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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended June 29, 2013

OR

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

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

Commission File Number: 0-23081

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**FARO TECHNOLOGIES, INC.**

(Exact name of Registrant as specified in its charter)

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

**59-3157093**  
(I.R.S. Employer  
Identification No.)

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

**32746**  
(Zip Code)

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

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller Reporting Company

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

There were 17,107,965 shares of the registrant's common stock outstanding as of July 26, 2013.

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[Table of Contents](#)

**FARO TECHNOLOGIES, INC.**

Quarterly Report on Form 10-Q  
Quarter Ended June 29, 2013

**INDEX**

	<b>PAGE NUMBER</b>	
<b><u>PART I. FINANCIAL INFORMATION</u></b>		
Item 1.	<a href="#">Financial Statements</a>	
a)	<a href="#">Consolidated Balance Sheets As of June 29, 2013 (Unaudited) and December 31, 2012</a>	3
b)	<a href="#">Consolidated Statements of Operations (Unaudited) For the Three and Six Months Ended June 29, 2013 and June 30, 2012</a>	4
c)	<a href="#">Consolidated Statements of Comprehensive Income (Unaudited) For the Three and Six Months Ended June 29, 2013 and June 30, 2012</a>	5
d)	<a href="#">Consolidated Statements of Cash Flows (Unaudited) For the Six Months Ended June 29, 2013 and June 30, 2012</a>	6
e)	<a href="#">Notes to Consolidated Financial Statements (Unaudited) For the Six Months Ended June 29, 2013 and June 30, 2012</a>	7-15
Item 2.	<a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	16-25
Item 3.	<a href="#">Quantitative and Qualitative Disclosures about Market Risk</a>	25
Item 4.	<a href="#">Controls and Procedures</a>	25
<b><u>PART II. OTHER INFORMATION</u></b>		
Item 1.	<a href="#">Legal Proceedings</a>	26
Item 1A.	<a href="#">Risk Factors</a>	27
Item 2.	<a href="#">Unregistered Sales of Equity Securities and Use of Proceeds</a>	27
Item 6.	<a href="#">Exhibits</a>	28
<b><u>SIGNATURES</u></b>		29

[Table of Contents](#)**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

<u>(in thousands, except share data)</u>	June 29, 2013 <u>(unaudited)</u>	December 31, 2012
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 111,308	\$ 93,233
Short-term investments	64,993	64,990
Accounts receivable, net	51,717	62,559
Inventories, net	47,781	48,894
Deferred income taxes, net	5,925	7,216
Prepaid expenses and other current assets	11,823	11,186
Total current assets	<u>293,547</u>	<u>288,078</u>
Property and Equipment:		
Machinery and equipment	33,296	32,236
Furniture and fixtures	6,443	6,516
Leasehold improvements	10,884	10,897
Property and equipment at cost	50,623	49,649
Less: accumulated depreciation and amortization	<u>(36,326)</u>	<u>(34,305)</u>
Property and equipment, net	<u>14,297</u>	<u>15,344</u>
Goodwill	18,656	18,816
Intangible assets, net	7,252	7,048
Service inventory	17,784	19,125
Deferred income taxes, net	<u>2,370</u>	<u>2,396</u>
Total Assets	<u>\$353,906</u>	<u>\$ 350,807</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 7,386	\$ 10,413
Accrued liabilities	16,443	18,216
Income taxes payable	1,088	4,886
Current portion of unearned service revenues	19,431	19,460
Customer deposits	3,047	2,662
Current portion of obligations under capital leases	15	45
Total current liabilities	<u>47,410</u>	<u>55,682</u>
Unearned service revenues - less current portion	11,344	11,221
Deferred tax liability, net	1,152	1,149
Obligations under capital leases - less current portion	<u>16</u>	<u>19</u>
Total Liabilities	<u>59,922</u>	<u>68,071</u>
Commitments and contingencies - See Note Q		
Shareholders' Equity:		
Common stock - par value \$.001, 50,000,000 shares authorized; 17,788,200 and 17,653,879 issued; 17,107,965 and 16,973,644 outstanding, respectively	18	18
Additional paid-in capital	187,098	181,094
Retained earnings	112,563	104,358
Accumulated other comprehensive income	3,380	6,341
Common stock in treasury, at cost - 680,235 shares	<u>(9,075)</u>	<u>(9,075)</u>
Total Shareholders' Equity	<u>293,984</u>	<u>282,736</u>
Total Liabilities and Shareholders' Equity	<u>\$353,906</u>	<u>\$ 350,807</u>

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

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

<u>(in thousands, except share and per share data)</u>	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
<b>SALES</b>				
Product	\$ 55,174	\$ 55,432	\$ 107,656	\$ 109,856
Service	13,155	11,330	26,043	22,135
Total Sales	68,329	66,762	133,699	131,991
<b>COST OF SALES</b>				
Product	22,921	22,320	44,260	42,826
Service	8,482	7,382	15,688	14,919
Total Cost of Sales (exclusive of depreciation and amortization, shown separately below)	31,403	29,702	59,948	57,745
<b>GROSS PROFIT</b>	36,926	37,060	73,751	74,246
<b>OPERATING EXPENSES:</b>				
Selling	16,716	15,841	33,366	31,879
General and administrative	7,826	8,134	15,341	14,762
Depreciation and amortization	1,736	1,689	3,569	3,368
Research and development	5,162	4,525	10,287	8,933
Total operating expenses	31,440	30,189	62,563	58,942
<b>INCOME FROM OPERATIONS</b>	5,486	6,871	11,188	15,304
<b>OTHER (INCOME) EXPENSE</b>				
Interest income	(19)	(20)	(35)	(121)
Other (income) expense, net	504	401	619	261
Interest expense	0	7	1	20
<b>INCOME BEFORE INCOME TAX EXPENSE</b>	5,001	6,483	10,603	15,144
<b>INCOME TAX EXPENSE</b>	1,370	1,749	2,398	3,660
<b>NET INCOME</b>	\$ 3,631	\$ 4,734	\$ 8,205	\$ 11,484
<b>NET INCOME PER SHARE - BASIC</b>	\$ 0.21	\$ 0.28	\$ 0.48	\$ 0.68
<b>NET INCOME PER SHARE - DILUTED</b>	\$ 0.21	\$ 0.28	\$ 0.48	\$ 0.67
Weighted average shares - Basic	17,097,973	16,921,012	17,054,354	16,861,221
Weighted average shares - Diluted	17,173,015	17,140,115	17,177,748	17,157,185

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

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

<u>(in thousands)</u>	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>June 29, 2013</u>	<u>June 30, 2012</u>	<u>June 29, 2013</u>	<u>June 30, 2012</u>
Net income	\$ 3,631	\$ 4,734	\$ 8,205	\$ 11,484
Currency translation adjustments	468	(3,022)	(2,961)	(1,688)
Comprehensive income	<u>\$ 4,099</u>	<u>\$ 1,712</u>	<u>\$ 5,244</u>	<u>\$ 9,796</u>

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

[Table of Contents](#)

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

<u>(in thousands)</u>	<u>Six Months Ended</u>	
	<u>June 29, 2013</u>	<u>June 30, 2012</u>
<b>CASH FLOWS FROM:</b>		
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 8,205	\$ 11,484
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,569	3,368
Compensation for stock options and restricted stock units	2,105	1,866
Provision for bad debts	315	(84)
Deferred income tax expense (benefit)	1,281	(744)
Change in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	9,644	3,535
Inventories, net	1,101	(6,173)
Prepaid expenses and other current assets	(765)	(1,569)
Income tax benefit from exercise of stock options	(814)	(1,114)
Increase (decrease) in:		
Accounts payable and accrued liabilities	(4,565)	(6,313)
Income taxes payable	(2,868)	933
Customer deposits	458	317
Unearned service revenues	594	1,191
Net cash provided by operating activities	<u>18,260</u>	<u>6,697</u>
<b>INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(891)	(2,533)
Payments for intangible assets	(832)	(443)
Net cash used in investing activities	<u>(1,723)</u>	<u>(2,976)</u>
<b>FINANCING ACTIVITIES:</b>		
Payments on capital leases	(76)	(98)
Income tax benefit from exercise of stock options	814	1,114
Proceeds from issuance of stock, net	<u>3,084</u>	<u>5,601</u>
Net cash provided by financing activities	<u>3,822</u>	<u>6,617</u>
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	<u>(2,284)</u>	<u>(130)</u>
INCREASE IN CASH AND CASH EQUIVALENTS	18,075	10,208
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>93,233</u>	<u>64,540</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 111,308</u>	<u>\$ 74,748</u>

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

**FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Unaudited for the Six Months Ended June 29, 2013 and June 30, 2012

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

**NOTE A – DESCRIPTION OF BUSINESS**

FARO Technologies, Inc. and its subsidiaries (collectively the “Company” or “FARO”) design, develop, manufacture, market and support software-based three-dimensional measurement and imaging systems for manufacturing, industrial, building construction and forensic applications. The Company’s principal products include the FaroArm, FARO Laser ScanArm and FARO Gage, all articulated electromechanical measuring devices, and the FARO Laser Tracker Vantage, FARO Focus<sup>3D</sup> and FARO 3D Imager AMP, all laser-based measuring devices. Markets for the Company’s products include automobile, aerospace, heavy equipment, and law enforcement agencies. The Company sells the vast majority of its products through 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 of the Company’s subsidiaries, all of which are wholly owned. All intercompany transactions and balances have been eliminated. The financial statements of the Company’s foreign subsidiaries are translated into U.S. dollars using exchange rates in effect at period-end for assets and liabilities and average exchange rates during each reporting period for results of operations. Adjustments resulting from financial statement translations are reflected as a separate component of accumulated other comprehensive income.

**NOTE C – BASIS OF PRESENTATION**

The accompanying unaudited interim consolidated financial statements of the Company include all normal recurring accruals and adjustments considered necessary by management for their fair presentation in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. The consolidated results of operations for the three and six months ended June 29, 2013 are not necessarily indicative of results that may be expected for the year ending December 31, 2013 or any future interim period.

The information included in this Quarterly Report on Form 10-Q, including the interim consolidated financial statements and the accompanying notes, should be read in conjunction with the audited consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012.

**NOTE D – RECLASSIFICATIONS**

From time to time the Company may reclassify certain amounts to conform to the current period presentation.

## [Table of Contents](#)

### NOTE E – IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (“ASU 2011-12”)*. ASU 2011-12 defers the specific requirement in ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income (“ASU 2011-05”)* to present items that are reclassified from accumulated other comprehensive income to net income separately with their respective components of net income and other comprehensive income. As part of this update, the FASB did not defer the requirement in ASU 2011-05 to report comprehensive income either in a single continuous statement or in two separate but consecutive financial statements. In February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (“ASU 2013-02”)*, which became effective during the quarter ended March 30, 2013. The adoption of ASU 2013-02 in the quarter ended March 30, 2013 did not have any impact on the Company’s consolidated financial statements.

### NOTE F – SHARE-BASED COMPENSATION

Share-based 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 typically the same as the vesting period. The vesting period for the share-based compensation awarded by the Company is generally three years. The Company uses the Black-Scholes option pricing model to determine the fair value of stock option grants. The Company uses the closing market price of its common stock on the date of grant to determine the fair value of restricted stock and restricted stock units.

The Company used the following assumptions for the Black-Scholes option-pricing model to determine the fair value of options granted during the six months ended June 29, 2013 and June 30, 2012:

	For the Six Months Ended	
	June 29, 2013	June 30, 2012
Risk-free interest rate	0.55%	0.61% - 0.66%
Expected dividend yield	0%	0%
Expected option life	4 years	4 years
Expected volatility	48.4%	50.4% - 50.7%
Weighted-average expected volatility	48.4%	50.7%

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

The Company recorded total share-based compensation expense of \$1,087 and \$1,093 for the three months ended June 29, 2013 and June 30, 2012, respectively, and \$2,188 and \$1,929 for the six months ended June 29, 2013 and June 30, 2012, respectively.



[Table of Contents](#)

A summary of stock option activity and weighted average exercise prices for the six months ended June 29, 2013 follows:

	<u>Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value as of June 29, 2013</u>
Outstanding at January 1, 2013	831,504	\$ 36.31		
Granted	238,767	43.78		
Forfeited	(58,644)	46.29		
Exercised	(116,910)	26.48		
Outstanding at June 29, 2013	<u>894,717</u>	<u>\$ 38.94</u>	<u>4.9</u>	<u>\$ 3,007</u>
Options exercisable at June 29, 2013	<u>445,699</u>	<u>\$ 31.37</u>	<u>3.7</u>	<u>\$ 2,999</u>

The weighted-average grant-date fair value of the stock options granted during the six months ended June 29, 2013 and June 30, 2012 was \$14.64 and \$22.57 per option, respectively. The total intrinsic value of stock options exercised during the three months ended June 29, 2013 and June 30, 2012 was \$0.0 million and \$0.4 million, respectively. The total intrinsic value of stock options exercised during the six months ended June 29, 2013 and June 30, 2012 was \$2.0 million and \$6.5 million, respectively. The fair value of stock options vested during the three months ended June 29, 2013 and June 30, 2012 was \$0.0 million and \$0.0 million, respectively. The total fair value of stock options vested during the six months ended June 29, 2013 and June 30, 2012 was \$3.2 million and \$1.7 million, respectively.

The following table summarizes the restricted stock and restricted stock unit activity and weighted average grant-date fair values for the six months ended June 29, 2013:

	<u>Shares</u>	<u>Weighted-Average Grant Date Fair Value</u>
Non-vested at beginning of period	31,236	\$ 45.80
Granted	15,316	36.91
Forfeited	(1,586)	51.89
Vested	(13,518)	45.27
Non-vested at June 29, 2013	<u>31,448</u>	<u>\$ 41.39</u>

As of June 29, 2013, there was \$8.3 million of total unrecognized stock-based compensation expense related to non-vested stock-based compensation arrangements. The expense is expected to be recognized over a weighted average period of 2.5 years.

[Table of Contents](#)

NOTE G – SUPPLEMENTAL CASH FLOW INFORMATION

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

	Six Months Ended	
	June 29, 2013	June 30, 2012
Cash paid for interest	\$ 1	\$ 20
Cash paid for income taxes	\$ 5,884	\$ 2,767

NOTE H – CASH AND CASH EQUIVALENTS

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

NOTE I – SHORT TERM INVESTMENTS

Short-term investments at June 29, 2013 and December 31, 2012 include U.S. Treasury Bills totaling \$65.0 million that mature through December 13, 2013. The weighted average interest rate on the U.S. Treasury bills is less than one percent. The investments are classified as held-to-maturity and recorded at cost. The fair value of the U.S. Treasury Bills at June 29, 2013 and December 31, 2012, approximated cost.

NOTE J – ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	As of	As of
	June 29, 2013	December 31, 2012
Accounts receivable	\$ 55,673	\$ 66,339
Allowance for doubtful accounts	(3,956)	(3,780)
Total	\$ 51,717	\$ 62,559

[Table of Contents](#)

## NOTE K – INVENTORIES

Inventories consist of the following:

	As of June 29, 2013	As of December 31, 2012
Raw materials	\$ 23,500	\$ 28,146
Finished goods	8,224	6,188
Sales demonstration inventory	18,829	18,729
Reserve for excess and obsolete	(2,772)	(4,169)
Inventory	<u>\$ 47,781</u>	<u>\$ 48,894</u>
Service inventory	<u>\$ 17,784</u>	<u>\$ 19,125</u>

## NOTE L – 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			
	June 29, 2013		June 30, 2012		June 29, 2013		June 30, 2012	
	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	17,097,973	\$ 0.21	16,921,012	\$ 0.28	17,054,354	\$ 0.48	16,861,221	\$ 0.68
Effect of dilutive securities	75,042	—	219,103	—	123,394	—	295,964	(0.01)
Diluted EPS	<u>17,173,015</u>	<u>\$ 0.21</u>	<u>17,140,115</u>	<u>\$ 0.28</u>	<u>17,177,748</u>	<u>\$ 0.48</u>	<u>17,157,185</u>	<u>\$ 0.67</u>

The effect of 445,814 and 430,248 securities were not included in the calculation of weighted average shares outstanding for the three months and six months ended June 29, 2013, as they were antidilutive. The effect of 240,616 and 240,116 securities were not included for the three months and six months ended June 30, 2012, as they were antidilutive.

[Table of Contents](#)

## NOTE M – ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	As of June 29, 2013	As of December 31, 2012
Accrued compensation and benefits	\$ 9,091	\$ 9,364
Accrued warranties	2,453	2,359
Professional and legal fees	1,472	1,472
Other accrued liabilities	3,427	5,021
	<u>\$16,443</u>	<u>\$ 18,216</u>

Activity related to accrued warranties was as follows:

	Six Months Ended	
	June 29, 2013	June 30, 2012
Beginning Balance	\$ 2,359	\$ 2,365
Provision for warranty expense	1,758	1,457
Warranty expired	(1,664)	(1,377)
Ending Balance	<u>\$ 2,453</u>	<u>\$ 2,445</u>

## NOTE N – INCOME TAXES

Total deferred income tax assets for the Company's foreign subsidiaries relating to net operating loss carryforwards were \$14.8 million at June 29, 2013 and December 31, 2012. The related valuation allowance was \$11.8 million at June 29, 2013 and December 31, 2012. The Company's effective tax rate decreased to 22.6% for the six months ended June 29, 2013 from 24.2% for the six months ended June 30, 2012 and included a reduction in the income tax rate of 0.8% and 2.8%, respectively, related to the tax benefit of the exercise of employee stock options. The effective tax rate for the six months ended June 29, 2013 also included the discrete tax benefit of 4.0% related to the retroactive legislative reinstatement on January 2, 2013 of the Research and Development tax credit for the year ended December 31, 2012, which is required to be included in the period the reinstatement was enacted into law. The Company's tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. Significant judgment is required in determining the Company's worldwide provision for income taxes. In the ordinary course of a global business, there are many transactions for which the ultimate tax outcome is uncertain. The Company reviews its tax contingencies on a regular basis and makes appropriate accruals as necessary.

## [Table of Contents](#)

The effective income tax rate for the six months ended June 29, 2013 and June 30, 2012 includes a reduction in the statutory corporate tax rate for the Company's operations in Switzerland. The favorable tax rate ruling requires the Company to maintain a certain level of manufacturing operations in Switzerland. The aggregate dollar effect of this favorable tax rate was approximately \$0.7 million, or \$0.04 per share, in the six month period ended June 29, 2013, and \$0.5 million, or \$0.03 per share, in the six month period ended June 30, 2012.

In 2005, the Company opened a regional headquarters and began to manufacture certain of its products in Singapore. In the third quarter of 2006, the Company received confirmation of a tax holiday for its operations from the Singapore Economic Development Board for a period of four years commencing January 1, 2006 and an additional six year extension at favorable tax rates subject to certain terms and conditions, including employment, spending, and capital investment. The Company and the Singapore Economic Development Board mutually agreed to end the program as of December 31, 2011, as the Company has expanded its operations in other locations within Asia to meet market demand. The aggregate dollar effect of this favorable tax rate was approximately \$0.2 million, or \$0.01 per share, during the six month period ended June 30, 2012.

### NOTE O – FAIR VALUE OF FINANCIAL INSTRUMENTS

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

### NOTE P – SEGMENT REPORTING

The Company has three reportable segments based upon geographic regions: Americas, Europe/Africa and Asia/Pacific. The Company does not allocate corporate expenses to Europe/Africa or Asia/Pacific regions. These corporate expenses are included in the Americas region. The Company does not incur Research and Development expenses in its Asia/Pacific region.

The Company develops, manufactures, markets, supports and sells Computer-Aided Design ("CAD")-based quality assurance products integrated with CAD-based inspection and statistical process control software in each of these regions. These activities represent approximately 99% of consolidated sales. The Company evaluates performance and allocates resources based upon profitable growth and assets deployed.

