UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended **July 1, 2006**

OR

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

For the transition period from _____ to _____

Commission File Number: 0-23081

FARO TECHNOLOGIES, INC.

(Exact name of Registrant as specified in its charter)

Florida	**59-3157093**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
125 Technology Park, Lake Mary, Florida	**32746**
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, including area code: **(407) 333-9911**

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

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

Large accelerated filer **o** Accelerated filer **x** Non-accelerated filer **o**

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 14,362,060 shares of the registrant's common stock as of July 26, 2006.

FARO TECHNOLOGIES, INC.

Quarterly Report on Form 10-Q
Quarter Ended July 1, 2006

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(in thousands, except share data)	July 1, 2006	December 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 6,917	$ 9,278
Short-term investments	15,790	16,490
Accounts receivable, net	34,497	28,654
Inventories	26,451	28,650
Deferred income taxes, net	2,879	2,155
Prepaid expenses and other current assets	3,046	2,200
Total current assets	89,580	87,427
Property and Equipment:		
Machinery and equipment	8,321	6,940
Furniture and fixtures	3,670	3,334
Leasehold improvements	2,299	1,710
Property and equipment at cost	14,290	11,984
Less: accumulated depreciation and amortization	(7,461)	(5,920)
Property and equipment, net	6,829	6,064
Goodwill	16,916	14,574
Intangible assets, net	6,459	6,395
Service Inventory	4,966	4,333
Deferred income taxes, net	3,724	3,855
Total Assets	$ 128,474	$ 122,648
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 7,711	$ 12,301
Accrued liabilities	8,032	5,569
Income taxes payable	2,224	1,406
Current portion of unearned service revenues	3,502	3,168
Customer deposits	294	201
Current portion of long-term debt and obligations under capital leases	128	163
Total current liabilities	21,891	22,808
Unearned service revenues - less current portion	2,247	803
Deferred tax liability, net	1,200	-
Long-term debt and obligations under capital leases - less current portion	199	177
Total Liabilities	25,537	23,788
Commitments and contingencies - See Note O		
Shareholders' Equity:		
Common stock - par value $.001, 50,000,000 shares authorized; 14,498,404 and 14,481,178 issued; 14,350,726 and 14,290,917 outstanding, respectively	14	14
Additional paid-in-capital	84,437	83,940
Retained earnings	18,606	17,256
Accumulated other comprehensive income (loss)	31	(2,199)
Common stock in treasury, at cost - 40,000 shares	(151)	(151)
Total Shareholders' Equity	102,937	98,860
Total Liabilities and Shareholders' Equity	$ 128,474	$ 122,648

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

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

(in thousands)	Three Months Ended		Six Months Ended	
	July 1, 2006	July 2, 2005	July 1, 2006	July 2, 2005
SALES	$ 38,042	$ 30,895	$ 70,098	$ 58,511
COST OF SALES (exclusive of depreciation and amortization, shown separately below)	15,480	12,505	28,701	22,778
GROSS PROFIT	22,562	18,390	41,397	35,733
OPERATING EXPENSES:				
Selling	11,610	9,358	21,861	17,024
General and administrative	7,130	4,368	12,777	7,836
Depreciation and amortization	1,062	789	2,073	1,480
Research and development	1,797	1,633	3,649	2,960
Total operating expenses	21,599	16,148	40,360	29,300
INCOME FROM OPERATIONS	963	2,242	1,037	6,433
OTHER INCOME (EXPENSE)				
Interest income	169	170	327	302
Other (expense) income , net	(88)	(111)	287	(139)
Interest expense	(4)	(76)	(6)	(78)
INCOME BEFORE INCOME TAX	1,040	2,225	1,645	6,518
INCOME TAX EXPENSE	187	313	296	1,137
NET INCOME	$ 853	$ 1,912	$ 1,349	$ 5,381
NET INCOME PER SHARE - BASIC	$ 0.06	$ 0.13	$ 0.09	$ 0.38
NET INCOME PER SHARE - DILUTED	$ 0.06	$ 0.13	$ 0.09	$ 0.37

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

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

	Six Months Ended	
	Jul 1, 2006	**Jul 2, 2005**
CASH FLOWS FROM:		
OPERATING ACTIVITIES:		
Net income	$ 1,349	$ 5,381
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	2,073	1,480
Amortization of stock options and restricted stock units	148	(60)
Income tax benefit from exercise of stock options	-	371
Deferred income tax benefit	(736)	(234)
Change in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable, net	(4,632)	(4,774)
Inventories	2,220	(5,931)
Prepaid expenses and other current assets	(743)	(645)
Increase (decrease) in:		
Accounts payable and accrued liabilities	(2,444)	(944)
Income taxes payable	726	312
Customer deposits	82	(118)
Unearned service revenues	1,598	633
Net cash used in operating activities	(359)	(4,529)
INVESTING ACTIVITIES:		
Acquisition of iQvolution	-	(5,135)
Purchases of property and equipment	(2,122)	(1,724)
Payments for intangible assets	(589)	(482)
Purchases of short-term investments	-	(3,300)
Proceeds from short-term investments	700	10,995
Net cash (used in) provided by investing activities	(2,011)	354
FINANCING ACTIVITIES:		
Payments of capital leases	(107)	(19)
Proceeds from issuance of stock, net	1	291
Net cash (used in) provided by financing activities	(106)	272
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	115	(1,504)
DECREASE IN CASH AND CASH EQUIVALENTS	(2,361)	(5,407)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	9,278	16,357
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 6,917	$ 10,950

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

NOTE A - DESCRIPTION OF BUSINESS

FARO Technologies, Inc. and subsidiaries (collectively the "Company" or "FARO") design, develop, manufacture, market and support software-based three-dimensional measurement devices for manufacturing, industrial, building construction and forensic applications. The Company's principal products include the Faro Arm, Faro Scan Arm, Digital Template and Faro Gage, all articulated electromechanical measuring devices, and the Faro Laser Tracker and the Faro Laser Scanner LS, both laser-based measuring devices. Markets for the Company's products include automobile, aerospace, heavy equipment, countertop manufacturers and law enforcement agencies. The Company sells the vast majority of its products though a direct sales force located in many of the world's largest industrialized countries.

NOTE B - PRINCIPLES OF CONSOLIDATION

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

NOTE C - BASIS OF PRESENTATION

The consolidated financial statements of the Company include all adjustments, consisting of only normal recurring items, considered necessary by management for their fair presentation in conformity with accounting principles generally accepted in the United States of America. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The consolidated results of operations for the three and six months ended July 1, 2006 are not necessarily indicative of results that may be expected for the year ending December 31, 2006 or any future period.

The information included in this Form 10-Q, including the interim consolidated financial statements and notes that accompany these financial statements, should be read in conjunction with the audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

NOTE D - RECLASSIFICATIONS

Certain amounts have been reclassified to conform to the current period presentation.

NOTE E - IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, *"Inventory Costs, an Amendment of ARB No. 43, Chapter 4."* SFAS No. 151 retains the general principle of ARB No. 43, Chapter 4, *"Inventory Pricing,"* that inventories are presumed to be stated at cost; however, it amends ARB No. 43 to clarify that abnormal amounts of idle facilities, freight, handling costs and spoilage should be recognized as current period expenses. Also, SFAS No. 151 requires fixed overhead costs be allocated to inventories based on normal production capacity. The guidance in SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company has adopted the provisions of SFAS No. 151 effective January 1, 2006. The impact of this statement was not material to the Company's financial position or results of operations.

In June 2006, the FASB issued Interpretation No. 48, *"Accounting for Uncertainty in Income Taxes"*("FIN 48"). This interpretation of SFAS No. 109, "Accounting for Income Taxes," provides guidance for recognizing and measuring tax positions taken or expected to be taken in a tax return that directly or indirectly affect amounts reported in financial statements. This Interpretation also provides accounting guidance for the related income tax effects of tax positions that do not meet the recognition threshold specified in this Interpretation. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is reviewing FIN 48 and has not yet determined the impact, if any, on its financial position or results of operations.

NOTE F - STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123R, *"Share-Based Payment."* SFAS No. 123R requires employee stock options and rights to purchase shares under stock participation plans to be accounted for under the fair value method, and eliminates the ability to account for these instruments under the intrinsic value method prescribed by APB Opinion No. 25, as allowed under the original provisions of SFAS No. 123. Under the intrinsic value based method, compensation cost is measured by the excess, if any, of the quoted market price of the stock at the grant 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 fair value of the award and is recognized over the service period, which is usually the vesting period.

SFAS 123R provides two alternative transition methods in the period of adoption: the modified prospective application method and the modified retrospective application method. The Company has adopted the provisions of SFAS No. 123R effective January 1, 2006 using the modified prospective application transition method. The modified prospective application requires the compensation cost for the portion of awards for which the requisite service has not yet been rendered that are outstanding as of the adoption date be recognized over the remaining service period. The compensation cost for that portion of awards will be based on the grant date fair value of those awards as calculated for pro forma disclosures under SFAS No. 123, as originally issued. All new awards and awards that are modified, repurchased, or cancelled after the adoption date will be accounted for under the provisions of SFAS No. 123R. The Company uses the Black-Scholes option pricing model to determine the fair value of stock option grants. The impact of this statement was not material to the Company's financial position or results of operations. Compensation costs of $12 related to the Company's stock option plan and $102 related to compensation costs of the restricted stock unit grants are included in operations in the six month period ended July 1, 2006.

Had compensation expense for stock options granted in the three and six month periods ended July 2, 2005 been recorded based on the fair market value at the grant date, the Company's net income and earnings per share would have been as follows:

	Three Months Ended July 2, 2005	Six Months Ended July 2, 2005
Net income, as reported	$ 1,912	$ 5,381
Add (Deduct): Stock-based employee compensation expense (income) included in reported net income, net of related tax effects	38	(38)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(639)	(1,227)
Pro forma net income	$ 1,311	$ 4,116
Earnings per share:		
Basic - as reported	$ 0.13	$ 0.38
Basic - pro forma	$ 0.09	$ 0.29
Diluted - as reported	$ 0.13	$ 0.37
Diluted - pro forma	$ 0.09	$ 0.28

We expect to incur minimal expenses in 2006 as calculated under the Black-Scholes method of SFAS 123, related to our adoption of SFAS 123R for the expensing of stock options as we vested substantially all of our unvested and “out-of-the-money” options in the fourth quarter of 2005. The reduction in pre-tax charges estimated by the Company as a result of the acceleration amounts to approximately $7.7 million over the course of the original vesting periods. Options to purchase approximately 704,310 shares of the Company’s stock or 52.5% of the Company’s total outstanding options were accelerated. The weighted average exercise price of the options subject to acceleration was $21.30. The aggregate pretax expense for the shares subject to acceleration that would have been reflected in the Company’s consolidated financial statements beginning in 2006 is approximately $7.7 million, including $4.3 million in 2006, $2.7 million in 2007, and $0.7 million in 2008. The fair value for any future grants will be included in expense over the vesting periods. These expenses will be apportioned according to the classification of the employees who have received stock options into cost of sales, selling, general and administrative or research and development costs.

NOTE G - SUPPLEMENTAL CASH FLOW INFORMATION

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

	Six Months Ended	
	Jul 1, 2006	Jul 2, 2005
Cash paid for interest	$ 6	$ 71
Cash paid for income taxes	606	322
Cash received from income tax refund	-	1,161
Non-Cash Activity:		
Value of shares issued for acquisition of iQvolution		$ 3,869
Value of shares issued for milestones related to the acquisition of iQvolution	$ 349	-
Purchase price adjustment for tax effects of acquisition of iQvolution	$ 1,506	-
Capital lease obligations	$ 83	-

NOTE H - ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	As of Jul 1, 2006	As of Dec. 31, 2005
Accounts receivable	$ 34,803	$ 28,868
Allowance for doubtful accounts	(306)	(214)
Total	$ 34,497	$ 28,654

NOTE I - INVENTORIES

Inventories consist of the following:

	As of Jul 1, 2006	As of Dec 31, 2005
Raw materials	$ 9,138	$ 11,820
Finished goods	4,366	4,976
Sales demonstration inventory	13,485	12,227
Reserve for excess and obsolete	(538)	(373)
Inventory	26,451	28,650
Service inventory	4,966	4,333
Total	$ 31,417	$ 32,983

NOTE J - EARNINGS PER SHARE

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

	Three Months Ended				Six Months Ended			
	July 1, 2006		July 2, 2005		July 1, 2006		July 2, 2005	
	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	14,303,013	$ 0.06	14,226,540	$ 0.13	14,312,369	$ 0.09	14,131,266	$ 0.38
Effect of dilutive securities	188,187	-	351,773	-	191,509	$ -	360,406	$ (0.01)
Diluted EPS	14,491,200	$ 0.06	14,578,313	$ 0.13	14,503,877	$ 0.09	14,491,672	$ 0.37

NOTE K - ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	As of Jul 1, 2006	As of Dec. 31, 2005
Accrued compensation and benefits	$ 4,536	$ 2,641
Accrued warranties	1,025	861
Professional and legal fees	1,545	1,239
Other accrued liabilities	926	828
	$ 8,032	$ 5,569

Activity related to accrued warranties was as follows:

	Jul 1, 2006	Jul 2, 2005
Beginning Balance	$ 861	$ 565
Provision for warranty expense	353	475
Warranty expired	(189)	(223)
Ending Balance	$ 1,025	$ 817

NOTE L - INCOME TAXES

The tax provision for the six months ended July 1, 2006 decreased from the tax provision for the six months ended July 2, 2005, principally due to a decrease in earnings. Total deferred tax assets for the Company’s foreign subsidiaries relating to net operating loss carryforwards were $5.4 million at July 1, 2006 and December 31, 2005. The related valuation allowance was $3.3 million and $3.5 million at July 1, 2006 and December 31, 2005, respectively. The Company’s effective tax rate increased to 18% for the six months ended July 1, 2006 from 17.4% in the prior year period as a result of the Company’s current projections for 2006. The Company currently estimates the effective tax rate will approximate 18% for the remainder of 2006. The Company’s tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, our tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of our products and the resulting effect on taxable income in each jurisdiction.

NOTE M - GEOGRAPHIC DATA

The Company develops, manufactures, markets and supports CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software. This one line of business represents approximately 99% of consolidated sales and is the Company's only segment. 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 following table presents information about the Company by geographic area:

	Three Months Ended		Six Months Ended	
	Jul 1, 2006	Jul 2, 2005	Jul 1, 2006	Jul 2, 2005
SALES				
Americas Region	$ 16,540	$ 15,033	$ 29,411	$ 25,944
Europe/Africa Region	15,140	12,099	27,628	23,939
Asia Pacific Region	6,362	3,763	13,059	8,628
TOTAL	$ 38,042	$ 30,895	$ 70,098	$ 58,511

NOTE N - OTHER COMPREHENSIVE INCOME

Other comprehensive income (loss) results from the effect of currency translation adjustments on the investments in (capitalization of) foreign subsidiaries combined with their accumulated earnings or losses.

	Three Months Ended		Six Months Ended	
(in thousands)	July 1, 2006	July 2, 2005	July 1, 2006	July 2, 2005
NET INCOME	$ 853	$ 1,912	$ 1,349	$ 5,381
OTHER COMPREHENSIVE INCOME (LOSS):				
Currency translation adjustments	1,756	(2,754)	2,231	(4,152)
COMPREHENSIVE INCOME (LOSS)	$ 2,609	$ (842)	$ 3,580	$ 1,229

NOTE O - COMMITMENTS AND CONTINGENCIES

Leases—The Company is a party to leases arising in the normal course of business, including leases with related parties, that expire on or before 2010. Total obligations under these leases will be approximately $2.5 million for 2006.

Purchase Commitments—The Company enters into purchase commitments for products and services in the ordinary course of business. These purchases generally cover production requirements for 60 to 90 days. On August 11, 2005, FARO entered into an agreement with DELCAM plc under which the Company agreed to purchase approximately $1.4 million in products over a 12-month term. At July 1, 2006, the Company had completed the purchase of $1.2 million in products under this agreement. Effective November 1, 2005, FARO entered into an agreement with Metrologic Group S.A. under which the Company agreed to purchase approximately $0.4 million in products over a 12-month term. At July 1, 2006, $.15 million had been purchased under this agreement. Other than the agreements listed above, the Company does not have any long-term commitments for purchases.

