.S operations being in a taxable position, and the deferred tax benefit of the Company's foreign loss being offset by a $3 million valuation allowance.

NET INCOME (LOSS). The Company's net income (loss) for 1998 decreased $8.1 million, from net income of $3.2 million in 1997 to a net loss of $4.9 million in 1998. This decrease was a result of a one-time in-process research and development charge ($3.2 million), amortization costs related to the CATS acquisition ($2.2 million), and higher sales, general and administrative, and research and development expenses as a percentage of sales.

1997 COMPARED TO 1996

SALES. Sales increased $8.9 million, or 60.5%, from $14.6 million in 1996 to $23.5 million in 1997. The increase was primarily the result of increased unit sales due to an

expanded sales effort that included the addition of sales personnel at existing offices, and the opening of sales offices. International sales increased to 35.0% of total sales in 1997, from 26.1% in 1996, in part because of increased sales in the European countries in which the Company has sales offices, and increased sales to several international distributors.

GROSS PROFIT. Gross profit increased $5.7 million, or 70.2%, from $8.2 million in 1996 to $13.9 million in 1997. Gross margin increased from 55.7% in 1996 to 59.1% in 1997. This margin increase was attributable to a reduction in product costs as a result of technological improvements, purchasing economies and production efficiencies.

SELLING EXPENSES. Selling expenses increased $1.9 million, or 52.1%, from $3.7 million in 1996 to $5.7 million in 1997. This increase was a result of the Company's expansion of sales and marketing staff in the United States and Europe, and expanded promotional efforts. Specifically, hiring, training, and salary expenses increased $965,000, sales commissions and bonuses increased $378,000, and promotional expenses increased $333,000. Selling expenses as a percentage of sales decreased from 25.5% in 1996 to 24.1% in 1997.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses increased $775,000, or 104.2%, from $774,000 in 1996 to $1.5 million in 1997. This increase resulted primarily from the hiring of additional administrative personnel, and increases in professional and legal expenses, in part as a result of the Company's periodic reporting requirements with the Securities and Exchange Commission resulting from the Company's initial public offering in September 1997. General and administrative expenses as a percentage of sales increased from 5.1% in 1996 to 6.5% in 1997.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses increased $345,000, or 47.3%, from $730,000 in 1996 to $1.1 million in 1997. This increase was primarily a result of a $246,000 increase in hiring, training, and salary cost related to new personnel. Research and development expenses as a percentage of sales decreased from 5.0% in 1996 to 4.6% in 1997, as the growth in these expenses did not match the percentage growth in sales.

EMPLOYEE STOCK OPTIONS EXPENSES. Employee stock options expenses increased $385,000 from $23,000 in 1996 to $408,000 in 1997. This increase was primarily attributable to the grant of 52,733 options in May 1997, which was made at an exercise price below the fair market value of the Common Stock on the date of the grant.

OTHER INCOME. Other income increased $475,000 from $25,000 in 1996 to $500,000 in 1997. This increase was attributable to interest income on the $30 million proceeds from the Company's initial public offering in 1997.

INTEREST EXPENSE. Interest expense decreased $102,000, or 47.9%, from $213,000 in 1996 to $111,000 in 1997. This reduction was attributable to the refinancing of the Company's indebtedness at a lower interest rate, and also the utilization of the proceeds from the Company's initial public offering to repay all indebtedness.

INCOME TAX EXPENSE. Income tax expense increased $999,000, or 89.5%, from $1.1 million in 1996 to $2.1 million in 1997. The provision for income taxes as a percentage of income before income taxes was 44.2% in the twelve months of 1996 and 39.7% in the twelve months of 1997. The lower effective tax rate in 1997 was because of a higher Research and Development tax credit and the creation of a Foreign Sales Corporation.

NET INCOME. Net income increased $1.8 million, or 128.0%, from $1.4 million in 1996 to $3.2 million in 1997. This increase was a result of increased sales, higher gross margin, $442,000 in interest income in 1997 which was zero in 1996, and a lower tax rate.

LIQUIDITY AND CAPITAL RESOURCES

In September 1997, the Company completed an initial public offering of common stock which provided net proceeds of $31.7 million. For the year ended December 31, 1998, net cash used by operating activities was $3.1 million compared to net cash used by operating activities of $705,000 for 1997. Net cash decreased due to increases in accounts receivable, inventories, and accounts payable. Net cash used in investing activities was $25.2 million for the year ended December 31, 1998 compared to $792,000 for 1997. Net cash used in investing activities increased in 1998 primarily due to a $17.0 million increase in short term investments, a $5.7 million acquisition of business, net of cash acquired, and $1.0 million in purchases of property and equipment related to the expansion of the Company's headquarters. Net cash provided by financing activities for the year ended December 31,1998 was $288,000 compared to net cash provided by financing activities of $30.2 million for 1997. The Company invests excess cash balances in short-term investment grade securities, such as money market investments, obligations of the U.S. government and its agencies, and obligations of state and local government agencies.

In April 1997, the Company obtained a one-year secured $1.0 million line of credit which bears interest at the 30-day commercial paper rate plus 2.65% per annum. There were no outstanding borrowings under this loan agreement at December 31, 1997.

The Company has available with two financial institutions short-term, revolving lines of credit aggregating $445,000. Under these lines, a subsidiary may borrow funds for operations. These lines of credit are personally guaranteed by certain shareholders. The amount outstanding on these lines at December 31, 1998 was approximately $296,000. The average interest rates on such borrowings at December 31, 1998 was 9%.

The Company's principal commitments at December 31, 1998 were leases on its headquarters and regional offices, and there were no material commitments for capital expenditures at that date. The Company believes that its cash, investments, cash flows from operations and funds available from its credit facilities will be sufficient to satisfy its working capital and capital expenditure needs at least through 1999.

FOREIGN EXCHANGE EXPOSURE

Sales outside the United States represent a significant portion of the Company's total revenues. Currently, the majority of the Company's revenues and expenses are invoiced

and paid in U.S. dollars. In the future, the Company expects a greater portion of its revenues to be denominated in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on the Company's business, results of operations and financial condition, particularly its operating margins, and could also result in exchange losses. The impact of future exchange rate fluctuations on the results of the Company's operations cannot be accurately predicted. Historically, the Company has not managed the risks associated with fluctuations in exchange rates but intends to undertake transactions to manage such risks in the future. To the extent that the percentage of the Company's non-U.S. dollar revenues derived from international sales increases in the future, the risks associated with fluctuations in foreign exchange rates will increase. The Company may use forward foreign exchange contracts with foreign currency options to hedge these risks.

INFLATION

The Company believes that inflation has not had a material impact on its results of operations in recent years and does not expect inflation to have a material impact on its operations in 1999.

YEAR 2000

The Company has invested significant resources in the latest information technologies over the past five years and therefore has minimized the effect of Year 2000 issues. Management initiated a program to evaluate all internal computer systems and applications, and products with computer systems and determined the adjustments necessary to become Year 2000 compliant. Management is confident that existing internal resources are sufficient to correct any internal systems deficiencies that have or may be determined. The Company has set a target date of September 30, 1999 for complete compliance of internal computer systems, applications, and products. The Company has also made inquiries of its major suppliers, customers and other third-party entities with which it has business relations to obtain assurances of their Year 2000 compliance. However, there can be no assurance that the systems of other companies on which the Company relies will be timely corrected, or that any failure by another company to correct such systems would not have a material adverse effect on the Company. Contingency plans are currently being developed to be implemented in the event any information technology system, non-information technology system, third party or supplier is not Year 2000 compliant in a timely manner.

The total cost to the Company of these Year 2000 Compliance activities has not been and is not anticipated to be material to its financial position or results of operations in a given year. The Company has a provision of $12,500 per quarter in 1999 to cover the cost of any unexpected corrections to any internal sysytems or product deficiencies. These costs are based on Management's best estimates, which were derived utilizing numerous assumptions of future events including the continued availability of certain resources, third party modification plans, and other factors. However, there can be no guarantee that these estimates will be achieved and actual results could differ from those plans.

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

The information required by this item is incorporated by reference herein from the section of this Report in Part II, Item 7, under the caption "Foreign Exchange Exposure."

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

INDEX TO FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders
of FARO Technologies, Inc.:

We have audited the accompanying consolidated balance sheets of FARO Technologies, Inc. and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of FARO Technologies, Inc. and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Jacksonville, Florida
February 19, 1999

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
	1998	1997
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,183,656	$28,815,069
Short-term investments	17,011,831	
Accounts receivable, less allowance for doubtful accounts of $139,690 and $9,534	8,963,343	6,159,173
Income taxes refundable	716,048	
Inventories	6,443,618	4,275,376
Prepaid expenses and other assets	155,037	109,649
Deferred income taxes	121,543	126,572
Total current assets	34,595,076	39,485,839
PROPERTY AND EQUIPMENT -- at cost:		
Machinery and equipment	1,873,146	1,014,309
Furniture and fixtures	899,616	605,913
Leasehold improvements	28,889	
Total	2,801,651	1,620,222
Less accumulated depreciation and amortization	(1,276,459)	(792,442)
Property and equipment -- net	1,525,192	827,780
INTANGIBLE ASSETS -- net	12,821,191	747,979
NOTES RECEIVABLE	178,688	
DEFERRED INCOME TAXES		130,735
TOTAL ASSETS	$ 49,120,147	$41,192,333
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short term notes payable to banks	$ 296,230	
Accounts payable and accrued liabilities	2,852,452	$ 1,196,967
Income taxes payable		413,167
Current portion unearned service revenues	329,731	476,802
Current portion of long-term debt	4,156	
Customer deposits	114,738	121,358
Total current liabilities	3,597,307	2,208,294
DEFERRED INCOME TAXES	78,220	
UNEARNED SERVICE REVENUES -- less current portion	31,905	44,628
LONG-TERM DEBT -- less current portion	37,324	
Total liabilities	3,744,756	2,252,922
COMMITMENTS AND CONTINGENCIES (Note 9)		
SHAREHOLDERS' EQUITY:		
Class A preferred stock -- par value $.001, 10,000,000 shares authorized, no shares issued and outstanding		
Common stock -- par value $.001, 20,000,000 shares authorized, 11,048,137 and 9,919,000 issued; 11,008,137 and 9,919,000 outstanding	11,048	9,919
Additional paid-in capital	47,520,732	36,502,004
Unearned compensation	(292,316)	(464,480)
Retained earnings (accumulated deficit)	(1,912,829)	3,018,265
Accumulated other comprehensive income	199,381	(126,297)
Common stock in treasury, at cost -- 40,000 shares in 1998	(150,625)	
Total shareholders' equity	45,375,391	38,939,411
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 49,120,147	$41,192,333

See notes to consolidated financial statements.