## [Table of Contents](#)

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

	Three Months Ended		Six Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
<b>Americas Region</b>				
Net sales to external customers	\$ 28,380	\$ 25,714	\$ 54,489	\$ 50,773
Depreciation and amortization	984	1,060	2,076	2,106
Operating (loss) income	1,287	(489)	279	49
Long-lived assets	21,501	22,379	21,501	22,379
Capital expenditures	439	332	761	894
Total assets	187,081	171,081	187,081	171,081
<b>Europe/Africa Region</b>				
Net sales to external customers	\$ 23,207	\$ 23,200	\$ 45,107	\$ 46,246
Depreciation and amortization	462	395	930	797
Operating income	(160)	1,613	1,789	3,917
Long-lived assets	16,286	16,146	16,286	16,146
Capital expenditures	289	580	532	762
Total assets	102,675	94,777	102,675	94,777
<b>Asia Pacific Region</b>				
Net sales to external customers	\$ 16,742	\$ 17,848	\$ 34,103	\$ 34,972
Depreciation and amortization	290	234	563	465
Operating income	4,359	5,747	9,120	11,338
Long-lived assets	2,417	2,623	2,417	2,623
Capital expenditures	345	791	442	1,045
Total assets	64,150	59,537	64,150	59,537
<b>Totals</b>				
Net sales to external customers	\$ 68,329	\$ 66,762	\$ 133,699	\$ 131,991
Depreciation and amortization	1,736	1,689	3,569	3,368
Operating income	5,486	6,871	11,188	15,304
Long-lived assets	40,204	41,148	40,204	41,148
Capital expenditures	1,073	1,703	1,735	2,701
Total assets	353,906	325,395	353,906	325,395

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

### NOTE Q – COMMITMENTS AND CONTINGENCIES

**Leases** — The Company is a party to leases arising in the normal course of business that expire on or before 2024. Total obligations under these leases are approximately \$6.2 million for 2013.

**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. As of June 29, 2013, the Company does not have any long-term commitments for purchases.

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

## [Table of Contents](#)

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

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

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

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

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

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

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

### NOTE R – LINE OF CREDIT

On July 11, 2006, the Company entered into a loan agreement providing for an available line of credit of \$30.0 million, which was most recently amended effective March 15, 2012. Loans under the Amended and Restated Loan Agreement, as amended, bear interest at the rate of LIBOR plus a fixed percentage between 1.50% and 2.00% and require the Company to maintain a minimum cash balance and tangible net worth measured at the end of the Company's fiscal quarters. As of June 29, 2013, the Company was in compliance with all of the covenants under the Amended and Restated Loan Agreement, as amended. The term of the Amended and Restated Loan Agreement, as amended, extends to March 31, 2015. The Company has not drawn on this line of credit.

## 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 Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.*

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," "project" and similar words, or discussions of our strategy or other intentions, identify forward-looking statements. Specifically, this Quarterly Report on Form 10-Q contains, among others, forward-looking statements regarding:

- the Company's ability to achieve and maintain profitability;
- the impact of fluctuations in exchange rates;
- market conditions in the regions where the Company operates;
- the effect of estimates and assumptions with respect to critical accounting policies and the impact of the adoption of recently issued accounting pronouncements;
- the impact of changes in technologies on the competitiveness of the Company's products or their components;
- the magnitude of increased warranty costs from new product introductions and enhancements to existing products;
- the sufficiency of the Company's plants to meet its manufacturing requirements;
- the outcome of litigation and its effect on the Company's business, financial condition or results of operations;
- the continuation of the Company's share repurchase program;
- the sufficiency of the Company's working capital, cash flow from operations, and credit facility to fund its long-term liquidity requirements;
- the impact of geographic changes in the manufacturing or sales of the Company's products on its tax rate; and
- the ability of the Company to comply with the requirements for favorable tax rates in foreign jurisdictions.

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

- economic downturn in the manufacturing industry or the domestic and international economies in the regions of the world where the Company operates;
- the Company's inability to further penetrate its customer base and target markets;
- development by others of new or improved products, processes or technologies that make the Company's products obsolete or less competitive;



## Table of Contents

- the Company's inability to maintain its technological advantage by developing new products and enhancing its existing products;
- the Company's inability to successfully identify and acquire target companies or achieve expected benefits from acquisitions that are consummated;
- the cyclical nature of the industries of the Company's customers and material adverse changes in its customers' access to liquidity and capital;
- the market potential for the computer-aided measurement ("CAM2") market and the potential adoption rate for the Company's products are difficult to quantify and predict;
- the inability to protect the Company's patents and other proprietary rights in the United States and foreign countries;
- fluctuations in the Company's annual and quarterly operating results and the inability to achieve its financial operating targets as a result of a number of factors, including, without limitation (i) litigation and regulatory action brought against the Company, (ii) quality issues with its products, (iii) excess or obsolete inventory, (iv) raw material price fluctuations, (v) expansion of the Company's 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 the Company's products, (viii) the length of the Company's sales cycle to new customers and the time and expense incurred in further penetrating its existing customer base, (ix) increases in operating expenses required for product development and new product marketing, (x) costs associated with new product introductions, such as product development, marketing, assembly line start-up costs and low introductory period production volumes, (xi) the timing and market acceptance of new products and product enhancements, (xii) customer order deferrals in anticipation of new products and product enhancements, (xiii) the Company's success in expanding its sales and marketing programs, (xiv) start-up costs associated with opening new sales offices outside of the United States, (xv) fluctuations in revenue without proportionate adjustments in fixed costs, (xvi) the efficiencies achieved in managing inventories and fixed assets, (xvii) investments in potential acquisitions or strategic sales, product or other initiatives, (xviii) shrinkage or other inventory losses due to product obsolescence, scrap or material price changes, (xix) adverse changes in the manufacturing industry and general economic conditions, (xx) compliance with government regulations including health, safety, and environmental matters, and (xxi) other factors noted herein;
- changes in gross margins due to changing mix of products sold and the different gross margins on different products and sales channels;
- the Company may incur additional material costs related to increases in sales of extended product warranties without a corresponding increase in revenue if actual product failure rates, parts and equipment costs, or service labor costs exceed the Company's estimates;
- the Company's inability to successfully maintain the requirements of Restriction of use of Hazardous Substances ("RoHS") and Waste Electrical and Electronic Equipment ("WEEE") compliance in its products;
- the inability of the Company's products to displace traditional measurement devices and attain broad market acceptance;
- the impact of competitive products and pricing in the CAM2 market and the broader market for measurement and inspection devices;
- the effects of increased competition as a result of 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, compliance with import and export regulations, and the burdens and potential exposure of complying with a wide variety of U.S. and foreign laws and labor practices;
- the loss of the Company's Chief Executive Officer or other key personnel;
- difficulties in recruiting research and development engineers and application engineers;
- the failure to effectively manage the effects of the Company's growth;

## [Table of Contents](#)

- the impact of reductions or projected reductions in government spending, particularly in the defense sector;
  - 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
- other risks and uncertainties discussed in Part I, Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

### **Overview**

The Company designs, develops, manufactures, markets and supports portable, software driven, 3-D measurement and imaging systems that are used in a broad range of manufacturing, industrial, building construction and forensic applications. The Company's FaroArm®, FARO Laser ScanArm® and FARO Gage articulated measuring devices, the FARO Laser Tracker Vantage™, the FARO Focus<sup>3D</sup>, the FARO 3D Imager AMP and their companion CAM2® software, provide for Computer-Aided Design, or CAD-based inspection and/or factory-level statistical process control, and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company uses the acronym "CAM2" for this process, which stands for computer-aided measurement.

As of June 29, 2013, the Company's products have been purchased by approximately 15,000 customers worldwide, ranging from small machine shops to such large manufacturing and industrial companies as Audi, Bell Helicopter, Bombardier, Boeing, British Aerospace, Caterpillar, Daimler AG, Ford, General Electric, General Motors, Honda, Johnson Controls, Komatsu America International, Lockheed Martin, NASA, Nissan, Northrup Grumman, Siemens and Volkswagen, among many others.

The Company derives revenues primarily from the sale of its FaroArm, FARO Laser ScanArm, FARO Gage, FARO Laser Tracker and FARO Focus<sup>3D</sup> measurement equipment, and their related multi-faceted software. Revenue related to these products is generally recognized upon shipment. In addition, the Company sells one- and three-year extended warranties and training and technology consulting services relating to its products. The Company recognizes the revenue from extended warranties on a straight-line basis. The Company also receives royalties from licensing agreements for its historical medical technology and recognizes the revenue from these royalties as licensees use the technology.

The Company manufactures its FaroArm, FARO Gage, FARO 3D Imager AMP, and FARO Laser Tracker ION products in the Company's manufacturing facilities located in Florida and Pennsylvania for customer orders from the Americas, in its manufacturing facility located in Switzerland for customer orders from the Europe/Africa region, and in its manufacturing facility located in Singapore for customer orders from the Asia/Pacific region. The Company manufactures its FARO Focus<sup>3D</sup> product in its facility located in Stuttgart, Germany. The Company expects all its existing plants to have the production capacity necessary to support its volume requirements through 2013.

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

In the six months ended June 29, 2013, 40.7% of the Company's sales were in the Americas compared to 38.5% in the first of six months of 2012, 33.7% were in the Europe/Africa region compared to 35.0% in the first six months of 2012, and 25.6% were in the Asia/Pacific region compared to 26.5% in the same prior year

## [Table of Contents](#)

period. In the second quarter of 2013, new order bookings decreased \$4.3 million, or 6.1%, to \$66.7 million from \$71.0 million in the prior year period. New orders in the second quarter of 2013 increased \$0.1 million, or 0.4%, in the Americas to \$27.5 million from \$27.4 million in the prior year period. New orders in the second quarter of 2013 decreased \$4.1 million, or 15.9%, to \$21.7 million in Europe/Africa from \$25.8 million in the second quarter of 2012. In Asia/Pacific, new orders in the second quarter of 2013 decreased \$0.3 million, or 1.7%, to \$17.5 million from \$17.8 million in the second quarter of 2012.

The Company accounts for wholly owned foreign subsidiaries in the currency of the respective foreign jurisdiction; therefore, fluctuations in exchange rates may have an impact on inter-company accounts reflected in the Company's consolidated financial statements. The Company is aware of the availability of off-balance sheet financial instruments to hedge exposure to foreign currency exchange rates, including cross-currency swaps, forward contracts and foreign currency options (see Foreign Exchange Exposure below). However, it does not regularly use such instruments, and none were utilized in 2012 or the six months ended June 29, 2013.

The Company was profitable in each quarter in the years ended December 31, 2012, 2011, and 2010. The Company incurred a net loss in the year ended December 31, 2009, primarily as a result of a decrease in product sales. The Company attributes the decrease in product sales principally to the decline of the global economy. Prior to 2009, the Company had a history of sales and earnings growth and 26 consecutive profitable quarters through December 31, 2008. Its historical sales and earnings growth were the result of a number of factors, including: continuing market demand for and acceptance of the Company's products, increased sales activity in part through additional sales staff worldwide, new products and product enhancements such as the FARO Edge Arm and FARO Focus<sup>3D</sup>, and the effect of acquisitions. However, the Company's historical financial performance is not indicative of its future financial performance.

## **Results of Operations**

### **Three Months Ended June 29, 2013 Compared to the Three Months Ended June 30, 2012**

Sales increased by \$1.5 million, or 2.3%, to \$68.3 million in the three months ended June 29, 2013 from \$66.8 million for the three months ended June 30, 2012. The Company's sales growth continues to be impacted by economic softness in Europe and Asia while there are signs of improvement in the Americas region. Product sales decreased by \$0.3 million, or 0.5%, to \$55.2 million for the three months ended June 29, 2013 from \$55.5 million for the second quarter of 2012. Service revenue increased by \$1.8 million, or 16.1%, to \$13.1 million for the three months ended June 29, 2013 from \$11.3 million in the same period during the prior year primarily due to an increase in warranty revenue.

Sales in the Americas region increased by \$2.7 million, or 10.5%, to \$28.4 million for the three months ended June 29, 2013 from \$25.7 million in the three months ended June 30, 2012. Product sales in the Americas region increased by \$1.6 million, or 7.7%, to \$22.5 million for the three months ended June 29, 2013 from \$20.9 million in the second quarter of the prior year. Service revenue in the Americas region increased by \$1.1 million, or 21.7%, to \$5.9 million for the three months ended June 29, 2013 from \$4.8 million in the same period during the prior year primarily due to an increase in warranty revenue.

Sales in the Europe/Africa region were \$23.2 million for the three months ended June 29, 2013 and the three months ended June 30, 2012. Product sales in the Europe/Africa region decreased by \$0.9 million, or 4.3%, to \$18.2 million for the three months ended June 29, 2013 from \$19.1 million in the second quarter of the prior year. Service revenue in the Europe/Africa region increased by \$0.9 million, or 19.9%, to \$5.0 million for the three months ended June 29, 2013 from \$4.1 million in the same period during the prior year primarily due to an increase in warranty revenue.

Sales in the Asia/Pacific region decreased by \$1.2 million, or 6.7%, to \$16.7 million for the three months ended June 29, 2013 from \$17.9 million in the three months ended June 30, 2012. Product sales in the Asia/Pacific region decreased by \$1.1 million, or 6.8%, to \$14.5 million for the three months ended June 29, 2013 from \$15.6 million in the second quarter of the prior year. Service revenue in the Asia/Pacific region remained at \$2.3 million for the three months ended June 29, 2013 and the three months ended June 30, 2012.

## [Table of Contents](#)

Gross profit decreased by \$0.2 million, or 0.4%, to \$36.9 million for the three months ended June 29, 2013 from \$37.1 million for the three months ended June 30, 2012. Gross margin decreased to 54.0% for the three months ended June 29, 2013 from 55.5% for the three months ended June 30, 2012. The decrease in gross margin is primarily due to a decrease in gross margin from product sales to 58.5% in the three months ended June 29, 2013 from 59.7% for the three months ended June 30, 2012, primarily as a result of lower average selling prices. Gross margin from service revenues increased to 35.5% in the three months ended June 29, 2013 from 34.8% for the three months ended June 30, 2012, primarily due to an increase in warranty revenue.

Selling expenses increased by \$0.9 million, or 5.5%, to \$16.7 million for the three months ended June 29, 2013 from \$15.8 million for three months ended June 30, 2012. This increase was primarily due to an increase in compensation expense of \$0.6 million and an increase in travel costs of \$0.3 million.

Worldwide sales and marketing headcount increased by 56, or 15.7%, to 413 at June 29, 2013 from 357 at June 30, 2012. Regionally, the Company's sales and marketing headcount increased by 25, or 24.3%, to 128 from 103 for the Americas; increased by 13, or 10.8%, in Europe/Africa to 133 from 120; and increased by 18, or 13.4%, in Asia/Pacific to 152 from 134.

As a percentage of sales, selling expenses increased to 24.5% of sales in the three months ended June 29, 2013 from 23.7% in the three months ended June 30, 2012. Regionally, selling expenses were 20.8% of sales in the Americas for the quarter, compared to 20.3% of sales in the second quarter of 2012; 30.7% of sales for Europe/Africa for the quarter compared to 28.8% of sales from the same period in the prior year; and 22.1% of sales for Asia/Pacific for the quarter compared to 22.0% of sales from the same period in the prior year.

General and administrative expenses decreased by \$0.3 million, or 3.8%, to \$7.8 million for the three months ended June 29, 2013 from \$8.1 million for the three months ended June 30, 2012, primarily due to a decrease in legal fees of \$1.2 million related to the FCPA matter, offset by an increase in compensation of \$0.3 million, an increase in other professional fees of \$0.3 million, and bad debt expenses of \$0.2 million.

Depreciation and amortization expense remained at \$1.7 million for the three months ended June 29, 2013 and June 30, 2012.

Research and development expenses increased to \$5.2 million for the three months ended June 29, 2013 from \$4.5 million for the three months ended June 30, 2012, primarily as a result of an increase in compensation expense of \$0.4 million and subcontractors' expense of \$0.2 million. Research and development expenses as a percentage of sales increased to 7.6% for the three months ended June 29, 2013 from 6.8% for the three months ended June 30, 2012.

Other expense (income), net increased by \$0.1 million to \$0.5 million of expense for the three months ended June 29, 2013, from \$0.4 million of expense for the three months ended June 30, 2012, primarily as a result of an increase in foreign currency transaction losses resulting from changes in foreign exchange rates on the value of current intercompany account balances of the Company's subsidiaries denominated in different currencies.

Income tax expense decreased by \$0.3 million to \$1.4 million for the three months ended June 29, 2013 from \$1.7 million for the three months ended June 30, 2012. This decrease was primarily due to a decrease in pretax income. The Company's effective tax rate increased to 27.4% for the three months ended June 29, 2013 from 27.0% in the prior year period. 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, the Company's tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction.

Net income decreased by \$1.1 million to \$3.6 million for the three months ended June 29, 2013 from \$4.7 million for the three months ended June 30, 2012 as a result of the factors described above.

## Six Months Ended June 29, 2013 Compared to the Six Months Ended June 30 2012

Total sales increased by \$1.7 million, or 1.3%, to \$133.7 million in the six months ended June 29, 2013 from \$132.0 million for the six months ended June 30, 2012. The Company's sales growth continues to be impacted by economic softness in Europe and Asia with improving conditions in the Americas region. Product sales decreased by \$2.2 million, or 2.0%, to \$107.7 million for the six months ended June 29, 2013 from \$109.9 million for the six months ended June 30, 2012. Service revenue increased by \$3.9 million, or 17.7%, to \$26.0 million for the six months ended June 29, 2013 from \$22.1 million in the same period during the prior year due primarily to an increase in warranty revenue.

Sales in the Americas region increased by \$3.7 million, or 7.3%, to \$54.5 million for the six months ended June 29, 2013 from \$50.8 million in the six months ended June 30, 2012. Product sales in the Americas region increased by \$1.4 million, or 3.4%, to \$42.8 million for the six months ended June 29, 2013 from \$41.4 million in the prior year period. Service revenue in the Americas region increased by \$2.3 million, or 24.7%, to \$11.7 million for the six months ended June 29, 2013 from \$9.4 million in the same period during the prior year, due primarily to an increase in warranty revenue.

Sales in the Europe/Africa region decreased by \$1.1 million, or 2.4%, to \$45.1 million for the six months ended June 29, 2013 from \$46.2 million in the six months ended June 30, 2012. Product sales in the Europe/Africa region decreased by \$2.6 million, or 6.9%, to \$35.3 million for the six months ended June 29, 2013 from \$37.9 million in the prior year period. Service revenue in the Europe/Africa region increased by \$1.5 million, or 17.8%, to \$9.8 million for the six months ended June 29, 2013 from \$8.3 million in the same period during the prior year due primarily to an increase in warranty revenue.

Sales in the Asia/Pacific region decreased by \$0.9 million, or 2.6%, to \$34.1 million for the six months ended June 29, 2013 from \$35.0 million in the six months ended June 30, 2012. Product sales in the Asia/Pacific region decreased by \$1.0 million, or 3.2%, to \$29.5 million for the six months ended June 29, 2013 from \$30.5 million in the prior year period. Service revenue in the Asia/Pacific region increased by \$0.1 million, or 2.6%, to \$4.6 million for the six months ended June 29, 2013 from \$4.5 million in the same period during the prior year, due primarily to an increase in warranty revenue.

Gross profit decreased by \$0.6 million, or 0.7%, to \$73.8 million for the six months ended June 29, 2013 from \$74.2 million for the six months ended June 30, 2012. Gross margin decreased to 55.2% for the six months ended June 29, 2013 from 56.3% for the six months ended June 30, 2012. The decrease in gross margin is primarily due to a decrease in gross margin from product sales to 58.9% in the six months ended June 29, 2013 from 61.0% for the six months ended June 30, 2012 primarily as a result of lower average selling prices and an increase in the sales mix of Laser Scanner product sold to distributors. Gross margin from service revenues increased to 39.8% in the six months ended June 29, 2013 from 32.6% for the six months ended June 30, 2012.

Selling expenses increased by \$1.5 million, or 4.7%, to \$33.4 million for the six months ended June 29, 2013 from \$31.9 million for the six months ended June 30, 2012, primarily due to an increase in compensation expense of \$0.9 million and an increase in travel related expenses of \$0.9 million, offset by a decrease in marketing and advertising expenses of \$0.2 million.

As a percentage of sales, selling expenses increased to 25.0% of sales in the six months ended June 29, 2013 from 24.2% in the six months ended June 30, 2012. Regionally, selling expenses were 21.2% of sales in the Americas for the six months ended June 29, 2013 compared to 21.3% of sales in the prior year period; 30.6% of sales for Europe/Africa for the six months ended June 29, 2013 compared to 28.3% of sales from the same period in the prior year; and 23.6% of sales for the six months ended June 29, 2013 compared to 22.8% of sales for Asia/Pacific from the same period in the prior year.

General and administrative expenses increased by \$0.6 million, or 3.9%, to \$15.3 million for the six months ended June 29, 2013 from \$14.7 million for the six months ended June 30, 2012, primarily due to an increase in compensation of \$1.0 million, bad debt expenses of \$0.4 million, and recruiting costs of \$0.3 million, offset by a decrease in professional fees related to the FCPA matter of \$1.4 million.

## [Table of Contents](#)

Depreciation and amortization expenses increased by \$0.3 million, or 6.0%, to \$3.6 million for the six months ended July 29, 2013 from \$3.3 million for the six months ended June 30, 2012.