Litigation— On November 25, 2003, Cimcore-Romer (now a division of Hexagon) filed a patent infringement suit against the Company in the Federal District Court for the Southern District of California alleging that certain of the Company's products sold in the United States, including the FARO Arm, infringe U.S. Patent 5,829,148 ('148 patent). The Company believes, and has contended in this litigation, that the Company does not infringe the '148 patent and that the '148 patent is invalid.

On July 12, 2005, the court issued an order granting Cimcore-Romer's motion for summary judgment of infringement of three claims of the ‘148 patent. On July 22, 2005, the Company announced its decision to limit the capability of its U.S.-based FARO Arm products (the FARO Arm, the FARO Gage and the Digital Template) by removing what the Company calls the "infinite rotation feature" by reducing this capability to 50 rotations or fewer. FARO believes that by limiting the range of the joint rotation to 50 rotations, it has removed from its U.S. products the ability to sweep through an unlimited arc, which is a feature of the ‘148 patent claims addressed by the court’s ruling required to infringe the '148 patent. The revised products have not, however, been considered by the courts. Accordingly, the Company cannot give assurance that the revised products will not be deemed to infringe the ‘148 patent.

On September 20, 2005, the Court vacated its order of summary judgment of infringement and agreed to reconsider its conclusions from the patent claim construction (“Markman”) ruling, which is a pretrial hearing often used in patent infringement cases. The new Markman hearing occurred on October 3, 2005 and the hearing-on-summary judgments of infringement occurred on November 14, 2005. On October 18, 2005, the Court issued a revised claim construction that the Company believes materially alters the Court’s previous Markman ruling by substantially narrowing what FARO believes to be key aspects of the claim construction. The Company believes that this narrower claim construction will ultimately lead to a finding that it does not infringe any claim of the ‘148 patent. On November 14, 2005, the Court denied both the Plaintiffs’ Renewed Motion for Summary Judgment of Infringement and the Defendant’s Faro’s Renewed Motion for Summary Judgment of Non-Infringement, and determined that there existed a genuine issue of material fact with respect to whether Faro infringed the assert patent. The case was originally set for trial for January 31, 2006. On January 18, 2006, the Court vacated the trial date and remanded the case to the magistrate for resumption of discovery regarding Plaintiffs’ alleged compliance with the patent marking provisions of 35 U.S.C. § 287 and all related issues. A hearing on Faro’s Motion for Partial Summary Judgment Regarding Plaintiffs’ Failure to Comply With the Patent Marking Provisions of 35 U.S.C. § 287 was held on May 11, 2006. A new trial date has been set for October 30, 2006.

In addition, the Company filed two separate requests for reexamination in the U.S. Patent and Trademark Office ("PTO") of the ‘148 Patent, both of which requests were granted. The PTO ruled in the first reexamination in September 2005. The Company believes that the PTO ruling bolsters the Company’s previous position that it does not infringe the '148 patent. More specifically, in the first reexamination, the PTO construed critical claim terms in a relatively narrow manner, which the Company believes is consistent with its stated positions in the patent litigation. This narrow claim construction led the PTO to differentiate the claims for the references at issue in the first reexamination. The Company believes that this narrow construction, while allowing the '148 claims to be confirmed valid over the aforementioned references in the first reexamination, will prevent the California District Court from ruling that Faro's products infringe the '148 patent. The Company’s second reexamination request was granted by the PTO in November 2005 and is based on new "prior art" (that is, earlier issued patent publications) submitted to the PTO which FARO believes will ultimately invalidate the '148 patent. This prior art reference was not at issue in the first reexamination proceeding. The PTO has not ruled in the second reexamination request.

In the event of an adverse ruling in the Cimcore-Romer litigation, however, the Company could be required to pay substantial damages, cease the manufacturing, use and sale of any infringing products, discontinue the use of certain processes or obtain a license, if available, from Cimcore-Romer with royalty payment obligations by the Company. An adverse decision in the Cimcore-Romer case could materially and adversely affect the Company’s financial condition and results of operations. At this time, however, the Company cannot estimate the potential impact, if any, that might result from this suit, and therefore, no provision has been made to cover such expense.

Securities Litigation— On December 6, 2005, the first of four essentially identical class action securities fraud lawsuits were filed against the Company and certain officers of the Company. On April 19, 2006, the four lawsuits were consolidated, and Kornitzer Capital Management, Inc. was appointed as the lead plaintiff. On May 16, 2006, Kornitzer filed its Consolidated Amended Class Action Complaint against the Company and the individual defendants. The amended complaint also names Grant Thornton LLP, the Company's independent registered public accounting firm, as an additional defendant.

In the amended complaint, Kornitzer seeks to represent a class consisting of all persons who purchased or otherwise acquired the Company's publicly traded securities between April 15, 2004 and March 15, 2006. On behalf of the alleged class, Kornitzer seeks an unspecified amount of damages, premised on allegations that each defendant made misrepresentations and omissions of material fact during the class period in violation of the Securities Exchange Act of 1934. Among other things, Kornitzer alleges that the Company's reported gross margins and net income were knowingly overstated as a result of manipulation of the Company's inventory levels, that the Company failed to disclose deficiencies associated with the Company's implementation and use of its enterprise resource planning system and material requirements planning system, made false and misleading statements regarding the Company's internal controls, failed to disclose the fact that the Company was accruing commissions and bonuses which would have a material, adverse effect upon the Company's profitability, and improperly reported sales and net income based, in part, on sales and new orders obtained in violation of the Foreign Corrupt Practices Act.

The Company filed a Motion to Dismiss the amended complaint on July 31, 2006. The lead plaintiff, Kornitzer, has until August 30, 2006 to file a response to the Motion to Dismiss. The Company has timely notified the issuer of its Executive Liability and Entity Securities Liability insurance policy of the Securities Litigation, and has reserved the full amount of its $250,000 retention under the policy. Although the Company believes that the material allegations made in the amended complaint are without merit and intends to vigorously defend the Securities Litigation, no assurances can be given with respect to the outcome of the Securities Litigation.

Voluntary Disclosure of Foreign Corrupt Practices Act Matter to the Securities and Exchange Commission and Department of Justice. - As previously reported on the Company's Form 10-K for the year ended December 31, 2005 and Form 10-Q for the first quarter ended April 1, 2006, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company's Audit Committee instituted an internal investigation into this matter in February 2006, and the Company voluntarily notified the SEC and the DOJ of this matter in March 2006. The internal investigation into this matter has been completed. The Company has provided to the SEC and the DOJ information obtained during the course of this investigation and is cooperating with both agencies.

The Company's internal investigation has identified certain improper payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA. If the SEC or the DOJ determines that violations of the FCPA have occurred, they could seek civil and criminal sanctions, including monetary penalties, against the Company and/or certain of its employees, as well as additional changes to the Company's business practices and compliance programs. Based on current information, it is not possible to predict at this time when the SEC or DOJ investigations will be resolved, what the outcome will be, what sanctions, if any, will be imposed, or the effect that such matters may ultimately have on the Company or its consolidated financial statements. Results of the investigation revealed that referral fee payments in possible violation of the FCPA were $165,000 and $265,000 in 2004 and 2005, respectively, which were recorded in selling expenses in the Company's statement of income. The related sales to customers to which payment of these referral fees had been made totaled approximately $1.3 million and $3.24 million in 2004 and 2005, respectively. Additional improper referral fee payments of $122,000 were made in January and February 2006 related to sales contracts in 2005. The Company anticipates incurring expenses of at least $3.7 million in 2006 relating to the FCPA matter. The Company has incurred approximately $3.2 million in the first half of 2006 related to the FCPA matter.

The Company has terminated certain personnel in the Asia-Pacific Region and has re-assigned the duties of other personnel in both the Asia-Pacific Region and the U.S. as a result of the internal investigation. The Company is instituting the following remedial measures:

- Contracted with a third party forensics accounting team to conduct an in-depth audit of the operations in China and in other countries in the Asia-Pacific Region and to make recommendations for improvement to the internal control systems.

- Reviewing third party distributor arrangements in an effort to assure that all contracts include adherence to the FCPA.

- Performing due diligence on all third party distributors and implementing a process to assess potential new distributors.

- Established an in-house internal audit function hiring a Director of Internal Audit.

- Consolidating the human resources, financial accounting and reporting functions for the Asia region into the Singapore Operations.

- Implemented an internal certification process to ascertain whether similar issues may exist elsewhere in the Company.

- Implemented a quarterly internal certification process to confirm adherence to company policy and all applicable laws and regulations that will include all regional leadership, country management and other sales management.

- Implementing additional training on FCPA and other matters for employees and a confidential compliance reporting system.

The Company reported sales in China of $9.0 million in 2005 and $4.2 million in 2004, approximately 7% and 4% of total sales, respectively. Depending on how this matter is resolved, the Company's sales in China could be significantly impacted. The termination of certain personnel and the cessation of improper payments in China may have an adverse effect on future operations in China because such action could negatively influence the decisions of a significant number of customers of the Chinese subsidiary to do business with that subsidiary. The potential magnitude of the loss of sales in China as a result of potential violations of the FCPA cannot be estimated at this time.

During the Company's internal investigation of its business practices in China, it became aware that income taxes related to certain commissions and bonus payments to its employees had not been properly reported. The Company has filed the appropriate payroll tax returns and remitted the deficiency.

NOTE P - CREDIT FACILITY

The Company has an available line of credit of $5.0 million. Terms of this line of credit require the Company to maintain certain ratios and balances with respect to a debt covenant agreement, including current ratio, consolidated EBITDA, indebtedness to consolidated net worth, fixed charge coverage ratio and consolidated tangible net worth. As of July 1, 2006, the Company was not in compliance with one of the financial covenants requiring the Company to maintain a Minimum Fixed Charge Coverage Ratio. The Company has obtained a waiver from the bank related to this covenant violation. As of December 31, 2005, the Company was in compliance with the required ratios. Drawings under the line of credit bear interest at a rate equivalent to LIBOR plus 1.75%. The line of credit is due on demand. There were no amounts outstanding under the line of credit at July 1, 2006.

On July 11, 2006, the Company entered into an Amended and Restated Loan Agreement (the "Amended Loan Agreement"). The Amended Loan Agreement replaces the Company's prior $5.0 million loan agreement entered into on September 17, 2003. The Amended Loan Agreement provides for an available line of credit of $30.0 million. Loans under the Amended Loan Agreement bear interest at the rate of LIBOR plus 1.75% and require the Company to maintain certain ratios and balances with respect to a debt covenant agreement, including current ratio, consolidated EBITDA, and senior funded debt to EBITDA. As of June 30, 2006, the Company is in compliance with all of the covenants under the Amended Loan Agreement. The term of the Amended Loan Agreement extends to April 30, 2009. The Company has not drawn on this line of credit.

NOTE Q - ACQUISITION

On March 29, 2005, the Company acquired 100% of the outstanding stock of privately held iQvolution AG ("iQvolution"). iQvolution, a German company, designs, manufactures and supplies three-dimensional laser scanning products and services. This purchase was a strategic acquisition to enable the Company to enter broader three-dimensional measurement markets. The purchase price for the transaction was approximately $13.6 million, including an initial cash payment of approximately $3.8 million and 314,736 shares of common stock valued at approximately $7.2 million based on the average closing price for the three days immediately preceding the closing, 152,292 shares of which were payable immediately. The remaining 162,444 shares of common stock, valued at approximately $3.7 million, were placed in escrow and may be paid over the following five years subject to achieving predetermined milestones with respect to purchased assets. Subsequent to the purchase, approximately $1.8 million in cash was paid out for the repayment of loans and approximately $0.4 million was paid in fees associated with the purchase. Additionally, the purchase price was adjusted downward by $0.1 million, and these funds were repaid to the Company in the third quarter of 2005 relating to the settlement of a purchase price adjustment clause within the purchase agreement. At July 1, 2006 and December 31, 2005, there were 84,773 and 150,261 shares being held in escrow, respectively.

The Company completed in the first quarter of 2006 the third party valuation of the assets acquired. The company made an adjustment to the purchase price to reflect a deferred tax liability of $1.5 million. The following table represents the fair value of the assets acquired and liabilities assumed and includes the final determination of the estimated fair values of deferred tax assets, non-compete, and intangible assets, which were preliminary as of December 31, 2005:

Current assets	$	907
Property and equipment	$	595
Deferred tax assets	$	141
Non-compete	$	348
Intangible assets	$	3,492
Goodwill	$	8,309
Current liabilities	$	(2,235)
Long term debt	$	(167)
Deferred tax liability	$	(1,506)
	$	9,884

The non-compete agreement is being amortized over 8 years. The intangible assets are being amortized over their useful lives of 10 years. The excess of the purchase price over the net assets acquired of $6.8 million was recorded as goodwill and is evaluated for impairment on a periodic basis in accordance with SFAS No. 142. The Company expects to record the value of the shares held in escrow to goodwill upon achievement of the predetermined milestones.

The operating results of iQvolution have been included in the consolidated statements of income since the date of acquisition. The following unaudited pro-forma consolidated results of operations for the three months ended April 2, 2005 are presented for informational purposes only and do not purport to be indicative of the consolidated results of operations which actually would have resulted had the acquisition occurred on the date indicated, or the consolidated results of operations which may result in the future.

(unaudited)	Three Months Ended April 1, 2005
Revenues	$ 27,987
Net income	$ 2,753
Income per share:	
Basic	$ 0.20
Diluted	$ 0.19

NOTE R - SUBSEQUENT EVENTS

Transactions with Related and Other Parties

The Company leases its headquarters in Lake Mary, Florida from Xenon Research, Inc., all of the issued and outstanding capital stock of which is owned by Simon Raab, the Company's Chairman and Co-Chief Executive Officer, and Diana Raab, his spouse. The prior lease expired on February 28, 2006, and the Company executed a new Lease Agreement on August 8, 2006 with Xenon Research. The term of the Lease commenced as of July 1, 2006 and expires at midnight on July 1, 2011 (the “Initial Term”). The Lease will be automatically renewed for one successive five-year term unless the Company provides Xenon Research with written notice of non-renewal at least 90 days prior to the end of the term. The Company also has a one-time right to terminate the Lease after three years (from July 1, 2006) upon written notice delivered to the Landlord one year prior to the date upon which the Company wishes to terminate the Lease.

During the first year of the Initial Term, the fixed rent will be $302,750.00 per annum payable monthly. Each year thereafter (on July 1), the fixed rent will be increased by three percent over the fixed rent for the preceding year. The lease is a “net lease,” meaning that the Company also is responsible for real estate taxes and insurance expenses covering the leased premises. The real estate taxes and insurance expenses are paid by Xenon Research, and the Company reimburses Xenon Research in equal monthly payments for such real estate taxes and insurance expenses with the reimbursement amount to be computed annually based on the real estate taxes and insurance expenses actually paid by Xenon Research. All payments of fixed rent and additional rent will include all applicable sales and use taxes.

Item 2. 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, including the notes thereto, included elsewhere in this Form 10-Q, and the Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2005 Annual Report, Form 10-K, for the year ended December 31, 2005.

FARO Technologies, Inc. ("FARO", the "Company", "us", "we", or "our") has made "forward-looking statements" in this report (within the meaning of the Private Securities Litigation Reform Act of 1995). Statements that are not historical facts or that describe our plans, beliefs, goals, intentions, objectives, projections, expectations, assumptions, strategies, or future events are forward-looking statements. In addition, words such as "may," "will," "believe," "plan," "should," "could," "seek," "expect," "anticipate," "intend," "estimate," "goal," "objective," "project," "forecast," "target" and similar words, or discussions of our strategy or other intentions identify forward-looking statements. Other written or oral statements that constitute forward-looking statements also may be made by the Company from time to time.