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEARS ENDED DECEMBER 31,		
	1998	1997	1996
SALES	$ 27,514,699	$23,516,385	$14,656,337
COST OF SALES	11,291,313	9,610,838	6,486,268
Gross profit	16,223,386	13,905,547	8,170,069
OPERATING EXPENSES:			
Selling	9,960,914	5,676,113	3,731,762
General and administrative	3,161,599	1,519,657	744,206
Depreciation and amortization	2,816,135	293,996	230,799
Research and development	2,587,181	1,075,505	730,124
Employee stock options	172,164	408,000	23,100
Purchased in-process research and development costs	3,210,000		
Total operating expenses	21,907,993	8,973,271	5,459,991
(LOSS) INCOME FROM OPERATIONS	(5,684,607)	4,932,276	2,710,078
OTHER INCOME (EXPENSE):			
Interest income	1,077,713	442,444	
Other income	139,355	57,308	25,145
Interest expense	(13,023)	(110,768)	(212,669)
(LOSS) INCOME BEFORE INCOME TAXES	(4,480,562)	5,321,260	2,522,554
INCOME TAX EXPENSE	450,532	2,114,630	1,115,892
NET (LOSS) INCOME	$ (4,931,094)	$3,206,630	$1,406,662
NET (LOSS) INCOME PER COMMON SHARE -- BASIC	$ (0.46)	$ 0.41	$ 0.20
NET (LOSS) INCOME PER COMMON SHARE -- DILUTED	$ (0.46)	$ 0.39	$ 0.19

See notes to consolidated financial statements.

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	COMMON STOCK		ADDITIONAL PAID-IN	UNEARNED
	SHARE	AMOUNTS	CAPITAL	COMPENSATION
BALANCE, JANUARY 1, 1996	7,000,000	$ 7,000	$ 3,971,764	$ (39,800)
Net income				
Comprehensive income				
Employee stock options, forfeitures and amortization of unearned compensation			(10,200)	33,300
BALANCE, DECEMBER 31, 1996	7,000,000	7,000	3,961,564	(6,500)
Net income				
Currency translation adjustment, net of tax				
Comprehensive income				
Granting of employee and director stock options			866,793	(501,834)
Amortization of unearned compensation				43,854
Issuance of common stock	2,919,000	2,919	31,673,647	
BALANCE, DECEMBER 31, 1997	9,919,000	9,919	36,502,004	(464,480)
Net loss				
Currency translation adjustment, net of tax				
Comprehensive loss				
Issuance of common stock	1,129,137	1,129	10,323,564	
Income tax benefit resulting from the exercise of stock options			695,164	
Amortization of unearned compensation				172,164
Acquisition of treasury stock				
BALANCE, DECEMBER 31, 1998	11,048,137	$11,048	$47,520,732	$ (292,316)

	RETAINED EARNINGS (ACCUMULATED DEFICIT)	ACCUMULATED OTHER COMPREHENSIVE INCOME	TREASURY STOCK	TOTAL
BALANCE, JANUARY 1, 1996	$(1,595,027)			$ 2,343,937
Net income	1,406,662			1,406,662
Comprehensive income				1,406,662
Employee stock options, forfeitures and amortization of unearned compensation				23,100
BALANCE, DECEMBER 31, 1996	(188,365)			3,773,699
Net income	3,206,630			3,206,630
Currency translation adjustment, net of tax		$ (126,297)		(126,297)
Comprehensive income				3,080,333
Granting of employee and director stock options				364,959
Amortization of unearned compensation				43,854
Issuance of common stock				31,676,566
BALANCE, DECEMBER 31, 1997	3,018,265	(126,297)		38,939,411
Net loss	(4,931,094)			(4,931,094)
Currency translation adjustment, net of tax		325,678		325,678
Comprehensive loss				(4,605,416)
Issuance of common stock				10,324,693
Income tax benefit resulting from the exercise of stock options				695,164
Amortization of unearned compensation				172,164
Acquisition of treasury stock			$ (150,625)	(150,625)
BALANCE, DECEMBER 31, 1998	$(1,912,829)	$ 199,381	$ (150,625)	$45,375,391

See notes to consolidated financial statements.

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

	YEARS ENDED DECEMBER 31,		
	1998	1997	1996
OPERATING ACTIVITIES:			
Net (loss) income	$ (4,931,094)	$ 3,206,630	$ 1,406,662
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Depreciation and amortization	3,030,272	701,996	253,899
Purchased in process research and development costs	3,210,000		
Provision for bad debts			28,432
Deferred income taxes	361,737	(125,107)	232,800
Loss on the sale of fixed assets		10,850	
Changes in operating assets and liabilities:			
Decrease (increase) in:			
Accounts receivable	(1,759,788)	(3,166,492)	(843,349)
Income taxes refundable	(716,048)		
Inventories	(2,137,905)	(976,632)	(1,230,457)
Notes receivable	124,683		
Prepaid expenses and other assets	66,972	(68,778)	55,435
Increase (decrease) in:			
Accounts payable and accrued liabilities	263,912	(513,847)	990,993
Income taxes payable	(413,167)	284,951	105,216
Unearned service revenues	(159,794)	50,151	471,278
Customer deposits	(6,620)	(109,035)	53,460
Net cash (used in) provided by operating activities	(3,066,840)	(705,313)	1,524,369
INVESTING ACTIVITIES:			
Purchases of property and equipment	(1,001,655)	(480,127)	(416,162)
Acquisition of business net of cash acquired	(5,668,382)		
Short-term investments	(17,011,831)		
Payment of patent costs	(105,651)	(203,549)	(134,046)
Payments for product design costs	(635,943)	(108,286)	
Payments for other intangibles	(754,559)		
Net cash used in investing activities	(25,178,021)	(791,962)	(550,208)
FINANCING ACTIVITIES:			
Repayment of related party loans			(2,200,000)
Proceeds from debt			1,625,816
Payments on debt	(186,447)	(1,501,267)	(140,556)
Proceeds from issuance of common stock, net	624,842	31,676,566	
Acquisition of treasury stock	(150,625)		
Net cash provided by (used in) financing activities	287,770	30,175,299	(714,740)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	325,678	(126,297)	
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(27,631,413)	28,551,727	259,421
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	28,815,069	263,342	3,921
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 1,183,656	$ 28,815,069	$ 263,342

See notes to consolidated financial statements.

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS -- FARO Technologies, Inc. and subsidiaries (the "Company") develops, manufactures, markets and supports Computer Aided Design (CAD)-based quality assurance products and CAD-based inspection and statistical process control software. The Company has three wholly-owned subsidiaries, FARO Worldwide, Inc, CATS GmbH, a German company, and Antares LDA, a Portugese company.

PRINCIPLES OF CONSOLIDATION -- The consolidated financial statements include the accounts of FARO and all wholly-owned subsidiaries (collectively, the "Company"). All significant intercompany transactions and balances have been eliminated. The financial statements of the foreign subsidiaries are translated into U.S. dollars using exchange rates in effect at period end for assets and liabilities and average exchange rates during each reporting period for results of operations. Adjustments resulting from translation of financial statements are reflected as a separate component of comprehensive income.

REVENUE RECOGNITION, PRODUCT WARRANTY AND EXTENDED MAINTENANCE CONTRACTS - -- Revenue related to the Company's 3-D measurement equipment and related software is recognized upon shipment as the Company considers the earnings process substantially complete as of the shipping date. Revenue from sales of software only is recognized when no further significant production, modification or customization of the software is required and where the following criteria are met: persuasive evidence of a sales agreement exists, delivery has occurred, and the sales price is fixed or determinable and collectible. Revenues resulting from sales of comprehensive support, training and technology consulting services are recognized as such services are performed. Extended maintenance plan revenues are recognized proportionately as maintenance costs are projected to be incurred. Prior to November 1, 1997, such revenues were recognized ratable over the contract term. The change in estimate with respect to the recognition of such revenues more accurately matches revenues with costs incurred. The Company warrants its products against defects in design, materials and workmanship for one year. A provision for estimated future costs relating to warranty expenses is recorded when products are shipped. Costs relating to extended maintenance plans are recognized as incurred.

CASH AND CASH EQUIVALENTS -- The Company considers cash on hand and amounts on deposit with financial institutions which have original maturities of three months or less to be cash and cash equivalents.

SHORT-TERM INVESTMENTS -- Short-term investments ordinarily consist of short-term debt securities acquired with cash not immediately needed in operations. Such amounts have maturities of less than one year.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--(CONTINUED)

INVENTORIES -- Inventories are stated at the lower of average cost or net realizable value. In order to achieve a better matching of production costs with the revenues generated in production, certain fixed overhead costs and certain general and administrative costs that are related to production are capitalized into inventory when they are incurred and are charged to cost of sales as product costs at the time of sale. Such amounts are not material to the consolidated financial statements.

Sales demonstration inventory is comprised of measuring devices utilized by sales representatives to present the Company's products to customers. These products remain in sales demonstration inventory for up to six months and are subsequently sold at prices that produce slightly reduced gross margins.

PROPERTY AND EQUIPMENT -- Property and equipment are recorded at cost. Depreciation is computed using the straight-line and declining-balance methods over the estimated useful lives of the various classes of assets as follows:

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

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

INTANGIBLES -- Goodwill represents the excess of purchase price over the fair value of businesses acquired and is amortized on a straight-line basis over 5 years.

Other acquired intangibles principally include core technology, existing product technology, workforce in place and customer relationships that arose in connection with the acquisition of CATS. Other acquired intangibles are recorded at fair value at the date of acquisition and are amortized over their estimated useful lives of primarily 3 to 5 years.

