

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2001

Transition report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number: 0-23081

FARO TECHNOLOGIES, INC.
(Exact name of Registrant as specified in its charter)

FLORIDA

(State or other jurisdiction of
incorporation or organization)

59-3157093

(I.R.S. Employer
Identification No.)

125 TECHNOLOGY PARK DRIVE, LAKE MARY, FLORIDA

32746

(Address of Principal Executive Offices)

(Zip Code)

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

Class: Voting Common Stock, \$.001 Par Value Outstanding at November 10, 2001:
11,035,252

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
	----- (UNAUDITED)	-----
CURRENT ASSETS:		
Cash and cash equivalents	\$ 5,463,850	\$ 8,029,318
Short term investments - at cost (Note C)	5,320,861	6,218,636
Accounts receivable - net of allowance	8,898,793	10,352,972
Income taxes refundable	552,413	-
Inventories (Note D)	6,252,487	6,364,290
Prepaid expenses and other assets	1,932,038	1,112,881
Deferred income taxes	-	203,816
	-----	-----
Total current assets	28,420,442	32,281,913
	-----	-----
PROPERTY AND EQUIPMENT - at cost:		
Machinery and equipment	4,077,035	3,580,892
Furniture and fixtures	1,314,155	1,253,248
Leasehold improvements	141,766	89,171
	-----	-----
Total	5,532,956	4,923,311
Less accumulated depreciation	(3,810,126)	(3,121,029)
	-----	-----
Property and equipment, net	1,722,830	1,802,282
	-----	-----
INTANGIBLE ASSETS - net	2,936,286	4,055,337
	-----	-----
INVESTMENTS - at cost (Note C)	3,301,842	4,755,572
	-----	-----
NOTES RECEIVABLE (Note E)	2,525,258	1,128,846
	-----	-----
DEFERRED INCOME TAXES	-	675,324
	-----	-----
TOTAL ASSETS	\$ 38,906,658	\$44,699,274
	=====	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:		
Accounts payable	\$ 2,196,089	\$ 2,982,814
Accrued liabilities	3,425,324	4,120,404
Income tax payable	-	684,409
Current portion of unearned service revenues	737,613	687,566
Customer deposits	141,334	133,984
	-----	-----
Total current liabilities	6,500,360	8,609,177
	-----	-----
OTHER LONG-TERM LIABILITIES	420,664	134,644
	-----	-----
TOTAL LIABILITIES	6,921,024	8,743,821
	-----	-----
SHAREHOLDERS' EQUITY:		
Class A preferred stock - par value \$.001, 10,000,000 shares authorized, no shares issued and outstanding		-
Common stock - par value \$.001, 50,000,000 shares authorized, 11,070,706 issued; 11,030,706 outstanding	11,071	11,066
Additional paid-in-capital	47,593,454	47,570,059
Unearned compensation	-	-
Accumulated deficit	(12,677,707)	(9,268,134)
Accumulated other comprehensive loss:		
Cumulative translation adjustments, net of tax	(2,790,559)	(2,206,913)
Common stock in treasury, at cost - 40,000 shares	(150,625)	(150,625)
	-----	-----
Total shareholders' equity	31,985,634	35,955,453
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 38,906,658	\$44,699,274
	=====	=====

See accompanying notes to condensed consolidated financial statements.

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

(Unaudited)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000	2001	2000
Sales	\$ 8,416,886	\$8,810,972	\$25,087,547	\$29,584,018
Cost of sales	3,116,386	3,196,895	10,019,714	11,133,799
Gross profit	5,300,500	5,614,077	15,067,833	18,450,219
Operating expenses:				
Selling	3,337,978	3,233,294	10,531,573	10,264,455
General and administrative	1,498,108	1,481,068	4,399,892	4,124,963
Depreciation and amortization	659,326	626,517	1,983,804	2,067,932
Research and development	894,422	876,605	2,605,644	2,691,460
Employee stock options	-	31,671	-	95,013
Total operating expenses	6,389,834	6,249,155	19,520,913	19,243,823
Loss from operations	(1,089,334)	(635,078)	(4,453,080)	(793,604)
Interest income	180,730	219,810	684,748	584,604
Other Income	429,275	139,937	579,232	252,634
Interest expense	294	-	(473)	-
(Loss) income before income taxes	(479,035)	(275,331)	(3,189,573)	43,634
Income tax expense	(220,000)	(85,056)	(220,000)	(230,193)
Net Loss	\$ (699,035)	\$ (360,387)	\$(3,409,573)	\$ (186,559)
NET LOSS PER SHARE - BASIC	(\$0.06)	(\$0.03)	(\$0.31)	(\$0.02)
NET LOSS PER SHARE - DILUTED	(\$0.06)	(\$0.03)	(\$0.31)	(\$0.02)

See accompanying notes to condensed consolidated financial statements.