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

- our inability to further penetrate our customer base;
- development by others of new or improved products, processes or technologies that make our products obsolete or less competitive;
- our inability to maintain our technological advantage by developing new products and enhancing our existing products;
- our inability to successfully identify and acquire target companies or achieve expected benefits from acquisitions that are consummated;
- the cyclical nature of the industries of our customers and the financial condition of our customers;
- the fact that the market potential for the CAM2 market and the potential adoption rate for our products are difficult to quantify and predict;
- the inability to protect our patents and other proprietary rights in the United States and foreign countries and the assertion and ultimate outcome of infringement claims against us, including the pending suit by Hexagon's Cimcore-Romer subsidiary against us;
- fluctuations in our annual and quarterly operating results and the inability to achieve our financial operating targets as a result of a number of factors including, without limitation (i) litigation and regulatory action brought against us, (ii) quality issues with our products, (iii) excess or obsolete inventory, (iv) raw material price fluctuations, (v) expansion of our manufacturing capability and other inflationary pressures, (vi) the size and timing of customer orders, (vii) the amount of time that it takes to fulfill orders and ship our products, (viii) the length of our sales cycle to new customers and the time and expense incurred in further penetrating our existing customer base, (ix) costs associated with new product introductions, such as product development, marketing, assembly line start-up costs and low introductory period production volumes, (x) the timing and market acceptance of new products and product enhancements, (xi) customer order deferrals in anticipation of new products and product enhancements, (xii) our success in expanding our sales and marketing programs, (xiii) costs associated with opening new sales offices outside of the United States, (xiv) fluctuations in revenue without proportionate adjustments in fixed costs, (xv) the efficiencies achieved in managing inventories and fixed assets, (xvi) investments in potential acquisitions or strategic sales, product or other initiatives, (xvii) shrinkage or other inventory losses due to product obsolescence, scrap or material price changes, (xviii) adverse changes in the manufacturing industry and general economic conditions, and (xix) other factors including the cost of investigation and ongoing litigation expenses noted herein;

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

- the outcome of the purported class action lawsuit;

- our inability to successfully implement the requirements of Restriction of use of Hazardous Substances (RoHS) and Waste Electrical and Electronic Equipment (WEEE) compliance into our products;

- the inability of our products to displace traditional measurement devices and attain broad market acceptance;

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

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

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

- our inability to maintain our level of sales or grow sales in China as a result of, among other things, the impact of our investigation of potential violations of the Foreign Corrupt Practices Act and modifications to our business practices in China;

- higher than expected increases in expenses relating to our Asia Pacific expansion or our Swiss manufacturing facility;

- our inability to find less expensive alternatives to stock options to attract and retain employees;

- difficulties in recruiting research and development engineers, and application engineers;

- the failure to effectively manage our growth;

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

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

- the matters set forth under “Cautionary Statements” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” below.

Overview

We design, develop, manufacture, market and support portable, software driven, 3-D measurement systems that are used in a broad range of manufacturing, industrial, building construction and forensic applications. The Company's Faro Arm, Faro Scan Arm and Faro Gage articulated measuring devices, the Faro Laser Tracker, and their companion CAM2 software, provide for Computer-Aided Design (CAD)-based inspection and/or factory-level statistical process control. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company uses the acronym “CAM2” for this process, which stands for computer-aided manufacturing measurement. The Company’s Digital Template articulated measuring device and its related software are used to measure the shape of existing counter tops and other structures in residential or commercial buildings to provide the data required to manufacture replacement countertops or other structures. The Digital Template reduces the time required to measure these existing products and to provide the data to manufacturing machines to create the replacement structures, compared to traditional techniques. In March 2005 the Company acquired iQvolution AG, a German designer, developer and manufacturer of a portable laser-based device for measuring the detailed composition of factories, oil refineries and other structures. This device and its related software, which the Company sells under the product name Laser Scanner LS also has forensic applications such as capturing detailed 3-D crime scene information. As of June 2006, the Company's products have been purchased by approximately 5,500 customers worldwide, ranging from small machine shops to such large manufacturing and industrial companies as Audi, Bell Helicopter, Boeing, British Aerospace, Caterpillar, Daimler Chrysler, General Electric, General Motors, Honda, Johnson Controls, Komatsu Dresser, Lockheed Martin, Nissan, Siemens and Volkswagen, among many others.

We continue to pursue international markets. We established sales offices in France and Germany in 1996, Great Britain in 1997, Japan and Spain in 2000, Italy in 2001, and China in 2003. We opened sales offices in South Korea and India in 2004. We established sales offices in Poland, Netherlands, Malaysia, Vietnam, and Singapore in 2005 and added a new regional headquarters in Singapore in the third quarter of 2005 along with a new manufacturing and service facility there in the fourth quarter of 2005. In 2003 we began to manage and report our global sales in three regions: the Americas, Europe/Africa and Asia/Pacific. In the first half of 2006, 42.0% of our sales were in the Americas compared to 44.3% in the first six months of 2005, 39.4% were in the Europe/Africa region compared to 40.9% in the first half of 2005 and 18.6% were in the Asia/Pacific region, compared to 14.8% in the prior year period (see also Note M- Geographic Data, to the financial statements above).

We derive revenues primarily from the sale of our Faro Arm, Faro Scan Arm, Faro Gage, Faro Laser Tracker and Faro Laser Scanner LS 3-D measurement equipment, and their related multi-faceted software. Revenue related to these products is recognized upon shipment. In addition, we sell one to three-year extended warranties and training and technology consulting services relating to our products. We recognize the revenue from extended warranties on a straight-line basis. We also receive royalties from licensing agreements for our historical medical technology and generally recognize the revenue from these royalties as licensees use the technology.

In 2003, we began to manufacture our Faro Arm products in Switzerland for customer orders from the Europe/Africa and Asia/Pacific regions. We began to manufacture our Faro Gage product, and parts of our Faro Laser Tracker product in our Swiss plant in the third quarter of 2004. We began complete production of the Faro Laser Tracker product in our Swiss plant in 2005. We began to manufacture our Faro Arm products in our Singapore plant in the fourth quarter of 2005, the Faro Laser Tracker in the first half of 2006 and we expect to begin production of our Faro Gage in the second half of 2006. We expect our Singapore plant will supply our Asia/Pacific market for these products. The manufacture of these products for customer orders from the Americas will be done in our manufacturing facilities located in Florida and Pennsylvania. Our Faro Laser Scanner LS product is currently manufactured in our new facility located in Stuttgart, Germany. We expect all our existing plants to have the production capacity necessary to support our growth through 2006.

We have had sixteen consecutive profitable quarters through July 1, 2006. Our sales growth and profitability has been a result of a number of factors, including: the acquisition of SMX, which manufactured the predecessor to the Faro Laser Tracker, the introduction in October 2002 of the latest generation of our traditional Faro Arm product, the introduction of the Faro Gage in September 2003, the introduction of our Faro Scan Arm product in 2004, the acquisition of iQvolution AG in 2005, which manufactured the predecessor to the Faro Laser Scanner LS, and an increase in the number of sales people worldwide.

The Company reports both sales and new orders in its quarterly earnings releases. In the second quarter of 2006, new order bookings increased $6.3 million, or 18.3%, to $40.8 million from $34.5 million in the year-ago quarter. New orders increased 24.5% in the Americas to $17.8 million, from $14.3 million in the second quarter of 2005. New orders increased 22.7% to $16.2 million in Europe/Africa from $13.2 million in the second quarter of 2005. In Asia/Pacific new orders declined 2.9% to $6.8 million from $7.0 million in the second quarter of 2005.

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 inter-company accounts reflected in our consolidated financial statements. We are aware of the availability of off-balance sheet financial instruments to hedge exposure to foreign currency exchange rates, including cross-currency swaps, forward contracts and foreign currency options (see Foreign Exchange Exposure below). However, we do not regularly use such instruments, and none were utilized in 2006 or 2005.

The Company's effective tax rate increased to 18% for the six months ended July 1, 2006 from 17.4% in the prior year period. The Company currently estimates the effective tax rate will approximate 18% for the remainder of 2006. The Company's tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, our tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of our products. We have received a favorable income tax rate commitment from the Swiss government as an incentive to establish a manufacturing plant in Switzerland, and in 2005 have entered into an agreement with the Singapore Economic Development Board for a favorable multi-year income tax rate commitment covering our Singapore headquarters and manufacturing operations.

We expect to incur minimal expenses in 2006 as calculated under the Black-Scholes method of SFAS 123, related to our adoption of SFAS 123(R) for the expensing of stock options as we vested substantially all of our unvested options in the fourth quarter of 2005. The reduction in pre-tax charges estimated by the Company as a result of the acceleration amounts to approximately $7.7 million over the course of the original vesting periods. Options to purchase approximately 704,310 shares of the Company's stock or 52.5% of the Company's total outstanding options were accelerated. The weighted average exercise price of the options subject to acceleration was $21.30. The aggregate pretax expense for the shares subject to acceleration that would have been reflected in the Company's consolidated financial statements beginning in 2006 is approximately $7.7 million, including $4.3 million in 2006, $2.7 million in 2007, and $0.7 million in 2008. The fair value for any future grants will be included in expense over the vesting periods. These expenses will be apportioned according to the classification of the employees who have received stock options into cost of sales, selling, general and administrative or research and development costs.

As previously reported on the Company's Form 10-K for the year ended December 31, 2005 and Form 10-Q for the first quarter ended April 1, 2006, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company's Audit Committee instituted an internal investigation into this matter in February 2006, and the Company voluntarily notified the SEC and the DOJ of this matter in March 2006. The internal investigation into this matter has been completed. The Company has provided to the SEC and the DOJ information obtained during the course of this investigation and is cooperating with both agencies.

The Company's internal investigation has identified certain improper payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA. If the SEC or the DOJ determines that violations of the FCPA have occurred, they could seek civil and criminal sanctions, including monetary penalties, against the Company and/or certain of its employees, as well as additional changes to the Company's business practices and compliance programs. Based on current information, it is not possible to predict at this time when the SEC or DOJ investigations will be resolved, what the outcome will be, what sanctions, if any, will be imposed, or the effect that such matters may ultimately have on the Company or its consolidated financial statements. Results of the investigation revealed that referral fee payments in possible violation of the FCPA were $165,000 and $265,000 in 2004 and 2005, respectively, which were recorded in selling expenses in the Company's statement of income. The related sales to customers to which payment of these referral fees had been made totaled approximately $1.3 million and $3.24 million in 2004 and 2005, respectively. Additional improper referral fee payments of $122,000 were made in January and February 2006 related to sales contracts in 2005. The Company anticipates incurring expenses of at least $3.7 million in 2006 relating to the FCPA matter. The Company has incurred approximately $3.2 million in the first half of 2006 related to the FCPA matter.

The Company has terminated certain personnel in the Asia-Pacific Region and has re-assigned the duties of other personnel in both the Asia-Pacific Region and the U.S. as a result of the internal investigation. The Company is instituting the following remedial measures:

- Contracted with a third party forensics accounting team to conduct an in-depth audit of the operations in China and in other countries in the Asia-Pacific region and to make recommendations for improvement to the internal control systems.

- Reviewing third party distributor arrangements in an effort to assure that all contracts include adherence to the FCPA.

- Performing due diligence on all third party distributors and implementing a process to assess potential new distributors.

- Established an in-house internal audit function including hiring a Director of Internal Audit.

- Consolidating the human resources, financial accounting and reporting functions for the Asia region into the Singapore Operations.

- Implemented an internal certification process to ascertain whether similar issues may exist elsewhere in the Company.

- Implemented a quarterly internal certification process to confirm adherence to company policy and all applicable laws and regulations that will include all regional leadership, country management and other sales management.

- Implementing additional training on FCPA and other matters for employees and a confidential compliance reporting system.

The Company had sales in China of $9.0 million in 2005 and $4.2 million in 2004, approximately 7% and 4% of total sales, respectively. Depending on how this matter is resolved, the Company's sales in China could be significantly impacted. The termination of certain personnel and the cessation of improper payments in China may have an adverse effect on future operations in China because such action could negatively influence the decisions of a significant number of customers of the Chinese subsidiary to do business with that subsidiary. The potential magnitude of the loss of sales in China as a result of potential violations of the Foreign Corrupt Practices Act cannot be estimated at this time.

During the Company's internal investigation of its business practices in China, it became aware that income taxes related to certain commissions and bonus payments to its employees had not been properly reported. The Company has filed the appropriate payroll tax returns and remitted the deficiency.

Results of Operations

Three Months Ended July 1, 2006 Compared to the Three Months Ended July 2, 2005

Sales increased by $7.1 million, or 23.0%, to $38.0 million in the three months ended July 1, 2006 from $30.9 million in the three months ended July 2, 2005. This increase resulted primarily from higher product sales due to the increase in the number of sales people worldwide. Sales in the Americas region increased $1.5 million, or 10.0%, to $16.5 million for the three months ended July 1, 2006 from $15.0 million in the three months ended July 2, 2005. Sales in the Europe/Africa region increased $3.0 million, or 24.8%, to $15.1 million for the three months ended July 1, 2006 from $12.1 million in the three months ended July 2, 2005. Sales in the Asia/Pacific region increased $2.6 million, or 68.4%, to $6.4 million for the three months ended July 1, 2006 from $3.8 million in the three months ended July 2, 2005.

Gross profit increased by $4.2 million, or 22.8%, to $22.6 million for the three months ended July 1, 2006 from $18.4 million for the three months ended July 2, 2005. Gross margin decreased to 59.3% for the three months ended July 1, 2006 from 59.5% for the three months ended July 2, 2005. Gross margin decreased primarily due to changes in the product mix, higher service costs and price discounts.

Selling expenses increased by $2.2 million, or 23.4%, to $11.6 million for the three months ended July 1, 2006 from $9.4 million for three months ended July 2, 2005. This increase was primarily due to higher compensation and commission expense of $1.4 million related to the increase in sales and marketing personnel and higher marketing costs of $0.9 million. Our sales growth is driven to a large extent by increased product sales, which are a result of market demand for and acceptance of our products, market size, and the total number of marketing and sales personnel. We will continue to selectively increase our sales and marketing headcount as the market demands. As part of our ongoing global sales force expansion, worldwide sales and marketing headcount increased by 39, or 17.3%, to 265 from 226 between July 1, 2006 and July 2, 2005. Regionally, our sales and marketing headcount increased by 7, or 9.0%, in the Americas, to 85 from 78; by 21, or 22.1%, in Europe/Africa to 116 from 95; and by 11, or 20.8%, in Asia/Pacific to 64 from 53 between July 1, 2006 and July 2, 2005. As a percentage of sales, selling expenses increased to 30.5% of sales in the three months ended July 1, 2006 from 30.4% in the three months ended July 2, 2005. Regionally, selling expenses were 28.2% of sales in the Americas for the quarter, compared to 27.2% of sales in the year-ago quarter, 32.5% of sales for Europe/Africa compared to 31.0% of sales, and 31.7% of sales compared to 41.5% of sales for Asia/Pacific.

General and administrative expenses increased by $2.7 million, or 61.4%, to $7.1 million for the three months ended July 1, 2006 from $4.4 million for the three months ended July 2, 2005. General and administrative expenses as a percentage of sales increased to 18.7% for the three months ended July 1, 2006 from 14.2% for the three months ended July 2, 2005 due primarily to increased professional and legal fees of $2.2 million primarily related to the Company's investigation of possible violations of the Foreign Corrupt Practices Act by its Chinese subsidiary and governance related matters.

Depreciation and amortization expenses increased by $0.3 million to $1.1 million for the three months ended July 1, 2006 from $0.8 million for the three months ended July 2, 2005 as a result of the acquisition of new equipment and intangible assets.

Research and development expenses increased by $0.2 million, or 12.5%, to $1.8 million for the three months ended July 1, 2006 from $1.6 million for the three months ended July 2, 2005. This increase resulted primarily from an increase in salaries and subcontractors expense of $0.13 million related to the Laser Scanner product line. Research and development expenses as a percentage of sales decreased to 4.7% for the three months ended July 1, 2006 from 5.2% for the three months ended July 2, 2005.

Interest income, net increased by $0.07 million to $0.16 million for the three months ended July 1, 2006 from $0.09 million for the three months ended July 2, 2005, due to an increase in interest rates, partially offset by a reduction in total cash and short-term investments.

Other (expense) income, net decreased by $0.02 million to $0.09 million for the three months ended July 1, 2006, from an expense of $0.11 million for the three months ended July 2, 2005, primarily as a result of foreign exchange transaction gains.