Product design costs incurred in the development of products after technological feasibility is attained are capitalized and amortized using the straight-line method over the estimated economic lives of the related products, not to exceed 3 years. The Company considers technological feasibility to be established when the Company has completed all planning, designing, coding and testing activities that are necessary to establish design specifications including function, features and technical performance requirements. Capitalization of product design costs ceases and amortization of such costs begins when the product is available for general release to customers.

Patents are recorded at cost. Amortization is computed using the straight-line method over the lives of the patents, which is 17 years.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--(CONTINUED)

Other intangibles are amortized over periods ranging from 2 to 5 years.

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

INCOME TAXES -- The Company utilizes the asset and liability method to measure and record deferred income tax assets and liabilities. Deferred tax assets and liabilities reflect the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

FAIR VALUE OF FINANCIAL INSTRUMENTS -- The Company's financial instruments include cash and cash equivalents, short-term investments, accounts receivable, accounts payable and liabilities to banks and shareholders. The carrying amount of long-term debt to banks approximates fair value based on interest rates that are currently available to the Company for issuance of debt with similar terms and remaining maturities. The carrying amounts of other financial instruments approximate their fair value because of their short-term maturities.

EARNINGS PER SHARE -- Basic earnings per share ("EPS") is computed by dividing earnings available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution of securities that could share in the earnings. A reconciliation of the number of common shares used in calculation of basic and diluted EPS is presented in Note 11.

CONCENTRATION OF CREDIT RISK -- Financial instruments which potentially expose the Company to concentrations of credit risk consist principally of operating demand deposit accounts. The Company's policy is to place its operating demand deposit accounts with high credit quality financial institutions.

In June 1996, the Company entered into an Original Equipment Manufacturer agreement with Mitutoyo Corporation ("Mitutoyo"), a Japanese company which manufactures and markets metrology tools. Under the agreement, Mitutoyo sells the Company's products under the name SPINARM. The agreement, which grants Mitutoyo a nonexclusive right to sales in Japan, expires in June 1999 and is renewable for successive one year terms.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--(CONTINUED)

No customer represented 10% or more of the Company's total sales for the years ended December 31, 1998 and 1997. One customer accounted for approximately 10% of total sales for the year ended December 31, 1996.

STOCK-BASED COMPENSATION -- In accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS No. 123"), the Company has elected to continue to account for its employee stock compensation plans under APB Opinion No. 25 with pro-forma disclosures of net earnings and earnings per share, as if the fair value based method of accounting defined in SFAS No. 123 has been applied. Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period.

LONG-LIVED ASSETS -- Long-lived assets, including property and equipment and intangible assets, are reviewed for impairment whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable. Impairment losses are recognized if expected future cash flows of the related assets are less than their carrying values.

ESTIMATES -- The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RECENTLY ADOPTED ACCOUNTING STANDARDS -- In June 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 130, "Reporting Comprehensive Income" ("SFAS No. 130") effective for fiscal years beginning after December 15, 1997. SFAS No. 130 requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. SFAS No. 130 does not require a specific format for that financial statement but requires that an entity display an amount representing total comprehensive income for the period in that statement. SFAS No. 130 requires that an entity classify items of other comprehensive income by their nature in a financial statement. For example, other comprehensive income may include foreign currency and unrealized gains and losses on certain investments in debt and equity securities. In addition, the accumulated balance of other comprehensive income must be displayed

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--(CONTINUED)

separately from retained earnings and additional paid in capital in the equity section of a statement of financial position. The Company adopted this accounting standard on January 1, 1998, as required. Prior year financial statements have been restated for comparative purposes.

In June 1997, the FASB issued SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information" ("SFAS No. 131"), effective for fiscal years beginning after December 15, 1997. SFAS No. 131 establishes standards for reporting information about operating segments in annual financial statements and requires selected information about operating segments in interim financial reports to shareholders. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. SFAS No. 131 requires reporting segment profit or loss, certain specific revenue and expense items and segment assets. It also requires reconciliations of total segment revenues, total segments profit or loss, total segment assets, and other amounts disclosed for segments to corresponding amounts reported in the financial statements.

In October 1997 the American Institute of Certified Public Accountants issued Statement of Position 97-2, "Software Revenue Recognition" (SOP 97-2). SOP 97-2 provides guidance on applying generally accepted accounting principles in recognizing revenue on software transactions and is effective for transactions entered into in fiscal years beginning after December 15, 1997. The Company adopted SOP 97-2 on January 1, 1998, as required. Adoption of this SOP 97-2 did not have a material effect on the financial statements.

In February 1998, the FASB issued SFAS No. 132, "Employer's Disclosures about Pensions and Other Postretirement Benefits" ("SFAS No. 132"), effective for fiscal years beginning after December 15, 1997. SFAS 132 revises employer disclosures about pension and other postretirement benefit plans. It does not change the measurement or recognition of those plans. This statement standardizes the disclosure requirements for pensions and other postretirement benefits to the extent practicable, requires additional information on changes in the benefit obligations and fair values of plan assets that will facilitate financial analysis and eliminates certain disclosures. Restatement of disclosures for earlier periods is required. Adoption of SFAS 132 did not have a material impact on the financial statements.

NEW ACCOUNTING STANDARDS -- In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", effective for fiscal years

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES--(CONTINUED)

beginning after June 15, 1999. SFAS 133 requires companies to record derivatives on the balance sheet as assets and liabilities, measured at fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. The Company has not completed its evaluation of the impact of this standard on the financial statements.

RECLASSIFICATIONS -- Certain prior year amounts have been reclassified to conform to current year presentation.

2. ACQUISITION OF CATS

On May 15, 1998, the Company acquired CATS for total consideration of $16,069,000 consisting of $5 million in cash, 916,668 shares of common stock and the assumption of certain outstanding liabilities of CATS. In addition, 333,332 shares of common stock will be issued provided CATS meets certain sales performance goals. The purchase price includes direct costs of the acquisition in the amount of $674,000.

The acquisition was recorded under the purchase method of accounting and the final allocation among tangible and intangible assets and liabilities is as follows:

Tangible assets	$ 1,522,000
Intangible assets:	
Developed and core technology	8,940,000
Workforce in place	550,000
Customer relations	590,000
Goodwill	2,871,000
In process technology	3,210,000
Liabilities	(1,614,000)
	$16,069,000

The valuation of CATS was based on management's estimates of after tax net cash flows and gives explicit consideration to the Security and Exchange Commission's ("SEC") recent views on in-process research and development in purchase transactions. In making the allocation of purchase price, the Company considered the present value of cash flows and income, the status of projects, completion costs and project risk. Specifically, the Company considered (1) the value of core technology and ensured that the relative allocations to core technology and in process technology were consistent with the relative

2. ACQUISITION OF CATS--(CONTINUED)

contributions of each of the final products and (2) the stage of completion of the individual projects and ensured that the value considered only the efforts completed as of the transaction date.

The amount allocated to in process research and development of $3.2 million was expensed upon acquisition, as it was determined that the underlying projects had not reached technological feasibility, had no alternative future use and successful future development was uncertain.

The operating results of CATS have been included in the consolidated statements since the date of acquisition. The following unaudited pro forma results of operations are presented for informational purposes assuming that the Company had acquired CATS as of January 1, 1997. The $3.2 million charge off for in process research and development has been excluded from the pro forma results as it represents a material non-recurring charge.

	YEAR ENDED DECEMBER 31,	
	1998	1997
Revenues	$28,357,000	$ 26,860,000
Net (loss) income	(1,215,000)	1,369,000
(Loss) income per share:		
Basic	$ (0.11)	$ 0.16
Diluted	$ (0.11)	$ 0.15

The pro forma results of operations have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisition occurred on the date indicated, or which may result in the future.

3. SUPPLEMENTAL CASH FLOW INFORMATION

Selected cash payments and noncash activities were as follows:

	YEARS ENDED DECEMBER 31,		
	1998	1997	1996
Cash paid for interest	$ 13,023	$ 110,768	$256,654
Cash paid for income taxes	569,481	1,951,286	777,876
Noncash investing and financing estimates:			
Business acquired:			
Fair value of assets acquired	17,667,397		
Liabilities assumed	(1,614,000)		
Common stock issued	10,395,015		

4. INVENTORIES

Inventories consist of the following:

	DECEMBER 31,	
	1998	1997
Raw materials, net of reserve for obsolescence of $46,930 in 1998	$2,778,081	$2,432,194
Finished goods	1,486,572	804,827
Sales demonstration	2,178,965	1,038,355
	$6,443,618	$4,275,376

5. INTANGIBLE ASSETS

Intangible assets consist of the following:

	DECEMBER 31,	
	1998	1997
Goodwill	$ 3,033,767	
Existing product technology	9,446,839	
Work force in place	581,181	
Customer relationships	623,449	
Product design costs	744,229	$108,286
Patents	956,439	850,788
Other	130,639	110,166
	15,516,543	1,069,240
Accumulated amortization	(2,695,352)	(321,261)
Intangible assets -- net	$12,821,191	$747,979

6. LINES OF CREDIT AND DEBT

Long-term debt consists of the following at December 31, 1998:

5.8% secured note	$ 10,092
Unsecured note to shareholders	31,388
	41,480
Less current portion	(4,156)
	$ 37,324

The secured note is collateralized by a telephone system with a carrying value of approximately $13,700. The unsecured note to shareholders is non-interest bearing and is due after December 31, 1999.

In April 1997, the Company obtained a one-year unsecured $1.0 million line of credit which bears interest at the 30-day commercial paper rate plus 2.65% per annum. The line of credit was extended in 1998 and expires on March 31, 1999. No borrowings were outstanding under this line of credit as of December 31, 1998 and 1997.

The Company has available with two financial institutions short-term, revolving lines of credit aggregating $445,000. Under these lines, a subsidiary may borrow funds for operations. These lines of credit are personally guaranteed by certain shareholders. The total amount outstanding on these lines at December 31, 1998 was approximately $296,000. The average interest rates on such borrowings at December 31, 1998 was 9%.