Research and development expenses increased to \$10.3 million for the six months ended June 29, 2013 from \$8.9 million for the six months ended June 30, 2012, primarily as a result of an increase in compensation expenses of \$1.1 million and subcontractors' expense of \$0.3 million. Research and development expenses as a percentage of sales increased to 7.7% for the six months ended June 29, 2013 from 6.8% for the six months ended June 30, 2012.

Other expense (income), net increased by \$0.4 million to \$0.6 million for the six months ended June 29, 2013 from \$0.2 million of expense for the six months ended June 30, 2012, primarily as a result of an increase in foreign exchange transaction losses resulting from changes in foreign exchange rates on the value of current intercompany account balances of the Company's subsidiaries denominated in different currencies.

Income tax expense decreased by \$1.3 million to \$2.4 million for the six months ended June 29, 2013 from \$3.7 million for the six months ended June 30, 2012. This change was primarily due to a decrease in pretax income. The Company's effective tax rate decreased to 22.6% for the six months ended June 29, 2013 from 24.2% in the prior year period, primarily as a result of a decrease in taxable income in jurisdictions with higher tax rates and a reduction in the income tax rates of 0.1% and 2.8%, respectively, related to the tax benefit of the exercise of employee stock options. The effective tax rate for the six months ended June 29, 2013 also included the discrete tax benefit of 4.0% related to the retroactive legislative reinstatement on January 2, 2013 of the Research and Development tax credit for the year ended December 31, 2012, which is required to be included in the period the reinstatement was enacted into law. The Company's tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company's tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction.

Net income decreased by \$3.3 million to \$8.2 million for the six months ended June 29, 2013 from \$11.5 million for the six months ended June 30, 2012 as a result of the factors described above.

### **Liquidity and Capital Resources**

Cash and cash equivalents increased by \$18.1 million to \$111.3 million at June 29, 2013, from \$93.2 million at December 31, 2012. The increase was primarily attributable to net income and non-cash expenses of \$15.5 million, proceeds from stock option exercises of \$3.1 million, and a decrease in working capital of \$3.6 million, partially offset by \$1.7 million in purchases of equipment and intangible assets for the six months ended June 29, 2013.

On July 11, 2006, the Company entered into a loan agreement providing for an available line of credit of \$30.0 million, which was most recently amended effective March 15, 2012. Loans under the Amended and Restated Loan Agreement, as amended, bear interest at the rate of LIBOR plus a fixed percentage between 1.50% and 2.00% and require the Company to maintain a minimum cash balance and tangible net worth measured at the end of the Company's fiscal quarters. As of June 29, 2013, the Company was in compliance with all of the covenants under the Amended and Restated Loan Agreement, as amended. The term of the Amended and Restated Loan Agreement, as amended, extends to March 31, 2015. The Company has not drawn on this line of credit.

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

The Company has no off balance sheet arrangements.

### **Critical Accounting Policies**

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

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

#### Revenue Recognition

Revenue related to the Company's measurement equipment and related software is generally recognized upon shipment, as the Company considers the earnings process 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 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 over the life of the plan. The Company warrants its products against defects in design, materials and workmanship for one year. A provision for estimated future costs relating to warranty expense is recorded when products are shipped. Costs relating to extended maintenance plans are recognized as incurred. Revenue from the licensing agreements for the use of the Company's historical technology for medical applications is recognized when the technology is used by the licensees.

#### Reserve for Excess and Obsolete Inventory

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

## Table of Contents

### Income Taxes

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

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

### Reserve for Warranties

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

### Goodwill Impairment

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

The Company first performs a qualitative assessment to determine whether it is necessary to perform the two-step goodwill impairment test. If the Company believes, as a result of its qualitative assessment, that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then the first and second steps of the goodwill impairment test are unnecessary.



## [Table of Contents](#)

If necessary, as a result of the qualitative assessment, the goodwill impairment test is applied using a two-step approach. In performing the first step, the Company calculates the fair values of the reporting units using discounted cash flows (“DCF”) of each reporting unit. If the carrying amount of the reporting unit exceeds the fair value, the second step is performed to measure the amount of the impairment loss, if any. In the second step, the implied fair value of the goodwill is estimated as the fair value of the reporting unit as calculated in the first step, less the fair values of the net tangible and intangible assets of the reporting unit other than goodwill. If the carrying amount of goodwill exceeds its implied fair value, an impairment loss is recognized in an amount equal to that excess, not to exceed the carrying amount of the goodwill. Management has concluded there was no goodwill impairment in the six months ended June 29, 2013 or the year ended December 31, 2012.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

#### ***Foreign Exchange Exposure***

The Company conducts a significant portion of its business outside the United States. As of June 29, 2013, 60.1% of its revenues were invoiced, and a significant portion of its operating expenses paid, in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on the Company’s results of operations and financial condition, and could specifically result in foreign exchange gains and losses. The impact of future exchange rate fluctuations on the results of the Company’s operations cannot be accurately predicted. To the extent that the percentage of its non-U.S. dollar revenues derived from international sales increases (or decreases) in the future, the Company’s exposure to risks associated with fluctuations in foreign exchange rates may increase (or decrease). The Company is aware of the availability of off-balance sheet financial instruments to hedge exposure to foreign currency exchange rates, including cross-currency swaps, forward contracts and foreign currency options. However, it does not regularly use such instruments, and none were utilized in the six months ended June 29, 2013.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to the Company’s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, the Company’s management carried out an evaluation, under the supervision and with the participation of its Chief Executive Officer and its Chief Financial Officer, of the effectiveness of the Company’s disclosure controls and procedures. Based upon that evaluation, the Company’s Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures, as defined by Rule 13a-15(e) under the Exchange Act, were effective as of June 29, 2013.

#### **Changes in Internal Control Over Financial Reporting**

There were no changes in the Company’s internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended June 29, 2013 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**

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

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

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

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

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

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

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

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

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[Table of Contents](#)

**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 the Company’s Form 10-K for the year ended December 31, 2012, as filed with the SEC. These risks could materially and adversely affect the Company’s business, financial condition, and results of operations. The risks described in the Company’s Form 10-K for the year ended December 31, 2012 are not the only risks it faces. The Company’s operations could also be affected by additional factors that are not presently known to the Company or by factors that it currently considers immaterial to its business.

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

**Purchases of Equity Securities by the Issuer Under the Share Repurchase Plan**

On November 24, 2008, the Company’s Board of Directors approved a \$30 million share repurchase program. Acquisitions for the share repurchase program will be made from time to time at prevailing prices as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The share repurchase program may be discontinued at any time. There is no restriction date or other restriction governing the period over which the Company can repurchase shares under the program. The Company made no stock repurchases during the six month period ended June 29, 2013 under this program.

## [Table of Contents](#)

### Item 6. Exhibits

3.1	Articles of Incorporation, as amended (Filed as Exhibit 3.1 to Registrant's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference)
3.2	Amended and Restated Bylaws (Filed as Exhibit 3.1 to Current Report on Form 8-K, dated February 3, 2010 and incorporated herein by reference)
4.1	Specimen Stock Certificate (Filed as Exhibit 4.1 to Registrant's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference)
10.1	Agreement of Lease, dated June 15, 2013, by and between 290 National Road Limited Partnership and Faro Technologies, Inc.
31-A	Certification of the President and Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31-B	Certification of the Principal Financial and Accounting Officer Pursuant to Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32-A	Certification of the President and Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32-B	Certification of the Principal Financial and Accounting Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

**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: July 30, 2013

By: /s/ Keith S. Bair  
Keith S. Bair  
Senior Vice President and Chief Financial Officer  
(Duly Authorized Officer and Principal Financial Officer)

**EXHIBIT INDEX**

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**AGREEMENT OF LEASE****MULTI-TENANT BUILDING**

**THIS AGREEMENT OF LEASE**, by and between 290 National Road Limited Partnership organized and existing under the laws of Pennsylvania (herein called Landlord) and Faro Technologies Inc. organized and existing under the laws of Florida (herein called Tenant).

**WITNESSETH:**

**1. Premises.** As used herein the term Building shall mean the Building containing approximately 90,364 rentable square feet on a tract of land (herein called the Lot) located at 290 National Road, West Whiteland Township, PA (the Building, the Lot and any other improvements thereon being herein collectively called the Property). Landlord does hereby demise and lease unto Tenant and Tenant does hereby lease and take from Landlord for the term and upon the terms, covenants, conditions and provisions set forth herein all that certain portion of the Building located on the west end of the Building containing 68,240 square feet, with Tenant's Proportionate Share equal to 75.55% of the Building and as shown outlined in red on Exhibit A (herein called "Floor Plan Outline") hereto which shall be completed in accordance with Article 2 hereof (herein called the Premises) together with the right, in common with other occupants of the Building, to use all driveways, sidewalks, and parking areas in common on the Lot. The common areas of the Lot are depicted on Exhibit A-1 attached hereto and shall not be re-configured or altered by Landlord without the prior written consent of Tenant. During the Term (defined below), Landlord shall make available to Tenant, its employees, customers and visitors a number of automobile parking spaces (on an unassigned, non-exclusive basis) in the parking areas of the Property based on a formula of two (2) parking space for each one thousand (1,000) square feet of area contained in the Premises rounded to the nearest whole number of spaces. Such parking shall be at no additional cost to Tenant. Within thirty (30) calendar days after substantial completion of the Premises, either party may have the Premises and Building measured by an architect using accepted BOMA Standards, based on the Industrial Standard Method A, Exterior Wall method which generally provides for measurement to the outside of exterior walls to calculate areas. The architect is subject to the other party's prior approval. The square footage so certified by such architect shall conclusively determine the square footage of the Building and the Premises for all purposes under this Lease, including, without limitation, calculation of minimum annual rent. If the Building square footage and the Premises square footage differ from the amounts set forth above, the minimum annual rent shall be adjusted on the basis of the square footage of the Building and the Premises so certified by such architect, using a rental rate of \$8.45 per square foot. In addition, Tenant's Proportionate Share shall be adjusted as necessary. If neither party elects to have the Demised Premises and Building measured in accordance with this Section 1, then neither minimum annual rent nor Tenant's Proportionate Share shall be adjusted.

**2. Completion by Landlord.** The Premises shall be completed by Landlord in accordance with the plans attached hereto as Exhibit B (herein called the Plans) and the specifications attached hereto as Exhibit C (herein called the Specifications) and to the extent required by the work letter attached hereto as Exhibit "D"; the cost of which shall be reimbursed to Landlord by Tenant in accordance with the terms of Exhibit "D". All necessary construction shall be commenced promptly and shall be Substantially Completed (as defined below) ready for use and occupancy by Tenant on the date set forth in Article 3. Provided, however, that the time for Substantial Completion of the Premises shall be extended for additional periods of time equal to the time lost by Landlord or Landlord's contractors, subcontractors or suppliers which are not within the reasonable control of such parties and which are due to strikes or other labor troubles, governmental restrictions and limitations, scarcity, unavailability or delays in obtaining fuel, labor or materials, war or other national emergency, accidents, floods, defective materials, fire damage or other casualties, adverse weather conditions, or any cause similar or dissimilar to the foregoing beyond the reasonable control of Landlord or Landlord's contractors, subcontractors or suppliers (any of the foregoing being referred to herein as "Force Majeure Delay"). All construction shall be done in a good and

workmanlike manner and shall comply at the time of completion with all applicable and lawful laws, ordinances, regulations and orders of the federal, state, county or other governmental authorities and private agreements affecting the Premises (collectively, "Governmental Requirements") having jurisdiction thereof. Landlord hereby warrants and guarantees the Premises against defective workmanship and materials for the one (1) year period following completion of the Premises (including punchlist items), including specifically, without limitation, that (i) the materials and equipment furnished by Landlord's contractors in the completion of the Premises will be of good quality and new, (ii) the Premises will be constructed in accordance with the final Specifications (as adjusted by approved change orders) in a good and workmanlike manner, (iii) such materials and equipment and the work of such contractors shall be first quality new materials, free from defects not inherent in the quality required or permitted hereunder; and (iv) the Premises shall be delivered to Tenant free of all mechanics' and materialmen's liens and encumbrances and in compliance with all legal requirements. Landlord shall also pass through to Tenant all materialman and equipment warranties for the Premises received by Landlord. Tenant and its authorized agents, employees and contractors shall have the right, at Tenant's own risk, expense and responsibility, at all reasonable times prior to the Commencement Date as hereinafter defined, to enter the Premises for the purpose of taking measurements and installing its furnishings and equipment; provided that Tenant, in so doing, shall not interfere with or delay the work to be performed hereunder by Landlord, and Tenant shall use contractors and workmen compatible with the contractors and workmen engaged in the work to be performed hereunder by Landlord, and Tenant shall have obtained Landlord's written consent, not to be unreasonably withheld, conditioned or delayed prior to installing any furnishings or equipment. Prior to the commencement of any work, Tenant shall furnish to Landlord the certificates of insurance and shall comply with all requirements set forth in the Tenant Construction Insurance Requirements attached as Exhibit E.

**3. Term. (a)** The term of this Lease shall commence on the latter of July 15th, 2014 or on the date when the Premises and the improvements required to be constructed by Landlord under Article 2 hereof have been Substantially Completed (herein called the "Commencement Date"). For purposes of this Paragraph 3, "Substantially Completed" shall mean the first date of the calendar month following all of the following events: (a) the improvements required to be constructed by Landlord under Article 2 have been substantially completed in accordance with Exhibits B and C, except for minor finish and punch-list work that will not prevent the Tenant's use and occupancy of the Premises, and (b) a certificate of occupancy has been issued for the Premises by the Township of West Whiteland. If the date of Substantial Completion is delayed as a result of changes requested by Tenant after approval of the Plans and Specifications, the term of the Lease shall commence on the date that Substantial Completion would have occurred if not for such changes, as extended for reasons other than those caused by Tenant. Unless sooner terminated or extended in accordance with the terms hereof, the term of this Lease shall end without the necessity for notice from either party to the other at 12:01 a.m. local time on the tenth (10th) anniversary of the first date of the first full calendar month following the date of Substantial Completions (herein called the "Expiration Date"). The parties shall promptly execute a Term Commencement Agreement to memorialize the Commencement Date in the form attached hereto as Exhibit F.

**(b) Early Occupancy.** Tenant and its authorized agents, employees and contractors shall, at all reasonable times on or after the date which is thirty (30) days prior to the Commencement Date, have the right, at Tenant's own risk, expense and responsibility, to occupy the Premises for the performance of Tenant's Work, provided that in so doing Tenant shall not interfere with or delay any work to be performed by Landlord regarding construction of the Building shell. Landlord agrees to reasonably cooperate with Tenant to allow for the performance of Tenant's Work. If Tenant occupies the Premises for the performance of Tenant's Improvement Work prior to the Commencement Date, Tenant shall abide by the terms and conditions of this Lease including payment of Impositions, insurance premiums and the cost of repairs and maintenance, or any sums designated herein as additional rent, as if the term of this Lease had already commenced, except that Tenant shall have no obligation to pay the minimum annual rent until the Commencement Date.



**(b) Renewal Term.**

(i) Tenant shall have the option (the "Renewal Option") to renew this Lease for three (3) additional terms of five (5) years each (each a "Renewal Term"). The Renewal Option shall be exercised by giving Landlord written notice (the "Option Notice") at least two hundred seventy (270) days prior to the end of the original term of this Lease or the then current Renewal Term. The Renewal Term shall be on the same terms and conditions as set forth in this Lease, except those regarding the payment of minimum annual rent for the Renewal Term which shall be ninety-five percent (95%) of the then fair market rent payable for similar industrial space in the Exton, PA area ("Fair Market Rent") in its shell condition (Fair Market Rent shall not take into account any increase in the rental value of the Premises associated with any improvements to the space beyond the shell). However, in no event shall the minimum annual rent for the first lease year of a Renewal Term be less than One Hundred three percent (103%) of the minimum annual rent payable for the last lease year of the original term or the last year of the applicable prior Renewal Term. Based upon the first lease year's rent of each Renewal Term, the minimum annual rent for each remaining lease year of each Renewal Term shall increase by three percent (3%) each year commencing on the anniversary of the prior lease year. In the event Tenant exercises the Renewal Option, "Term" shall be defined to include such extension. In the event Tenant shall desire to enter into a lease for the Premises beyond the Renewal Terms, Landlord and Tenant mutually reserve the right to renegotiate the terms and conditions of such lease.

**(ii) Determination of Fair Market Rent.**

(1) In the event Tenant elects to exercise a Renewal Option, then during the period (the "Analysis Period") beginning on the date of exercise and ending thirty (30) days thereafter, the parties shall, in good faith, attempt to determine and agree upon the Fair Market Rent.

(2) In the event that Landlord and Tenant are unable, within the Analysis Period, to agree upon the Fair Market Rent, the Fair Market Rent shall be determined by the following appraisal mechanism: During the first two weeks following the Analysis Period, Landlord and Tenant shall attempt to agree upon a single appraiser who shall be MAI certified and have a minimum of five (5) years experience in the greater Exton area in real estate leasing or appraisal of leases in similar industrial buildings in the greater Exton area and who has not conducted within the previous three years, does not presently conduct, and does not anticipate conducting, a material amount of business with either Landlord or Tenant or their Affiliates or lenders, or otherwise has a financial interest in or with either Landlord or Tenant or their Affiliates and who is otherwise independent (the "Appraiser Qualifications"). If Tenant and Landlord are unable to agree upon a single appraiser within said two week period, then Landlord and Tenant shall draw by lot to determine which of them (the "First Party") within the following seven (7) days shall provide the other party (the "Second Party") with the names and qualifications of three (3) appraisers who are acceptable to the First Party and who meet the Appraiser Qualifications. Such list shall be accompanied by a statement of all business conducted by each such proposed appraiser with the First Party within the previous three years. The Second Party within fifteen (15) days thereafter shall select one of the three (3) appraisers and shall notify the First Party in writing of its selection. The appraiser so selected shall be the appraiser hereunder. The parties shall share equally in the cost of the appraiser.

(3) Within fifteen (15) days following the selection of the appraiser, Landlord and Tenant shall each notify the other (but not the appraiser) of their determination of the Fair Market Rent. During the next seven (7) days, both Landlord and Tenant shall prepare a written critique of the other's determinations and on the seventh day Landlord and Tenant shall deliver to each other their written critiques. On the tenth (10th) day following delivery of the critiques to each other, Landlord's and Tenant's determinations (as originally submitted to the other party, with no modifications or additions whatsoever permitted) and Landlord's and Tenant's critique shall be submitted to the appraiser. On and not before the fifteenth (15th) day thereafter, the appraiser shall determine the Fair Market Rent. Absent manifest error, the appraiser's decision shall be final, conclusive and binding on Landlord and Tenant.

**4. Use of Premises.** Tenant shall have the right to use the Premises for manufacturing, testing, assembling and selling of all lawful products, including, without limitation, measuring and testing equipment and general office space (the "Permitted Use"). Landlord hereby agrees that the Permitted Use and the improvements contemplated to be constructed are allowed by all Governmental Requirements.

**5. Minimum Annual Rent.**

**(a) Minimum Annual Rent.** Tenant shall pay a minimum annual rent of Five Hundred Seventy Six Thousand Six Hundred Twenty Eight dollars (\$576,628.00), or \$8.45 per square foot of Premises, without notice or demand, and without setoff, in equal monthly installments of Forty Eight Thousand Fifty Two dollars (\$48,052.33) in advance, on the first day of each calendar month during the Term of this Lease. Provided, however, that rent for the first full month shall be paid upon the signing of this Lease. If the Commencement Date shall fall on a day other than the first day of a calendar month, the rent shall be apportioned pro rata on a per diem basis for the period between the Commencement Date and the first day of the following calendar month and such apportioned sum shall be paid on such Commencement Date. In addition, Tenant shall pay Landlord without setoff the additional rent as hereinafter set forth. Unless otherwise specifically provided, all sums shall be paid to Landlord by electronic funds transfer at the Financial Institution of Landlord's choice which shall be identified to Tenant by Landlord prior to the Commencement Date. Tenant shall be entitled to rely on written direction from Gregory M. Walters or Charles Lyddane as Landlord's agent, with respect to such election by Landlord.

**(b) Adjustment.** The minimum annual rent shall be adjusted at the end of the second lease year and at the end of each succeeding lease year, effective the first day of the next succeeding lease year. The adjustment shall be calculated as follows:

**(i)** The increase shall be 3% per lease year, for the balance the original term of the Lease as specified in Exhibit F-1 of this Lease.