Income tax expense decreased by $0.1 million to $0.2 million for the three months ended July 1, 2006 from $0.3 million for the three months ended July 2, 2005. This decrease was primarily due to a decrease in pretax income. Total deferred taxes for the Company's foreign subsidiaries relating to net operating loss carryforwards were $5.4 million at July 1, 2006 and December 31, 2005. The related valuation allowance was $3.3 million and $3.5 million at July 1, 2006 and December 31, 2005, respectively. The Company's effective tax rate increased to 18% for the three months ended July 1, 2006 from 14.1% in the prior year period as a result of an increase in pretax income in higher tax rate jurisdictions. The Company currently estimates the effective tax rate will approximate 18% for the remainder of 2006. The Company's tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, our tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of our products and the resulting effect on taxable income in each jurisdiction..

Net income decreased by $1.0 million to $0.9 million for the three months ended July 1, 2006 from $1.9 million for the three months ended July 2, 2005 as a result of the factors described above.

Six Months Ended July 1, 2006 Compared to the Six Months Ended July 2, 2005

Sales increased by $11.6 million, or 19.8%, to $70.1 million in the six months ended July 1, 2006 from $58.5 million in the six months ended July 2, 2005. This increase resulted primarily from higher product sales due to the increase in the number of sales people worldwide. Sales in the Americas region increased $3.5 million, or 13.5%, to $29.4 million for the six months ended July 1, 2006 from $25.9 million in the six months ended July 2, 2005. Sales in the Europe/Africa region increased $3.7 million, or 15.5%, to $27.6 million for the six months ended July 1, 2006 from $23.9 million in the six months ended July 2, 2005. Sales in the Asia/Pacific region increased $4.5 million, or 52.3%, to $13.1 million for the six months ended July 1, 2006 from $8.6 million in the six months ended July 2, 2005.

Gross profit increased by $5.7 million, or 16.0%, to $41.4 million for the six months ended July 1, 2006 from $35.7 million for the six months ended July 2, 2005. Gross margin decreased to 59.1% for the six months ended July 1, 2006 from 61.0% for the six months ended July 2, 2005. Gross margin decreased primarily due to changes in the product mix, higher service costs and price discounts.

Selling expenses increased by $4.9 million, or 28.8%, to $21.9 million for the six months ended July 1, 2006 from $17.0 million for six months ended July 2, 2005. This increase was primarily due to higher compensation and commission expense of $3.1 million related to the increase in sales and marketing personnel, higher marketing costs of $1.4 million and higher product demonstration costs of $0.3 million. Our sales growth is driven to a large extent by the growth in the number of sales people. As part of our ongoing global sales force expansion, worldwide sales and marketing headcount increased by 39, or 17.3%, to 265 from 226 between July 1, 2006 and July 2, 2005. Regionally, our sales and marketing headcount increased by 7, or 9.0%, in the Americas, to 85 from 78; by 21, or 22.1%, in Europe/Africa to 116 from 95; and by 11, or 20.8%, in Asia/Pacific to 64 from 53 between July 1, 2006 and July 2, 2005. As a percentage of sales, selling expenses increased to 31.2% of sales in the six months ended July 1, 2006 from 29.1% in the six months ended July 2, 2005. Regionally, selling expenses were 28.5% of sales in the Americas for the six months, compared to 27.0% of sales in the prior year period, 32.0% of sales for Europe/Africa compared to 29.6% of sales and 36.0% of sales compared to 34.7% of sales for Asia/Pacific.

General and administrative expenses increased by $5.0 million, or 64.1%, to $12.8 million for the six months ended July 1, 2006 from $7.8 million for the six months ended July 2, 2005. General and administrative expenses as a percentage of sales increased to 18.3% for the six months ended July 1, 2006 from 13.3% for the six months ended July 2, 2005 due to increased professional and legal fees of $3.6 million primarily related to the Company's investigation of possible violations of the Foreign Corrupt Practices Act by its Chinese subsidiary and governance related matters, and an increase in salaries of $0.7 million.

Depreciation and amortization expenses increased by $0.6 million to $2.1 million for the six months ended July 1, 2006 from $1.5 million for the six months ended July 2, 2005 as a result of the acquisition of new equipment and intangible assets.

Research and development expenses increased by $0.6 million, or 20.0%, to $3.6 million for the six months ended July 1, 2006 from $3.0 million for the six months ended July 2, 2005. This increase resulted primarily from an increase in salaries and subcontractors expense of $0.5 million related to the addition of the Laser Scanner product line. Research and development expenses as a percentage of sales were 5.1% for the six months ended July 1, 2006 and July 2, 2005.

Interest income, net increased by $0.10 million to $0.32 million for the six months ended July 1, 2006 from $0.22 million for the six months ended July 2, 2005, due to an increase in interest rates, partially offset by a reduction in total cash and short-term investments.

Other (expense) income, net increased by $0.43 million to income of $0.29 million for the six months ended July 1, 2006, from an expense of $0.14 million for the six months ended July 2, 2005, primarily as a result of foreign exchange transaction gains.

Income tax expense decreased by $0.8 million to $0.3 million for the six months ended July 1, 2006 from $1.1 million for the six months ended July 2, 2005. This decrease was primarily due to a decrease in pretax income. Total deferred taxes for the Company's foreign subsidiaries relating to net operating loss carryforwards were $5.4 million at July 1, 2006 and December 31, 2005. The related valuation allowance was $3.3 million and $3.5 million at July 1, 2006 and December 31, 2005, respectively. The Company's effective tax rate increased to 18% for the three months ended July 1, 2006 from 17.4% in the prior year period. The Company currently estimates the effective tax rate will approximate 18% for the remainder of 2006. The Company's tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, our tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of our products and the resulting effect on taxable income in each jurisdiction.

Net income decreased by $4.1 million to $1.3 million for the six months ended July 1, 2006 from $5.4 million for the six months ended July 2, 2005 as a result of the factors described above.

Liquidity and Capital Resources

On September 17, 2003, the Company entered into a loan agreement with a bank for a line of credit of $5.0 million. This agreement, which bears interest at the rate of LIBOR plus 1.75%, was renewed in August 2005 and had been due on demand. On July 11, 2006, the Company entered into an Amended and Restated Loan Agreement (the "Amended Loan Agreement"). The Amended Loan Agreement replaces the Company's prior $5.0 million loan agreement entered into on September 17, 2003. The Amended Loan Agreement provides for an available line of credit of $30.0 million. Loans under the Amended Loan Agreement bear interest at the rate of LIBOR plus 1.75%.

On January 10, 2005, the Company filed a Registration Statement on Form S-3 with the Securities and Exchange Commission allowing it to raise proceeds of up to $125 million. The proceeds from any offerings with respect to this registration statement, if any, would be used for either repayment or refinancing of debt, acquisition of additional businesses or technologies or for working capital and general corporate purposes. To date, we have not raised any capital under this Form S-3 Registration Statement. The Company must file in a timely manner all reports under the Securities and Exchange Act of 1934 (with certain exceptions) with the SEC for a period of 12 months in order to be able to use its S-3 registration statement.

Cash and cash equivalents at July 1, 2006 were $6.9 million, a decrease of $2.4 million from $9.3 million at December 31, 2005. The decrease was primarily attributable to net cash used in operating activities of $0.4 million, purchases of equipment and intangible assets of $2.8 million, offset by proceeds from sales of investments of $0.7 million. In addition, the Company has short term investments of $15.8 million and $16.5 million at July 1, 2006 and December 31, 2005, respectively.

Cash used in operations was $0.4 million in the first six months of 2006 compared to $4.5 million in the comparable prior year period, a decrease of $4.1 million primarily attributable to a reduction in inventory of $2.2 million in the first half of 2006 compared to an increase of $5.9 million in the first half of 2005, offset by a decrease in net income of $4.0 million.

Net cash used in investing activities was $2.0 million in the first six months of 2006 compared to net cash provided by investing activities of $0.4 million in the prior year period. This increase of $2.4 million was primarily the result of a decrease in net proceeds from short term investments of $7.0 million, of which $5.1 million was used for the purchase of iQvolution in the prior period of 2005.

We believe that our working capital, together with anticipated cash flow from our operations and our credit facility will be sufficient to fund our long-term liquidity requirements.

Critical Accounting Policies

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

Revenue Recognition - Revenue related to the Company's 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 deemed 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 on a straight-line basis. 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. Revenue from the licensing agreements for the use of its technology for medical applications is generally recognized as received. Amounts representing royalties for the current year and not received as of year-end are estimated as due (based on historical data) and recognized in the current year.

The Reserve for Excess and Obsolete Inventory - Since the value of inventory that will ultimately be realized cannot be known with exact certainty, we rely upon both past sales experience and future sales forecasts. Inventory is considered obsolete if we have withdrawn those products from the market or if we had no sales of the product for the past 12 months, and have no sales forecasted for the next 12 months. Inventory is considered excess if the quantity on hand exceeds 12 months of remaining usage. The resulting obsolete and excess parts are then reviewed to determine if a substitute usage or a future need exists. Items without an identified current or future usage will be reserved in an amount equal to 100% of the FIFO cost of such inventory.

Income Taxes - We review our deferred tax assets on a regular basis to evaluate their recoverability based upon expected future reversals of deferred tax liabilities, projections of future taxable income, and tax planning strategies that we might employ to utilize such assets, including net operating loss carryforwards. Based on the positive and negative evidence described in Financial Accounting Standards Board Statement No. 109, *"Accounting for Income Taxes"*, we establish a valuation allowance against the net deferred assets of a taxing jurisdiction in which we operate unless it is "more likely than not" that we will recover such assets through the above means. In the future, our evaluation of the need for the valuation allowance will be significantly influenced by our ability to achieve profitability and our ability to predict and achieve future projections of taxable income.

The Company operates in a number of different countries around the world. In 2003, the Company began to manufacture its products in Switzerland, where it has received a favorable income tax rate commitment from the Swiss government as an incentive to establish a manufacturing plant there. In 2005, the Company opened a regional headquarters and began to manufacture its products in Singapore, where it has received a favorable multi-year income tax rate commitment from the Singapore Economic Development Board as an incentive to establish a manufacturing plant and regional headquarters there.

Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of global business, there are many transactions for which the ultimate tax outcome is uncertain. We have appropriately reserved for our tax uncertainties based on the criteria established by SFAS 5, *"Accounting for Loss Contingencies"*.

The Reserve For Warranties - The Company establishes a liability for twelve-month warranties included with the initial purchase price of the equipment by the creation of a warranty reserve, which is an estimate of the repair expenses likely to be incurred for the remaining period of warranty measured in installation-months in each major product group. Warranty reserve is reflected in accrued liabilities in the accompanying consolidated balance sheets. The warranty expense is estimated by determining the total repair expenses for each product group in the period and determining a rate of repair expense per installation month. The rate is multiplied by the number of machine-months of warranty for each product group sold during the period to determine the provision for warranty expenses for the period. The Company reevaluates its exposure to warranty costs at the end of each period using the estimated expense per installation month for each major product group, the number of machines remaining under warranty and the remaining number of months each machine will be under warranty. While such expenses have historically been within expectations, we cannot guarantee this will continue in the future.

Transactions with Related and Other Parties

The Company leases its headquarters in Lake Mary, Florida from Xenon Research, Inc., all of the issued and outstanding capital stock of which is owned by Simon Raab, the Company's Chairman and Co-Chief Executive Officer, and Diana Raab, his spouse. The prior lease expired on February 28, 2006, and the Company executed a new Lease Agreement on August 8, 2006 with Xenon Research. The term of the Lease commenced as of July 1, 2006 and expires at midnight on July 1, 2011 (the “Initial Term”). The Lease will be automatically renewed for one successive five-year term unless the Company provides Xenon Research with written notice of non-renewal at least 90 days prior to the end of the term. The Company also has a one-time right to terminate the Lease after three years (from July 1, 2006) upon written notice delivered to the Landlord one year prior to the date upon which the Company wishes to terminate the Lease.

During the first year of the Initial Term, the fixed rent will be $302,750.00 per annum payable monthly. Each year thereafter (on July 1), the fixed rent will be increased by three percent over the fixed rent for the preceding year. The lease is a “net lease,” meaning that the Company also is responsible for real estate taxes and insurance expenses covering the leased premises. The real estate taxes and insurance expenses are paid by Xenon Research, and the Company reimburses Xenon Research in equal monthly payments for such real estate taxes and insurance expenses with the reimbursement amount to be computed annually based on the real estate taxes and insurance expenses actually paid by Xenon Research. All payments of fixed rent and additional rent will include all applicable sales and use taxes.

Foreign Exchange Exposure

We conduct a significant portion of our business outside the United States. At present, approximately 58% of our revenues are invoiced, and a significant portion of our operating expenses paid, in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on our business, results of operations and financial condition, and could specifically result in foreign exchange gains and losses. The impact of future exchange rate fluctuations on the results of our operations cannot be accurately predicted. To the extent that the percentage of our non-U.S. dollar revenues derived from international sales increases (or decreases) in the future, our exposure to risks associated with fluctuations in foreign exchange rates may increase (or decrease).

Item 3. 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 I, Item 2, under the caption “Foreign Exchange Exposure”, above.

Item 4. Controls and Procedures

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of its management, including its Co-Chief Executive Officers and its Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures as such term is defined under Securities Exchange Act of 1934, as amended (the "Exchange Act") Rule 13a-15(e). Based on that evaluation, the Company's Co-Chief Executive Officers and Chief Financial Officer concluded that as of the end of the period covered by this report the Company's disclosure controls and procedures were, as a result of the investigation described below, ineffective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) accumulated and communicated to the Company's management, including its Co-Chief Executive Officers and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As previously reported on the Company's Form 10-K for the year ended December 31, 2005 and Form 10-Q for the first quarter ended April 1, 2006, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company's Audit Committee instituted an internal investigation into this matter, and the Company voluntarily notified the SEC and the DOJ of this matter and provided them with information obtained during the course of the investigation and is cooperating with both agencies. The Company's internal investigation has identified certain payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA.

Management has evaluated the effectiveness of internal control over financial reporting as of December 31, 2005, in relation to criteria described in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations Commission of the Treadway Commission (COSO). Based upon this evaluation and the facts that arose prior to filing the Form 10-K for the year ended December 31, 2005, management has concluded that certain deficiencies exist in the design and operation of internal controls related to financial reporting, which represent a material weakness in internal control over financial reporting.

As a result of these findings, management has undertaken the following actions to address the control deficiencies:

- Contracted with a third party forensics accounting team to conduct an in-depth audit of the operations in China and in other countries in the Asia-Pacific Region and to make recommendations for improvement to the internal control systems.
- Reviewing third party distributor arrangements in an effort to assure that all contracts include adherence to the FCPA.
- Performing due diligence on all third party distributors and implementing a process to assess potential new distributors.
- Established an in-house internal audit function including hiring a Director of Internal Audit.
- Consolidating the human resources, financial accounting and reporting functions for the Asia region into the Singapore Operations.
- Implemented an internal certification process to ascertain whether similar issues may exist elsewhere in the Company.
- Implemented a quarterly internal certification process to confirm adherence to company policy and all applicable laws and regulations that will include all regional leadership, country management and other sales management.

· Implementing additional training on FCPA and other matters for employees and a confidential compliance reporting system.

The matters described above constitute changes to the Company's internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Litigation— On November 25, 2003, Cimcore-Romer (now a division of Hexagon) filed a patent infringement suit against us in the Federal District Court for the Southern District of California alleging that certain of our products sold in the United States, including the FARO Arm, infringe U.S. Patent 5,829,148 ('148 patent). The Company believes, and has contended in this litigation, that the Company does not infringe the '148 patent and that the '148 patent is invalid.

On July 12, 2005, the court issued an order granting Cimcore-Romer's motion for summary judgment of infringement of three claims of the '148 patent. On July 22, 2005, the Company announced its decision to limit the capability of its U.S.-based FARO Arm products (the FARO Arm, the FARO Gage and the Digital Template) by removing what we call the "infinite rotation feature" by reducing this capability to 50 rotations or fewer. FARO believes that by limiting the range of the joint rotation to 50 rotations, it has removed from its U.S. products the ability to sweep through an unlimited arc, which is a feature of the '148 patent claims addressed by the court's ruling required to infringe the '148 patent. The revised products have not, however, been considered by the courts. Accordingly, the Company cannot give assurance that the revised products will not be deemed to infringe the '148 patent.