7. RELATED PARTY TRANSACTIONS

LEASES -- The Company leases its plant and office building from Xenon Research, Inc. ("Xenon"), a 24% shareholder. The lease, which was amended in 1997 to provide for additional premises and an increase in base rent of approximately $150,000, expires on February 28, 2001. The Company has two five-year renewal options. The base rent during renewal periods will reflect changes in the U.S. Bureau of Labor Statistics, Consumer Price Index for all Urban Consumers. Rent expense under this lease was approximately $300,000 for 1998 and $150,000 for both 1997 and 1996.

8. INCOME TAXES

(Loss) income before taxes consisted of the following:

	1998	1997	1996
Domestic	$ 712,795	$5,584,295	$2,567,455
Foreign	(5,193,357)	(263,035)	(44,901)
Loss (income) before income taxes	$ (4,480,562)	$5,321,260	$2,522,554

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

	1998	1997	1996
Current:			
Federal	$ 75,174	$1,945,035	$ 721,700
State	13,621	294,702	161,392
	88,795	2,239,737	883,092
Deferred:			
Federal	107,597	(108,646)	221,100
State	10,666	(16,461)	11,700
Foreign	243,474		
	361,737	(125,107)	232,800
	$450,532	$2,114,630	$1,115,892

Income taxes for the years ended December 31, 1998, 1997 and 1996 differ from the amount computed by applying the federal statutory corporate rate to income before income taxes. The differences are reconciled as follows:

	1998	1997	1996
Tax expense (benefit) at statutory rate	$ (1,523,391)	$1,809,228	$ 857,700
State income taxes, net of federal benefit	46,719	181,713	114,200
Nontaxable interest income	(121,442)		
Foreign tax rate difference	(943,551)		
Research and development credit	(103,309)	(64,893)	
Nondeductible items	22,831	159,198	61,000
Change in deferred tax asset valuation allowance	3,033,000		
Other	39,675	29,384	82,992
Total income tax expense	$ 450,532	$2,114,630	$1,115,892

8. INCOME TAXES--(CONTINUED)

The components of the Company's net deferred tax asset at December 31, 1998 and 1997 are as follows:

	1998	1997
Deferred tax assets:		
Employee stock options	$ 87,347	$200,599
Unearned service revenue	150,312	178,271
Intangible assets	2,089,000	
Tax credits and carryforwards	1,178,970	
Other	72,187	14,770
Total deferred tax assets	3,577,816	393,640
Valuation allowance	(3,033,000)	
Net deferred tax assets	544,816	393,640
Deferred tax liabilities:		
Patent amortization	72,963	72,963
Depreciation	22,979	22,979
Foreign currency translation adjustment	132,920	
Product design costs	272,631	40,391
Total deferred tax liabilities	501,493	136,333
Net deferred tax asset	$ 43,323	$257,307

At December 31, 1998, the Company's foreign subsidiaries had deferred tax assets relating to net operating loss carryforwards, which do not expire, and intangible assets of $944,000 and $2,089,000, respectively. For financial reporting purposes, a valuation allowance of $3,033,000 has been recognized to offset the deferred tax assets relating to the net operating losses and intangible assets.

9. COMMITMENTS AND CONTINGENCIES

LEASES -- The following is a schedule of future minimum lease payments required under noncancelable operating leases, including leases with related parties (see Note 7), in effect at December 31, 1998:

YEAR ENDING DECEMBER 31	AMOUNT
1999	$1,027,000
2000	816,000
2001	333,000
2002	189,000
2003	189,000
Total future minimum lease payments	$2,554,000

Rent expense for 1998, 1997 and 1996 was approximately $641,000, $236,000, and $173,000, respectively.

LITIGATION -- In the normal course of business, the Company is subject to various proceedings, lawsuits and other claims. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. While these uncertainties could affect future operations, the Company believes that after final disposition, any monetary liability or financial impact would not be expected to have a materially adverse effect on the Company's consolidated financial statements.

10. STOCK OPTION PLANS

The Company has three stock option plans that provide for the granting of stock options to key employees and nonemployee members of the Board of Directors. The 1993 Stock Option Plan ("1993 Plan") and the 1997 Employee Stock Option Plan ("1997 Plan") provide for granting incentive stock options and nonqualified stock options to officers and key employees of the Company. The Nonemployee Director Plan provides for granting nonqualified stock options and formula options to nonemployee directors.

The Company is authorized to grant options for up to 1,000,000 shares of common stock under the 1993 Plan, of which 295,997 and 133,218 options have been granted at exercise prices of $.36 and $3.60, respectively. These options vest over primarily 3 and 4 year periods.

The Company is authorized to grant options for up to 750,000 shares of common stock under the 1997 Plan, of which 328,000 options have been granted at exercise prices of $12 and $13.20 (for those meant to qualify for treatment as incentive stock options). These options vest over a three year period.

10. STOCK OPTION PLANS--(CONTINUED)

The Company is authorized to grant up to 250,000 shares of common stock under the Nonemployee Director Plan. Each nonemployee director is granted 3,000 options upon election or reelection to the Board of Directors (formula options). Formula options granted directors are generally granted upon the same terms and conditions as options granted to officers and employees. These options vest over a three year period. Additionally in 1997, certain nonemployee directors were granted options to purchase 160,000 of common stock in consideration for their prior service on the Board of Directors. These options vested upon grant at an exercise price of $12.

Additionally, the Company's 1997 Nonemployee Directors' Fee Plan permits nonemployee directors to elect to receive directors' fees in the form of common stock rather than cash. Common stock issued in lieu of cash directors' fees is issued at the end of the quarter in which the fees are earned, with the number of shares being based on the fair market value of the common stock for the five trading days immediately preceding the last business day of the quarter.

Compensation cost charged to operations associated with the Company's stock option plans was $172,164, $408,000 and $23,100 in 1998, 1997 and 1996, respectively. Compensation cost was based on the difference between the value of the stock, at date of grant, and its exercise price multiplied by the number of shares vested in each year.

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

	YEARS ENDED DECEMBER 31,					
	1998		1997		1996	
	OPTIONS	WEIGHTED-AVERAGE EXERCISED PRICE	OPTIONS	WEIGHTED-AVERAGE EXERCISED PRICE	OPTIONS	WEIGHTED-AVERAGE EXERCISED PRICE
Outstanding at beginning of year	955,723	$ 8.00	190,512	$ 0.36	210,902	$ 0.36
Granted	535,381	8.64	797,001	9.90		
Forfeited	(84,470)	8.22	(31,790)	9.67	(20,390)	0.36
Exercised	(212,469)	1.17				
Outstanding at end of year	1,194,165	9.73	955,723	8.00	190,512	0.36
Options exercisable at year-end	417,780	10.78	498,680	6.67		
Weighted-average fair value of options granted during the year	$ 5.26		$ 4.82			

10. STOCK OPTION PLANS--(CONTINUED)

A summary of stock options outstanding and exercisable as of December 31, 1998 follows:

EXCISE PRICE	OPTIONS OUTSTANDING	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE (YEARS)	OPTIONS EXERCISABLE
$ 0.36	31,385	3.50	31,385
3.57	94,686	8.72	31,562
3.31	185,000	9.95	
10.34	130,594	9.55	
12.00	652,500	8.96	254,833
13.20	100,000	3.71	100,000
	1,194,165		417,780

Remaining non-exercisable options as of December 31, 1998 become exercisable as follows:

1999	300,593
2000	300,593
2001	175,199
	776,385

Had compensation cost for the Company's stock-based compensation plans been determined consistent with SFAS No. 123, the Company's net earnings and earnings per share would have been as follows:

		YEARS ENDED DECEMBER 31, 1998	1997	1996
Net income	As reported	$ (4,931,094)	$ 3,206,630	$ 1,406,662
	Pro forma	(5,720,379)	2,345,551	1,382,140
Income per share -- Basic	As reported	$ (0.46)	$ 0.41	$ 0.20
	Pro forma	(0.54)	0.30	0.19
Income per share -- Assuming dilution	As reported	$ (0.46)	$ 0.39	$ 0.19
	Pro forma	(0.54)	0.29	0.19

10. STOCK OPTION PLANS--(CONTINUED)

The Company used the Black-Scholes option-pricing model to determine the fair value of grants made. There were no options granted in 1996. The following assumptions were applied in determining the pro forma compensation cost:

	YEARS ENDED DECEMBER 31,	
	1998	1997
Risk-free interest rate	4.86 to 5.83%	5.63%
Expected dividend yield	0%	0%
Expected option life	3-10 years	3-10 years
Expected stock price volatility	91.32%	46.33%

The effects of applying SFAS No. 123 for the pro forma disclosures are not representative of the effects expected on reported net income and income per share in future years since the disclosures do not reflect compensation expense for options granted prior to 1996.

11. EARNINGS PER SHARE

A reconciliation of the number of common shares used in calculation of basic and diluted EPS is presented below:

	YEARS ENDED DECEMBER 31,					
	1998		1997		1996	
	SHARES	PER-SHARE AMOUNT	SHARES	PER-SHARE AMOUNT	SHARES	PER-SHARE AMOUNT
Basic EPS	10,632,708	$ (0.46)	7,831,715	$ 0.41	7,000,000	$ 0.20
Effect of dilutive securities:						
Stock options			355,495		349,041	
Warrants			1,838			
Diluted EPS	10,632,708	$ (0.46)	8,189,048	$ 0.39	7,349,041	$ 0.19

12. BENEFIT PLAN

During 1996, the Company established a defined contribution retirement plan (401(k)) for its employees, which provides benefits for all employees meeting certain age and service requirements. The Company may make a discretionary contribution each Plan year as determined by its Board of Directors. Discretionary contributions or employer matches can be made to the participant's account but cannot exceed 4% of compensation. The Company made no contributions to the Plan during the three years ending December 31, 1998.