**(ii)** In addition, the increase during a Renewal Term shall be a minimum of 3% per lease year.

**6. Taxes and Other Impositions.:**

**(a) Payment.** As additional rent hereunder, Tenant shall pay a its Proportionate Share throughout the Term of this Lease all levies, taxes, assessments and all other charges, imposts or burdens, general or special, foreseen or unforeseen, whether or not particularized by name, ordinary or extraordinary, which are applicable to the term of this Lease, and which are created, levied, assessed, confirmed, adjudged, imposed or charged by any federal, state or municipal government or public authority, or under any law, ordinance or regulation thereof, or pursuant to any recorded covenants or agreements (all of which are hereinafter referred to as "Impositions") upon or with respect to the Premises or directly upon this Lease or the rent payable hereunder or amounts payable by any subtenants or other occupants of the Premises, or upon this transaction or any related documents to which Tenant is a party or successor in interest, or against Landlord because of Landlord's estate or interest herein. Additionally, Tenant shall pay as aforesaid a proportionate share as defined in Paragraph 33(h) of any Imposition which is not imposed upon the Premises as a separate entity but which is imposed upon the Lot, the Building or the Property or upon the appurtenances, leases, rents, transactions or documents relating to the Lot, the Building or the Property. Tenant shall pay its proportionate share of all impositions as an Operating Expense in accordance with the provisions of Article 10 of this Lease. In the event an Imposition is imposed directly on the Premises, Tenant shall be responsible to pay the full amount thereof which shall be billed to Tenant in the same manner as provided in Article 13.

**(b) New Methods of Taxation.** Nothing herein contained shall be interpreted as requiring Tenant to pay any income, excess profits, transfer, sales, revenue, corporate capital stock, franchise or margin tax imposed or assessed upon Landlord; Landlord shall timely pay all such taxes without reimbursement by Tenant. In addition, Tenant shall not be required to pay any increase in taxes due to a reassessment performed as a result of the sale or transfer of the Property during the initial Term of this Lease. Taxes payable by Tenant shall be calculated solely on any normal and ordinary increases in assessment valuation for the Property.

**(c) Monthly Deposits.** Notwithstanding the foregoing provisions of this Article 6, Tenant shall pay to Landlord (or to any mortgagee as directed by Landlord), at the time when the monthly installment of minimum rent is payable, an amount equal to one-twelfth (1/12th) of the annual Impositions as reasonably estimated by Landlord. Tenant also shall pay to Landlord or to such mortgagee, as the case may be, at least thirty (30) days before any fine, penalty, interest or cost may be added thereto for the non-payment thereof, the amount by which the Impositions becoming due exceed the monthly payments on account thereof previously made by Tenant. The amounts paid by Tenant pursuant to this Paragraph (c) shall be used to pay the Impositions, but such amounts shall not be deemed to be trust funds and no interest shall be payable thereon. Within one hundred twenty (120) days after the end of each calendar year, Landlord shall submit to Tenant a statement of the actual amount of Impositions for such calendar year, and the actual amount owed by Tenant, and within thirty (30) days after receipt of such statement, Tenant shall pay any deficiency between the actual amount owed and the estimates paid during such calendar year, or in the event of overpayment, Landlord shall credit the amount of such overpayment toward the next installment of rent owed by Tenant or remit such overpayment to Tenant within thirty (30) days if the Term has expired or has been terminated. The obligations in the immediately preceding sentence shall survive the expiration or any earlier termination of this Lease. If the Commencement Date shall fall on other than the first day of the calendar year, and/or if the Expiration Date shall fall on other than the last day of the calendar year, Tenant's proportionate share of the Impositions for such calendar year shall be apportioned prorata. Landlord may correct any statement of expense for twelve (12) months after it is initially issued (but not later).

**(d) Contest by Landlord.** Landlord may bring proceedings to contest the validity or amount of any Imposition or to recover payments therefore. Tenant shall reasonably cooperate with Landlord (at not cost to Tenant) with respect to such proceedings to the extent reasonably necessary. Landlord shall provide copies of bills for contested Impositions promptly upon Landlord's receipt of the same. If Landlord does not elect to contest Impositions for a particular period during the Term, Tenant may request that Landlord contest such Impositions by written notice to Landlord given, if at all, within sixty (60) days following Tenant's receipt of the statement delivered by Landlord to Tenant. Landlord may then elect either to contest such taxes or to allow Tenant to so contest such taxes subject to Landlord's reasonable approval of the firm or individual hired to conduct such contest. In either case, Tenant shall be responsible for all costs of contesting such taxes. Any resulting savings over and above the cost of such contest shall be distributed on a pro rata basis between Landlord, Tenant and the other tenants of the Building that contributed toward payment of the applicable tax bill.

## **7. Insurance.**

**(a) Insurance.** Landlord shall maintain and keep in effect throughout the term of this Lease insurance (100% replacement value) against loss or damage to the Building or the Property by fire and such other casualties as may be included within either fire and extended coverage insurance or all-risk insurance, boiler insurance, plate glass insurance, war risk insurance (when available) and such other insurance as Landlord may desire or as may reasonably be required from time to time by any mortgagee or as may be required generally by mortgage lending institutions. Tenant shall pay its proportionate share of the insurance premiums for the insurance coverages to be maintained by the Landlord pursuant to this Paragraph (a) as an Operating Expense in accordance with Article 10.

**(b) Liability.** Tenant, at Tenant's sole cost and expense, shall maintain and keep in effect throughout the Term insurance against liability for bodily injury (including death) or property damage in or about the Premises under a policy of comprehensive general liability insurance, with such limits as to each as may be reasonably required by Landlord from time to time, but not less than \$1,000,000 Per Occurrence and \$2,000,000 Aggregate and an Umbrella Policy with a limit of \$1,000,000. The policies of comprehensive general liability and Umbrella insurance shall name Landlord and Tenant as Additional Insured. Each such policy shall provide that it shall not be cancelable without at least thirty (30) days prior written notice to Landlord and to any mortgagee named in an endorsement thereto and shall be issued by an insurer and in a form satisfactory to Landlord. At least twenty (20) business days prior to the Commencement Date, a certificate of insurance shall be delivered to Landlord. If Tenant shall fail, refuse or neglect to obtain or to maintain any insurance that it is required to provide or to furnish Landlord with satisfactory evidence of coverage on any such policy, and such failure continues for ten (10) days following written notice of such failure by Landlord to Tenant, Landlord shall have the right to purchase such insurance. All such payments made by Landlord shall be recoverable by Landlord from Tenant, together with interest thereon, as additional rent promptly upon being billed therefor.

**(c) Waiver of Subrogation.** Each of the parties hereto hereby releases the other, to the extent of the releasing party's insurance coverage, from any and all liability for any loss or damage covered by such insurance which may be inflicted upon the property of such party even if such loss or damage shall be brought about by the fault or negligence of the other party, its agents or employees; provided, however, that this release shall be effective only with respect to loss or damage occurring during such time as the appropriate policy of insurance shall contain a clause to the effect that this release shall not affect said policy or the right of the insured to recover thereunder. If any policy does not permit such a waiver, and if the party to benefit therefrom requests that such a waiver be obtained, the other party agrees to obtain an endorsement to its insurance policies permitting such waiver of subrogation if it is available. If an additional premium is charged for such waiver, the party benefiting therefrom agrees to pay the reasonable amount of such additional premium promptly upon being billed therefor.

**(d) Increase of Premiums.** Tenant will not do anything or fail to do anything which will cause the cost of Landlord's insurance to increase or which will prevent Landlord from procuring policies (including but not limited to public liability) from companies and in a form satisfactory to Landlord. If any breach of this Paragraph (d) by Tenant shall cause the rate of fire or other insurance to be increased, Tenant shall pay the reasonable amount of such increase as additional rent promptly upon being billed therefore but only after Landlord has first provided documented evidence that Tenant has, in fact, directly cause any such increase. In addition, in the event the nature of Tenant's business shall cause Landlord's insurance to increase, Tenant shall pay the amount of such increase as additional rent promptly upon being billed therefore but only after Landlord has first provided written evidence that Tenant has, in fact, directly cause any such increase. Landlord hereby represents to Tenant that the Permitted Use will not cause the cost of Landlord's insurance to increase or prevent Landlord from procuring policies.

#### **8. Repairs and Maintenance.**

**(a)** Except as specifically otherwise provided in Paragraphs (b) and (c) of this Article, Tenant, at its sole cost and expense and throughout the Term of this Lease, shall keep and maintain the Premises in good order and condition, free of accumulation of dirt and rubbish, and shall promptly make all repairs necessary to keep and maintain such good order and condition, whether such repairs are interior or exterior, ordinary or extraordinary, foreseen or unforeseen. Tenant shall not use or permit the use of any portion of the Property for outdoor storage. When used in this Article 8, the term repairs shall include replacements and renewals when necessary. All repairs made by Tenant shall

utilize materials and equipment which are at least equal in quality and usefulness to those originally used in constructing the Building and the Premises. Tenant shall maintain all systems in the Premises. Tenant shall pay all costs of maintenance of all systems in the Premises. Notwithstanding the other provisions of this Lease, Tenant shall not be required to make any capital repairs or capital replacements during the final two (2) years of the Lease.

**(b)** Landlord, throughout the Term of this Lease shall, at its sole cost and expense (without pass-through to Tenant) make all necessary repairs to the roof, floor slab, footings and foundations and the structural steel columns and girders forming a part of the Premises, provided, however, that Landlord shall have no responsibility to make any repair unless and until Landlord receives written notice of the need for such repair. Tenant shall not be required to pay for the cost of all repairs to be performed by Landlord pursuant to this Paragraph (b) as an Operating Expense in accordance with Article 10 or otherwise unless such repair is made necessary because of Tenant's wrongful or negligent acts or omissions or acts and omissions not intended in the design and engineering of the Building.

**(c)** Landlord, throughout the Term of this Lease, shall make all necessary repairs to the walls, exterior portions of the Premises and the Building, utility lines, plumbing lines, waste lines, fire protection systems, water lines and all equipment and other utility facilities in the Building (exclusive of any of the foregoing which is within the Premises and located above the floor slab), and to any driveways, sidewalks, curbs, loading, parking and landscaped areas, and all other exterior improvements and common areas on the Property which serve all of the tenants of the Building (herein collectively the common areas); provided, however, that Landlord shall have no responsibility to make any repairs unless and until Landlord receives written notice of the need for such repair. Tenant shall pay its proportionate share of the cost of all repairs to be performed by the Landlord pursuant to this Paragraph (c) as an Operating Expense in accordance with Article 10.

**(d)** Landlord shall keep and maintain all common areas of the Property and any sidewalks, parking areas, curbs and access ways adjoining the Property in a clean and orderly condition, free of accumulation of dirt, rubbish, snow and ice, and shall keep and maintain all landscaped areas in a neat and orderly condition. Tenant shall pay its proportionate share of the cost of all work to be performed by Landlord pursuant to this Paragraph (d) as an Operating Expense in accordance with Article 10.

**(e)** Notwithstanding anything herein to the contrary, repairs to the Premises and the Property made necessary by Tenant's specific use, manner of use or occupancy of the Property or by Tenant's installations in or upon the Property, or by any act or omission of Tenant or any employee, agent, contractor, or invitee of Tenant shall be made at the sole cost and expense of Tenant. Tenant shall not bear the expense of any repairs to the Premises or the Property arising out of or caused by any other tenant's use, manner of use or occupancy of the Property or by any other tenant's installations in or upon the Property, or by any act or omission of any other tenant or any other tenant's employees, agents, contractors or invitees.

**(f)** Tenant, at Tenant's cost, shall furnish janitorial services to the Premises during the Term of this Lease. Landlord shall furnish janitorial service to the common areas of the Property, if any. Tenant shall pay its proportionate share of the cost of such janitorial services to be furnished by Landlord pursuant to this Paragraph (f) as an Operating Expense in accordance with Article 10.

**(g)** The time for Landlord's performance of any of its obligations under this Lease shall be extended for additional periods of time equal to the time lost by Landlord or Landlord's agents, contractors, subcontractors or suppliers due to strikes or other labor troubles, governmental restrictions and limitations, scarcity, unavailability or delays in obtaining fuel, labor or materials, war or other national emergency, accidents, floods, defective materials, fire damage or other casualties, adverse weather conditions, or any cause similar or dissimilar to the foregoing beyond the reasonable control of Landlord or Landlord's agents, contractors, subcontractors or suppliers.

**9. Operating Expenses.** Tenant agrees to reimburse Landlord throughout the term of this Lease, as additional rent for Tenant's Proportionate Share of the actual costs and expenses paid or incurred in connection with the management, operation, maintenance and repair of the Property (herein called "Operating Expenses"), including:

(a) the reasonable cost of heating, ventilation, air conditioning, steam, electricity, gas, water, sewer service, mechanical, and other systems and all other utilities and the cost of supplies and equipment and maintenance and service contracts in connection therewith to the extent such systems and utilities are shared among tenants or maintained for the common benefit of the tenants of the Building ( it is acknowledged that the Premises contains substantially independent or sub-metered utility systems);

(b) the reasonable cost of repairs, replacements and maintenance and cleaning common areas of the Property including, without limitation, the cost of janitorial and other service agreements and trash removal and repairs and maintenance to the extent performed by Landlord pursuant to Paragraphs 8 (b) (c) and (d);

(c) reasonable wages, salaries, payroll taxes and other labor costs and employee benefits of all on-site employees, and all off-site employees to the extent engaged in the specific operation, management, maintenance and repair of the Property, including, taxes, reasonable insurance, retirement, and medical benefits;

(d) reasonable fees, charges and other costs, including, market-based property management fees, consulting fees, attorneys' fees and accounting fees of all contractors engaged by Landlord specifically in connection with the Property, and all such fees, charges or other costs charged by Landlord if Landlord performs management services in connection with the Property provided Landlord provides written evidence that such fees, charges and costs are reasonable and market-based;

(e) the cost of any capital improvements made to the Property after the date of this Lease intended to decrease Operating Expenses (but only to the extent of the actual decrease) (amortized over such reasonable period as determined by Generally Accepted Accounting Principles (GAAP) , together with interest on the unamortized balance(s) at the rate of five percent (5%) per annum as are actually be payable by Landlord on funds borrowed for the purpose of constructing and completing such capital improvements);

(f) the cost of any capital improvements made to the Property after the date of this Lease that are required under any governmental law or regulation that was not applicable to the Property at the date of this Lease (amortized over such reasonable period as determined by Generally Accepted Accounting Principles (GAAP)) (except to the extent specifically required due to the use of a portion of the Property by Landlord or another tenant, and not required due to the use of the Premises by Tenant), together with interest on the unamortized balance(s) at the rate of five percent (5%) per annum as are actually payable by Landlord on funds borrowed for the purpose of constructing and completing such capital improvements;

(g) the reasonable cost of supplies, materials, equipment and tools used in the management, operation, maintenance and repair of the Property, including, without limitation, any rental fees;

(h) all costs and fees for licenses, inspections or permits that Landlord may be required to obtain in connection with repairs the cost of which are permissible operating expense pass-throughs;

(i) reasonable costs of exterior and interior landscaping;

(j) intentionally omitted.

(k) reasonable fees, costs and disbursements incurred in connection with proceedings to contest, determine, or reduce Operating Expenses or real estate taxes and to the extent said expenses actually reduce Operating Expenses;

(l) all levies, taxes, assessments, and all other charges, imposts or burdens of whatsoever kind and nature, general or special, foreseen or unforeseen, whether or not particularized by name, ordinary or extraordinary, which are applicable to the term of this Lease, and which are created, levied, assessed, confirmed, adjudged, imposed or charged by any federal, state or municipal government or public authority, or under any law, ordinance or regulation thereof, or pursuant to any recorded covenants or agreements imposed upon the Property or upon the appurtenances, leases, rents, transactions or documents relating to the Property; and

(m) reasonable premiums for insurance against loss or damage to the Building or the Property by fire and such other casualties as may be included within either fire and extended coverage insurance or all-risk insurance, boiler insurance, plate glass insurance, war risk insurance (when available) and such other insurance as Landlord may desire or as may reasonably be required from time to time by any mortgagee or as may be required generally by mortgage lending institutions in accordance with Paragraph 7(a).

“Operating Expenses” shall not include the following (the “Operating Expense Exclusions”):

(aa) leasing and broker commissions, accountants’ or attorneys’ fees, costs and disbursements and other expenses incurred in connection with proposals, negotiations, or disputes with tenants or other occupants or prospective tenants or other occupants, or associated with the enforcement of any leases or the defense of Landlord’s title to or interest in the Building, Lot or any part thereof;

(bb) any costs incurred in renovating or otherwise improving or decorating, painting or redecorating space for tenants or other occupants or any vacant space in the Building except Common Areas (to the extent the Common Areas benefit all of the tenants in the Building);

(cc) (any costs incurred due to a violation by Landlord or any tenant of the terms and conditions of any lease in the Building, and interest and penalties on uncured violations of any law, statute, rule or regulation applicable to the Building or any covenant, condition or restriction applicable to the Building;

(dd) capital improvement costs, interest on debt or amortization payments on any mortgages or deeds of trust or any other borrowings of Landlord (except as specifically allowed by by Section 9(e) or 9(f) of this Lease);

(ee) capital expenditures, and any other expense that under generally accepted accounting principles and practices would not be considered a maintenance or operating expense;

(ff) salaries, benefits or other compensation paid to leasing agents, promotional directors, officers, directors and executives of Landlord above the rank of building manager, or not specifically and actively involved in the day-to-day operations or management of the Building;

(gg) all contributions to any organizations, whether political or charitable;

(hh) any interest or penalties for late payments; any costs reimbursed by insurance unless disputed by third parties;

(ii) ground lease rental;

- (jj) the cost of remediating environmental contamination not caused by Tenant; and maintenance and repairs for which other tenants are responsible under their respective leases;
- (kk) Fees paid to affiliates of Landlord to the extent that such fees exceed the customary amount charged for the services provided;
- (ll) Intentionally omitted.
- (mm) Costs of providing janitorial services and trash removal to any leaseable areas of the Building, except as specifically required pursuant to Article 8 (f);
- (nn) Reserves;
- (oo) Business interruption insurance and rental value insurance, except as required pursuant to Article 7 (a);
- (pp) Landlord's general corporate overhead and administrative expenses except if it is solely for the Building;
- (qq) A property management fee for the Building not higher than those for comparable buildings in the Exton Area based upon market rates charged by local property management firms (exclusive of capital expenditures, tenant reimbursements and ancillary income from other tenants [e.g., income from antennae, or satellite dishes, paid parking, security deposits and interest thereon, etc., and exclusive of such property management fee]) for the relevant calendar year;
- (rr) Expenses for any item or service not provided to Tenant, but provided exclusively to certain other tenants in the Building;
- (ss) Expenses for any item or service which Tenant pays directly to a third party or separately reimburses Landlord and expenses incurred by Landlord to the extent the same are reimbursable or reimbursed from any other tenants, occupants of the property or third parties;
- (tt) Cost of correcting any latent defects or original design defects in the Building shell and Building systems construction, labor or materials as part of Landlord's work in connection with construction of the Building shell;
- (uu) Cost of repairs necessitated by Landlord's negligence or willful misconduct;
- (vv) Cost to correct any penalty or fine incurred by Landlord due to Landlord's violation of any federal, state, or local law or regulation and any interest or penalties due for late payment by Landlord of any of the Building Operating Expenses;
- (ww) Expenses for the replacement of any item covered under warranty;
- (xx) Expenses incurred by Landlord for repairs or other work occasioned by fire, windstorm, or other insurable casualty or condemnation;



(yy) Intentionally omitted; and

(zz) Other items not customarily included as operating expenses for similar buildings.

Landlord shall at all times use commercially reasonable efforts to operate the Property in a commercially reasonable manner at costs not disproportionately higher than those experienced by other comparable buildings in the greater Exton, PA area.

**10. Payment of Tenant's Share of Operating Expenses.** Commencing on the Commencement Date, Tenant shall pay to Landlord as additional rent one twelfth (1/12th) of Tenant's Proportionate Share of Operating Expenses for each calendar year on or before the first day of each month during such calendar year, in advance, in an amount reasonably estimated by Landlord in good faith and billed by Landlord to Tenant. Landlord shall have the right to revise such estimate from time to time. Within one hundred twenty (120) days after the end of each calendar year, Landlord shall furnish Tenant with a statement ("Landlord's Operating Expense Statement"), setting forth the actual amount of Operating Expenses and Impositions for such calendar year, and Tenant's Proportionate Share of Operating Expenses. If the actual amount of Tenant's Proportionate Share of Operating Expenses and Impositions due for such calendar year differs from the estimated amount of Tenant's Proportionate Share of Operating Expenses and Impositions paid by Tenant for such calendar year, then, if Tenant owes any amounts to Landlord, such amounts shall be paid by Tenant (whether or not this Lease has terminated) within thirty (30) days after receipt of Landlord's Operating Expense Statement, and if Landlord owes any amounts to Tenant, such amounts shall be credited against the next installments of Base Rent and Additional Rent due from Tenant (or if the Lease has terminated for any reason other than Tenant's default, paid to Tenant within thirty (30) days after delivery of Landlord's Operating Expense Statement); provided, however, that in no event shall Operating Expenses actually payable for a given calendar year be less than zero. Notwithstanding the foregoing, for purposes of computing Tenant's payment of Operating Expenses, the "Controllable Operating Expenses," as defined herein, for any lease year shall not include an increase of more than three percent (3%) over such Operating Expenses for the preceding lease year. "Controllable Operating Expenses" shall mean all Operating Expenses (including accounting services, storm water inspections for the first five years of the term of this Lease, window cleaning twice a year, Building and cleaning supplies, sprinkler backflow and alarm inspection, pest control and trash removal) other than real estate taxes, assessments, governmental fees, general repairs and Property maintenance, all utility usage charges and related expenses, snow removal and insurance premiums.