On September 20, 2005, the Court vacated its order of summary judgment of infringement and agreed to reconsider its conclusions from the patent claim construction ("Markman") ruling, which is a pretrial hearing often used in patent infringement cases. The new Markman hearing occurred on October 3, 2005 and the hearing-on-summary judgments of infringement occurred on November 14, 2005. On October 18, 2005, the Court issued a revised claim construction that the Company believes materially alters the Court's previous Markman ruling by substantially narrowing what FARO believes to be key aspects of the claim construction. The Company believes that this narrower claim construction will ultimately lead to a finding that it does not infringe any claim of the '148 patent. On November 14, 2005, the Court denied both the Plaintiffs' Renewed Motion for Summary Judgment of Infringement and the Defendant's Faro's Renewed Motion for Summary Judgment of Non-Infringement, and determined that there existed a genuine issue of material fact with respect to whether Faro infringed the assert patent. The case was originally set for trial for January 31, 2006. On January 18, 2006, the Court vacated the trial date and remanded the case to the magistrate for resumption of discovery regarding Plaintiffs' alleged compliance with the patent marking provisions of 35 U.S.C. § 287 and all related issues. A hearing on Faro's Motion for Partial Summary Judgment Regarding Plaintiffs' Failure to Comply With the Patent Marking Provisions of 35 U.S.C. § 287 was held on May 11, 2006. A new trial date has been set for October 30, 2006.

In addition, the Company filed two separate requests for reexamination in the U.S. Patent and Trademark Office ("PTO") of the '148 Patent, both of which requests were granted. The PTO ruled in the first reexamination in September 2005. The Company believes that the PTO ruling bolsters the Company's previous position that it does not infringe the '148 patent. More specifically, in the first reexamination, the PTO construed critical claim terms in a relatively narrow manner, which the Company believes is consistent with its stated positions in the patent litigation. This narrow claim construction led the PTO to differentiate the claims for the references at issue in the first reexamination. The Company believes that this narrow construction, while allowing the '148 claims to be confirmed valid over the aforementioned references in the first reexamination, will prevent the California District Court from ruling that Faro's products infringe the '148 patent. The Company's second reexamination request was granted by the PTO in November 2005 and is based on new "prior art" (that is, earlier issued patent publications) submitted to the PTO which FARO believes will ultimately invalidate the '148 patent. This prior art reference was not at issue in the first reexamination proceeding. The PTO has not ruled in the second reexamination request.

In the event of an adverse ruling in the Cimcore-Romer litigation, however, we could be required to pay substantial damages, cease the manufacturing, use and sale of any infringing products, discontinue the use of certain processes or obtain a license, if available, from Cimcore-Romer with royalty payment obligations by us. An adverse decision in the Cimcore-Romer case could materially and adversely affect our financial condition and results of operations. At this time, however, the Company cannot estimate the potential impact, if any, that might result from this suit, and therefore, no provision has been made to cover such expense

Securities Litigation - On December 6, 2005, the first of four essentially identical class action securities fraud lawsuits were filed against the Company and certain officers of the Company (the "Securities Litigation"). On April 19, 2006, the four lawsuits were consolidated, and Kornitzer Capital Management, Inc. was appointed as the lead plaintiff. On May 16, 2006, Kornitzer filed its Consolidated Amended Class Action Complaint against the Company and the individual defendents. The amended complaint also names Grant Thornton LLP, the Company's independent registered public accounting firm, as an additional defendant.

In the amended complaint, Kornitzer seeks to represent a class consisting of all persons who purchased or otherwise acquired the Company's publicly traded securities between April 15, 2004 and March 15, 2006. On behalf of the alleged class, Kornitzer seeks an unspecified amount of damages, premised on allegations that each defendant made misrepresentations and omissions of material fact during the class period in violation of the Securities Exchange Act of 1934. Among other things, Kornitzer alleges that the Company's reported gross margins and net income were knowingly overstated as a result of manipulation of the Company's inventory levels, that the Company failed to disclose deficiencies associated with the Company's implementation and use of its enterprise resource planning system and material requirements planning system, made false and misleading statements regarding the Company's internal controls, failed to disclose the fact that the Company was accruing commissions and bonuses which would have a material, adverse effect upon the Company's profitability, and improperly reported sales and net income based, in part, on sales and new orders obtained in violation of the Foreign Corrupt Practices Act.

The Company filed a Motion to Dismiss the amended complaint on July 31, 2006. The lead plaintiff, Kornitzer, has until August 30, 2006 to file a response to the Motion to Dismiss. The Company has timely notified the issuer of its Executive Liability and Entity Securities Liability insurance policy of the Securities Litigation, and has reserved the full amount of its $250,000 retention under the policy. Although the Company believes that the material allegations made in the amended complaint are without merit and intends to vigorously defend the Securities Litigation, no assurances can be given with respect to the outcome of the Securities Litigation.

Voluntary Disclosure of Foreign Corrupt Practices Act Matter to the Securities and Exchange Commissions and Department of Justice - As previously reported on the Company's Form 10-K for the year ended December 31, 2005 and Form 10-Q for the first quarter ended April 1, 2006, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company's Audit Committee instituted an internal investigation into this matter in February 2006, and the Company voluntarily notified the SEC and the DOJ of this matter in March 2006. The internal investigation into this matter has been completed. The Company has provided to the SEC and the DOJ information obtained during the course of this investigation and is cooperating with both agencies.

The Company's internal investigation has identified certain improper payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA. If the SEC or the DOJ determines that violations of the FCPA have occurred, they could seek civil and criminal sanctions, including monetary penalties, against the Company and/or certain of its employees, as well as additional changes to the Company's business practices and compliance programs. Based on current information, it is not possible to predict at this time when the SEC or DOJ investigations will be resolved, what the outcome will be, what sanctions, if any, will be imposed, or the effect that such matters may ultimately have on the Company or its consolidated financial statements. Results of the investigation revealed that referral fee payments in possible violation of the FCPA were $165,000 and $265,000 in 2004 and 2005, respectively, which were recorded in selling expenses in the Company's statement of income. The related sales to customers to which payment of these referral fees had been made totaled approximately $1.3 million and $3.24 million in 2004 and 2005, respectively. Additional improper referral fee payments of $122,000 were made in January and February 2006 related to sales contracts in 2005. The Company anticipates incurring expenses of at least $3.7 million in 2006 relating to the FCPA matter. The Company has incurred approximately $3.2 million in the first half of 2006 related to the FCPA matter.

The Company has terminated certain personnel in the Asia-Pacific Region and has re-assigned the duties of other personnel in both the Asia-Pacific Region and the U.S. as a result of the internal investigation. The Company is instituting the following remedial measures:

- Contracted with a third party forensics accounting team to conduct an in-depth audit of the operations in China and in other countries in the Asia-Pacific region and to make recommendations for improvement to the internal control systems.

- Reviewing third party distributor arrangements in an effort to assure that all contracts include adherence to the FCPA.

- Performing due diligence on all third party distributors and implementing a process to assess potential new distributors.

- Established an in-house internal audit function including hiring a Director of Internal Audit.

- Consolidating the human resources, financial accounting and reporting functions for the Asia region into the Singapore Operations.

- Implemented an internal certification process to ascertain whether similar issues may exist elsewhere in the Company.

- Implemented a quarterly internal certification process to confirm adherence to company policy and all applicable laws and regulations that will include all regional leadership, country management and other sales management.

- Implementing additional training on FCPA and other matters for employees and a confidential compliance reporting system.

The Company reported sales in China of $9.0 million in 2005 and $4.2 million in 2004, approximately 7% and 4% of total sales, respectively. Depending on how this matter is resolved, the Company's sales in China could be significantly impacted. The termination of certain personnel and the cessation of improper payments in China may have an adverse effect on future operations in China because such action could negatively influence the decisions of a significant number of customers of the Chinese subsidiary to do business with that subsidiary. The potential magnitude of the loss of sales in China as a result of potential violations of the FCPA cannot be estimated at this time.

During the Company's internal investigation of its business practices in China, it became aware that income taxes related to certain commissions and bonus payments to its employees had not been properly reported. The Company has filed the appropriate payroll tax returns and remitted the deficiency.

Other than the litigation mentioned above, the Company is not involved in any other legal proceedings other than routine litigation arising in the normal course of business. The Company does not believe the results of such litigation, even if the outcome were unfavorable to the Company, would have a material adverse effect on the Company's business, financial condition or results of operations.

Item 1A. Risk Factors

In addition to the other information set forth in this Form 10-Q, you should carefully consider the factors discussed under "Risk Factors" in our Form 10-K for the year ended December 31, 2005 as filed with the Securities and Exchange Commission. These risks could materially and adversely affect our business, financial condition, and results of operations. The risks described in our Form 10-K for the year ended December 31, 2005 are not the only risks we face. Our operations could also be affected by additional factors that are not presently known to us or by factors that we currently consider immaterial to our business.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

The Company leases its headquarters in Lake Mary, Florida from Xenon Research, Inc., all of the issued and outstanding capital stock of which is owned by Simon Raab, the Company's Chairman and Co-Chief Executive Officer, and Diana Raab, his spouse. The prior lease expired on February 28, 2006, and the Company executed a new Lease Agreement on August 8, 2006 with Xenon Research. The term of the Lease commenced as of July 1, 2006 and expires at midnight on July 1, 2011 (the "Initial Term"). The Lease will be automatically renewed for one successive five-year term unless the Company provides Xenon Research with written notice of non-renewal at least 90 days prior to the end of the term. The Company also has a one-time right to terminate the Lease after three years (from July 1, 2006) upon written notice delivered to the Landlord one year prior to the date upon which the Company wishes to terminate the Lease.

During the first year of the Initial Term, the fixed rent will be $302,750.00 per annum payable monthly. Each year thereafter (on July 1), the fixed rent will be increased by three percent over the fixed rent for the preceding year. The lease is a "net lease," meaning that the Company also is responsible for real estate taxes and insurance expenses covering the leased premises. The real estate taxes and insurance expenses are paid by Xenon Research, and the Company reimburses Xenon Research in equal monthly payments for such real estate taxes and insurance expenses with the reimbursement amount to be computed annually based on the real estate taxes and insurance expenses actually paid by Xenon Research. All payments of fixed rent and additional rent will include all applicable sales and use taxes.

Item 6. Exhibits

10	Lease Agreement dated August 8, 2006, between the Company and Xenon Research, Inc.
31-A	Certification of the Chairman of the Board and Co-Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31-B	Certification of the President and Co-Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31-C	Certification of the Principal Financial and Accounting Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32-A	Certification of the Chairman of the Board and Co-Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32-B	Certification of the President and Co-Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32-C	Certification of the Principal Financial and Accounting Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

FARO Technologies, Inc.
(Registrant)

Date: August 9, 2006

By: /s/

Keith S. Bair
Interim Chief Financial Officer (Duly Authorized Officer and Principal Financial Officer)

FARO TECHNOLOGIES, INC.

INDEX TO EXHIBITS

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32-C	Certification of the Principal Financial and Accounting Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

EXHIBIT 10

LEASE AGREEMENT

XENON RESEARCH, INC.

as Landlord

AND

FARO TECHNOLOGIES, INC.

as Tenant

DATED: As of August 8, 2006

THIS LEASE AGREEMENT (the "Lease") is made as of August 8, 2006 between **Xenon Research, Inc.** ("Landlord"), a Florida corporation having its principal place of business at 1640 East Adams Drive, Maitland, Florida 32751 and **FARO Technologies, Inc.** ("Tenant") a Florida corporation having its principal place of business at 125 Technology Park, Lake Mary, Florida 32746.

WITNESSETH:

Landlord and Tenant do hereby covenant and agree as follows:

ARTICLE I

DEMISED PREMISES

Section 1.1. Landlord does hereby lease and demise unto Tenant and Tenant does hereby hire and take from Landlord, all those certain plots, pieces or parcels of land, together with the buildings, structures and improvements thereon, located at 125 Technology Park, Lake Mary, Florida 32746 (said land, together with any and all buildings, structures and improvements now or hereafter erected thereon by Landlord or Tenant, being hereinafter referred to as the "Demised Premises").

ARTICLE II

TERM

Section 2.1. The term of this Lease shall commence as of July 1, 2006 (the "Commencement Date") and expire at midnight on July 1, 2011, both dates inclusive, unless sooner terminated as hereinafter provided (the "Initial Term"). Thereafter, this Lease shall automatically renew for one (1) successive term of five (5) years, unless Tenant provides Landlord written notice of non-renewal, which notice is delivered at least 90 days prior to the end of the then current term of this Lease (hereinafter the "Renewal Term," and hereinafter the Initial Term and the Renewal Term are collectively referred to as the "Term"). The date the Lease expires pursuant to this paragraph or such earlier termination date as may be provided for elsewhere in this Lease shall be referred to as the "Expiration Date."

Section 2.2. Notwithstanding anything to the contrary in Section 2.1 hereof, Tenant may in its sole discretion terminate this Lease after three (3) years from the Commencement Date upon written notice delivered to Landlord, which notice shall be delivered one (1) year prior to the date upon which Tenant wishes to early terminate this Lease. The parties agree and acknowledge that the early termination right set forth in this Section 2.2 is a one time right which shall become effective and may be exercised after three (3) years from the Commencement Date. Upon this earlier termination, the parties shall be released from any and all further liability and obligations under this Lease (including Tenant's obligation to pay Fixed Rent and Additional Rent) other than those obligations which specifically survive termination of this Lease.

ARTICLE III

RENT AND ADDITIONAL RENT

Section 3.1. During the first year of the Initial Term, Tenant shall pay to Landlord, as fixed rent (the "Fixed Rent") for the Demised Premises $302,750.00 per annum payable in equal monthly installments, each in advance on the first day of each month during the first year of the Initial Term hereof, and without offset or deduction of any kind whatsoever, except as herein specifically set forth. Commencing on the first anniversary of the Commencement Date and on each anniversary of the Commencement Date thereafter during the Initial Term and Renewal Term, the Fixed Rent shall be increased by an amount equal to the product of three percent (3%) multiplied by the Fixed Rent for the immediate preceding twelve month period. During the Term, Tenant shall pay to Landlord the Fixed Rent payable in equal monthly installments, each in advance on the first day of each month during the term hereof, without offset or deduction of any kind whatsoever, except as herein specifically set forth.

Section 3.2. Tenant shall also pay and discharge as additional rent (the "Additional Rent") all other amounts, liabilities and obligations of whatsoever nature that Tenant assumes or agrees to pay under this Lease. In the event of any failure on the part of Tenant to pay any of the Additional Rent, Landlord shall have all legal, equitable and contractual rights, powers and remedies provided either in this Lease or by statute or otherwise in the case of nonpayment of the Fixed Rent.

Section 3.3. Except as provided in Section 3.6, Tenant further agrees to pay, in addition to, but not in lieu of, the Fixed Rent or Additional Rent any and all sales and use tax now or hereafter imposed by any governmental entity upon, applicable to, or measured by or on the Fixed Rent and Additional Rent and any other charge payable to Landlord under this Lease. Tenant shall pay to Landlord, concurrently with each such payment of Fixed Rent and Additional Rent, or such other charges hereunder, the amount of sales and use tax attributable to the payment being made to Landlord. If any such tax is required to be paid to the governmental taxing authority directly by Landlord, whether during the Term of the Lease or subsequent to the termination of this Lease (including any underpayments, if such tax is levied on the amounts paid by Tenant), then Landlord upon demand shall be fully reimbursed by Tenant for such payment.

Section 3.4. All Fixed Rent and Additional Rent payable hereunder shall be made payable to Landlord and sent to Landlord's address as above set forth, or to such other person or persons or at such other place as may be designated by notice from Landlord or Landlord's successors, to Tenant, from time to time, and shall be made in United States currency which shall be legal tender for all debts, public and private.

Section 3.5. This Lease shall be deemed and construed to be a "net lease" and Tenant shall pay to Landlord, absolutely net through the Expiration Date, the Fixed Rent and Additional Rent without deduction, abatement, or set-off whatsoever, except for any deduction, set-off, or abatement permitted under this Lease. Under no circumstances or conditions, whether now existing or hereafter arising, or whether beyond the present contemplation of the parties, shall Landlord be expected or required to make any payment of any kind whatsoever or be under any other obligation or liability hereunder, except as otherwise provided in this Lease.