13. SEGMENT GEOGRAPHIC DATA

The Company develops, manufactures, markets and supports Computer Aided Design (CAD)-based quality assurance products and CAD-based inspection and statistical process control software. This one line of business represents more than 99% of consolidated sales. The Company operates through sales teams established by geographic area. Each team is equipped to deliver the entire line of Company products to customers within its geographic area. The Company has aggregated the sales teams into a single operating segment as a result of the similarities in the nature of products sold, the type of customers and the methods used to distribute the Company's products. The following table presents information about the Company by geographic area:

	1998		1997		1996	
SALES	SALES	LONG-LIVED ASSETS	SALES	LONG-LIVED ASSETS	SALES	LONG-LIVED ASSETS
SALES:						
United States	$14,740,829	$ 2,707,921	$15,439,776	$1,522,627	$10,829,543	$1,087,830
Germany	4,920,197	11,592,359	1,235,066			
United Kingdom	1,916,115		1,263,294		791,727	
France	1,647,798					
Canada			1,252,423			
Korea					890,509	
Other foreign	4,289,760	46,103	4,325,826	53,132	2,144,558	
Total	$27,514,699	$14,346,383	$23,516,385	$1,575,759	$14,656,337	$1,087,830

14. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

QUARTER ENDED	MARCH 31, 1998	JUNE 30, 1998	SEPTEMBER 30, 1998	DECEMBER 31, 1998
Sales	$ 6,682,201	$ 7,721,808	$ 4,972,182	$ 8,138,508
Gross profit	4,000,439	4,941,965	2,512,039	4,768,943
Net income	1,023,391	(1,709,731)	(2,740,809)	(1,480,263)
Net income per share:				
Basic	0.10	(0.16)	(0.25)	(0.13)
Diluted	0.10	(0.16)	(0.25)	(0.13)

QUARTER ENDED	MARCH 31, 1997	JUNE 30, 1997	SEPTEMBER 30, 1997	DECEMBER 31, 1997
Sales	$ 4,889,471	$ 5,429,064	$ 5,909,306	$ 7,288,544
Gross profit	2,940,922	3,189,333	3,530,192	4,245,100
Net income	719,731	535,877	829,115	1,121,907
Net income per share:				
Basic	0.09	0.07	0.11	0.11
Diluted	0.09	0.07	0.11	0.11

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

None.

PART III

Certain information required by Part III is omitted from this Report in that the Registrant will file a definitive proxy statement pursuant to Regulation 14A (the "Proxy Statement") not later than 120 days after the end of the fiscal year covered by this Report and certain information included therein is incorporated herein by reference. Only those sections of the Proxy Statement that specifically address the Items set forth herein are incorporated by reference. Such incorporation does not include the Compensation Committee Report or the Performance Graph included in the Proxy Statement.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The information to be set forth under the captions "Election of Directors" and "Section 16 (a) Beneficial Ownership Reporting Compliance" in the Proxy Statement are incorporated herein by reference.

The information concerning the company's executive officers required by this Item is incorporated by reference herein from the section of this Report in Part I, Item 1, entitled "Executive Officers of the Registrant."

ITEM 11. EXECUTIVE COMPENSATION.

The information to be set forth under the caption "Executive Compensation" in the Proxy Statement is incorporated herein by reference; provided, however that the Company specifically excludes from such incorporation by reference any information set forth under the caption "Compensation Committee Report on Executive Compensation."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

Security ownership of certain beneficial owners and management to be set forth under the caption "Beneficial Owners and Management" in the Proxy Statement is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information to be set forth under the caption "Certain Relationships and Related Transactions" in the Proxy Statement is incorporated herein by reference.

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) DOCUMENTS FILED AS PART OF THIS REPORT. The following documents are filed as part of this Report:

(1) FINANCIAL STATEMENTS. Included in Part II, Item 8 is an index to the Consolidated Financial Statements of FARO Technologies, Inc. and Report of Deloitte & Touche LLP, Independent Certified Public Accountants filed as part of this Form 10-K

(2) FINANCIAL STATEMENT SCHEDULES. Schedules not listed in the index to the Consolidated Financial Statements included in Part II, Item 8, have been omitted because they are not applicable or are not required or the information required to be set forth therein is included in the Consolidated Financial Statements or Notes thereto.

(3) EXHIBITS.

EXHIBIT NO.	DESCRIPTION
3.1	Articles of Incorporation, as amended (FILED AS EXHIBIT 3.1 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
3.2	Bylaws, as amended (FILED AS EXHIBIT 3.2 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
4.1	Specimen Stock Certificate (FILED AS EXHIBIT 4.1 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.1	1997 Stock Option Plan, as amended (FILED AS EXHIBIT 10.1 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.2	1997 Employee Stock Option Plan (FILED AS EXHIBIT 10.2 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.3	1997 Non-Employee Director Stock Option Plan (FILED AS EXHIBIT 10.3 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.4	1997 Non-Employee Directors' Fee Plan (FILED AS EXHIBIT 10.4 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.5	Term WCMA Loan and Security Agreement, dated September 24, 1996, between the Registrant and Merrill Lynch Business Financial Services, Inc. (FILED AS EXHIBIT 10.5 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.6	WCMA Note, Loan and Security Agreement, dated April 23, 1997, between the Registrant and Merrill Lynch Business Financial Services, Inc. (FILED AS EXHIBIT 10.6 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.7	Business Lease, dated March 1, 1991, between the Registrant (as successor-by-merger) to FARO Medical Technologies (U.S.), Inc.) and Xenon Research, Inc. (FILED AS EXHIBIT 10.7 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)

EXHIBIT NO.	DESCRIPTION
10.8	OEM Purchase Agreement, dated June 7, 1996 between the Company and Mitutoyo Corporation (FILED AS EXHIBIT 10.8 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.9	Nonexclusive Unique Application Reseller Agreement, dated September 9, 1996, between the Registrant and Autodesk, Inc. (FILED AS EXHIBIT 10.9 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.10	Form of Patent and Confidentiality Agreement between the Registrant and each of its employees (FILED AS EXHIBIT 10.10 TO REGISTRANT'S REGISTRATION STATEMENT ON FORM S-1, NO. 333-32983, AND INCORPORATED HEREIN BY REFERENCE)
10.11	Nonexclusive Unique Application Reseller Agreement, dated as of March 1, 1998, between the Registrant and Autodesk, Inc. (FILED AS EXHIBIT 10.11 TO REGISTRANT'S FORM 10-K FOR CALENDAR YEAR 1997, 0-23081, AND INCORPORATED HEREIN BY REFERENCE)
10.12	First Amendment to Business Lease, dated as of January 20, 1998, between the Registrant and Xenon Research, Inc., successor by merger to FARO Medical Technologies (US), Inc. (FILED AS EXHIBIT 10.12 TO REGISTRANT'S FORM 10-K FOR CALENDAR YEAR 1997, NO. 0-23081 AND INCORPORATED HEREIN BY REFERENCE)
10.13	Faro OEM Purchase Agreement, dated March 12, 1999 between the Company and Brown & Sharpe Manufacturing Company. (FILED HEREWITH)
11.1	Statement re Computation of Per Share Earnings (INCORPORATED BY REFERENCE FROM PAGE 1 TO THE REGISTRANT'S 1998 ANNUAL REPORT TO STOCKHOLDERS FILED AS EXHIBIT 13.1)
13.1	Annual Report to Stockholders for the year ended December 31, 1998 (TO BE DEEMED PREVIOUSLY FILED HEREWITH ONLY TO THE EXTENT REQUIRED BY THE INSTRUCTIONS TO EXHIBITS FOR REPORTS ON FORM 10-K)
21.1	List of Subsidiaries (FILED HEREWITH)
23.1	Consent of Deloitte & Touche LLP (FILED HEREWITH)
24.1	Power of Attorney (INCLUDED ON PAGE 51 OF THIS REPORT)
27.1	Financial Data Schedule for the year ended December 31, 1998 (FILED HEREWITH FOR SEC FILING PURPOSES ONLY)
99.1	Properties

(b) REPORTS ON FORM 8-K

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FARO TECHNOLOGIES, INC.

By: /s/ GREG A. FRASER

Gregory A. Fraser, Ph.D.
Executive Vice President, Secretary,
Treasurer and Chief Financial Officer

Dated: April 2, 1999

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

NAME AND SIGNATURE	TITLE	DATE
/s/ SIMON RAAB Simon Raab	Chairman of the Board, President, Chief Executive Officer (Principal Executive Officer), and Director	April 2, 1999
/s/ GREGORY A. FRASER Gregory A. Fraser	Executive Vice President, Secretary, Treasurer, Chief Financial Officer (Principal Financial and Accounting Officer), and Director	April 2, 1999
/s/ HUBERT D'AMOURS Hubert d' Amours	Director	April 2, 1999
/s/ PHILIP COLLEY Philip Colley	Director	April 2, 1999
/s/ ALEXANDRE RAAB Alexandre Raab	Director	April 2, 1999
/s/ NORMAN H. SCHIPPER Norman H. Schipper	Director	April 2, 1999
/s/ ANDRE JULIEN Andre Julien	Director	April 2, 1999

EXHIBIT INDEX

EXHIBIT		PAGE
10.13	Faro OEM Purchase Agreement, dated March 12, 1999 between the Company and Brown & Sharpe Manufacturing Company. (FILED HEREWITH)	
21.1	List of Subsidiaries (FILED HEREWITH)	
23.1	Consent of Deloitte & Touche LLP (FILED HEREWITH)	
27.1	Financial Data Schedule for the year ended December 31, 1998	
99.1	Properties	

EXHIBIT 10.13

FARO OEM PURCHASE AGREEMENT

FARO Technologies, Inc.
125 Technology Park
Lake Mary, Florida 32746

Hereinafter "FARO"

and

Brown & Sharpe Manufacturing Company
Precision Park
200 Frenchtown Road
North Kingstown, RI 02818

Hereinafter "COMPANY"

1.0 SCOPE

1.1 FARO sells and licenses certain measurement equipment, computer hardware, software products and replacement and service products.

In particular, Faro sells its products directly to users, through a variety of distributors, and to original equipment manufacturers (OEM) and will continue to do so.

COMPANY wishes to purchase certain products more specifically described in Appendix A1 hereto, (hereafter referred to as "PRODUCTS"), from FARO for resale, and is willing to provide its customers, for their own use and not for resale, the service and support necessary for systems so incorporated.

2.0 APPOINTMENT

2.1 FARO appoints COMPANY as a non-exclusive authorized OEM purchaser of the PRODUCTS and COMPANY accepts this appointment. This appointment shall continue until expiration or termination of this agreement in accordance with its terms, but is conditioned upon COMPANY's ongoing compliance with this agreement.