**11. Objections to Statements.** Tenant acknowledges that Landlord's ability to budget and incur expenses depends on the finality of Landlord's tax statements and Landlord's Operating Expense Statements, and Tenant shall have one year following receipt of any such statement within which to raise any objection to the calculations contained in any such statement. Failure of Tenant to object within such one year period shall be deemed a waiver of any such objection. Tenant shall continue to make all payments required under this Lease pending resolution of any such objection. If Tenant makes a timely objection within the said one year period, Landlord and Tenant shall use reasonable efforts and due diligence in attempting to resolve such dispute within a reasonable time. No delay by Landlord in providing any statement shall be deemed a default by Landlord or a waiver of Landlord's right to require payment of Tenant's obligations for actual or estimated Impositions or Operating Expenses; provided however that (i) Landlord shall be estopped from correcting or issuing a new charge more than one (1) year following the end of the year in which the charge was incurred and (ii), should Landlord delay in providing any statement or document related to an objection by Tenant, the objection period shall be extended on a day for day basis,

**12. Tenant's Review.** Tenant may, within one (1) year after receiving Landlord's Operating Expense Statement for any year, have the right upon written request to review Landlord's books and records relating to Operating Expenses for such year. Within thirty (30) days, after receipt of Tenant's notice, Landlord shall make such books and

records available to Tenant at either Landlord's home office or at the Building. Tenant shall be solely responsible for all costs and expenses incurred in connection with such review and may utilize any and all resources available to it to validate and verify Operating Expenses. If Tenant's inspection proves that Landlord's calculation of Tenant's share of Operating Expenses for the inspected calendar year resulted in an overpayment by more than five percent (5%) of Tenant's share, Landlord shall also pay the reasonable fees and expenses of Tenant's independent professionals, if any, conducting said inspection. Tenant shall treat as confidential all information obtained by Tenant in conducting such review.

**13. Utility Charges.** Tenant shall be solely responsible for and shall pay promptly all rents, costs and charges for water service, sewer service, gas, electricity, light, heat, steam, power, telephone and other communication services, and any and all other utilities or services rendered to or servicing the Premises. All utilities are separately metered, except water and sewer.

**14. Net Lease.** Except for the obligations of Landlord expressly set forth herein, this Lease is a net lease and Landlord shall receive the minimum annual rent as hereinabove provided as net income from the Premises, not diminished by any Imposition or any expenses or charges required to be paid to maintain and carry the Premises and the Property or to continue the ownership of Landlord other than payments under any mortgages now existing or hereafter created by Landlord, and Landlord is not and shall not be required to render any services of any kind to Tenant.

**15. Governmental Regulations.** (a) Throughout the Term of this Lease and at its sole cost and expense, Tenant shall: (i) comply promptly with all laws, ordinances, notices, orders, rules, regulations and requirements of all federal, state and municipal governments and all departments, commissions, boards and officers thereof, and of the National Board of Fire Underwriters or any other body now or hereafter constituted exercising similar functions; and (ii) keep in force at all times all licenses, consents and permits necessary for the lawful use of the Premises for the purposes herein provided; and (iii) comply with the requirements of all public liability, fire and other policies of insurance covering the Premises whether any of the foregoing are foreseen or unforeseen, ordinary or extraordinary. Provided, however, that Tenant shall not be required to comply with the foregoing laws, ordinances and notices with respect to the footings and foundations and the structural steel columns and girders forming a part of the Premises (Landlord will comply with same at its sole cost and expense) unless the need for such compliance arises out of or is caused by Tenant's particular use, manner of use or occupancy of the Premises (as opposed to general use by any tenant of similar space), or by Tenant's installations in or upon the Premises or by any act or omission of Tenant or any employee, agent, contractor or invitee of Tenant. Without limiting the generality of the foregoing, Tenant shall comply with the requirements of (a) the Occupational Safety and Health Act (and all regulations promulgated thereunder), and (b) the Americans with Disabilities Act (and all regulations promulgated thereunder), as the same may be amended from time to time (collectively, the "Act"). Notwithstanding the foregoing, Landlord, at its sole cost and expense, shall be responsible for causing any work completed by it pursuant to this Lease to comply with Title III of the Americans With Disabilities Act of 1990 (the "ADA"), or the regulations promulgated thereunder (as said Title III is in effect and pertains to the general public), as of the Lease Commencement Date. The Act may require, among other things, that the Premises be designed to remove architectural barriers so that the Premises will be readily accessible to people with disabilities, on the same basis as the Premises are accessible to those without such disabilities. The foregoing obligation of Tenant shall not however permit Tenant to make, without Landlord's prior written approval, any alterations to the Premises which otherwise would require Landlord's approval under this Lease, and Tenant shall comply with all of the requirements of this Lease in making any such alterations.

**(b) Hazardous Materials.**

“Hazardous Substance” shall mean any hazardous or toxic substance, material or waste which is or becomes regulated by any local, state or federal governmental authority having jurisdiction. The term “Hazardous Substance” includes, without limitation, any material or substance which is (i) designated as a “hazardous substance” pursuant to Section 311 of the Federal Water Pollution Control Act (33 U.S.C. Section 1317), (ii) defined as a “hazardous waste” pursuant to Section 1004 of the Resource Conservation and Recovery Act, 42 U.S.C. Section 6901 et seq. (42 U.S.C. Section 6903), (iii) defined as a “hazardous substance” pursuant to Section 101 of the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. Section 9601 et seq. (42 U.S.C. Section 9601), (iv) petroleum or (v) asbestos or asbestos-containing materials.

Tenant shall not cause or suffer or allow any Hazardous Substances, to be brought upon, kept, used, discharged, deposited or leaked in or about the Premises or the Property by Tenant or any of Tenant’s contractors, employees or invitees or by anyone in the Premises (other than Landlord or its agents, employees or contractors) (“Tenant Parties”), except to the extent such Hazardous Substances are customarily kept or used by typical office tenants. If Tenant or its agents discharge Hazardous Substances upon the Property which results in contamination of the Premises or the Property, then Tenant shall indemnify, defend and hold Landlord harmless from any and all claims, judgments, damages, penalties, fines, costs, liabilities, expenses and losses (including, but not limited to, diminution in value of the Property using a fair market appraisal of the Landlord’s interest in the Property, damages for the loss or restriction on use of leasable space or of any amenity of the Building, damages arising from any adverse impact on marketing of space and sums paid in settlement of claims, attorneys’ fees, consultant fees and expert fees) which arise during or after the Term as a result of such contamination. This indemnification shall include, without limitation, costs incurred in connection with any investigation of site conditions or any clean-up, remedial, removal or restoration work required by any federal, state or local governmental agency or political subdivision because of any Hazardous Substance present in the soil or groundwater on or under the Property. Tenant’s obligations hereunder shall survive the termination or expiration of this Lease.

Landlord represents and warrants to Tenant, to the best of Landlord’s knowledge based upon that certain Phase I Environmental Site Assessment 290 National Road Exton Pennsylvania prepared by ePhase and dated April 26, 2007 and revised June 14, 2013, that as of the Commencement Date the Property does not contain Hazardous Materials in excess of legally permitted maximum thresholds. If at any time it is determined that the Property is contaminated with Hazardous Materials (whether caused before or after the date on which the parties entered in to this Lease), so long as such contamination is not caused by Tenant or Tenant Parties, Landlord will, at its sole cost and expense, diligently pursue such remediation activities for any contamination as required by law (“Remediation Activities”), (and the costs thereof shall not be charged to Tenant through operating expenses or otherwise). Landlord’s obligations pursuant to this paragraph shall survive the expiration or termination of this Lease, and Landlord shall indemnify Tenant with respect to any costs that Tenant must incur in connection with Remediation Activities to comply with legal requirements so long as Tenant has not caused the environmental condition necessitating the Remediation Activities.

Landlord and Tenant will immediately notify the other of any violation of any environmental laws or the release or suspected release of Hazardous Materials in, under or about the Property of which such party has actual knowledge, and both parties shall immediately deliver to the other a copy of any notice, filing or permit sent or received with respect to the foregoing. Landlord hereby represents and warrants to Tenant that Landlord has provided Tenant with copies of all environmental reports or assessments related to the Property prepared for Landlord or in the possession of Landlord or Landlord’s property manager. Notwithstanding the foregoing, if the Remediation Activities (a) result in the Premises being unusable for the reasonable conduct of Tenant’s business, (b) are not necessitated by the

wrongful acts or omissions of Tenant or its agents, and (c) continue for more than three (3) consecutive business days after Tenant notifies Landlord, then Tenant shall be entitled to a reasonable abatement of Rent (to the extent the Premises is unusable for the reasonable conduct of Tenant's business) accruing from and after the expiration of such three (3) consecutive business day period and continuing for so long as Tenant is so prevented from using the Premises. If the Premises are unusable by Tenant for one hundred twenty (120) or more days, then Tenant shall have the right to terminate this Lease.

**16. Signs.** Except for signs which are located wholly within the interior of the Premises and which are not visible from the exterior of the Premises, no signs shall be placed, erected, maintained or painted at any place upon the Premises without the prior written consent of Landlord as to the size, design, color, location, content, illumination, composition or material and mobility thereof. However, Landlord agrees to timely approve such Tenant exterior signage that is in compliance with the requirements of all governmental authorities. Landlord will review and approve such signage that is in compliance with the requirements of this Article and such signage shall be described and depicted on an Exhibit to be attached hereto. All signs shall be maintained by Tenant in good condition during the term of this Lease, and Tenant shall remove all signs at the termination of this Lease and shall repair and restore any damage caused by the installation or removal thereof, reasonable wear and tear excluded. In the event Tenant shall fail to adequately and reasonably maintain or repair its signage (including but not necessarily limited to, the sign causing damage, deterioration, discoloration or staining to the Building) Landlord shall have the right to make such repairs or maintenance and Tenant shall pay to Landlord as additional rent the reasonable cost of such repairs or maintenance promptly upon being billed therefor. Landlord will assist with, but Tenant shall be solely responsible for obtaining all governmental approvals associated with its signage. In addition, Tenant shall be solely responsible for all sign permit and/or license fees and all costs and expenses associated with Tenant's signage.

#### **17. Alterations, Additions and Fixtures.**

**(a)** Subject to the provisions of Article 18 hereof, Tenant shall have the right to install in the Premises any trade fixtures from time to time during the Term of this Lease; provided, however, that no such installation or removal thereof shall adversely affect the structural portion of the Premises and that Tenant shall repair and restore any damage or injury, if any, to the Premises or the Property caused thereby.

**(b)** Tenant shall not make or permit to be made any alterations, improvements or additions that do not affect the structural portion of the Premises in excess of \$50,000 without on each occasion first presenting to Landlord plans and specifications therefor and obtaining Landlord's prior written consent thereto; except that Tenant may make minor nonstructural changes to the interior of the Premises without the consent of Landlord provided that: (i) Tenant supplies Landlord with plans and specifications and any necessary permits therefor at least ten (10) days in advance of commencing construction thereof; (ii) such alterations and improvements do not impair the structural strength of the Building or any other improvements or reduce the value of the Property; (iii) Tenant shall take or cause to be taken all steps that are required by Article 19 hereof and that are required or permitted by law in order to avoid the imposition of any mechanic's, laborer's or materialman's lien upon the Premises, Building or Lot; and (iv) the occupants of the Building and of any adjoining real estate are not annoyed or disturbed by reason thereof. Any and all alterations, improvements and additions to the Property which are constructed, installed or otherwise made by Tenant shall be the property of Tenant until the expiration or sooner termination of this Lease; at that time all such alterations and additions shall remain on the Property and become the property of Landlord without payment therefor by Landlord; unless, if requested by Tenant in writing at the time Landlord approves installation of the improvements, Landlord also gives written notice to Tenant whether it will be required to remove the same; in which event at the expiration or termination of this Lease Tenant will remove such alterations, improvements and additions, and repair and restore any damage to the Property caused by the installation or removal thereof if required by Landlord. In no event shall Tenant be required to remove approved Tenant's Work or any of the improvements installed by Landlord in connection with this Lease.

**18. Mechanics' Liens.** Tenant shall promptly pay any contractors and materialmen who supply labor, work or materials to Tenant at the Premises or the Property so as to minimize the possibility of a lien attaching to the Premises or the Property. Tenant shall take all steps permitted by law in order to avoid the imposition of any mechanic's, laborer's or materialman's lien upon the Premises, the Property or the Lot. Should any such lien or notice of lien be filed for work performed for Tenant other than by Landlord, Tenant shall bond against or discharge the same within fifteen (15) business days after the lien or claim has been issued regardless of the validity of such lien or claim. Nothing in this Lease is intended to authorize Tenant to do or cause any work or labor to be done or any materials to be supplied for the account of Landlord, all of the same to be solely for Tenant's account and at Tenant's risk and expense. Throughout this Lease the term mechanic's lien is used to include any lien, encumbrance or charge levied or imposed upon the Premises or the Property or any interest therein or income therefrom on account of any mechanic's, laborer's or materialman's lien or arising out of any debt or liability to or any claim or demand of any contractor, mechanic, supplier, materialman or laborer and shall include without limitation any mechanic's notice of intention given to Landlord or Tenant, any stop order given to Landlord or Tenant, any notice of refusal to pay naming Landlord or Tenant and any injunctive or equitable action brought by any person entitled to any mechanic's lien.

**19. Landlord's Right of Entry.**

(a) Tenant shall permit Landlord and the authorized representatives of Landlord and of any mortgagee or any prospective mortgagee to enter the Premises at all reasonable times after providing at least twenty-four (24) hours prior notice to Tenant and confirmation by Tenant (except in the event of an emergency) for the purpose of (i) inspecting them or (ii) making any necessary repairs thereto or to the Property and performing any work therein. Except as otherwise provided herein, during the progress of any work on the Premises or the Property Landlord will attempt not to inconvenience Tenant. If, due to the above-described entry and activities by Landlord a disturbance occurs which results in the Premises being unusable for the reasonable conduct of Tenant's business, then Tenant shall be entitled to a reasonable abatement of Rent (to the extent the Premises is unusable for the reasonable conduct of Tenant's business) continuing for so long as Tenant is so prevented from using the Premises.

(b) Landlord shall have the right at all reasonable times after providing at least twenty-four (24) hours prior notice to Tenant and confirmation by Tenant to enter and to exhibit the Premises for the purpose of sale or mortgage, and, during the last nine (9) months of the term of this Lease, to enter and to exhibit the Premises to any prospective tenant excepting any areas which may contain proprietary business fixtures, equipment, documents, plans, drawings, prototypes or files.

**20. Damage by Fire or Other Casualty.**

(a) If the Premises or Building shall be damaged or destroyed by fire or other casualty, Tenant shall promptly notify Landlord, and Landlord shall repair, rebuild or replace such damage and shall repair, rebuild or replace such damage and restore the Premises to substantially the same condition in which they were immediately prior to such damage or destruction.

(b) The work shall be commenced promptly and completed with due diligence, taking into account the time required by Landlord to effect a settlement with, and procure insurance proceeds from, the insurer, and for delays beyond Landlord's reasonable control.

(c) The net amount of any insurance proceeds (excluding proceeds received pursuant to a rental coverage endorsement) recovered by reason of the damage or destruction of the Property in excess of the cost of adjusting the insurance claim and collecting the insurance proceeds (such excess amount being hereinafter called the net insurance proceeds) shall be applied towards the full cost of restoration and Landlord shall pay for any shortfall without pass-through to Tenant. If the net insurance proceeds are more than adequate, the amount by which the net insurance proceeds exceed the cost of restoration will be retained by Landlord or applied to repayment of any mortgage secured by the Property. Notwithstanding the foregoing, in the event that the Premises are (i) in the reasonable opinion of Landlord, so destroyed that they cannot be repaired or rebuilt within one hundred twenty (120) days after the date of such damage, then Landlord shall give written notice to Tenant of such determination (the "Determination Notice") within thirty (30) days of such casualty. Either Landlord or Tenant may terminate and cancel this Lease effective as of the date of such casualty by giving written notice to the other party within thirty (30) days after Tenant's receipt of the Determination Notice. Upon the giving of such termination notice, all obligations hereunder with respect to periods from and after the effective date of termination shall thereupon cease and terminate. If no such termination notice is given, Landlord shall, to the extent of the available insurance proceeds, make such repair or restoration of the Premises to the approximate condition existing prior to such casualty, promptly and in such manner as not to unreasonably interfere with Tenant's use and occupancy of the Premises (if Tenant is still occupying the Premises). Notwithstanding the foregoing, in the event that Landlord is unable to substantially repair or restore the Premises in accordance with the Determination Notice on or before the date which is the one hundred eightieth (180<sup>th</sup>) day after such casualty as may be extended by Force Majeure Delay for up to sixty (60) days, Tenant may, at its option terminate this Lease by written notice to Landlord given within thirty (30) days following the expiration of such period, and thereafter neither Landlord nor Tenant shall have any further obligation hereunder except those which would otherwise survive a termination of the Lease.

(d) Landlord's obligation or election to restore the Premises under this Article shall not include the repair, restoration or replacement of the fixtures, improvements, alterations, furniture or any other property owned, installed, made by, or in the possession of Tenant.

(e) Landlord shall maintain a rental coverage endorsement or other comparable form of coverage as part of its fire and extended coverage or all-risk insurance policy. Tenant will receive an abatement of its minimum annual rent and all additional rent (including but not limited to payment of Impositions and Tenant's Proportionate Share of the Operating Expenses) during all times that the Premises or any part thereof cannot be used for the reasonable operation of Tenant's business.

**21. Non-Abatement of Rent.** Except as otherwise expressly provided in this Lease there shall be no abatement or reduction of the minimum rent, additional rent or other sums payable hereunder for any cause whatsoever, and this Lease shall not terminate, and Tenant shall not be entitled to surrender the Premises.

**22. Mutual Indemnification.** Except to the extent caused by the negligence or willful misconduct of Landlord or any Landlord Related Parties (defined below), Tenant shall indemnify, defend and hold Landlord, its trustees, members, principals, beneficiaries, partners, officers, directors, employees and agents (the "Landlord Related Parties") harmless against and from all liabilities, obligations, damages, penalties, claims, actions, costs, charges and expenses, including, without limitation, reasonable attorneys' fees and other professional fees (collectively referred to as "Losses"), which may be imposed upon, incurred by or asserted against Landlord or any of the Landlord Related Parties by any third party and (a) occasioned wholly or in part by any wrongful act or omission of Tenant, its agents, contractors, employees, licensees or invitees; unless such loss, injury or damage was caused by the negligence or willful misconduct of the Landlord, its agents, employees, licensees or invitees. (b) arising out of any negligence or willful misconduct of Tenant, the Tenant Related Parties (defined below) or any of Tenant's transferees, contractors, invitees or licensees; (c) arising out of any acts or omissions of Tenant, the Tenant Related Parties or any of Tenant's transferees,

contractors, invitees or licensees occurring during the performance of any demolition, construction, repair or maintenance work in the Building; or (d) any breach of this Lease by Tenant. Except to the extent caused by the negligence or willful misconduct of Tenant or any Tenant Related Parties, Landlord shall indemnify, defend and hold Tenant, its trustees, members, principals, beneficiaries, partners, officers, directors, employees and agents ("Tenant Related Parties") harmless against and from all Losses which may be imposed upon, incurred by or asserted against Tenant or any of the Tenant Related Parties by any third party and arising out of (a) any negligence or willful misconduct of Landlord, the Landlord Related Parties or any of Landlord's contractors; (b) any acts or omissions of Landlord, the Landlord Related Parties or any of Landlord's contractors occurring during the performance of any demolition, construction, repair or maintenance work in the Building; or (c) any breach of this Lease by Landlord.