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock		Additional Paid-in Capital	Unearned Compensation	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Total
	Shares	Amounts						
BALANCE, JANUARY 1, 2000	11,059,510	\$11,060	\$47,544,844	\$(123,404)	\$ (9,307,651)	\$(1,374,878)	\$(150,625)	\$36,599,346
Net income					39,517			39,517
Currency translation adjustment, net of tax						(832,035)		(832,035)
Comprehensive loss								(792,518)
Issuance of common stock	5,715	6	25,215					25,221
Amortization of unearned compensation				123,404				123,404
BALANCE, DECEMBER 31, 2000	11,065,225	11,066	47,570,059	-	(9,268,134)	(2,206,913)	(150,625)	35,955,453
Net loss					(3,409,573)			(3,409,573)
Currency translation adjustment, net of tax						(583,646)		(583,646)
Comprehensive loss								(3,993,219)
Issuance of common stock	5,481	5	23,395					23,400
BALANCE, SEPTEMBER 30, 2001 (Unaudited)	11,070,706	\$11,071	\$47,593,454	\$ -	\$(12,677,707)	\$(2,790,559)	\$(150,625)	\$31,985,634

See accompanying notes to condensed consolidated financial statements

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

(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
OPERATING ACTIVITIES:		
Net loss	\$(3,409,573)	\$ (186,559)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,983,804	2,067,932
Bad debt expense	201,239	95,000
Inventory reserve	300,000	355,000
Provision for deferred income taxes	876,265	(108,106)
Employee stock options	-	95,013
Change in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	951,363	505,904
Income tax refundable	(552,413)	82,878
Inventories	(262,943)	(407,389)
Prepaid expenses and other assets	(842,820)	(319,976)
Increase (decrease) in:		
Accounts payable and accrued liabilities	(1,359,529)	774,103
Unearned service revenues	369,805	371,702
Income tax payable	(684,395)	-
Customer deposits	12,409	(5,217)
Net cash (used in) provided by operating activities	(2,416,788)	3,320,285
INVESTING ACTIVITIES:		
Proceeds from (payments for) investments, net	2,351,506	(722,958)
Purchases of property and equipment	(657,975)	(860,060)
Payments of patent costs	-	(114,421)
Notes Receivable	(1,396,412)	(1,147,647)
Payments for intangibles and other	(254,926)	(131,798)
Net cash provided by (used in) investing activities	42,193	(2,976,884)
FINANCING ACTIVITIES:		
Payments on debt	(20,927)	(7,159)
Proceeds from issuance of common stock, net	23,398	4,221
Net cash provided by (used in) financing activities	2,471	(2,938)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(193,344)	(359,830)
DECREASE IN CASH AND CASH EQUIVALENTS	(2,565,468)	(19,367)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	8,029,318	6,637,184
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 5,463,850	\$ 6,617,817

See accompanying notes to condensed consolidated financial statements.

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 30, 2001 and 2000

(UNAUDITED)

NOTE A - DESCRIPTION OF BUSINESS

FARO Technologies, Inc. and subsidiaries develops, manufactures, markets and supports Computer Aided Design (CAD)-based quality assurance products and CAD-based inspection and statistical process control software.

The Company has four wholly owned subsidiaries FARO FSC, Ltd.; FARO Europe GmbH & Co. KG, a German company, FARO Japan KKK, a Japanese company, and Antares LDA, a Portuguese company. The consolidated financial statements include the accounts of FARO Technologies, Inc. and all wholly owned subsidiaries (collectively, the "Company"). All significant intercompany transactions and balances have been eliminated. The financial statements of foreign subsidiaries have been translated into U.S. dollars using the current exchange rate in effect at each balance sheet date, for assets and liabilities, and the weighted average exchange rates during each reporting period, for results of operations. Cumulative adjustments resulting from translation of the financial statements are reflected as a separate component of comprehensive loss in the equity section.

NOTE B - BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all the information and footnote disclosure required by accounting principles generally accepted in the United States for complete consolidated financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the consolidated financial position and operating results for the interim periods have been included. The consolidated results of operations for the nine months ended September 30, 2001 are not necessarily indicative of results that may be expected for the year ending December 31, 2001. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company as of December 31, 2000 and 1999, and for each of the three years in the period ended December 31, 2000 included in the Company's 2000 Annual Report to Stockholders.

In June 2000, the FASB issued Statement No. 138, Accounting for Certain Hedging Activities, which amended Statement No. 133, Accounting for Certain Hedging Activities and required concurrent adoption with Statement No. 133. The Company adopted these new Statements effective January 1, 2001. The Company's adoption of these Statements did not have a significant effect on its results of operations or financial position.