2.2 Conditions of continued appointment.

2.2.1 COMPANY agrees as follows:

a. To resell PRODUCTS only as an integral component of hardware or software manufactured by COMPANY. Compliance with this Section requires the COMPANY to relabel the PRODUCTS in a manner that the PRODUCTS will not compete with "off-the-shelf" PRODUCTS sold by FARO in its other sales programs.

b. COMPANY will only advertise and promote Products as integral components of its own hardware and software as described in Appendix A2.

c. COMPANY will sell PRODUCTS using existing methods of direct sale and distribution.

d. COMPANY'S use of PRODUCTS in the manufacturing process shall be subject to the confidentiality provisions of Paragraph 6.2 hereafter.

2.2.2 FARO agrees as follows:

a. FARO will sell PRODUCTS to COMPANY in conjunction with the sale of COMPANY's hardware and software or for retrofit on previously sold COMPANY hardware and software on the commercial terms of delivery and payment set forth in Section 4.1, 4.6 and 4.7.

b. FARO will train up to four (4) COMPANY personnel selling and supporting FARO'S PRODUCTS at FARO'S training facility in Lake Mary, Florida at a mutually agreed time.

2.3 LICENSE OF PATENT RIGHTS
FARO has right, title, and interest in and to patents and patent applications concerning features of, and methods of operating, articulated-arm coordinate measuring machines and related technologies (collectively "the Patents"). FARO hereby grants COMPANY a non-exclusive license to (I) use PRODUCTS that include features covered by the Patents and, in the use of such PRODUCTS, use any methods of operation covered by the Patents and (ii) resell the PRODUCTS.

FARO does not grant COMPANY any license to manufacture or otherwise assist in the making of the PRODUCTS or to use the methods of operation set forth in the Patents in operating any machine other than the PRODUCTS.

2.4 INDEMNIFICATION

FARO agrees to provide COMPANY with the following protection against claims of proprietary right infringement of the PRODUCTS:

a. Nature of Indemnification: FARO shall indemnify, defend and hold harmless the COMPANY from and against all liability or expense of any kind arising out of or relating to any claim, demand or action against the COMPANY alleging that the PRODUCTS or any portion thereof as furnished under this agreement and used within the scope of the license hereunder infringes any third party rights in copyright or issued patent or the trade secret rights of any third party, provided that the COMPANY promptly gives written notice of the claim, demand or action to FARO and permits FARO to control the defense of and settlement of such claim, demand or action either in FARO'S for the COMPANY'S name (at FARO'S option).

b. Undertakings if Infringement Found. In the event that the PRODUCTS or any portion thereof, as furnished under this Agreement and used within the scope of the license hereunder, are held in such a suit or proceeding to infringe a third-party proprietary right as set forth in Section (a) immediately above, and that the use of the PRODUCTS or portion thereof is enjoined, FARO shall, at FARO's sole option and expense, and as its sole responsibility and the COMPANY's sole remedy therefor (other than indemnification pursuant to Section (a) immediately above), (i) procure for the COMPANY and purchasers of the PRODUCTS from the COMPANY the right to continue using the PRODUCTS or portions thereof; or (ii) replace the same with noninfringing goods of equivalent functions and efficiency; or (iii) refund the purchase price of the affected PRODUCTS less depreciation calculated on a 7-year, straight-line basis.

2.5 The license is to be sublicensed by COMPANY only to COMPANY's customers under the minimum terms and conditions set forth in Appendix A5.

2.6 FARO represents and warrants to the COMPANY that the PRODUCTS to be purchased by the COMPANY from FARO and resold pursuant to this agreement will perform in all respects to the "FARO" Product Test and Performance Specifications set forth in Appendix A6. In the event Products sold and properly installed at an end users location fail to perform to stated specifications FARO agrees with COMPANY to provide a replacement product which meets the specifications at its' cost and expense.

3.0 OBLIGATIONS OF COMPANY

3.1 COMPANY shall, in good faith, aggressively market and sell the PRODUCTS as part of an integral system with its hardware and/or software.

3.2 PRODUCT Installation

COMPANY is responsible, at its own cost and expense, for installation, integration and support of the PRODUCT with COMPANY'S hardware and/or software.

3.3 Customer Assistance

COMPANY shall provide its customers with ongoing presale and post-sale education orientation services on the PRODUCTS. COMPANY will provide technical support including information and training on PRODUCT configurations, compatibility and general PRODUCT information. COMPANY shall provide to FARO copies of all written selling materials which it intends or has provided to customers in compliance with this Section.

3.4 Service

FARO will enter into a Warranty & Service Contract only with COMPANY. COMPANY may not obligate FARO under any Warranty and/or Service Contract with any of COMPANY'S customers and no Warranty or Service Contract between FARO and COMPANY may be assigned by COMPANY to any other party.

4.0 COMPANY PRICE DISCOUNTS; PAYMENT TERMS; PRODUCT DELIVERY

4.1 FARO agrees to sell to COMPANY such PRODUCTS as COMPANY may order for purchase pursuant to FARO's current price list, for the OEM discount rates set forth in Section 4.2 hereafter. An obligation by FARO to ship a PRODUCT shall arise only at the time it receives a signed purchase order from COMPANY. PRODUCTS shall be delivered in the time and manner set forth on the COMPANY'S purchase order.

4.2 FARO will reduce the officially applicable FARO list prices for each PRODUCT listed on Appendix A1 by $8,000.00 to compensate for the removal of the personal computer and AnthroCam software. Faro will further grant COMPANY a quantity one discount of 40% for total combined unit purchase quantities up to 399 units and 50% for combined unit purchase quantities of 400 and higher during the calendar

year. Discount is applied to the reduced officially applicable FARO list price for the PRODUCTS listed in Appendix A1.

4.3 For each of the COMPANY'S customer orders that are delivered to the United Kingdom, France and Germany, FARO agrees to reduce the COMPANY'S Purchase Prices as stated in Appendix A1 by the applicable duty rates for those countries. Also, for any additional countries where FARO establishes direct sales/pricing, FARO will give the applicable discounts as calculated by the methods used to derive duty rates for the United Kingdom, France and Germany.

4.4 COMPANY recognizes the need to have demonstration equipment on hand for use as a marketing and sales tool. FARO hereby agrees to sell to the COMPANY up to 15 units, of their choosing, per year at a discount of 70% off the reduced officially applicable FARO list price for PRODUCTS listed in Appendix A1.

4.5 COMPANY hereby certifies that it either holds or will acquire prior to offering for resale a valid Reseller Exemption Certificate issued by each taxing jurisdiction or entity in the Marketing Territory where such certificate is required as a condition for the avoidance of applicable sales or use taxes, covering any PRODUCT. Prior to any shipment of PRODUCT under this Agreement, COMPANY will provide FARO with a copy of each such certificate, thereby entitling COMPANY to be treated by FARO as exempt from collection of tax on such PRODUCTS in each jurisdiction or entity from which a certificate is obtained. COMPANY shall indemnify and hold harmless FARO from and against any taxes, duties, tariffs, or other assessments levied by or on behalf of any taxing jurisdiction or entity that fails to issue or disputes the validity of coverage of, any such exemption certificates. In the event FARO is obligated to collect any sales or use tax (whether it is Florida sales and use tax or from some other jurisdiction), the sales tax shall be paid by COMPANY in addition to the purchase price of the PRODUCTS.

4.6 Price Adjustments

Price reductions shall be affected under normal circumstances during the course of a year. In such cases, COMPANY shall be eligible for such decreases immediately upon notification by FARO. Price increases will not be passed on to COMPANY for a period of one year from date on contract inception, at which time a new price structure will be negotiated. Where the purchase order has been received by FARO prior to notification of a price adjustment the sale will be honored at the old price. Where the purchase order is received by FARO after notification of a price adjustment, the new price shall apply.

4.6 Payment of Invoices

The COMPANY will pay invoices to FARO on forty five (45) day net after shipment from Faro Technologies.

4.7 Freight and Handling

Price basis shall be freight collect F.O.B. destination Brown & Sharpe North Kingstown, U.S.A.

5.0 WARRANTY AND SERVICE

5.1 FARO shall warrant to COMPANY and COMPANY only, a warranty of twelve (12) months commencing on the date of receipt of PRODUCT by COMPANY'S customer, on the PRODUCTS, under the standard terms and conditions of FARO'S Industrial Division Warranty and Service Plan as described in Appendix A3 incorporated and made a part of this agreement. It shall be COMPANY'S responsibility to notify FARO at the time goods are received by COMPANY'S customer.

6.0 PROPRIETARY RIGHTS

6.1 Trademark Use during Agreement

During the term of this agreement, COMPANY may, but shall not be obligated to, display the registered trademarks "FARO", the FARO logo, and other trademarks or trade names belonging or licensed to FARO in connection with COMPANY's promotion of FARO PRODUCTS, provided that all such usage is labeled as a trademark or trade name of FARO. COMPANY acknowledges that any goodwill and trademark rights resulting from COMPANY's use of FARO's trademarks and trade name shall belong to and inure to the benefit of FARO.

6.2 Duties Concerning Proprietary and Confidential Information

6.2.1 Duty to Refrain From Reverse Engineering

PRODUCTS sold or provided by FARO to COMPANY may include features or operate by methods known or understood only by FARO or a limited number of business associates or affiliates of FARO. COMPANY agrees not to reverse engineer, test or disassemble the PRODUCTS in an effort to analyze, understand

or otherwise determine such features or methods of operation, or any additional trade secrets, business secrets, know-how or other proprietary technical information of FARO, including information concerning the designing of the PRODUCTS or processes by which the PRODUCTS were manufactured.

6.2.2 Duties Concerning Confidential Information

(a)"Confidential Information" shall include any information disclosed by FARO to COMPANY that relates to the design, manufacture, features, or operation of the PRODUCTS (or related software) or any additional trade secrets, business secrets, know-how and other proprietary technical information, whether patentable or unpatentable (and in any and all tangible embodiments thereof), of FARO, which is disclosed in writing marked "Confidential" (or "Trade Secrets", "Property of FARO" or the like) or, if orally disclosed, is identified as "Confidential" (or as "Trade Secrets", "Property of FARO" or the like) at the time of disclosure and then confirmed in such a writing by FARO within thirty (30) days after such oral disclosure.