**23. Condemnation. (a)** If any portion of the Premises or parking or points of access to the Property are taken or condemned for a public or quasi-public use, and the ability to utilize the Premises for Tenant's Permitted Use is materially and adversely affected then each of Landlord and Tenant shall have the right to terminate this Lease effective as of the date of such taking by giving written notice to the other party within thirty (30) days after such taking. Upon the giving of such termination notice, all obligations hereunder with respect to periods from and after the effective date of termination shall thereupon cease and terminate. If no such termination notice is given, Landlord shall, to the extent of the available condemnation proceeds, make such repair or restoration of the Premises as nearly as reasonably possible to the approximate condition existing prior to such taking, promptly and in such manner as not to unreasonably interfere with Tenant's use and occupancy of the Premises (if Tenant is still occupying the Premises). Notwithstanding the foregoing, in the event that Landlord is unable to substantially repair or restore the Premises in accordance with the Condemnation Determination Notice on or before the date which is one hundred twentieth (120<sup>th</sup>) day after such taking, as may be extended by Force Majeure Delay for up to sixty (60) days, Tenant may, at its option and as its sole remedy, terminate this Lease by written notice to Landlord given within thirty (30) days following the expiration of such period, and thereafter neither Landlord nor Tenant shall have any further obligation hereunder except those which would otherwise survive a termination of the Lease. In the event of a termination as described above, the Base Rent herein reserved and all Additional Rent and other sums payable hereunder shall be apportioned and paid in full by Tenant to Landlord to that date, all Base Rent, Additional Rent and other sums payable hereunder prepaid for periods beyond that date shall forthwith be repaid by Landlord to Tenant, and neither party shall thereafter have any liability hereunder, except that any obligation or liability of either party, actual or contingent, under this Lease which has accrued on or prior to such termination date shall survive.

**(c) Award.** In the event of a condemnation affecting Tenant, Tenant shall have the right to make a claim against the condemner for removal expenses, business dislocation damages and moving expenses and the costs of fixtures and equipment installed by Tenant; provided and to the extent, however, that such claims or payments do not reduce the sums otherwise payable by the condemner to Landlord. Except as aforesaid, Tenant hereby waives all claims against the condemner, and Tenant hereby assigns to Landlord all claims against the condemner including, without limitation, all claims for leasehold damages and diminution in value of Tenant's leasehold interest.

**24. Quiet Enjoyment.** Tenant, unless Tenant is in default which is uncured under this Lease, shall quietly have and enjoy the Premises during the Term of this Lease without hindrance or molestation by anyone claiming by or through Landlord, subject, however, to the exceptions, reservations and conditions of this Lease.

**25. Assignment and Subletting.**

**(a) Restricted Assignment.** Tenant shall not assign, mortgage, pledge or encumber this lease, or sublet the whole or any part of the Premises, without the prior written consent of Landlord which consent shall not be unreasonably

withheld, conditioned or delayed. This prohibition against assigning or subletting shall be construed to include a prohibition against any assignment or subletting by operation of law, and/or a transfer by any person or persons controlling Tenant on the date of the lease of such control to a person or persons not controlling Tenant on the date of the lease. In the event of any assignment of this Lease made with or without Landlord's consent, Tenant nevertheless shall remain liable for the performance of all of the terms, conditions and covenants of this Lease and shall require any assignee to execute and deliver to Landlord an assumption of liability agreement in form satisfactory to Landlord including an assumption by the assignee of all of the obligations of Tenant and the assignee's ratification of and agreement to be bound by all the provisions of this Lease. Landlord shall be entitled to, and Tenant shall promptly remit to Landlord, 50% of any profit which may inure to the benefit of Tenant as a result of any subletting of the Premises or assignment after deduction of any expenses related to assignment of this Lease.

**(b) Corporate or Partnership Transfers.** Tenant shall have the right, without the necessity of obtaining Landlord's consent, to: (i) assign this Lease to its parent or any wholly owned subsidiary of Tenant or to any entity controlled by or in common control with or controlling Tenant; or (ii) transfer the Lease by assignment, consolidation, or merger to or with, in the reasonable opinion of Landlord a reputable business entity having substantially the same credit worthiness of Tenant as of the date of execution of this Lease. Tenant shall provide reasonable written notice thereof to Landlord, but in no event less than thirty (30) days.

**(c) Percentage Agreements.** It is agreed that Tenant shall not enter into any assignment, sublease, license, concession or other agreement for use, occupancy or utilization of the whole or any part of the Premises with or without Landlord's consent, which provides for rental or other payment for such use, occupancy or utilization based, in whole or in part on the net income or profits derived by any person or entity from the space leased, used, occupied or utilized (other than an amount based on a fixed percentage or percentages of receipts or sales), and any such purported assignment, sublease, license, concession or other agreement shall be absolutely void and ineffective as a conveyance of any right or interest in the possession, use, occupancy or utilization of any part of the Premises.

#### **26. Subordination.**

(a) This Lease shall be subject and subordinate to the lien of any mortgage, deed of trust or ground lease hereafter placed on all or any part of the Property, provided that Landlord shall deliver to Tenant a Subordination, Non-Disturbance and Attornment Agreement in the form acceptable to Tenant executed by the holder thereof (a "Holder"). Upon execution by Tenant, Landlord shall record the SNDA in the appropriate governmental offices for giving notice of interests in real property for the city or county, as the case may be, where the Property is located (the "Recording Office"), at Landlord's sole cost.

(b) Simultaneously with the execution and delivery of this Lease, Landlord shall deliver to Tenant the SNDA executed by Landlord. Landlord shall deliver the SNDA as executed by the Holder of the first mortgage, encumbering the Property within five (5) days after the construction loan closing for the Property. Tenant shall execute the SNDA simultaneously with the execution of this Lease. Landlord shall, within ten (10) days after receipt of the fully executed SNDA record the SNDA in the appropriate Recording Office at Landlord's sole cost.

Tenant shall be entitled to rely upon any notice requesting that Tenant make all future rent payments to a Holder and Tenant shall not be liable to Landlord for any payment made to a Holder in accordance with such notice.

#### **27. Memorandum of Lease; Tenant's Certificate.**

(a) Tenant, at any time and from time to time and within ten (10) business days after Landlord's written request, shall execute, acknowledge and deliver to Landlord a short form or memorandum of this Lease or estoppel certificate for recording purposes.



(b) Tenant, at any time and from time to time and within ten (10) business days after Landlord's written request, so long as there are no material and substantial defects in the Premises which Landlord is obligated to remedy and which Landlord is not proceeding to remedy, and so long as Landlord is not otherwise in default of this Lease, shall execute, acknowledge and deliver to Landlord a written instrument in recordable form certifying that this Lease is unmodified and in full force and effect (or, if there have been modifications, that it is in full force and effect as modified and stating the modifications); stating that the improvements required by Article 2 hereof have been completed; certifying that Tenant has accepted possession of the Premises; stating the date on which the term of the Lease commenced and the dates to which minimum rent, additional rent and other charges have been paid in advance, if any; stating that to the best knowledge of the signer of such instrument Landlord is not in default of this Lease; stating any other fact or certifying any other condition reasonably requested by Landlord or required by any mortgagee or prospective mortgagee or purchaser of the Premises or any interest therein; and stating that it is understood that such instrument may be reasonably relied upon by any mortgagee or prospective mortgagee or purchaser of the Premises or any interest therein or by any assignee of Landlord's interest in this Lease or by any assignee of any mortgagee. The foregoing instrument shall be addressed to Landlord and to any mortgagee, prospective mortgagee, purchaser or other party specified by Landlord.

**28. Curing Tenant's Defaults.** If Tenant shall be in default in the performance of any of its obligations hereunder and Tenant does not commence such performance (and diligently pursue same) within thirty (30) days after written notice from Landlord, Landlord, without any obligation to do so, in addition to any other rights it may have in law or equity, may elect to cure such default on behalf of Tenant after written notice (except in the case of emergency) to Tenant. Tenant shall reimburse Landlord upon demand for any actual sums paid or costs incurred by Landlord in curing such default, which sums and costs together with interest thereon shall be deemed additional rent payable promptly upon being billed therefor. If Landlord does so cure such default, then upon payment by Tenant of the costs required by this Section 28, such default shall be deemed cured and Landlord shall have no further recourse with respect thereto.

**29. Surrender.**

(a) Subject to the terms of Paragraphs 17(b) and 20(a) and (c) hereof at the expiration or earlier termination of the term hereof, Tenant shall promptly yield up, clean and neat, and in the same condition, order and repair in which they are required to be kept throughout the term hereof, the Premises and all improvements, alterations and additions thereto, and all fixtures and equipment servicing the Building, ordinary wear and tear, casualty and condemnation excepted.

(b) If Tenant, or any person claiming through Tenant, shall continue to occupy the Premises after the expiration or earlier termination of the term or any renewal thereof, such occupancy shall be deemed to be under a tenancy-at-will under the same terms and conditions set forth in this Lease; except, however, that the minimum annual rent during such continued occupancy shall be one and one half the per diem amount set forth in Paragraphs 5 (a) and (b) hereof . Anything to the contrary notwithstanding, any holding over by Tenant without Landlord's prior written consent shall constitute a default hereunder and shall be subject to all the remedies set forth in Article 26 hereof.

**30. Defaults-Remedies.**

(a) **Tenant Defaults.** It shall be an event of default:

(i) If Tenant does not pay in full when due and without demand any and all installments of minimum rent or additional rent or any other charges or payments whether or not herein included as rent after the expiration of applicable notice and grace periods; or

(ii) If Tenant violates or fails to perform or otherwise breaches any agreement, term, covenant or condition herein contained after the expiration of applicable notice and grace periods; or

(iii) Intentionally omitted.

(iv) If Tenant becomes insolvent or bankrupt in any sense or makes an assignment for the benefit of creditors or offers a composition or settlement to creditors, or if a petition in bankruptcy or for reorganization or for an arrangement with creditors under any federal or state law is filed by or against Tenant, or a bill in equity or other proceeding for the appointment of a receiver, trustee, liquidator, custodian, conservator or similar official for any of Tenant's assets is commenced, or if any of the real or personal property of Tenant shall be levied upon by any sheriff, marshal or constable; provided, however, that any proceeding brought by anyone other than the parties to this Lease under any bankruptcy, reorganization arrangement, insolvency, readjustment, receivership or similar law shall not constitute a default until such proceeding, decree, judgment or order has continued unstayed for more than sixty (60) consecutive days.

(v) If any of the events enumerated in Paragraph (a)(iv) of this Article shall happen to any guarantor of this Lease;

**(b) Landlord Remedies.** Then, and in any such event, Landlord shall have the following rights:

(i) To charge a late payment penalty equal to the prime rate of interest as published by the Wall Street Journal plus five percent (5%) of any amount owed to Landlord pursuant to this Lease which is not paid within five (5) business days of the date which is set forth in the Lease if a date is specified, or, if a date is not specified, within thirty (30) days of the mailing of a bill therefore by Landlord. If Landlord incurs a penalty in connection with any payment which Tenant has failed to make within the times required in this Lease, Tenant shall pay Landlord, in addition to such sums, the full amount of such penalty incurred by Landlord. In the event the Wall Street Journal shall no longer publish the Prime Rate of interest, Landlord shall designate a substitute publication which publishes a substantially equivalent rate of interest.

(ii) Intentionally Omitted

(iii) To enter the Premises and without further demand or notice proceed to distress and sale of the goods, chattels and personal property were found and to levy the rent and other charges herein payable as rent, and Tenant shall pay all costs and officers' commissions which are permitted by law, including watchmen's wages and sums chargeable to Landlord, and further including commission(s) charged by the constable or other person making the levy, and in such case all costs, officers' commissions and other charges shall immediately attach and become part of the claim of Landlord for rent, and any tender of rent without said costs, commissions and charges made after the issuance of a warrant of distress, shall not be sufficient to satisfy the claim of Landlord.

(iv) To re-enter the Premises, together with all additions, alterations and improvements, and, at the option of Landlord, remove all persons and all or any property therefrom either by summary dispossession proceedings or by any suitable action or proceeding at law or by force or otherwise, without being liable for prosecution or damages therefor, and repossess and enjoy the Premises. Upon recovering possession of the Premises as a result of a default on the part of Tenant, Landlord may, at Landlord's option, either terminate this Lease or make such alterations and repairs as

may be necessary in order to relet the Premises and relet the Premises or any part or parts thereof, either in Landlord's name or otherwise, for a term or terms which may, at Landlord's option, be less than or exceed the period which would otherwise have constituted the balance of the term of this Lease and at such rent or rents and upon such other terms and conditions as in Landlord's sole discretion may seem advisable and to such person or persons as may in Landlord's discretion seem best; upon each such reletting all rents received by Landlord from such reletting shall be applied: first, to the payment of any costs and expenses of such reletting, including brokerage fees and attorney's fees and all costs of such alterations and repairs; second, to the payment of any indebtedness other than rent due hereunder from Tenant to Landlord; third, to the payment of rent due and unpaid hereunder; and the residue, if any, shall be held by Landlord and applied in payment of future rent as it may become due and payable hereunder. If such rentals received from such reletting during any month shall be less than that to be paid during that month by Tenant, Tenant shall pay any such deficiency to Landlord. Such deficiency shall be calculated and paid monthly. No such re-entry or taking possession of the Premises or the making of alterations or improvements thereto or the reletting thereof shall be construed as an election on the part of Landlord to terminate this Lease unless written notice of such intention be given to Tenant. Landlord shall in no event be liable in any way whatsoever for failure to relet the Premises or, in the event that the Premises or any part or parts thereof are relet, for failure to collect the rent under such reletting. Tenant, for Tenant and Tenant's successors and assigns, hereby irrevocably constitutes and appoints Landlord Tenant's and their agent to collect the rents due and to become due under all subleases of the Premises or any parts thereof without in any way affecting Tenant's obligation to pay any unpaid balance of rent due or to become due hereunder. Notwithstanding any such reletting without termination, Landlord may at any time thereafter elect to terminate this Lease for such previous breach.

(v) To terminate this Lease and the term hereby created without any right on the part of Tenant to waive the forfeiture by payment of any sum due or by other performance of any condition, term or covenant broken. Whereupon Landlord shall be entitled to recover, in addition to any and all sums and damages for violation of Tenant's obligations hereunder in existence at the time of such termination, damages for Tenant's default in an amount equal to the amount of the rent reserved for the balance of the term of this Lease, as well as all other charges, payments, costs and expenses herein agreed to be paid by Tenant, all discounted at the rate of six percent (6%) per annum to their then present worth, less the fair rental value of the Premises for the remainder of said term, also discounted at the rate of six percent (6%) per annum to its then present worth, all of which amount shall be immediately due and payable from Tenant to Landlord.

(vi) Whenever not prohibited by the law of the state in which the Property is located, when this Lease and the term or any extension or renewal thereof shall have been terminated on account of any default by Tenant, or when the term hereby created or any extension or renewal thereof shall have expired, it shall be lawful for any attorney of any court of record to appear as attorney for Tenant as well as for all persons claiming by, through or under Tenant, and to sign an agreement for entering in any competent court an amicable action in ejectment and judgment against Tenant and all persons claiming by, through or under Tenant and therein confess judgment for the recovery by Landlord of possession of the Premises, for which this Lease shall be his sufficient warrant; thereupon, if Landlord so desires, an appropriate writ of possession may issue forthwith, without any prior writ or proceeding whatsoever, and provided that if for any reason after such action shall have been commenced it shall be determined and possession of the Premises remain in or be restored to Tenant, Landlord shall have the right for the same default and upon any subsequent default or defaults, or upon the termination of this Lease or Tenant's right of possession as hereinbefore set forth, to bring one or more further amicable action or actions as hereinbefore set forth to recover possession of the Premises and confess judgment as hereinbefore provided.

(vii) Intentionally omitted.

Notwithstanding the foregoing, Landlord shall use reasonable efforts to mitigate its damages in the event of a default by Tenant.

**(c) Landlord Default/Tenant Remedies.**

(i) It shall be a default by Landlord if Landlord shall fail to fulfill any covenant or provision of this Lease on its part to be performed that will materially and adversely affect the ability of Tenant to conduct its normal, daily business on the Premises for the Permitted Use and fail to remedy such failure within thirty (30) days after Tenant shall have given Landlord written notice of such failure, provided that Tenant shall not exercise any of the rights or remedies contained in this Article 30 (c) (ii) or (iii) if Landlord begins to cure the default within ten (10) business days and continues actively and diligently and in good faith to completely cure the default;

(ii) Without limiting the rights described in subparagraph 30(c)(i) and (iii), in the event that (i) Landlord, for any reason fails to fulfill any covenant or provision of this Lease on its part to be performed (a "Failure"), and (ii) such Failure materially and adversely interferes with the conduct of Tenant's business, as reasonably determined by Tenant; and (iii) Landlord does not commence to remedy such Failure within twenty (20) days after Landlord receives actual notice of such Failure (the "Remedy Commencement Period") (and thereafter diligently pursue such remedy to completion), then Tenant shall have the right, but not the obligation, to remedy Landlord's Failure and charge Landlord for the reasonable cost of such remedy, which charges shall be payable by Landlord within ten (10) business days of Tenant's demand therefor, and upon Landlord's failure to pay the same Tenant shall have the right to seek damages for such failure which shall be Tenant's exclusive remedy. Notwithstanding the foregoing, if the Failure is of such a nature as to result in an imminent risk of personal injury or damage to Tenant's property, then the Remedy Commencement Period shall be five (5) days, rather than twenty (20) days as set forth above.

(iii) Without limiting the rights described in subparagraph (i) and (ii) above, in the event that Landlord fails to fulfill any covenant or provision of this Lease, and such failure materially and adversely interferes with the conduct of Tenant's business, as reasonably determined by Tenant, and (iii) such failure is not remedied within thirty (30) days after Tenant shall have given Landlord written notice of such failure, as extended by the grace period as provided in Article 30 (c) (i) above, then Tenant shall have the right to seek damages for such failure which shall be Tenant's exclusive remedy.

**(d) Non-Waiver.** No waiver by Landlord or Tenant of any breach by the other of any obligations, agreements or covenants herein shall be a waiver of any subsequent breach or of any obligation, agreement or covenant, nor shall any forbearance by either party to seek a remedy for any breach by the other be a waiver by such party of any rights and remedies with respect to such or any subsequent breach.

**(e) Grace Period.** Notwithstanding anything hereinabove stated, except in the case of emergency as set forth in Article 28 and except in the event of any default enumerated in Paragraphs (a) (i) , (iv) and (v) of this Article, neither party hereto will exercise any right or remedy provided for in this Lease or allowed by law because of any default of the other, except those remedies contained in Paragraph (b)(i) of this Article, unless such party shall have first given thirty (30) days written notice thereof to the defaulting party, and the defaulting party shall have failed to cure the default within such period; provided, however, that if the default consists of something other than the failure to pay money which cannot reasonably be cured within ten (10) business days, neither party hereto will exercise any such right or remedy if the defaulting party begins to cure the default within the ten (10) business days and continues actively and diligently in good faith to completely cure said default; and further provided that Landlord shall not be required to give

such ten (10) business days notice more than two (2) times during any twelve (12) month period. Grace periods shall not apply with respect to dates established in connection with Landlord's construction of the work described in Article 2 above.

**(f) Rights and Remedies Cumulative.** Except as otherwise specifically provided in this Lease, no right or remedy herein conferred upon or reserved to Landlord is intended to be exclusive of any other right or remedy provided herein or by law, but each shall be cumulative and in addition to every other right or remedy given herein or now or hereafter existing at law or in equity or by statute.

**(g) Mutual Waiver of Consequential Damages.** Notwithstanding any provision in this Lease, in no event shall either Landlord or Tenant be liable for any indirect or consequential damages in connection with this Lease.

**31. Condition of Title and Premises.** Tenant confirms that the Property, the Lot and the Premises, the title thereto, the zoning thereof, have been examined by Tenant, and Tenant accepts them in the condition or state in which they now are, or any of them now is, without relying on any representation, covenant or warranty, express or implied, in fact or in law, by Landlord and without recourse to Landlord, as to the title thereto, the encumbrances thereon, the appurtenances thereto, the nature, condition or usability thereof or the use or uses to which the Premises and the Property or any part thereof may be put, except as to work to be performed by Landlord pursuant to Article 2 hereof. Notwithstanding the foregoing, Landlord hereby represents that there are no private restrictions affecting the Property which would prohibit the construction of the improvements contemplated herein or which prohibit the Permitted Use. In addition, Landlord hereby represents that, to its knowledge, the improvements contemplated hereunder shall be in compliance with all legal requirements, including, without limitation, zoning requirements.

### **32. Interpretation.**

**(a) Captions.** The captions in this Lease are for convenience only and are not a part of this Lease and do not in any way define, limit, describe or amplify the terms and provisions of this Lease or the scope or intent thereof.