Section 3.6. Landlord shall be responsible for the payment of "Taxes" (as hereinafter defined) and "Insurance Expenses" (as hereinafter defined") for the Demised Premises. In addition to the monthly payment of Fixed Rent as set forth above, Tenant shall be responsible for an additional amount to be computed annually based on the amount of the Taxes and Insurance Expenses covering the Demised Premises (hereinafter referred to as the "Premium"). The Premium shall be adjusted annually based upon increases in the Taxes and Insurance Expenses covering the Demised Premises. This Premium shall be construed as Additional Rent and shall be paid monthly in addition to monthly Fixed Rent.

For purposes of this Section 3.6, "Insurance Expenses" means the total costs and expenses paid or incurred by Landlord in connection with the obtaining of insurance on the Demised Premises or any part thereof or interest therein including, without limitation, premiums for "all risk" fire and extended coverage insurance, commercial general liability insurance, rent loss or abatement insurance, earthquake insurance, flood or surface water coverage, and other insurance as Landlord deems necessary in its sole and absolute discretion, and any deductibles paid under policies of any such insurance. The foregoing shall not be deemed an agreement by Landlord to carry any particular insurance relating to the Demised Premises. Nothing in this section shall be deemed to change or alter the amounts of insurance Tenant is to carry as set forth below.

For purposes of this Section 3.6, "Taxes" means all real estate taxes and assessments, which shall include any form of tax, assessment (including any special or general assessments and any assessments included within any tax bill for the Demised Premises or any part thereof, including, without limitation, entitlement fees, allocation unit fees and or penalty (if a result of Tenant's delinquency), sales tax, rent tax, occupancy tax or other tax (other than net income, estate, succession, inheritance, transfer or franchise taxes), imposed by any authority having the direct or indirect power to tax, or by any city, county, state or federal government or any improvement or other district or division thereof, whether such tax is determined by the area of the Demised Premises, or any part thereof, or the Fixed Rent and other sums payable hereunder by Tenant..

For purposes of establishing the Premium for the initial year of the Term, the parties will use the ad valorem tax bill for the preceding year if the new ad valorem tax bill has not be issued and the preceding years insurance premium invoices for the Demised Premises. Every year, the Premium to be paid monthly from Tenant to Landlord in addition to the monthly Fixed Rent shall be adjusted to reflect changes in the Taxes and Insurance Expenses.

ARTICLE IV

USE OF PREMISES

Section 4.1. The Demised Premises may be used and occupied for manufacturing, assembly, distribution, storage, and office facilities or for any other lawful use or purpose whatsoever.

Section 4.2. Tenant shall not use or knowingly permit to be used any part of the Demised Premises for any unlawful or disreputable purpose.

Section 4.3. Tenant shall obtain all necessary, permits, licenses, and consents from any or all appropriate governmental authorities to conduct its business, and shall keep such permits, licenses, and consents in full force and effect.

Section 4.4. Landlord shall, if necessary, execute any applications or documents which may be reasonably required by Tenant in connection with the operation of the Demised Premises as provided in this Article IV; provided, however, that Landlord shall in no event be obligated to pay or incur any obligation, expense or liability of any nature whatsoever in connection therewith.

Section 4.5. The statement in this Lease of the nature of the use by Tenant of the Demised Premises shall not be deemed or construed to constitute a representation or guaranty by Landlord that such use may be conducted in the Demised Premises or is lawful or permissible under any existing certificate of occupancy or is otherwise permitted by law. In the event that Tenant is unable to use or operate the Demised Premises for the purposes as set forth in Section 4.1 hereof due to circumstances beyond the control of Tenant, Tenant shall have the option of terminating this Lease upon 90 days written notice to Landlord.

ARTICLE V

CONDITION OF PREMISES, ALTERATIONS AND REPAIRS

Section 5.1. Tenant has examined the Demised Premises, is familiar with the physical condition thereof and is leasing the Demised Premises “AS IS”. Landlord has not made and does not make any representations or warranties, either express or implied, as to the physical condition, expenses, operation, use and maintenance, or any other matter or thing affecting or related to the Demised Premises.

Section 5.2.

A. Landlord shall repair and maintain in good order and condition, ordinary wear and tear excepted, the roof, the outside walls, the structural portions of the Demised Premises, and the electrical, plumbing, and HVAC systems servicing the Demised Premises. Landlord shall make repairs or replacements or cause them to be made within a reasonable time (depending on the nature of the repair or replacement needed) after receiving notice from Tenant. All maintenance shall be performed in a manner reasonably intended to minimize disturbance of Tenant’s business. At Tenant’s request, any such maintenance shall be performed during non-business hours. If Landlord fails to undertake and complete all any maintenance or repairs as required under this Lease, the failure of which materially and adversely affects Tenant’s business operations, then thirty (30) days after written request (or such longer period as is necessary if the repair cannot be reasonably completed within the thirty (30) day period and Landlord commences within such 30 day period and is diligently pursuing completion of such repair), Tenant shall have the right, to undertake and complete such maintenance or repairs at Landlord’s cost and expense. In performing such work, Tenant shall (i) proceed in accordance with the applicable provisions of this Lease and all applicable laws; (ii) use only such contractors, suppliers, etc. as are duly licensed in the State of Florida and insured to effect such repairs and who perform such repairs in first class buildings in the normal course of their business; (iii) upon commencing such repairs, complete the same within a reasonable period of time, (iv) effect such repairs in a good and workmanlike quality; (v) use new materials; and (vi) indemnify and hold Landlord and its lender(s), if any, harmless from any and all liability, damage and expense arising from injury to persons or personal property arising out of or resulting from Tenant’s exercise of such rights. Landlord shall have thirty (30) days from receipt of Tenant’s invoice(s) for such costs to make payment in full. In the event Landlord fails to tender full payment within said thirty (30) day period, Tenant may thereafter begin to offset such costs against up to 10% of each monthly installment of Fixed Rent due under this Lease until the entire cost has been recovered.

B. Except as provided in Section 5.2(A) above, Landlord shall have no maintenance obligation with respect to the Demised Premises and no obligation to make any repairs, in, on, or to the Demised Premises. Tenant assumes the full and sole responsibility for the condition, operation, repair, replacement, maintenance, and management of the Demised Premises, including all improvements, throughout the Lease Term, except to the extent expressly set forth in Section 5.2(A). Tenant shall maintain the Demised Premises (including, without limitation, all furniture, fixtures, equipment, and decorations) in good repair and in a clean, attractive, first-class condition. Without limiting the generality of foregoing, Tenant agrees to repair, replace, and maintain in good and operational order and condition the non-structural interior portions of the Demised Premises, including interior doors, interior windows, plate and window glass, floor coverings, wall coverings, furniture, fixtures, equipment, and appliances and the electrical and mechanical systems not considered office standard which have been installed for the exclusive use and benefit of Tenant such as electrical services for computers or similar items and security or telephone systems for the Demised Premises. All replacements shall be of equal quality and class to the original items replaced. Tenant shall not commit or allow to be committed any waste on any portion of the Demised Premises.

C. In no event shall Landlord be required to repair any items it is required to do so under Section 5.2(A) due to the gross negligence or intentional wrongful acts of Tenant, its employees, agents or anyone else under its direct control.

Section 5.3.

A. Tenant may, at its sole cost and expense, make changes, alterations, installations, additions or improvements in or to the Demised Premises of any nature or kind with Landlord's prior written consent in each instance (not to be unreasonably withheld, conditioned or delayed), provided only that, upon its completion, each such change, alteration, installation or improvement will not, in Landlord's reasonable judgment, materially lessen the fair market value of the Demised Premises nor change the primary usage or character of the Demised Premises. All fixtures (other than trade fixtures, office furniture and removable equipment), fences, railings, structures, other improvements and equipment installed in or upon the Demised Premises at any time, either by Tenant or by Landlord on Tenant's behalf, whether prior to or during the Term, shall become the property of Landlord and shall remain upon and be surrendered with the Demised Premises unless (i) Landlord, by notice to Tenant no later than thirty (30) days prior to the date fixed as the termination of this Lease, elects to have the same removed or demolished by Tenant, in which event, the same shall be removed or demolished from the Demised Premises by Tenant forthwith, at Tenant's expense. Nothing in this Article shall be construed to prevent Tenant's removal of trade fixtures furnished or installed by Tenant, but upon removal of any such trade fixtures from the Demised Premises or upon removal of other installations as may be required by Landlord, Tenant shall immediately and at its expense, repair and restore the Demised Premises to the condition existing prior to such installation and Tenant shall repair any damage to the Demised Premises caused by such removal. All property permitted or required to be removed by Tenant which remains in the Demised Premises at the end of the term shall be deemed abandoned and may, at the election of Landlord, either (i) be retained by Landlord as its property without payment therefor or (ii) be disposed of by Landlord without accountability to Tenant as Landlord may see fit. Whether Landlord retains such abandoned property as its property or disposes of it as aforesaid, all costs of removal and repair to the Demised Premises incurred by Landlord in connection with said abandoned property shall be paid by Tenant to Landlord on demand, which payment obligation shall survive the expiration or earlier termination of the Term.

B. Tenant shall, before making any changes, alterations, additions, installations or improvements, at its expense, obtain all permits, approvals and certificates required by any governmental or quasi-governmental bodies and (upon completion) certificates of final approval thereof and shall deliver promptly duplicates of all such permits, approvals and certificates to Landlord. Tenant agrees to carry and will cause Tenant's contractors and sub-contractors to carry such worker's compensation, general liability, personal and property damage insurance as Landlord may from time to time reasonably require. Tenant agrees to obtain and deliver to Landlord, to the extent permitted by applicable law, written and unconditional waivers of mechanic's liens upon the Demised Premises for all work, labor and services to be performed and materials to be furnished in connection with such work, signed by all contractors, sub-contractors, materialmen and laborers to become involved in such work.

C. In accordance with the applicable provisions of the "Construction Lien Law" and specifically Section 713.10, Florida Statutes, no interest of Landlord, whether personally or in the Demised Premises, shall be subject to liens for improvements made by Tenant or caused to be made by Tenant hereunder. Further, Tenant acknowledges that Tenant, with respect to improvements or alterations made by Tenant or caused to be made by Tenant hereunder, shall promptly notify, as required by state law, the contractor making such improvements to the Demised Premises of this provision exculpating Landlord's liability for such liens. Upon Landlord's request, Tenant shall execute the memorandum attached hereto as Exhibit "A" or a form with similar content prepared by Landlord.

Notwithstanding the foregoing, if any construction lien or other lien, attachment, judgment, execution, writ, charge or encumbrance is filed against the Demised Premises, or any alterations, fixtures or improvements therein or thereto, as a result of any work action or inaction done by or at the direction of Tenant or any of Tenant's agents, Tenant will discharge the same of record within ten (10) days after the filing thereof, failing which Tenant will be in default under this Lease. In such event, without waiving Tenant's default, Landlord, in addition to all other available rights and remedies, without further notice, may discharge the same of record by payment, bonding or otherwise, as Landlord may elect, and upon request Tenant will reimburse Landlord for all costs and expenses so incurred by Landlord plus interest thereon from the date of such expenditure at the highest rate allowed by law.

ARTICLE VI

INSURANCE

Section 6.1. Tenant shall keep in force at Tenant's expense so long as this Lease remains in effect and during such other times as Tenant occupies the Demised Premises or any part thereof, a policy or policies of comprehensive general commercial liability insurance, with the premiums thereon fully paid on or before the due dates, for Tenant's own protection covering the Demised Premises and Tenant's use thereof, in reasonable amounts as reasonably determined by Landlord, or such greater amounts as may be reasonably required from time to time by a mortgagee. Tenant shall also keep in force fire, extended coverage and water damage insurance for Tenant's personal property, including, but not confined to inventory, trade fixtures, floor coverings, furniture and all other property of Tenant whether removable or not at termination of this Lease, including leasehold betterments and improvements; such insurance on leasehold betterments and improvements shall be in amounts sufficient to cover the full replacement cost of any repair or reconstruction from any such hazard during the entire Term, such insurance naming the Landlord as an additional named insured as its interest may appear. Tenant shall also maintain business interruption insurance and employers' liability insurance as may be customary, prudent or appropriate during the term of this Lease. Tenant shall maintain such worker's compensation insurance as statutorily required.

Section 6.2. Landlord shall keep in force casualty, fire, extended coverage and water damage insurance insuring Landlord's interest in the Demised Premises.

Section 6.3. All insurance maintained by Tenant and Landlord pursuant to this Article shall provide that (i) no cancellation, material change or reduction thereof shall be effective until at least thirty (30) days after written notice thereof is given to Landlord or Tenant as applicable, (ii) the rights of the insured(s) to receive and collect the proceeds thereof shall not be diminished because of any additional insurance carried by Landlord on its own account, (iii) all losses shall be payable notwithstanding any act or negligence of Landlord or Tenant which might, absent such agreement, result in a forfeiture of all or part of such insurance payment and notwithstanding the occupation of the Demised Premises for purposes more hazardous than permitted by the terms of such policy; (iv) be written with insurance companies authorized to do business in Florida, reasonably acceptable to Landlord, and having an A. M. Best Rating of A-/VIII or better in Best's Insurance Guide (or a similar rating in an equivalent publication if Best's Insurance Guide is no longer in publication); and (v) be written on an occurrence basis and endorsed to name Landlord and Landlord's mortgagee, if any, as additional insureds.

Section 6.4. At either Landlord or Tenant's request at any time following the commencement of the Initial Term, either party shall deliver to other party certificates of insurance and copies of the insurance policies evidencing the insurance required to be maintained under this Article. Landlord and Tenant also shall deliver to the other party at least thirty (30) days prior to the expiration date of any such policy or policies or any other policies required to be maintained under this Article (or of any renewal policy or policies), certificates for the renewal policies of such insurance. Each party covenants to furnish to the other party promptly upon the other party's request copies of insurance policies required to be maintained by the applicable party hereunder, certified by the insurance carrier or broker.

Section 6.5. To the extent permitted by law and to the extent that insurance is in force and collectible, Landlord and Tenant each hereby release and waive all right each of them would have against the other, by any of subrogation or otherwise, arising from or caused by any hazard covered by insurance on the Demised Premises. Each party shall obtain such release and waiver from each insurance company issuing the policies required under Lease.

Section 6.6. Tenant shall not do or suffer to be done, or keep or suffer to be kept, anything in, upon or about the Demised Premises which will contravene Landlord's policies insuring against loss or damage by fire or other hazards, including, but not limited to, public liability, or which will prevent Landlord from securing such policies in companies acceptable to Landlord. If anything is done, permitted to be done or suffered to be done by Tenant or kept in, upon and about the Demised Premises which shall cause the rate of fire or other insurance on the Demised Premises in companies acceptable to Landlord to be increased beyond the minimum rate from time to time applicable to the Demised Premises for the permitted use or permitted uses made thereof, Tenant shall pay, as Additional Rent hereunder, the amount of any such increase promptly upon demand by Landlord and shall cease such action until such payment is made.

Section 6.7. Tenant waives any rights of action against Landlord for loss or damage to its improvements, fixtures and personal property in the Demised Premises, except damage caused by the gross negligence or misconduct of Landlord, its agents or employees.

Section 6.8. Anything in this Lease to the contrary notwithstanding, Landlord and Tenant each hereby waives any and all rights of recovery, claim, action or cause of action, against the other, its agents, servants, partners, shareholders, officers or employees, for any loss or damage that may occur to the Demised Premises or any improvements thereto or thereon, or any personal property of such party therein or thereon, by reason of fire, the elements, or any other cause which is insured against under the terms of the standard fire and extended coverage insurance policies referred to in this Article, regardless of cause or origin, including the negligence of the other party hereto, its agents, officers, partners, shareholders, servants or employees, and covenants that no insurer shall hold any right of subrogation against such other party.

ARTICLE VII

DAMAGE OR DESTRUCTION

Section 7.1.If the Demised Premises shall be (i) so damaged that substantial alteration or reconstruction of the Demised Premises shall, in Landlord's opinion, be required (whether or not the Demised Premises shall have been damaged by such casualty); or (ii) any mortgagee of the Demised Premises should require that the insurance proceeds payable as a result of a casualty be applied to the payment of any mortgage debt on the Demised Premises; or (iii) there is any material uninsured loss to the Demised Premises; or (iv) the Demised Premises shall be partially damaged by casualty during the last year of the then current Term, and the estimated cost of repair exceeds ten (10%) percent of the Fixed Rent then remaining to be paid by Tenant for the balance of the then current Term; either Landlord or Tenant may, within ninety (90) days after such casualty, give written notice to the other party of such party's election to cancel and terminate this Lease, and the balance of the Term shall automatically expire on the fifth (5th) day after such notice is delivered.