(b) COMPANY agrees not to disclose, distribute or otherwise disseminate any such Confidential Information to any individual and/or entity without first obtaining the express written authorization of FARO. COMPANY agrees to keep all Confidential Information secret and confidential and to prevent the unauthorized disclosure of such information by using the same degree of care, but no less than a reasonable degree of care, to prevent the unauthorized disclosure of Confidential Information as COMPANY uses to protect its own confidential information of a like nature.

(c) This Agreement imposes no obligation upon COMPANY with respect to information which COMPANY can demonstrate: (i) is generally available to the public on the date of this Agreement or becomes generally available to the public after the date of this Agreement (other than as the result of disclosure by COMPANY in violation of this Agreement); (ii) is legally in COMPANY's possession at the time of receipt from FARO; (iii) is obtained by COMPANY through independent research or development without reference to any Confidential Information; or (iv) is obtained by COMPANY from a third party who is in lawful possession of the information and who has the right to make disclosure thereof. Confidential Information shall not be deemed in COMPANY's possession or publicly known merely because it is embraced by more general information in COMPANY's possession or because it is embraced in general terms in publications or patents. In addition, Confidential Information consisting of a combination of features shall not be deemed to be within the exceptions set forth in clauses (i) - (iv) above merely because individual features are in the public domain or in the possession of COMPANY

(d) COMPANY's duties under this Agreement with respect to any item of Confidential Information will expire 3 years from the date that item of Confidential Information is first received by COMPANY from FARO. This Agreement shall not in and of itself require FARO to disclose Confidential Information to COMPANY. Confidential Information will remain the property of FARO notwithstanding disclosure hereunder. Upon demand by FARO, COMPANY shall return to FARO any and all tangible embodiments of Confidential Information requested by FARO.

7.0 ASSIGNMENT

This Agreement is personal to COMPANY. Based on COMPANY's current ownership, COMPANY is appointed as an authorized FARO Distributor because of COMPANY's commitments in this Agreement and FARO's confidence in COMPANY. COMPANY shall not assign, transfer or sell its rights under this Agreement or delegate its duties hereunder without the prior written consent of FARO, which may be granted or withheld, in Faro's sole discretion, and any attempt at assignment, transfer, sale or delegation without such consent shall be void.

8.0 TERM AND VALIDITY OF AGREEMENT

8.1 Upon full execution, this Agreement shall be in full force and effect for an initial term of one (1) year unless terminated in accordance with the terms of this Agreement. Thereafter, the Agreement may be extended annually through mutual written agreement by both parties. Termination during the first year may be effected at any time by either party, if the other is in default, by giving the other party ninety (90) days prior written notice of such termination. Termination after the first year of the Agreement may be effected by either party, if the other party is in default, by giving the other party 30 days notice, or without cause, by giving 90 days notice. An event of default for this Agreement shall be:

8.1.1 A breach of any material provision hereof without cure, or after the expiration of applicable cure periods, if any are set forth elsewhere in this agreement.

8.1.2 If either party files a voluntary petition in bankruptcy, or for reorganization or for an arrangement, pursuant to the Federal Bankruptcy Code.

8.1.3 Notwithstanding the notice provisions set forth above, in the event COMPANY is in violation of any of the provisions of Sections 6.1 or 6.2, no prior notice of default or right to cure shall be required in order for FARO to terminate this Agreement or exercise any remedies in the event of default.

8.2 Notwithstanding any termination or expiration of the Agreement, the obligations of the parties with respect to PRODUCTS sold to COMPANY prior to the effective date of termination or expiration shall remain in effect.

9.0 REMEDIES.

9.1 In addition to any other remedies that the parties may have by law or pursuant to this agreement, the prevailing party in any litigation or other effort to enforce or interpret this Agreement shall be entitled to recover its reasonable attorney's fees and the costs and expenses of litigation, including such fees and costs as may be incurred before trial, at trial, in bankruptcy and creditor's reorganization proceedings and on appeal.

10.0 APPLICABLE LAW

This agreement shall be governed by and interpreted in accordance with the laws of the State of Florida.

11.0 RELATIONSHIP BETWEEN FARO AND COMPANY

11.1 The purpose of this agreement is to establish a OEM purchase arrangement between FARO as the manufacturer of PRODUCTS and COMPANY as a manufacturer and seller of metrology hardware and software products that have applications to the PRODUCTS. FARO does not intend to and is not selling to COMPANY a "franchise" or "business opportunity" as such terms are defined by applicable law. COMPANY hereby represents and warrants to FARO that COMPANY already engages in an established business of the development, manufacture and sale of metrology hardware and software products and is not looking to FARO to establish any type of system to sell PRODUCTS nor to establish a new business in reliance upon FARO. COMPANY acknowledges that no fee has been paid to FARO as consideration for entering into this agreement and that the only consideration that will be paid to FARO is the purchase price of PRODUCTS purchased from FARO in accordance with Section 4.0 of this Agreement.

11.2 COMPANY is an approved OEM purchaser of PRODUCTS only and not an agent of FARO for any purpose. COMPANY has no authority to bind FARO to any contract or agreement with any party for any reason.

11.3 The relationship between COMPANY and FARO is defined solely by this Agreement and all prior agreements, (oral or written) letters of understanding, or

other writings not binding on COMPANY or FARO. This agreement may only be changed in a written instrument executed by COMPANY and FARO.

12. COUNTERPARTS

This Agreement shall be drawn up in two copies and signed by both parties thereto. Each party shall receive one fully executed copy.

FARO TECHNOLOGIES, INC.

BY: /s/ GREGORY A. FRASER Date: March 10, 1999

Gregory A. Fraser
Executive Vice President, Chief Financial Officer

BROWN & SHARPE MANUFACTURING COMPANY

BY: /s/ Phil James Date: March 12, 1999

Phil James
Vice President

APPENDICES

Appendix A1: Faro PRODUCTS and List Prices list for COMPANY

Appendix A2: COMPANY Hardware and Software Product List

Appendix A3: FARO Warranty Service Plans

Appendix A4: Initial PRODUCT Purchase Order

Appendix A5: Minimum Terms and Conditions of Customer Licenses

Appendix A6: FARO Test and Certification Procedure

APPENDIX A1

FARO PRODUCTS AND LIST PRICES

FARO Products and List Prices are attached to this Appendix A1 consisting of 1 page.

Item Description	FARO List Price	Reduction *	Discount %	B&S Purchase Price
Gold (all)	$49,900	$8,000	40% (0-399u)	$25,140
Gold (all)	$49,900	$8,000	50% (400-+u)	$20,950
Gold 7 Axis	$55,900	$8,000	40% (0-399u)	$28,740
Gold 7 Axis	$55,900	$8,000	50% (400-+u)	$23,950
Accessories	Faro Price List	$0	40%	
Service Support	Faro Mkt Rates	$0	40%	
Extended Warranty	Faro Mkt Rates	$0	40%	
Silver (all)	$39,900	$8,000	40% (0-399u)	$19,140
Silver (all)	$39,900	$8,000	50% (400-+u)	$15,950
Silver 7 Axis	$44,900	$8,000	40% (0-399u)	$22,140
Silver 7 Axis	$44,900	$8,000	50% (400-+u)	$18,450
Accessories	Faro Price List	$0	40%	
Service Support	Faro Mkt Rates	$0	40%	
Extended Warranty	Faro Mkt Rates	$0	40%	
Sterling (all)	$29,900	$8,000	40% (0-399u)	$13,140
Sterling (all)	$29,900	$8,000	50% (400-+u)	$10,950
Sterling 7 Axis	$34,900	$8,000	40% (300-+u)	$16,140
Sterling 7 Axis	$34,900	$8,000	50% (400-+u)	$13,450
Accessories	Faro Price List	$0	40%	
Service Support	Faro Mkt Rates	$0	40%	
Extended Warranty	Faro Mkt Rates	$0	40%	

APPENDIX A2

COMPANY HARDWARE AND SOFTWARE PRODUCT LIST

SOFTWARE/HARDWARE	SUPPLIER
EXISTING SOFTWARE PRODUCTS	
1. PC-DIMIS	Brown & Sharpe
2. REFLEX	Brown & Sharpe
3. TUTOR	Brown & Sharpe

ADDITIONAL BROWN & SHARPE SOFTWARE PRODUCTS AS THEY ARE RELEASED.

APPENDIX A3

FARO WARRANTY SPECIFICATIONS

(APPENDIX B, SECTION 4.00, FROM FAROARM OPERATOR'S MANUAL: PURCHASE CONDITIONS)

APPENDIX A4

PURCHASE ORDER FOR INITIAL PRODUCT PURCHASE

APPENDIX A5

MINIMUM TERMS AND CONDITIONS OF CUSTOMER LICENSES

1. Licensor, (COMPANY) as an authorized reseller, hereby grants Licensee (COMPANY's Customer) a nonexclusive sublicense to practice methods covered by any of FARO's patents providing the patented methods are practiced with a FARO product. This license specifically excludes practice of any method covered by FARO's patents with other than a FARO product.

2. Licensee agrees not to alter, reverse engineer or disassemble products manufactured and/or sold licensed by FARO Technologies, Inc., 125 Technology Park Drive, Lake Mary, FL 32746 ("FARO").

3. FARO retains all ownership rights on a worldwide basis to all methods and products manufactured and/or sold or licensed by FARO (either directly or through others), including but not limited to, all patent rights, copyrights, trademarks, servicemarks, related goodwill and confidential and proprietary information.

4. Licensee is hereby notified that FARO is a third party beneficiary to this License to the extent that this License contains provisions which relate to Licensee's use of the patented. Such provisions are made expressly for the benefit of FARO and are enforceable by FARO in addition to the Licensor.