**(b) Entire Agreement.** This Lease represents the entire agreement between the parties hereto and there are no collateral or oral agreements or understandings between Landlord and Tenant with respect to the Premises or the Property. No rights, easements or licenses are acquired in the Property or any land adjacent to the Property by Tenant by implication or otherwise except as expressly set forth in the provisions of this Lease. This Lease shall not be modified in any manner except by an instrument in writing executed by the parties. Tenant agrees to make such changes to this Lease as are required by any mortgagee, provided such changes do not substantially affect Tenant's rights and obligations hereunder. The masculine (or neuter) pronoun, singular number, shall include the masculine, feminine and neuter genders and the singular and plural number.

**(c) Exhibits.** Each writing or plan referred to herein as being attached hereto as an Exhibit or otherwise designated herein as an Exhibit hereby made a part hereof.

**(d) Covenants.** The terms, covenants and obligations set forth herein all constitute conditions and not covenants of this Lease.

**(e) Interest.** Wherever interest is required to be paid hereunder, such interest shall be at the Prime Rate of interest as published by the Wall Street Journal plus 1% (the "Interest Rate"). In the event of a default

hereunder, interest shall be payable at the Interest Rate plus 6%. In the event the Wall Street Journal shall no longer publish the Prime Rate of interest, Landlord shall designate a substitute publication which publishes a substantially equivalent rate of interest.

### 33. Definitions.

**(a) Landlord.** The word Landlord is used herein to include the Landlord named above as well as its heirs, successors and assigns, each of whom shall have the same rights, remedies, powers, authorities and privileges as he would have had had he originally signed this Lease as Landlord. Any such person, whether or not named herein, shall have no liability hereunder after he ceases to hold title to the Premises except for obligations which may have theretofore accrued. Neither Landlord nor any principal of Landlord nor any owner of the Building or the Lot, whether disclosed or undisclosed, shall have any personal liability with respect to any of the provisions of this Lease or the Premises, and if Landlord is in breach or default with respect to Landlord's obligations under this Lease or otherwise, Tenant shall look solely to the equity of Landlord in the Premises for the satisfaction of Tenant's claims.

**(b) Tenant.** The word Tenant is used herein to include the Tenant named above as well as its successors and assigns, each of which shall be under the same obligations, liabilities and disabilities and each of which shall have the same rights, privileges and powers as it would have possessed had it originally signed this Lease as Tenant. Each and every of the persons named above as Tenant shall be bound jointly and severally by the terms, covenants and agreements contained herein. However, no such rights, privileges or powers shall inure to the benefit of any assignee of Tenant immediate or remote, unless the assignment to such assignee is permitted or has been approved in writing by Landlord. Any notice required or permitted by the terms of this Lease may be given by or to any one of the persons named above as Tenant, and shall have the same force and effect as if given by or to all thereof.

**(c) Mortgage and Mortgagee.** The word mortgage is used herein to include any lien or encumbrance on the Premises or the Property or on any part of or interest in or appurtenance to any of the foregoing, including without limitation any ground rent or ground lease if Landlord's interest is or becomes a leasehold estate. The word mortgagee is used herein to include the holder of any mortgage, including any ground lessor if Landlord's interest is or becomes a leasehold estate. Wherever any right is given to a mortgagee, that right may be exercised on behalf of such mortgagee by any representative or servicing agent of such mortgagee.

**(d) Person.** The word person is used herein to include a natural person, a partnership, a corporation, an association, and any other form of business association or entity.

**(e) Date of this Lease.** The date of this Lease shall be the date upon which this Lease has been fully executed by both parties.

**(f) Index.** The word index is used herein to mean the U.S. City Average Consumer Price Index for Urban Wage Earners and Clerical Workers (revised series) 1984 = 100 issued from time to time by the Federal Bureau of Labor Statistics or any successor agency that shall issue the index or any other measure hereafter employed by the Federal Bureau of Labor Statistics or any successor agency in lieu of such index. If there be any controversy as to the measure to be substituted, then the controversy shall be resolved by arbitration. The arbitrators shall be guided by the intention of the parties hereto to modify the minimum annual rent to reflect upward changes in the cost of living. The fees and expenses of arbitration shall be borne by Landlord and Tenant.

**(g) Lot.** The metes and bounds description of the Lot is set forth in Exhibit G attached hereto.

**(h) Proportionate Share.** Tenant's proportionate share of the Operating Expenses, any Imposition and

any other cost, charge, rent, expense or payment herein designated as additional rent shall be calculated, unless otherwise specified, by multiplying the relevant sum by a fraction, the numerator of which shall be the square foot area of the Premises and the denominator of which shall be the square foot area of the Building as set forth in Article 1 hereof, which is 75.62%.

**(i) "Lease Year".** The "first lease year" shall be the twelve (12) month period commencing on the Commencement Date, if the Commencement Date is the first day of a calendar month or, if the Commencement Date is other than on the first day of a calendar month, the period commencing on the Commencement Date and continuing through the last day of the twelfth full calendar month thereafter. Each "lease year" after the first lease year shall be a consecutive twelve (12) month period commencing on the first day of the calendar month immediately following the preceding lease year.

**34. Notices.** All notices, demands, requests, consents, certificates and waivers required or permitted hereunder from either party to the other shall be in writing and sent by United States certified mail, return receipt requested, postage prepaid. Notices to Tenant shall be addressed to FARO Technologies, Inc, 250 Technology Park, Lake Mary, FL 32746. and, after the Commencement Date, to the Premises. Notices to Landlord shall be addressed to 290 National Road LP ,10 Woodford Lane, Malvern, PA 19355, with a copy to any mortgagee or other party designed by Landlord. Either party may at any time, in the manner set forth for giving notices to the other, specify a different address to which notices to it shall be sent.

**35. Security Deposit.** At the time of signing this Lease Tenant shall deposit with Landlord the sum of Forty Eight Thousand Fifty Two Dollars (\$48,052.33) to be retained by Landlord as cash security for the faithful performance and observance by Tenant of the covenants, agreements and conditions of this Lease. Notwithstanding anything to the contrary contained in any law or statute now existing or hereafter passed (i) Tenant shall not be entitled to any interest whatever on the cash security, (ii) Landlord shall not be obligated to hold the cash security in trust or in a separate account and (iii) Landlord shall have the right to commingle the cash security with its other funds. Landlord may use, apply or retain the whole or any part of the cash security to the extent required for the payment of any minimum rent, any additional rent or any other sums payable hereunder as to which Tenant is in default or to the extent required for the reimbursement to Landlord of any sum which Landlord may expend or may be required to expend by reason of Tenant's default in respect to any of the covenants, agreements or conditions of this Lease which remains uncured past any applicable notice and cure periods. If Tenant shall fully and faithfully comply with all of the covenants, agreements and conditions of this Lease, the cash security shall be returned to Tenant after the Expiration Date and surrender of the Premises to Landlord. If the Premises are sold to a bona fide purchaser, Landlord shall have the right to transfer the aforesaid cash security to such purchaser, by which transfer Landlord shall be released from all liability and Tenant shall look solely to the new landlord for the return thereof so long as liability for the security deposit is expressly assumed by such purchaser.

**36. Modification of Premises.** In the event the size of the Premises shall be modified during the design process (or pursuant to the re measurement procedures set forth above), the parties agree to execute an amendment to this Lease memorializing any change in the rent and in the Proportionate Share attributable to the Premises.

*Remainder of page left blank*

IN WITNESS WHEREOF, and in consideration of the mutual entry into this Lease and for other good and valuable consideration, and intending to be legally bound, each party hereto has caused this agreement to be duly executed under seal.

Date signed:

**Landlord:**

June 24, 2013

290 National Road LP

By: CLGW, 290 LLC., General Partner

By: /s/ Charles Lyddane  
Member

By: /s/ Gregory M. Walters  
Member

Date signed:

**Tenant:**

June 24, 2013

**Faro Technologies, INC.**

By: /s/ Jay Freeland  
President

Attest: /s/ Nancy Setteducati  
Secretary

[Corporate Seal]

**Corporate Resolution and Authorization of Agency**

It is hereby certified that at a meeting of a quorum of directors of the corporation which is the Tenant herein was held on May 24, 2013 and that it was resolved to enter into this lease and further that the officers of the corporation and \_\_\_\_\_ as agent for the corporation, have been authorized, empowered and directed in the corporate name and with the corporate seal to execute and deliver any or all documents and to pay all fees and charges necessary to carry out the entry into and compliance with this lease.

/s/ Nancy Setteducati

**Secretary**

**Faro Technologies, Inc.**



**EXHIBIT "D"**

**WORK LETTER**

290 National Road Limited Partnership (herein called Landlord) and Faro Technologies Inc. (herein called Tenant). hereby agree as follows:

**1. Tenant's Acknowledgment of Building Shell Plans And Specifications.**

Within eight (8) weeks of the execution of the lease to which this Work Letter is attached (the "Lease"), Landlord will deliver to the Tenant Building<sup>1</sup> shell and land development plans and specifications for the improvements at the Property, the standards and guidelines for work at the Building and such other structural, electrical and mechanical drawings, specifications and information (collectively, the " Building Shell Plans and Specifications") describing the Building, as Tenant may reasonably require to assure itself that the improvements at the Property are sufficient to meet the Tenant's occupancy needs and for its use in preparing the plans and specifications to be used for the construction of interior fitout improvements and certain exterior improvements for the Premises (collectively referred to as the "Premises Plans"). Within ten (10) business days of receipt, Tenant will acknowledge the sufficiency of the Building Shell Plans and Specifications for the purposes intended, or give Landlord notice of any deficiencies in the Building Shell Plans and Specifications.

**2. Designation of Tenant's Construction Representative.**

Brad Lloyd shall be "Tenant's Construction Representative." Tenant agrees that Tenant's Construction Representative: (a) shall be available to meet and consult with Landlord or its designated representatives on a continuing basis during design and engineering and at the Premises during construction as Tenant's representative concerning the matters which are the subject of this Work Letter; and (b) shall have the power legally to bind Tenant under this Work Letter in giving direction to Landlord, in giving approval of construction documents and work, and in making requests and approvals for changes during the construction of the Premises Fitout<sup>2</sup> portion of the Landlord's Work. The Tenant may from time to time designate in writing a different individual to be Tenant's Construction Representative.

**3. Preparation, Review and Approval of Premises Fitout Plans and Specification**

Tenant shall consult with the Tenant's architect, engineer, designer and such other consultants as Tenant shall deem necessary for development and completion of the Premises Plans as described in Paragraph 1 above which shall describe the fixed improvements for the Premises Fitout containing: architectural, mechanical, electrical, plumbing and structural plans and other documents to fix and describe the size and character of the elements of the Premises Fitout described in the Basis of Design (BOD) dated July , 2012 prepared by the Tenant's architect and engineer including walls, ceilings, finishes and the mechanical, electrical, plumbing and other systems and components to be located in the interior and on the exterior of the Premises.

<sup>1</sup> Capitalized terms not defined herein shall be given the same meaning as defined in the Lease.

<sup>2</sup> Defined more fully in Paragraph 9 below.

(a) Design Development Documents - Subject to the procedural requirements set forth in subparagraph 3(c) and subject to receipt by the Tenant of the Building Shell Plans and Specifications, within sixteen (16) weeks of the execution of the Lease, Tenant will deliver to Landlord the Premises Plans. Tenant shall cause to be prepared and delivered to Landlord for its review and comment one (1) set of "Design Development Documents" to implement the Premises Plans prepared by Tenant's consultants.

(b) Construction Documents - Subject to the procedural requirements set forth in subparagraph 3(c) and subject to receipt by the Tenant of the Building Shell Plans and Specifications, within twenty-four (24) weeks of the execution of the Lease, Tenant shall cause to be prepared and delivered to Landlord one (1) set of complete and final "Construction Documents" for the Premises Fitout consisting of working drawings and specifications, as approved by Tenant for the permitting and construction of the Premises Fitout by Landlord for Tenant's occupancy. The furniture, fixtures and equipment improvements and any other improvements to be supplied and installed by the Tenant (collectively, the "Tenant Improvement Work") shall be described in separate plans and specifications and shall also be supplied by the Tenant simultaneously to the Landlord for its information. All other work not so described shall be considered the responsibility of the Landlord (collectively, "Landlord's Work"). These Construction Documents as approved by the Tenant and reviewed by the Landlord in accordance with the procedural requirements set forth in subparagraph 3(c) below shall be considered to be "Issued for Construction."

(c) Landlord Review and Comments. Tenant shall submit for Landlord's review and comment the Design Development Documents and Construction Documents for the Premises Fitout and the Tenant Improvement Work. The review by Landlord of the Design Development Documents and Construction Documents shall be subject to the following procedural requirements:

(i) Landlord shall, within five (5) business days after its receipt of the applicable documents, review the same, and return the same to Tenant with comments and suggestions.

(ii) With respect to any modifications to the Building shell set forth in the Tenant's plans and specification submissions described in 3a and 3b: (A) if and to the extent that in the opinion of the Landlord the Tenant's plans or specifications involve any modification to the Building shell's structural, mechanical, electrical or plumbing systems or components or create issues of life and safety of the occupants, or involve cost in excess of Landlord's budget for construction of the Building shell, then such approval may be withheld by Landlord in its absolute and sole discretion and (B) if and to the extent that the modifications, in Landlord's sole judgment, do not involve modification to such systems, components or safety, or involve cost in excess of Landlord's budget for construction of the Building, such approval shall not be unreasonably withheld or delayed by Landlord. Upon receipt of such a request for changes from the Landlord, the Tenant Agrees to make changes and modifications to the plans and specifications in response to the Landlord's request for changes within five (5) business days and return them promptly to the Landlord. Notwithstanding the foregoing, except for issues of life and safety of the occupants, or in the event of inordinate delay as determined by Landlord in its sole opinion, if Tenant shall pay all costs in excess of Landlord's budget for construction of the Building Shell in a manner satisfactory to Landlord, and subject to the approval of Landlord's lender, Landlord agrees to not to unreasonably withhold approval Tenant's plans and specifications.

(d) The scope of Landlord's review of the portion of the Tenant's plans and specifications shall be for general compatibility with Building components only and shall not, in any manner, be deemed review for compliance with federal, state or local governmental authority or agency laws, codes and regulations (including, without limitation, the ADA and regulations thereunder), for completeness, for constructability, for availability of materials specified, or for suitability for the purposes intended, all of which shall remain the responsibility of Tenant. Such review by Landlord shall not, in any manner, relieve Tenant of its obligation to provide to Landlord such complete plans and specifications in a timely manner to enable Landlord to complete the Landlord's Work.

#### 4. Tenant Delays.

Each of the following shall constitute a "Tenant Delay" (collectively, "Tenant Delays"):

(a) Tenant's failure to deliver plans, specification, revisions, comments, requests or information as provided in Article 3 hereof, or any failure by Tenant to furnish any required notice, plan, drawing, information, approval or consent within any respective required time period as set forth in this Exhibit "D" or elsewhere in the Lease.

(b) Delays in furnishing materials, services, supplies, labor or components required by the Tenant.

(c) Delays caused by the performance of any work or activity in the Premises by Tenant or any of its employees, agents, or contractors.

(d) The inclusion of any item in Landlord's Work or the Tenant Improvement Work required by Tenant: (i) which is required for the issuance of a temporary or permanent Certificate of Occupancy for the Premises, but is not obtainable (or is not actually delivered) by the dates specified by Landlord in the Construction Schedule (as defined below) to permit Substantial Completion (as defined below) or (ii) which results in delays in obtaining a building permit or any other permit or authorization required for the performance of Landlord's Work or the Tenant Improvement Work or a temporary or permanent Certificate of Occupancy for the Premises. Landlord shall prepare and submit to Tenant, a schedule (the "Construction Schedule") on which Landlord shall designate the dates by which various items included in the Landlord's Work and the Tenant Improvement Work must be delivered for inclusion in the Landlord's Work and the Tenant Improvement Work. The period of any Tenant Delay pursuant to this subparagraph 4(e) shall be the period of time from the date on which any item should have been delivered to satisfy the Construction Schedule and the date on which such item is actually delivered for inclusion in the Landlord's Work and the Tenant Improvement Work.

(e) A failure by Tenant timely to pay Landlord any amounts which Tenant is obligated to pay to Landlord pursuant to subparagraph 8(b) below.

(f) Any other default by Tenant of any of its obligations under this Lease.

## 5. Bidding/Pricing of Landlord's Work and Contractor selections

The bidding and/or pricing process and award of the contract for construction shall be as set forth below:

(a) Selection of General Contractor. The selection of the general contractor who shall perform the improvements at the Property shall be determined solely by Landlord. Said Contractor (the "Landlord's Contractor") shall be retained by Landlord to perform the Landlord's Work under such terms and conditions as Landlord shall deem appropriate for the proper and expeditious prosecution of the Building shell and Premises Fitout (as defined in Paragraph 9 below).

(b) Cost Estimating. During the preparation of the Premises Fitout Plans the Landlord's Contractor will act as a construction manager advising the Landlord and Tenant on matters of constructability and cost. The Landlord's Contractor will prepare estimates of cost at various times during the process for the review and use by the Tenant and Landlord in a preliminary determination of the cost and budgeting of the Premises Fitout. The Tenant will be responsible through its consultants or materialmen for establishing the cost of the items of Work contained in the Tenant Improvement Work.

(c) Selection of Bidders for Landlord's Work for Premises Fitout. During the preparation of the Premises Fitout Plans and prior to bidding, the Landlord will instruct the Landlord's Contractor to prepare a list of qualified subcontractors and materialmen from which to obtain bids and pricing for the Work. The list will include a minimum of three (3) qualified subcontractors per category or division of work. Landlord shall deliver to Tenant the listing of prospective subcontractors for purposes of constructing the Premises Fitout. Tenant may also submit to Landlord a list of proposed qualified subcontractors and materialmen for purposes of obtaining bids for constructing the Premises Fitout. Such listings shall be subject to the joint comments and approval of Landlord and Tenant who will mutually agree on the selections. The bidding process shall be administered by Landlord. The final selection of qualified bidders will be mutually determined by the Landlord and Tenant.

(i) Tenant shall, within five (5) business days after its receipt of the list of bidders, review and approve the same, or return the same to Landlord with requested modifications deletions or additions.

(d) Review of Bids. The Landlord will cause the Landlord's Contractor to prepare a final cost estimate document based on the detailed bids for the Premises Fitout. The bids will be made available to the Tenant for its review and comment with the final cost estimate. The final cost estimate shall be used by the Tenant and Landlord as the basis for award and the selection of the subcontractors and materialmen to perform the Premises Fitout. Said subcontractors and materialmen shall be retained by the Landlord's Contractor on behalf of Landlord under such terms and conditions as are appropriate for the proper and expeditious prosecution of the Premises Fitout. Landlord reserves the right to negotiate the cost with any and all bidders in order to achieve the best price for the Work.

## 6. Performance of Landlord's Work.

(a) The portion of the Work to be performed by Landlord is to be done by Landlord's Contractor.

(b) Landlord with the Landlord's Contractor shall supervise, oversee, schedule and coordinate the performance of the Landlord's Work. Landlord may (a) make

substitutions of material or components of equivalent grade and quality when and if any specified material or component shall not be readily or reasonably available, and (b) make changes to the work necessitated by conditions met in the course of construction, provided that if any change is material and substantial in nature, then Tenant's approval of such change shall first be obtained (which approval shall not be unreasonably withheld or delayed so long as there shall be general conformity with the Construction Documents).

(c) With respect to the Landlord's Work, the term "Substantial Completion" or "Substantially Complete" shall mean that state of completion of Landlord's Work which will allow Tenant to install the Tenant Improvement Work, and in addition:

(i) reasonable means of access to the Premises, during ordinary business hours, shall be available to Tenant; and

(ii) utilities and all other facilities, other than the facilities to be installed by Tenant, necessary to Tenant's use and occupancy of the Premises (including, but not limited to, heating, ventilation, air-conditioning, lavatories and electrical facilities) shall have been installed and shall be operational and available to Tenant in reasonable quantities. Said facilities shall not be deemed to be unavailable if only minor or insubstantial details of construction, decoration or mechanical adjustment remain to be done. The foregoing minor or insubstantial details are referred to in this Work Letter as "Punchlist Items". It is further agreed that Tenant shall be provided with an As-built Records Document and an Operations and Maintenance Manual.

(d) The term "Substantial Completion Date" shall mean the earlier of: (i) the date on which the Landlord's Work and the Tenant Improvement Work is Substantially Complete or (ii) the date that the Landlord's Work and the Tenant Improvement Work is Substantially Complete, less a period equal to the aggregate duration of all Tenant Delays.