Section 7.2. If Landlord does not have the right to terminate this Lease pursuant to Section 7.1 above, or if Landlord has the right to terminate and does not elect to do so, Landlord shall commence and proceed with reasonable diligence to restore the Demised Premises to substantially the same condition they were in immediately prior to the happening of the casualty.

Section 7.3. Fixed Rent, Additional Rent and other such sums payable by Tenant hereunder, shall abate in proportion to the portion of the Demised Premises not useable by Tenant as a result of any casualty, as of the date on which the Demised Premises becomes unusable. Landlord shall not be liable to Tenant for any delay in restoring the Demised Premises or any inconvenience or annoyance to Tenant or injury to Tenant's business resulting in any way from such damage or the repairs, Tenant's sole remedy being the right to an abatement of Fixed Rent, Additional Rent and other such sums payable by Tenant hereunder, or termination of this Lease as provided above.

ARTICLE VIII

ASSIGNMENT AND SUBLETTING

Section 8.1. Except as specifically provided in this Article VIII, Tenant may not assign, sublet, underlet, mortgage or encumber this Lease or any of its interests hereunder, without the prior written consent of Landlord, which consent may be withheld in Landlord's sole discretion. Any transfer of Tenant's interest in this Lease or the Demised Premises by operation of law, regardless of whether the same is characterized as voluntary or involuntary, shall be construed as an "assignment" governed by this Article VIII. Landlord's written consent to any one assignment shall not act as a waiver of the requirements of consent with respect to any subsequent assignment.

Section 8.2. Upon a permitted assignment or subletting under this Article VIII, the assignee shall assume all rights and obligations of Tenant under this Lease. Any assignee of Tenant shall deliver to Landlord an assumption agreement in a form reasonably satisfactory to Landlord no less than ten (10) days after the effective date of the proposed assignment. Notwithstanding anything to the contrary contained in this Lease, upon a permitted assignment of this Lease, the assigning Tenant's liability under this Lease shall terminate.

Section 8.3. Notwithstanding any contrary provision of this Article VIII, Landlord shall not withhold its consent to an assignment or subletting by Tenant so long as the proposed assignee (i) agrees in writing to be bound by all of the terms and conditions contained herein; and (ii) demonstrates to Landlord's satisfaction, which may not be unreasonably withheld, adequate tangible financial resources to meet the obligations of Tenant under this Lease.

Section 8.4. Notwithstanding any contrary provision of this Article VIII, Landlord's consent shall not be necessary for any assignment or subletting to any person or entity (i) which is an affiliate of Tenant; (ii) with which or into which Tenant has merged or consolidated; or (iii) which acquires all, substantially all or a majority of Tenant's assets or leases in the state in which the Demised Premises is located. For purposes of this Section 8.4, an "affiliate" of a person or entity shall mean any other person or entity which controls, is controlled by, or is under common control with such person or entity.

ARTICLE IX

SUBORDINATION; NON-DISTURBANCE

Section 9.1. Tenant agrees to subordinate its interest in this Lease to any future mortgage or deed of trust encumbering the Demised Premises and held by an institutional mortgagee by the execution of a Subordination, Non-Disturbance and Attornment Agreement ("SNDA") in form reasonably acceptable to Tenant and mortgagee. Tenant agrees to execute and deliver the SNDA within ten (10) days request from Landlord. Such SNDA should provide that the Lease will remain in effect and the mortgagee will recognize the Tenant as a lessee so long as the Tenant is not in default under the lease. Tenant's interest in this Lease shall not be subordinate to any future mortgage or deed of trust until Tenant receives a fully executed SNDA from the holder of such mortgage or deed of trust.

ARTICLE X

OBLIGATIONS OF TENANT

Section 10.1. Tenant shall promptly comply with all laws, ordinances, orders, rules, regulations, and requirements of all governmental or quasi-governmental authorities or bodies then having jurisdiction over the Demised Premises (or any part thereof) and/or the use and occupation thereof by Tenant, of every nature and kind, whether any of the same relate to or require (i) structural or non-structural changes to or in and about the Demised Premises or any buildings or other improvements thereon including, without limitation, any equipment located thereon, or (ii) changes or requirements incident to or as the result of any use or occupation thereof or otherwise, and Tenant shall so perform and comply, whether or not such laws, ordinances, orders, rules, regulations or requirements shall now exist or shall hereafter be enacted or promulgated and whether or not the same may be said to be within the present contemplation of the parties hereto.

Section 10.2. Any work performed or alterations or changes made to the Demised Premises shall be subject to, and performed in accordance with, the provisions of Article V hereof.

Section 10.3. Tenant shall indemnify and save harmless Landlord and his agents against and from (a) any and all claims arising from (i) the conduct of business in the Demised Premises, (ii) any work or thing whatsoever done, or any condition created in or abut the Demised Premises by the Tenant during the Term, or (iii) any negligent or wrongful act or omission of Tenant or any of its subtenants or licensees or its or their employees, agents, or contractors, and (b) all liabilities, costs and expenses, including reasonable attorney's fees and disbursements, incurred or suffered by Landlord, in or in connection with any such claim, action or proceeding brought thereon. In case any action or proceeding shall be brought against Landlord by reason of any such claim, Tenant, upon notice from Landlord, shall resist and defend such action or proceeding by counsel chosen by Tenant who shall be reasonably satisfactory to Landlord. Tenant or its counsel shall keep Landlord fully apprised at all times of the status of such defense.

Section 10.4.

A. If at any time prior to, or during the Term hereof (or within the statutory period thereafter if attributable to Tenant), any mechanic's or other lien shall be filed against the Demised Premises or any part thereof for work performed by the Tenant, Tenant shall at its sole cost and expense cause the same to be discharged by payment, bonding or otherwise, as provided by law, within 30 days after receipt of notice by Tenant of the filing thereof. In default of Tenant's procuring the discharge of any such lien as aforesaid, Landlord may, without notice, and without prejudice to his other remedies hereunder, procure the discharge thereof by bonding or payment or otherwise, and all cost and expense which Landlord shall incur shall be paid by Tenant to Landlord as Additional Rent forthwith.

B. Landlord shall not under any circumstances be liable to pay for any work, labor or services rendered or materials furnished to or for the account of Tenant upon or in connection with the Demised Premises, and no mechanic's or other lien for such work, labor or services or material furnished shall, under any circumstances, attach to or affect the reversionary interest, of Landlord in and to the Demised Premises or in and to any buildings, alterations, repairs, or improvements to be erected or made thereon.

ARTICLE XI

DEFAULT BY TENANT

Section 11.1. Each of the following shall be deemed an event of default (an "Event of Default") and a material breach of this Lease by Tenant:

(a) If the Fixed Rent or any Additional Rent herein reserved shall not be paid as and when the same shall become due and payable, and such default shall continue for a period of ten (10) days after written notice by Landlord to Tenant.

(b) If Tenant shall default in the performance or observance of any of the other agreements, conditions, covenants or terms herein contained, and such default shall continue for a period of thirty (30) days after written notice by Landlord to Tenant (provided this 30 day cure period shall be extended for such reasonable period of time as is necessary to cure the default, if the alleged default is not reasonable capable of cure within said 30-day period and Tenant commences and continues to diligently cure the alleged default).

(c) If Tenant should fail to pay the Fixed Rent or any Additional Rent when due and payable more than three (3) times in any six (6) month period during the Term.

Section 11.2. Upon the occurrence of any Event of Default, Landlord shall have the right thereafter to terminate and end this Lease and the term hereby granted, as well as all of the right, title and interest of Tenant hereunder, by giving to Tenant a written notice of the termination of this Lease, and upon the expiration of the time fixed in such termination notice, which shall not be less than fifteen (15) days after the giving thereof, this Lease and the term hereby granted, as well as all of the right, title and interest of Tenant hereunder, shall wholly cease and expire in the same manner, and with the same force and effect (except as to Tenant's liability as hereinafter provided) as if the expiration of time fixed in such notice were the end of the Term; and Tenant shall then immediately quit and surrender to Landlord the Demised Premises, including any and all buildings, additions and improvements erected thereon, all other improvements, and Landlord may enter into or repossess the Demised Premises, whether by force, summary proceedings or otherwise; and Tenant hereby waives any and all rights to recover or regain possession of the Demised Premises or to reinstate or to redeem this Lease, as permitted or provided by or under any of the provisions of any statute, law or decision now or hereafter in force and effect, and Tenant hereby waives any and all right to any second or further trial in ejectment, or to any other actions, as provided by any statute, law or decision now or hereafter in force and effect; and Tenant hereby also waives the service of any further notice demanding rent, or of intention to reenter, as provided by any present or future statute, law or decision.

Section 11.3. In the event of a cancellation or termination of this Lease, other than the early termination permitted in accordance with Section 2.2 above, either by operation of law, or by the issuance of a warrant of dispossess, or by the service of a notice of termination as above provided, or otherwise, for any cause or causes whatsoever, except by fire or other casualty or condemnation by public or private authority as herein provided, Tenant shall, nevertheless, remain liable to Landlord to pay a sum equal to the Fixed Rent and Additional Rent herein reserved for the balance of the term herein originally demised; and Landlord may, without notice, repair or alter the Demised Premises in such manner as Landlord may deem necessary or advisable and/or let or relet the Demised Premises, and any and all parts thereof, for the whole, or any part, of the remainder of the said original Term, or for any period of time beyond the expiration of the originally demised Term, in Landlord's name, or as the agent of Tenant, and, out of any rent so collected and received, Landlord shall first pay to himself the expense and cost of retaking, repossessing, repairing and/or altering the Demised Premises, and the expense of removing all persons and property therefrom, and second, pay to himself any cost or expense sustained in securing any new tenant or tenants, and third, pay to himself any balance remaining on account of the liability of Tenant to Landlord for the sum equal to the rent reserved herein and unpaid by Tenant for the remainder of the Term.

Section 11.4. Should any rent so collected by Landlord after the payments aforesaid, be insufficient fully to pay to Landlord a sum equal to the Fixed Rent and Additional Rent stipulated for herein, the balance or deficiency shall be paid by Tenant on the rent days above specified; that is, upon each of such rent days, Tenant shall pay to Landlord the amount of the deficiency then existing; and Tenant hereby agrees to be and remain liable for any such deficiency. The right of Landlord to recover from Tenant the amount thereof, or a sum equal to the amount of Fixed Rent and Additional Rent herein reserved, if there shall be no reletting, shall survive the issuance of any warrant of dispossess, or other termination of this Lease; and Tenant hereby expressly waives any defense that might be predicated upon the issuance of such warrant of dispossess, or other termination or cancellation of the hereby demised term.

Section 11.5. A suit or suits for the recovery of such deficiency or damages, or for a sum equal to any installment or installments of the Fixed Rent or Additional Rent due hereunder, may be brought by Landlord, from time to time, at his election, and nothing herein contained shall be deemed to require Landlord to await the date whereon this Lease, or the term hereof, would have expired by limitation, had there been no such default by the Tenant or no such termination or cancellation.

ARTICLE XII

REMEDIES OF LANDLORD

Section 12.1. In the event that Tenant shall fail to pay any of the items required to be paid by Tenant pursuant hereto (other than the Fixed Rent), Landlord may, but shall not be required to, pay any such items, premiums or sums, and shall thereupon become entitled to repayment from Tenant, on demand, of any amount so paid.

Section 12.2. No performance by Landlord of any of the obligations on Tenant's part to be performed hereunder shall be or be deemed to be a waiver of Tenant's default in the failure to perform the same nor shall the performance thereof by Landlord release or relieve Tenant from any obligations on Tenant's part to be performed under this Lease.

Section 12.3. Landlord shall at all times during the Term, upon reasonable notice given to Tenant, have the right and privilege to enter the Demised Premises and the buildings, additions and improvements thereon at reasonable times for the purpose of inspecting the same to prospective purchasers or mortgagees thereof. Also, provided Landlord provides tenant with reasonable advance notice, Landlord shall also have the right and privilege during the last ninety (90) days prior to the Expiration Date (i) to enter the Demised Premises and the buildings, additions and improvements thereon at reasonable times during business hours for the purpose of exhibiting the same to prospective new tenants; and (ii) to display the customary "To Let" and "For Sale" signs on said buildings. Landlord shall, during the Term, have the right and privilege to enter the Demised Premises at any time without notice in the event of an emergency.

Section 12.4. Landlord shall, at all times during the Term, upon reasonable notice given to Tenant, have the right to enter the Demised Premises or any part thereof, for the purpose of making such repairs or alterations therein as Landlord deems necessary, but such right of access shall not be construed as obligating Landlord to make any repairs to or replacements of said building or buildings, additions or improvements or as obligating Landlord to make any inspection or examination of said building or buildings, additions or improvements.

Section 12.5. The rights and remedies given to Landlord in this Lease are distinct, separate and cumulative, and no one of them, whether or not exercised by the Landlord, shall be deemed to be in exclusion of any of the others, or of any rights or remedies otherwise provided at law or in equity.

Section 12.6. In addition to and cumulative with any other remedy herein, Landlord shall have the right to impose a late fee of five percent (5%) on any payment of Fixed Rent, Additional Rent or any other sum due hereunder which is not paid within thirty (30) days of the date due. If after such thirty (30) day period any payment of Fixed Rent, Additional Rent or other such amount due hereunder shall bear interest at the annual rate equal to the lower of eighteen percent (18%) or the highest rate allowed by law.

ARTICLE XIII

DEFAULT BY LANDLORD

Section 13.1. Landlord shall be in default under this Lease if Landlord fails to perform any of its obligations or breaches any of its covenants contained in this Lease and said failure or breach continues for a period of thirty (30) days after written notice from Tenant to Landlord (this thirty (30) day period shall be extended for such reasonable period of time as is necessary to cure the default, if the alleged default is not reasonably capable of cure within the thirty (30) day period and Landlord commences and continues diligently to cure said default).

ARTICLE XIV

TENANT'S REMEDIES

Section 14.1. Upon a default by Landlord, Tenant shall have the right to terminate this Lease or vacate the Demised Premises in the event of a breach by Landlord which is not timely cured. In addition, if Landlord is in default under this Lease, Tenant may commence an independent action against Landlord for any remedy available to Tenant at law or in equity, all such remedies to be cumulative and non-exclusive. In addition, should Tenant obtain a final, unappealable monetary judgment against Landlord, Tenant may offset such judgment against all Fixed Rent and Additional Rent and other sums next due under this Lease until Tenant has fully recovered the amount of such judgment. In all events, Landlord's liability under this Lease shall be limited to Landlord's interest in the Demised Premises.

ARTICLE XV

NO WAIVER BY LANDLORD

Section 15.1. No receipt of moneys by Landlord from Tenant after the termination or cancellation of this Lease shall reinstate, continue or extend the Term, or affect any notice theretofore given to Tenant, or operate as a waiver of the right of Landlord to enforce the Fixed Rent or Additional Rent then due, or thereafter falling due, or operate as a waiver of the right of Landlord to recover possession of the Demised Premises by proper suit, action, proceeding or remedy, except as in this Lease otherwise specifically stated; it being agreed that after the service of notice to terminate or cancel this Lease, or the commencement of suit, action or summary proceedings, or any other remedy, or after a final order or judgment for the possession of the Demised Premises, Landlord may demand, receive and collect any moneys due, or thereafter falling due, without, in any manner, affecting such notice, proceeding, suit, action, order or judgment; and any and all such moneys collected shall be deemed to be payments on account of the use and occupation of the Demised Premises or, at the election of Landlord, on account of Tenant's liability hereunder.

Section 15.2. The failure of Landlord to enforce any agreement, condition, covenant or term, by reason of its breach by Tenant, shall not be deemed to void, waive or affect the right of Landlord to enforce the same agreement, condition, covenant or term on the occasion of a subsequent default or breach.

Section 15.3. The specific remedies to which Landlord may resort under the terms of this Lease are cumulative and are not intended to be exclusive of any other remedies to which Landlord may be lawfully entitled in case of any breach by Tenant of any of the terms, covenants and conditions of this Lease. The failure of Landlord to insist in any one or more case upon the strict performance of any of the terms, covenants and conditions of this Lease, or to exercise any right or remedy herein contained, shall not be construed as a waiver or relinquishment for the future of such terms, covenants and conditions. The receipt by Landlord of rent with knowledge of the breach of any of such terms, covenants and conditions shall not be deemed a waiver of such breach. The acceptance of any check or payment bearing or accompanied by any endorsement, legend or statements shall not, of itself, constitute any change in or termination of this Lease. No surrender of the Demised Premises by Tenant (prior to any termination of this Lease) shall be valid unless consented to in writing by Landlord.