APPENDIX A6
FARO TEST AND CERTIFICATION PROCEDURE

GOLD SERIES / CLASS 1 CERTIFICATION
Class 1: Gold Series

A basic 4 quadrant certification included with all machines and comprised of:

1. Vertical level single point repeatability test in 4 quadrants with 2 repeats from 25 direction.

2. Position 1.5M step gauge test in 4 quadrants.

3. FARO ball bar 10points per quadrant in 4 quadrants.

4. Lengths, 1/3, 2/3 and 3/4 of radius, 3 position per quadrant free ball bar test in 4 quadrants.

5. Extreme checkout. Vertical and horizontal free ball bar with extreme arm extension. Vertical and horizontal at mid radial reach in 4 quadrants.

PASS/FAIL CRITERIA

All data expressed on 2 SIGMA. This means that 95.5% of the data must fall within the specified band

MODEL	DIAMETER	SINGLE POINT SIGMA INCHES	DISPLACEMENT SIGMA INCHES	SINGLE POINT SIGMA METRIC	DISPLACEMENT SIGMA METRIC
G04-00	4'/1.2m	+\-.0010"	+\-.0014"	+\-.025	+\-.035
G06-00	6'/1.8m	+\-.0016"	+\-.0023"	+\-.041	+\-.057
G08-00	8'/2.4m	+\-.0020"	+\-.0028"	+\-.051	+\-.072
G10-00	10'/3.0m	+\-.0033"	+\-.0047"	+\-.084	+\-.119
G12-00	12'/3.6m	+\-.0047"	+\-.0066"	+\-.119	+\-.169

All data expressed on 3 SIGMA.

MODEL	DIAMETER	SINGLE POINT SIGMA INCHES	DISPLACEMENT SIGMA INCHES	SINGLE POINT SIGMA METRIC	DISPLACEMENT SIGMA METRIC
G04-00	4'/1.2m	+\-.0015"	+\-.0021"	+\-.038	+\-.053
G06-00	6'/1.8m	+\-.0024"	+\-.0034"	+\-.061	+\-.086
G08-00	8'/2.4m	+\-.0030"	+\-.0042"	+\-.076	+\-.108
G10-00	10'/3.0m	+\-.0050"	+\-.0070"	+\-.126	+\-.178
G12-00	12'/3.6m	+\-.0071"	+\-.0100"	+\-.179	+\-.253

CLASS 1 CERTIFICATION DATA FILE CHECKLIST

Serial Number _____ Date ----/----/----

Examiner:_____

1. Calibrate 1/4"(6.35mm) ball probe on 1"(25.4mm) sphere on base and record results:

   X-

   Y-

   Z-

   ERROR-

2. Calibrate 1/4"(6.35mm) ball probe on single hole on step gauge and record results

   X-

   Y-

   Z-

   ERROR-

Compare the above results X-X, Y-Y, and Z-Z. They should not deviate more than single point accuracy.

A basic 4 quadrant certification included with all Gold Series and comprised of:

2 vertical level single point repeatability test in 4 quadrants with 2 repeats from 25 directions. Level 1 (6" - 18")/(150mm-458mm) Level 3 (35" - 60")/(900mm-1.5m) from center to electro.

Region		Quad.	Level	Filename	Passed
4'-1.2m	10'-3.0m				
6'-1.8m	12'-3.6m				
8'-2.4m					
(A)	(B)	1	1	data1	
(A)	(B)	1	3	data2	
(A)	(B)	2	1	data3	
(A)	(B)	2	3	data4	
(A)	(B)	3	1	data5	
(A)	(B)	3	3	data6	
(A)	(B)	4	1	data7	
(A)	(B)	4	3	data8	

1.5m step gauge test in 4 quadrants 3 orientations per quadrant.

Position 1: Tangential flat

Position 2: Radial Flat

Position 3:Tangential 45/degrees/

REGION			QUAD	POSITION	FILENAME	COMPLETE	PASSED
4'-1.2M	8'-2.4M	12'					
6'-1.8M	10'-3.0M	3.6M					
/ (A)	(B)	(C)	1	1	data9		
/ (A)	(A)	(C)	1	2	data10		
/ (A)	(B)	(B)	2	1	data11		
/ (A)	(A)	(C)	2	2	data12		
/ (A)	(B)	(C)	3	1	data13		
/ (A)	(A)	(C)	3	2	data14		
/ (A)	(B)	(B)	4	1	data15		
/ (A)	(A)	(C)	4	2	data16		
/ (A)	(B)	(C)	4	3	data17		
/ (A)	(B)	(C)	3	3	data18		
/ (A)	(B)	(C)	2	3	data19		
/ (A)	(B)	(C)	1	3	data20		

CLASS 1 CERTIFICATION DATA FILE CHECKLIST (CONT'D)

Serial Number _____ Date ----/----/----

Examiner:_____

FARO ball bar 20 positions per quadrant in 4 quadrants).

QUAD.	FILENAME	1.2M	1.8-2.4M	3.0-3.6M	PASSED
Front (3,4)	data21	~300mm	~550mm	~950mm	
Rear (1,2)	data22	~300mm	~550m	~950mm	

Multiple length, 3 position free ball bar test in 4 quadrants. (exit "sphere to sphere" and append between every length change).

REGION			LENGTH (MM)			QUAD	POSITION	FILENAME	PASSED
1.2-1.8M	2.4-3 0M	3.6 M	1.2M	1.8M	2.4M-3.0M	3.6M			
								data23	
(A)	(A)	(C)	600.	600.	600.	1100.	1	3	
(A)	(A)	(C)	600	600	600	1100	2	3	
(A)	(A)	(C)	600	600	600	1100	3	3	
(A)	(A)	(C)	600	600	600	1100	4	3	
(A)	(A)	(C)	850	1100	1600	2100	1	3	
(A)	(A)	(C)	850	1100	1600	2100	2	3	
(A)	(B)	(C)	850	1100	1600	2100	3	3	
(A)	(B)	(C)	850	1100	1600	2100	4	3	
(A)	(A)	(C)	600	600	600	1600	1	1	
(A)	(A)	(C)	600	600	600	1600	3	1	
(A)	(B)	(C)	850	1100	1100	1100	3	1	
(A)	(B)	(C)	850	1100	1100	1100	1	1	
(A)	(A)	(C)	600	600	600	1600	2	2	
(A)	(A)	(C)	600	600	600	1600	4	2	
(A)	(A)	(C)	850	1100	1100	1100	4	2	
(A)	(A)	(C)	850	1100	1100	1100	2	2	

EXHIBIT 21.1

FARO TECHNOLOGIES, INC. LIST OF SUBSIDIARIES
- ----------

Faro Worldwide Inc.
125 Technology Park Drive
Lake Mary, Florida 32746
USA

CATS GmbH and Co. KG
Erbprinzenstr. 31
76133 Karlsruhe
Gerany

Antares LDA
Rua das Leirinhas N. 48 Aradas
3810 Aveiro
Portugal

EXHIBIT 23.1

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement Nos. 333-41115, 333-41125, 333-41131, and 333-41135 of FARO Technologies, Inc. on Form S-8 of our report dated February 19, 1999, appearing in this Annual Report on Form 10-K of FARO Technologies, Inc. for the year ended December 31, 1998.

Deloitte & Touche LLP

Jacksonville, Florida
April 2, 1999

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED BALANCE SHEET AS OF DECEMBER 31, 1998 AND THE CONSOLIDATED STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31, 1998 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FILING ON FORM 10-K FOR THE ANNUAL PERIOD ENDED DECEMBER 31, 1998.

YEAR
DEC-31-1998
JAN-01-1998
DEC-31-1998
1,183,656
17,011,831
8,963,343
149,224
6,443,618
34,595,076
2,801,651
1,276,459
49,120,147
3,597,307
0
0
0
11,048
45,364,343
49,120,147
27,514,699
27,514,699
11,291,313
21,907,993
0
0
13,023
(4,480,562)
450,532
0
0
0
0
(4,931,094)
(.46)
(.46)

EXHIBIT 99.1

PROPERTIES

FARO USA

CORPORATE HEADQUARTERS -

FLORIDA
125 TECHNOLOGY PARK DRIVE
LAKE MARY, FLORIDA 32746
TELEPHONE: 407-333-9911
FACSIMILE: 407-333-4181

CALIFORNIA
5000 BIRCH STREET, SUITE 3000
NEWPORT BEACH, CALIFORNIA 92660
TELEPHONE: 949-475-6878
FACSIMILE: 949-475-6879

ILLINOIS
1415 WEST 22ND STREET
TOWER FLOOR
OAK BROOK, ILLINOIS 60523
TELEPHONE: 630-571-3400
FACSIMILE: 630-571-3401

KANSAS:
1133 SOUTH ROCK ROAD
SUITE 3-361
WICHITA, KANSAS 67207
TELEPHONE: 316-523-1504
FACSIMILE: 316-526-8535

MICHIGAN
39111 WEST SIX MILE ROAD, SUITE 101
LIVONIA, MICHIGAN 48152
TELEPHONE: 734-591-6742
FACSIMILE: 734-591-6753

NORTH CAROLINA
SOUTHPARK TOWERS, 12TH FLOOR
6000 FAIRVIEW ROAD
CHARLOTTE, NORTH CAROLINA 28210
TELEPHONE: 704-553-7260
FACSIMILE: 704-553-7264

OHIO
2720 AIRPORT DRIVE, SUITE 114
COLUMBUS, OHIO 43219
TELEPHONE: 614-428-4290
FACSIMILE: 614-428-4291

TEXAS
DALLAS - NORTH SUITE 700
5001 LBJ FREEWAY
DALLAS, TEXAS 75244
TELEPHONE: 972-409-0823
FACSIMILE: 972-409-0824

- ---

FARO EUROPE

EUROPEAN HEADQUARTERS -

GERMANY
ERBPRINZENSTR. 31
76133 KARLSRUHE
GERMANY
TELEPHONE:
011-49-721-912-820
FACSIMILE:
011-49-721-912-8249

FARO UK
42 WARWICK ROAD
KENILWORTH
WARWICKSHIRE, CVB THE
TELEPHONE:
011-44-1926-863-036
FACSIMILE:
011-44-1926-851-238

FARO FRANCE
46, AVENUE DES FRERES LUMIERE
78190 TRAPPES
FRANCE
TELEPHONE:
011-33-1-3016-0600
FACSIMILE:
011-33-1-3016-0606