#### 7. Performance of Tenant Improvement Work.

(a) Tenant shall, in good and workmanlike manner, cause the Tenant Improvement Work to be completed by a contractor chosen by the Tenant (the Tenant's Contractor) in accordance with the Construction Documents. In performing such Tenant Improvements, Tenant shall comply with the provisions of Article 18 of the Lease. Landlord's representatives may visit the Premises or the Building at intervals appropriate to the stage of construction of the Tenant Improvement Work so as to become familiar with the progress of such work.

(b) The basis for award and the selection of the contractor(s) to perform the Tenant Improvement Work shall be determined solely by Tenant. The Tenant's Contractor shall be retained by Tenant under such terms and conditions as Tenant shall deem appropriate for the proper and expeditious prosecution of the Tenant Improvement Work; provided, however, Tenant's Contractor shall be subject to the various rules and restrictions of Landlord affecting building operations, tenant occupancy, clean-up, safety, coordination and insurance issues.

(c) The work shall be performed by responsible contractors approved in advance by Landlord. Any such contractor shall not, in Landlord's opinion, prejudice Landlord's relationship with Landlord's contractors or subcontractors or the relationship between such contractors and their subcontractors or employees, or disturb harmonious labor relations in the Building. The approved contractors and consultants shall furnish in advance and maintain in

effect workers' compensation insurance in accordance with statutory requirements and comprehensive general public liability insurance in accordance with the Exhibit E Insurance Requirements, attached to the Lease naming Landlord, Landlord's mortgagee and others as required, and (if reasonably required by Landlord) Landlord's contractors and subcontractors then performing work in the Building, as additional insured parties with limits satisfactory to Landlord, and who shall deliver releases of liens signed by Tenant's Contractors and all subcontractors and materialmen for all work that has been performed and paid for to date each time that a draw is paid under the applicable contract. In addition, the provisions of Article 18 of the Lease regarding mechanics liens shall apply to the Tenant Improvement Work. In the event of an inconsistency between this paragraph 7 (c) and Article 18 of the Lease, the more strict provision shall prevail.

(d) No such work shall be performed in such manner or at such times as to interfere with any work being done by any of Landlord's or any of Tenant's contractors and subcontractors in the Premises or in the Building generally. Landlord shall, however, endeavor to allow Tenant access for such work at reasonable times and at the earliest time consistent with the restrictions of this paragraph 7. Each of Tenant's contractors shall be subject to the reasonable decisions of Landlord as to such matters, but Landlord shall not be responsible for any aspect of the work performed by Tenant's contractors or for the coordination of the work of Tenant's contractors with Landlord's contractors and subcontractors.

(e) Tenant shall be solely responsible for (i) the transportation, safekeeping and storage of materials and equipment used in the performance of work by its contractors, subcontractors, architects and engineers, (ii) for the removal of waste and debris resulting therefrom, (iii) for defects (latent or otherwise) left in work performed and/or improvements designed by its architects and engineers or contractors, and (iv) for any damage caused by any of Tenant's contractors or consultants to any work performed by Landlord's contractors and subcontractors. Tenant shall also indemnify and hold harmless Landlord and Landlord's mortgagee from any and all claims arising out of Tenant's and Tenant's contractors' and consultants' actions.

(f) Tenant shall not contract with any person or entity as to whom Landlord has reasonable objection. The terms and conditions of any contract for construction between Tenant and Tenant's separate contractors shall be subject to the prior review and written approval of Landlord prior to execution.

**8. Tenant's Construction Representative's Access, Inspection and Approval.**

(a) Landlord and Tenant with their respective consultants shall make periodic joint inspections of the Premises from time to time during construction at reasonable times on business days, and each time shall jointly approve a written statement or assessment of the status of construction, the tasks remaining to be completed and ultimately the date of Substantial Completion.

(b) As to all Landlord's Work, performed by or on behalf of Landlord prior to the Substantial Completion Date and not objected to by Tenant in accordance with this Work Letter, it shall be conclusively deemed on the Substantial Completion Date that such work was satisfactorily performed in accordance with and meets the requirements of this Lease. Landlord shall have no liability for work performed by Tenant's specialty contractors or work performed by or on behalf of Landlord in accordance with the Construction Documents to the extent such work was defectively designed by Tenant's architects or engineers. As to any Punchlist Items,

Landlord shall supervise the completion of such item within sixty (60) days after Tenant's notice thereof (except for items which cannot reasonably be completed within such sixty (60)-day period, which items shall be completed as promptly as practicable using diligent efforts thereafter).

9. Landlord's Work, and Payment by the Tenant

(a) The Landlord's Work shall be divided into Building shell and Premises Fitout work. The Landlord shall be obligated to provide a building in "Cold Dark Shell" condition ready for fitting out the Premises with any interior and exterior improvements related to the Tenant's requirements for manufacturing and testing labs, general office and support spaces (herein called the "Premises Fitout"). The Landlord's Work for the Building sShell shall include all offsite improvements and site work contained in the Land Development plans attached as an exhibit to this Lease, including but not limited to curb work and sidewalks and utility extensions to the site as necessary. Also included are the building shell structure and exterior finishes with window wall and entry systems set and masonry knock out panels for truck dock openings on the rear of the building, perimeter walls studded and insulated on the interior, sprinkler mains hung with turned up heads, water and gas stubbed into the building, main electrical service set, and a 5" concrete floor slab with a troweled and sealed finish.

(b) The Landlord's Work for the Premises Fitout shall include all improvements necessary to prepare the Premises for the Tenant's use including but not necessarily limited to, the installation of HVAC units, duct work and controls, lighting and finish ceiling, partitions and their finish, floor coverings, doors and hardware, electrical distribution, plugs and switches, restroom, plumbing, specialized concrete floor slabs related to labs, testing and manufacturing, code required life safety interior signage, fixtures and millwork except that the work related to interior graphics, logos or directional signage, exterior signage, furniture and that portion of the fixtures, millwork and specialized equipment and fixtures, in connection with the Tenant Improvement Work performed by the Tenant.

(c) Prior to the commencement of the Landlord's Premises Fitout, The Tenant shall deliver to Landlord an irrevocable letter of credit in the form attached hereto as Exhibit "A" (the LOC) issued by a reputable financial institution approved by Landlord in the amount of Two Million Two Hundred Fifty Thousand Dollars (\$2,250,000) as security for payment of Landlord's Cost (as defined below) and any Excess (as defined in item 9(d) below) to Landlord for the Premises Fitout . The Tenant shall pay to Landlord the Landlord's Cost of the Premises Fitout not later than thirty (30) days after receipt of Landlord's invoice. Landlord shall invoice the Tenant for Landlord's Cost as Landlord is invoiced by the Landlord's Contractor The Landlord agrees to deliver to Tenant not less than ten (10) days prior notice of Landlord's intention to draw upon the LOC for failure of Tenant to make a required payment. As used herein, the term "Landlord's Cost" shall mean the sum of (i) all costs and expenses paid or incurred by Landlord for (or in connection with) the construction and completion of the Premises Fitout Work (including, without limitation, contract or purchase price(s) for materials, components, labor, change orders, services, insurance requirements, "general conditions," permits, and other costs incurred for Landlord to supervise, oversee, schedule, coordinate, perform and complete the Premises Fitout Work), plus (ii) Landlord's professional, designer, consultant, architectural and engineering fees (if applicable) and costs, including, without limitation, the cost of review, preparation and revisions to drawings and other plans relating to the Premises Fitout Work plus (iii) legal fees incurred in connection with preparing and/or negotiating any construction contracts.

(d) The estimated cost of completion of the Premises Improvement work ("Estimated Premises Cost") is set forth on Exhibit "B" attached hereto. The Estimated Premises Cost shall be adjusted as necessary during the design or construction of the Premises. To the extent Landlord's Cost is determined from time to time (in Landlord's reasonable judgment) to exceed the Estimated Premises Cost, Tenant shall pay such excess ("Excess") to Landlord within thirty (30) days after Landlord presents Tenant with an invoice for any such Excess.

(e) The cost of the Tenant Improvement Work shall be paid by the Tenant directly to Tenant's Contractors with one (1) copy of the Contractor's invoice for the Work and evidence of the Tenant's payment provided simultaneously to the Landlord.

10. Additional Rent. All payments to be made from Tenant to Landlord pursuant to this Work Letter are hereby deemed to be Additional Rent under the Lease.

Tenant's Initial's

Landlord's Initial's

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EXHIBIT "D - A"

[FORM OF LETTER OF CREDIT]

IRREVOCABLE LETTER OF CREDIT

No.

[Date]

290 National Road, L.P.  
224 East Biddle Street  
West Chester, PA 1980

Dear Sir or Madam:

We hereby establish, effective immediately, an irrevocable letter of credit in your favor at the request and for the account of FARO Technologies, Inc. up to an aggregate amount of U.S. \$2,250,000, in favor of 290 National Road L.P., and available by your sight draft drawn on us. Partial draws are permitted. Any draw request submitted under this letter of credit shall be payable upon the following terms and conditions and when accompanied by the following documents:

A signed statement by 290 National Road, L.P. (Beneficiary) indicating that the amount drawn represents monies due under a certain Work Letter dated the \_\_\_\_\_ day of \_\_\_\_\_, 2013 between FARO Technologies, Inc. and 290 National Road, L.P. Gregory Walters or Charles R.A. Lyddane or any officer purporting to sign for the beneficiary may sign such statement for the beneficiary.

This letter of credit sets forth in full the terms of our undertaking, and such undertaking shall not in any way be modified, amended or amplified by reference to any documents, instrument or agreement referred to herein or in which this letter of credit is referred to or to which this letter of credit relates, and any such reference shall not be deemed to incorporate herein by reference any document, instrument or agreement.

We hereby engage with you that the drafts drawn and presented strictly in compliance with the terms of this credit will be duly honored by us if: (i) presented at our office at 120 East Baltimore Street Baltimore MD 21202, PA; by personal delivery or by registered or certified mail or courier on or before 2:00PM on July 15, 2014.

This letter of credit shall be automatically extended for six months from the present or any future expiration date unless sixty (60) days prior to such expiration date we shall notify you by certified mail, return receipt requested, that we elect not to consider this letter of credit renewed for any such additional period. Upon receipt of such notice you may draw on us by means of your draft for the remaining balance of the letter of credit accompanied by your statement that the letter of credit has not been extended.

Except so far as otherwise expressly stated, this credit is subject to the Pennsylvania Uniform Commercial Code and, to the extent consistent therewith, the Uniform Customs and Practice for Documentary Credits (1993 Revision), International Chamber of Commerce Publications No. 500.

\_\_\_\_\_  
Vice President Bank

**EXHIBIT E**

**TENANT CONSTRUCTION INSURANCE REQUIREMENTS**

The Tenant will furnish to the Landlord certificates of insurance identifying the Additional Insureds in the Description of Operations on the certificates, and submit prior to the beginning of on-site operations. The coverage and amounts below are minimum requirements and do not establish limits to the contractor's or consultant's liability. Other coverage and higher limits may be provided at the contractor's or consultant's option and expense.

1. **STATUTORY WORKERS' COMPENSATION and EMPLOYER'S LIABILITY** including coverage under the United States Longshoremen's and Harbor Workers' Compensation Act and/or Jones' Act (if applicable), and All States Coverage. Employers' Liability Shall be limits not less than:

Bodily Injury, each Employee	\$100,000
Bodily Injury, each Accident	\$500,000
Disease, each Employee	\$100,000

2. **COMMERCIAL GENERAL LIABILITY** To be provided on an "occurrence" basis, with coverage to include explosion, collapse and underground hazards (XCU), Blanket Contractual, Products, Independent Contractors, Completed Operations, Personal Injury, and Employees as additional insureds, with limits not less than:

\$1,000,000	Each Occurrence, Bodily Injury and Property Damage combined
\$2,000,000	Aggregate*
\$1,000,000	Personal and Advertising Injury
\$2,000,000	Products/Completed Operations Aggregate

\* Aggregate shall apply separately to each project (aggregate not to include other projects) and must be identified as such on the certificate of insurance.

3. **AUTOMOBILE LIABILITY**, including the ownership, maintenance, or use of owned, non-owned, leased and hired automobiles, and including uninsured and underinsured motorists coverage. Automobiles of Subcontractors and material suppliers must also meet the same insurance requirements if they will be used at the site. Limits shall be less than:

\$1,000,000	Combined Single Limit Each Occurrence, with no Aggregate
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4. **EXCESS UMBRELLA LIABILITY**, to provide insurance in excess of Employer's Liability, Commercial General Liability, and Automobile Liability policies required hereunder, on a following-form basis.

\$5,000,000	Each Occurrence
\$2,000,000	General Policy Aggregate

Initials: Landlord: \_\_\_\_\_ Tenant: \_\_\_\_\_

5. **PROFESSIONAL LIABILITY/ERRORS & OMISSIONS INSURANCE (if applicable)** All contractors and consultants who will perform, or retain others to perform, professional services in connection with the work (including, but not limited to Architects, Engineers, Consultants, Design-Building and Project/Construction Managers) shall provide Professional Liability Insurance covering negligent acts, errors, or omissions in the performance of their work, with limits not less than:

\$1,000,000	Each Claim
\$1,000,000	Annual Aggregate

6. **CONTRACTORS POLLUTIONS LIABILITY (if applicable)** All contractors and consultants who will perform environmental services (including but not limited to asbestos or lead abatement, testing or remediation) shall provide Contractors Pollution Liability with limits not less than:

\$1,000,000	Each Claim or Occurrence
\$1,000,000	Annual Aggregate

The Contractors Pollution Liability policy shall include coverage for Emergency Response Costs, Contingent Transportation, Non-Owned Disposal Sites (if applicable), and Natural Resource Damage. If coverage is written on a claims-made basis, an Extended Reporting Period, or tail coverage, shall be provided for two (2) years following completion of the insured's services. In the alternative, the Contractors Pollution Liability policy shall be renewed for not less than two years following completion. The policy retroactive date shall be no later than the effective date of this Agreement.

7. The Contractor or Consultant shall be responsible for and maintain property insurance coverage at their option and expense to cover tools, equipment, etc. owned or rented, the capital value of which is not included in the cost of work.
8. All policies are to be written by (A- VIII Rated or better) insurance companies licensed to do business in the state in which the work is to be performed.
9. All certificates are to contain substantially the following statement: "The insurance evidenced by this certificate shall not be cancelled, except after ten (10) days prior written notice to Certificate Holder."
10. Commercial General Liability insurance under a "claims-made" policy is not acceptable. Coverage must be provided on an "occurrence basis."
11. The Contractor or Consultant shall require his subcontractors, while engaged in performing work at the jobsite, to maintain identical insurance coverage and comply with the conditions above. Contractor or Consultant shall be responsible for securing and maintaining certificates of insurance from all subcontractors and subconsultants evidencing the required insurance coverages.

Initials: Landlord: \_\_\_\_\_ Tenant: \_\_\_\_\_

12. Each Certificate of Liability Insurance from the Tenants consultants, contractors and vendors shall include this Additional Insureds statement to be entered into the Description of Operations section of the certificate:

“The Walters Company, 290 National Road, LLC, and their partnerships, and each of their respective officers, directors, agents, shareholders, partners, and employees are to be named as “additional insured” on a primary and noncontributory basis on all liability insurance except Employers’ Liability and Professional Liability. Additional insured status shall apply to General Liability Completed Operations coverage.

All policies, including Workers’ Compensation, shall provide for a waiver of subrogation in favor of the additional insured parties”.

Initials: Landlord: \_\_\_\_\_ Tenant: \_\_\_\_\_

**EXHIBIT F**

**TERM COMMENCEMENT AGREEMENT**

THIS AGREEMENT made as of \_\_\_\_\_, 200\_\_\_\_, between the following parties (“Landlord” and “Tenant”, respectively):

LANDLORD: 290 National Road, L.P.

TENANT: Faro Technologies, Inc

RECITALS

A. By lease dated \_\_\_\_\_, 2014 (the “Lease”), Landlord leased to Tenant certain premises described in the Lease consisting of 68,240 square feet in the building numbered and known as 290 National Road, West Whiteland Township, Chester County, PA (the “Premises”).

NOW, THEREFORE, Landlord and Tenant agree as follows:

1. The Commencement Date of the Lease is \_\_\_\_\_, 20\_\_\_\_.
2. Nothing in this Term Commencement Agreement is intended to change or modify the rights of the parties under the Lease.

IN WITNESS WHEREOF, Landlord and Tenant have caused this Term Commencement Agreement to be executed as of the date first above written.

**290 NATIONAL ROAD, L.P.**

By: CLGW 290, LLC., General Partner

By: \_\_\_\_\_

**FARO TECHNOLOGIES, INC.**

By: \_\_\_\_\_

Attest: \_\_\_\_\_

Initials Landlord: \_\_\_\_\_ Tenant: \_\_\_\_\_

EXHIBIT F-1

RENT INCREASE SCHEDULE

290 National Road, Exton Pennsylvania

Lease Year	Rent	Increase	Next Year's Rent
1	\$ 8.45	3%	\$ 8.70
2	\$ 8.70	3%	\$ 8.96
3	\$ 8.96	3%	\$ 9.23
4	\$ 9.23	3%	\$ 9.51
5	\$ 9.51	3%	\$ 9.80
6	\$ 9.80	3%	\$ 10.09
7	\$10.09	3%	\$ 10.39
8	\$10.39	3%	\$ 10.70
9	\$10.70	3%	\$ 11.03
10	\$11.03		

This schedule is for the initial term of the Lease.

EXHIBIT G

All that certain lot or piece of ground situate in West Whiteland Township, County of Chester, Commonwealth of Pennsylvania bounded and described according to a Plan of Property for Wolfson-Verrichia Group Inc. made by Bohler Engineering Inc. dated 6/1/1997 last revised 4/8/98 and recorded in Chester County as Plan 14551, as follows to wit:

BEGINNING at a point on the North side of the Pa State Highway Route 30 By-Pass, said point being the southwesterly corner of lot 1 on said plan and the southeasterly corner of the about to be described lot; thence from the point of beginning and along the Route 30 By-Pass the four following courses and distances (1) South 70 degrees 50 minutes 08 seconds West 49.64 feet (2) South 18 degrees 05 minutes 32 seconds East 64.01 feet (3) South 70 degrees 30 minutes 18 seconds West 947.76 feet (4) South 73 degrees 21 minutes 11 seconds West 53.61 feet, thence North 08 degrees 36 minutes 04 seconds West 160.38 feet to a point on the south side of National Road, thence along the same and through the bed of a cul de sac, North 81 degrees 23 minutes 56 seconds East 154.95 feet to a point, thence North 08 degrees 36 minutes 04 seconds West partly along the west side of a sanitary sewer easement 430.02 feet to a point, thence North 34 degrees 13 minutes 18 seconds East 429.21 feet to a point in line of a Penn Dot Mitigation lot, thence along the same the two following courses and distances (1) South 71 degrees 25 minutes 16 seconds East crossing the aforesaid sanitary sewer easement 450 feet (2)

North 71 degrees 42 minutes 05 seconds East 87.46 feet to a point in line of lot 1, thence along the same, South 19 degrees 37 minutes 51 seconds East 464.09 feet to the first mentioned point and place of beginning

Being Lot 2 on said Plan

Tenant's Initials

Landlord's Initials



**FARO Technologies, Inc.****Certification Pursuant to Rule 13a-14(a)/15d-14(a), as Adopted 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 officer(s) 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 15d-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 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 officer(s) 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 functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control 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 control over financial reporting.

Date: July 30, 2013

/s/ Jay W. Freeland

Name: Jay W. Freeland

Title: President and Chief Executive Officer  
(Principal Executive Officer)



## FARO Technologies, Inc.

## Certification Pursuant to Rule 13a-14(a)/15d-14(a), as Adopted 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 officer(s) 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 15d-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 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 officer(s) 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 functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control 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 control over financial reporting.

Date: July 30, 2013

/s/ Keith S. Bair

Name: Keith S. Bair

Title: Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)

**FARO Technologies, Inc.****Certification Pursuant to 18 U.S.C. Section 1350, as Adopted 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 and Chief Executive Officer and Director of FARO Technologies, Inc. (the Company), hereby certify that the Quarterly Report on Form 10-Q for the quarter ended June 29, 2013 (the Report) fully complies with the requirements of Section 13(a) or 15(d) 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

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Jay W. Freeland  
President and Chief Executive Officer  
(Principal Executive Officer)  
July 30, 2013

**FARO Technologies, Inc.****Certification Pursuant to 18 U.S.C. Section 1350, as Adopted 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 and Chief Financial Officer of FARO Technologies, Inc. (the Company), hereby certify that the Quarterly Report on Form 10-Q for the quarter ended June 29, 2013 (the Report) fully complies with the requirements of Section 13(a) or 15(d) 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

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Keith S. Bair  
Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)  
July 30, 2013