ARTICLE XVI

CONDEMNATION

Section 16.1. If (i) the entire Demised Premises shall be taken in or by condemnation or other eminent domain proceedings pursuant to any law, general or special, or (ii) any portion of the Demised Premises, or the use or occupancy thereof, shall be taken in or by such proceedings so as to (A) render the remaining portion thereof unsuitable for the conduct of Tenant's business or for Tenant's use or (B) prevent Tenant from carrying on its normal operations at the Demised Premises for a period of four (4) consecutive months, then Tenant shall, not later than 60 days after any such taking, give notice to Landlord of its intention to terminate this Lease on any business day specified in such notice which occurs not less than 60 nor more than 180 days after the giving of such notice by Tenant and this Lease shall thereupon terminate on the date specified in such notice.

Section 16.2. If Tenant fails to terminate this Lease within the time and in the manner set forth in Section 16.1 above, or elects not to terminate this Lease, this Lease shall continue in full force and effect but Fixed Rent and Additional Rent or other sums payable by Tenant hereunder shall abate in direct proportion to the number of rentable square feet of space of the Demised Premises so taken.

Section 16.3. In any case in which this Lease shall not terminate, but shall continue with respect to the portion of the Demised Premises remaining after the taking, Landlord shall restore that portion of the Demised Premises so remaining to as near a complete architectural unit as is practical; provided, however, that if Landlord's costs and expenses incurred or to be incurred in connection with such restoration are reasonably estimated by Landlord to exceed the award to be received by Landlord, Landlord, regardless of whether Landlord and Tenant have earlier elected to continue this Lease as to the remaining Demised Premises, may nevertheless terminate this Lease by written notice to Tenant within thirty (30) days following Landlord's receipt of payment representing full compensation for the Demised Premises so taken or damaged by such taking.

Section 16.4. Except to the extent set forth in Section 16.5 below, all awards in condemnation, whether recovered as a result of litigation, or in settlement thereof, or as part of a private purchase in lieu of condemnation, and whether termed compensation or damages, but payable in any event for the taking of all or a portion of the Demised Premises shall belong solely to Landlord. Tenant assigns to Landlord all of Tenant's right, title, and interest, if any, in and to such awards in condemnation, and all rights to an apportionment thereof. Tenant consents to Landlord's withdrawal of any sum deposited into the court registry of any court of competent jurisdiction by a condemning authority, at any time during the pendency of condemnation proceedings, should such proceedings be initiated against Landlord, except to the extent to which any sums so deposited represent damages or compensation which belong to Tenant pursuant to the provisions of Section 16.5 below.

Section 16.5. Tenant shall have the right to claim and recover, provided Tenant asserts and pursues such claims against the condemning authority, only that compensation or damage representing Tenant's moving and relocation expenses and the value of personal property and trade fixtures owned by Tenant and which do not become the property of Landlord upon the expiration or sooner termination of this Lease. Tenant may also pursue its business damage claim against the condemning authority.

ARTICLE XVII

ESTOPPEL CERTIFICATE

Section 17.1. At any time and from time to time either party, upon request of the other party, will execute, acknowledge and deliver an instrument, stating, if the same be true, that this Lease is a true and exact copy of the Lease between the parties hereto, that there are no amendments hereto (or stating what amendments there may be), that the same is then in full force and effect and that, to the best of its knowledge, there are no offsets, defenses or counterclaims with respect to the payment of Rent hereunder or in the performance of the other terms, covenants and conditions hereof on the part of Tenant or Landlord, as the case may be, to be performed, and that as of such date no default has been declared hereunder by either party or if so, specifying the same. Such instrument will be executed by the other party and delivered to the requesting party within fifteen (15) days of receipt of a written request therefor.

ARTICLE XVIII

QUIET ENJOYMENT

Section 18.1. Tenant, upon payment of the rents herein reserved and upon the due performance and observance of all the covenants, conditions and agreements herein contained on Tenant's part to be performed and observed, shall and may at all times during the term hereby granted peaceably and quietly have, hold and enjoy the Demised Premises without any manner of suit, trouble or hindrance of and from any person whatsoever.

ARTICLE XIX

SURRENDER

Section 19.1. Tenant shall, on the last day of the term hereof, or upon the sooner termination of the term hereof, quit and surrender to Landlord the Demised Premises vacant, free of all furniture and other personal property, and in good order and condition, ordinary wear and tear and obsolescence excepted, and Tenant shall remove or demolish all of the fixtures, fences, railings, structures and other improvements which Landlord shall elect pursuant to and in accordance with Section 5.4 hereof. Tenant's obligation to observe and perform this covenant shall survive the expiration or earlier termination of the Term.

Section 19.2. Upon the expiration of the Term, all Fixed Rent and Additional Rent and other items payable by Tenant under this Lease shall be apportioned to the date of termination. Tenant's obligation to pay such amounts shall survive the expiration or earlier termination of the Term.

ARTICLE XX

UTILITIES

Section 20.1. Tenant shall pay for all utility services, including electricity, water, garbage, sewage, and other charges and expenses in connection with the Demised Premises.

ARTICLE XXI

SECURITY DEPOSIT

Section 21.1. As a condition precedent to Landlord's obligations under this Lease, Tenant shall deposit with Landlord upon the execution of this Lease by Landlord and Tenant, the sum of one month's rent, representing a security deposit ("Security Deposit"), to secure Tenant's full and faithful performance of all of the terms, covenants and conditions of this Lease. The Security Deposit shall be held by Landlord as security for Tenant's full and faithful performance of the terms, covenants, and conditions of this Lease including the payment of Fixed Rent and Additional Rent. The Security Deposit shall not be considered an advance payment of Rent and shall never constitute liquidated damages for any default by Tenant. The Security Deposit may be commingled with other funds of Landlord and Landlord shall pay to Tenant any and all interest that may accrue on the Security Deposit during the Term.

Section 21.2. Notwithstanding anything to the contrary in Section 21.1, Landlord hereby agrees to waive the requirement of the Security Deposit. However in the event Tenant is permitted to assign or sublet in accordance with the terms and conditions of this Lease, the provisions of Section 21.1 shall apply to the permitted assignee.

ARTICLE XXII

FORCE MAJEURE

Section 22.1. Notwithstanding anything in this Lease to the contrary, if Landlord or Tenant shall be delayed or hindered in, or prevented from the performance of, any act required under this Lease (other than the payment of Rent by Tenant) by reason of strike, lockout, civil commotion, warlike operation, invasion, rebellion, hostilities, military or usurped power, sabotage, government regulations or controls, inability to obtain any material, utility, service, or financing, through hurricanes, floods, other natural disasters, or acts of God, or for any other cause beyond the direct control of the party who is seeking additional time for the performance of such act, then performance of such act shall be excused for the period of the delay and the period for the performance of any such act shall be extended for a reasonable period, in no event to exceed a period equivalent to the period of such delay.

ARTICLE XXIII

BROKER

Section 23.1. Landlord and Tenant represent and warrant that they neither consulted nor negotiated with any broker or finder with respect to the Demised Premises. Landlord and Tenant agree to indemnify, defend, and save the other harmless from and against any claims for fees or commissions from anyone with whom they have dealt in connection with the Demised Premises or this Lease including attorneys' fees incurred in connection with the defense of any such claim.

ARTICLE XXIV

HAZARDOUS SUBSTANCES

Section 24.1. The term "Hazardous Substances" shall mean pollutants, contaminants, toxic or hazardous wastes, or any other substances, the removal of which is required, or the use of which is restricted, regulated, prohibited or penalized by any "Environmental Law" which term shall mean any federal, state or local law or ordinance relating to pollution or protection of the environment. Tenant agrees that (a) no activity will be conducted on the Demised Premises that will produce any Hazardous Substance, except for such activities that are part of the ordinary course of Tenant's business activities (the "Permitted Activities"), provided said Permitted Activities are conducted in accordance with all Environmental Laws and have been approved in advance in writing by Landlord; (b) the Demised Premises will not be used in any manner for the storage of any Hazardous Substances except for the temporary storage of such materials that are used in the ordinary course of Tenant's business (the "Permitted Materials"), provided such Permitted Materials are properly stored in a manner and location meeting all Environmental Laws and approved in advance in writing by Landlord; (c) Tenant will not install any underground tanks of any type; (d) Tenant will not allow any surface or subsurface conditions to exist or come into existence that constitute, or with the passage of time may constitute, a public or private nuisance; (e) Tenant will not permit any Hazardous Substances to be brought onto the Demised Premises, except for the Permitted Materials, and if so brought or found located thereon, the same shall be immediately removed, with proper disposal, and all required cleanup procedures shall be diligently undertaken pursuant to all Environmental Laws. If, at any time during or after the Term, the Demised Premises are found to be so contaminated or subject to said conditions, Tenant shall indemnify, defend, and hold Landlord harmless from all claims, demands, actions, liabilities, costs, expenses, damages and obligations of any nature arising from or as a result of the use of the Demised Premises by Tenant. The foregoing indemnification shall survive the termination or expiration of this Lease

ARTICLE XXV

HOLDOVER

Section 25.1. Tenant agrees to quit and surrender vacant, full, broom-clean possession of the Premises to Landlord on the Expiration Date free and clear of any leases, tenancies, and rights of occupancy in anyone claiming through Tenant. If Tenant shall fail or refuse to surrender vacant, full, broom-clean possession of the Demised Premises to Landlord on or before the expiration of this Lease, then Tenant shall pay to Landlord for each day or fraction of a day that Tenant shall fail to surrender such vacant, full, broom-clean possession of the Demised Premises to Landlord an agreed-upon sum equal to two (2) times the quotient obtained by dividing (i) the sum of the monthly installments of Fixed Rent then payable under this Lease by (ii) 30. In addition Tenant shall pay to Landlord for each day or fraction of a day that Tenant shall fail to surrender such vacant, full, broom-clean possession of the Premises to Landlord an agreed-upon sum equal to the quotient obtained by dividing (i) one-twelfth of all Additional Rent then payable under this Lease; by (ii) 30.

ARTICLE XXVI

RULES AND REGULATIONS

Section 26.1. Tenant acknowledges that the Demised Premises are located within an office park and that there is an office park association which has promulgated such rules and regulations governing buildings located in the office park. Tenant agrees that all activities conducted by Tenant, its employees, agents and invitees on the Demised Premises will comply with the rules and regulations promulgated by the office park association.

ARTICLE XXVII

MISCELLANEOUS PROVISIONS

Section 27.1. It is mutually agreed by and between Landlord and Tenant that the respective parties shall and they hereby do waive trial by jury in any action, proceeding or counterclaim brought by either of the parties hereto against the other on any matters whatsoever arising out of or in any way connected with this Lease or Tenant's use or occupancy of the Demised Premises.

Section 27.2.

(a) The term "Landlord" as used herein shall mean only the owner or the mortgagee in possession for the time being of the Demised Premises, so that in the event of any sale, transfer or conveyance of the Demised Premises, Landlord shall be and hereby is entirely freed and relieved of all agreements, covenants and obligations of Landlord hereunder.

(b) The term "Tenant" as used herein shall mean the tenant named herein, and from and after any valid assignment or transfer in whole of said Tenant's interest under this Lease pursuant to the provisions of Article VIII, shall mean only the assignee or transferee thereof.

(c) The words "re-enter" and "re-entry" as used herein shall not be restricted to their technical legal meaning.

Section 27.3. The headings herein are inserted only as a matter of convenience and for reference and in no way define, limit or describe the scope or intent of this Lease nor in any way affect this Lease.

Section 27.4. This Lease shall be governed by and construed in accordance with the laws of the State of Florida.

Section 27.5. This Lease contains the entire agreement between the parties and may not be extended, renewed, terminated or otherwise modified in any manner except by an instrument in writing executed by the party against whom enforcement of such modification is sought.

Section 27.6. The agreements, terms, covenants and conditions herein shall bind and inure to the benefit of Landlord and Tenant and their respective heirs, personal representatives, successors and permitted assigns.

Section 27.7. Notice wherever provided for herein shall be in writing and shall be given either by personal service with acknowledgment of receipt, by certified or registered mail, return receipt requested, by overnight courier or by facsimile, to the persons and at the addresses hereinabove set forth, or to such other persons or at such other addresses as may be designated by written notice from either party to the other. Notices shall be deemed given on the date of the mailing or personal service thereof.

Section 27.8. If any provision of this Lease shall be invalid or unenforceable, the remainder of the provisions of this Lease shall not be affected thereby and each and every provision of this Lease shall be enforceable to the fullest extent permitted by law.

Section 27.9. This Lease shall not become binding upon Landlord, unless and until Landlord shall have unconditionally delivered a fully executed copy of this Lease to Tenant.

Section 27.10. **RADON IS A NATURALLY OCCURRING RADIOACTIVE GAS THAT, WHEN IT HAS ACCUMULATED IN A BUILDING IN SUFFICIENT QUANTITIES, MAY PRESENT HEALTH RISKS TO PERSONS WHO ARE EXPOSED TO IT OVER TIME. LEVELS OF RADON THAT EXCEED FEDERAL AND STATE GUIDELINES HAVE BEEN FOUND IN BUILDINGS. ADDITIONAL INFORMATION REGARDING RADON AND RADON TESTING MAY BE OBTAINED FROM YOUR COUNTY PUBLIC HEALTH UNIT. LANDLORD DOES NOT MAKE ANY REPRESENTATION, EXPRESS OR IMPLIED, AS TO THE PRESENCE OR ABSENCE OF RADON GAS AT THE DEMISED PREMISES.**

IN WITNESS WHEREOF, the parties hereto have executed this Lease as of the day and year first above set forth.

WITNESSES:

"Landlord"

Xenon Research, Inc., a Florida corporation

Name: _____

By: /s/ Simon Raab
Name: Simon Raab
Title: President

Name: _____

"Tenant"

FARO Technologies, Inc., a Florida corporation

Name: _____

By: /s/ Jay Freeland
Name: Jay Freeland
Title: Co-CEO

Name: _____

EXHIBIT 31-A

FARO Technologies, Inc.
Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Simon Raab certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of FARO Technologies, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-(15)(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-(15)(f) and 15(d)-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 9, 2006

/s/

Name: Simon Raab
Title: Chairman of the Board and Co-Chief Executive Officer-Director (Principal Executive Officer)

EXHIBIT 31-B

FARO Technologies, Inc.
Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jay W. Freeland certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of FARO Technologies, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-(15)(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-(15)(f) and 15(d)-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 9, 2006

/s/

Name: Jay W. Freeland
Title: President and Co-Chief Executive Officer-Director (Principal Executive Officer)

EXHIBIT 31-C

FARO Technologies, Inc.
Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Keith S. Bair certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of FARO Technologies, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-(15)(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-(15)(f) and 15(d)-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 9, 2006

/s/

Name: Keith S. Bair
Title: Interim Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT 32-A

FARO Technologies, Inc.
Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, the undersigned Chairman of the Board, Co-Chief Executive Officer and Director of FARO Technologies, Inc., (the Company) hereby certify, based on my knowledge, that the Quarterly Report on Form 10-Q, for the quarter ended July 1, 2006 (the Report) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/

Simon Raab
August 9, 2006

EXHIBIT 32-B

FARO Technologies, Inc.
Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, the undersigned President, Co-Chief Executive Officer and Director of FARO Technologies, Inc., (the Company) hereby certify, based on my knowledge, that the Quarterly Report on Form 10-Q, for the quarter ended July 1, 2006 (the Report) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/

Jay W. Freeland
August 9, 2006

EXHIBIT 32-C

FARO Technologies, Inc.
Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, the undersigned Senior Vice President, Chief Financial Officer, and Director of FARO Technologies, Inc., (the Company), and the principal financial officer and principal accounting officer of the Company for the period covered the Report, hereby certify, based on my knowledge, that the Quarterly Report on Form 10-Q, for the quarter ended July 1, 2006 (the Report) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/

Keith S. Bair
August 9, 2006