In July 2001, the Financial Accounting Standard Board issued Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). SFAS No. 142 establishes accounting and reporting standards for acquired goodwill and other intangible assets, and supersedes APB Opinion No.17, "Intangible Assets". SFAS No. 142 requires that goodwill no longer be amortized to earnings, but instead be reviewed for impairment. The provisions of this Statement are required to be applied starting with fiscal years beginning after December 15, 2001, and as such the company has not yet adopted SFAS No. 142. Once adopted, operating expenses will be reduced by approximately \$310,000 on a quarterly basis for amortization and may increase for assets determined to be impaired, if any, during a respective quarter.

NOTE C - CASH AND CASH EQUIVALENT AND INVESTMENTS

Cash and cash equivalents - The Company considers cash on hand and amounts on deposit with financial institutions which have original maturities of three months or less to be cash and cash equivalents. All short-term investments in debt securities which have maturities of three months or less are classified as trading securities, which are carried at market value based upon the quoted market prices of those investments at each respective balance sheet date.

Investments - Short-term investments and investments ordinarily consist of debt securities acquired with cash not immediately needed in operations. At September 30, 2001 and December 31, 2000 short-term investments of \$5.3 million and \$6.2 million, respectively, consist of government agency securities and corporate notes with maturities not exceeding one year. Investments have maturities of at least one year (none have maturities exceeding two years).

Investments consist of the following:

	September 30, 2001	December 31, 2000
	-----	-----
Government agency securities	\$2,039,872	\$ 898,840
Certificates of deposit	339,000	240,309
Corporate notes	922,970	3,616,423
	-----	-----
Total investments	\$3,301,842	\$4,755,572
	=====	=====

NOTE D - INVENTORIES

Inventories consist of the following:

	September 30, 2001	December 31, 2000
	-----	-----
Raw materials	\$ 554,156	\$ 486,002
Work-in-process	1,759,125	1,610,210
Finished goods	602,147	991,169
Sales demonstration	3,337,059	3,276,909
	-----	-----
Total inventories	\$6,252,487	\$6,364,290
	=====	=====

NOTE E - NOTES RECEIVABLE

In April 2001, the Company and SpatialMetrix Corporation ("SMX") entered into an agreement pursuant to which the Company provided to SMX \$1.5 million in financing. SMX Corp. is a manufacturer and worldwide supplier of laser trackers and targets, as well as metrology software and contract inspection services. The Company provided the \$1.5 million in financing to SMX by entering into a Participation Agreement with SMX's bank pursuant to which the Company funded and simultaneously acquired a \$1.5 million interest in SMX's \$3.8 million bank line of credit.

In October 2001, the Company and SMX entered into an additional agreement pursuant to which the Company would provide to SMX up to an additional \$1.5 million in financing. The Company amended its Participation Agreement with SMX's bank so that the additional financing to SMX also would be made through an additional participation with SMX's bank line of credit. Consequently, SMX's bank line of credit can increase to a maximum of \$5.3 million, of which FARO would own up to \$3 million. In October 2001, the Company provided \$750,000 of this additional financing to SMX. The Company has agreed to make additional advances to SMX from the remaining \$750,000 in financing upon the attainment by SMX of product development benchmarks to the satisfaction of the Company.

In addition to the financing provided to SMX, the Company and SMX entered into an agreement in September 2001 pursuant to which the Company has an option to acquire SMX. The acquisition agreement is exercisable by the Company at the end of any calendar quarter until the option expires on December 31, 2002 or later depending on certain conditions

SMX's line of credit bears interest at a rate of 3% in excess of SMX's bank's prime rate, which increases by an additional 5% during any default on the line of credit. The line of credit matures on December 28, 2001, which will be accelerated if the Company exercises its option to acquire SMX before that date.

In 1998, the Company acquired CATS GmbH for total consideration of \$16 million (including direct costs of the acquisition), consisting of \$5 million in cash, 916,668 shares of the Company's Common Stock and the assumption of certain outstanding liabilities of CATS. The acquisition agreement provided that the Company would provide a loan to each of the two former shareholders of CATS to fund their tax liability in connection with the Company's acquisition of CATS. Such former CATS shareholders remain key employees of the Company.

Pursuant to a Loan Agreement dated August 2, 1999 with each of the former CATS shareholders, the Company agreed to loan to the former CATS shareholders an amount equal to their tax obligation to the German tax authorities in connection with the Company's acquisition of CATS. In June 2000, the German tax authorities issued a tax assessment to each of the former CATS shareholders. In connection therewith, on June 20, 2000 the Company and each of the former CATS shareholders entered into an Amended and Restated Loan Agreement and the Company granted loans to the former CATS shareholders in the aggregate amount of \$1.1 million ("the Loans"). The Loans are for a term of three years, at an interest rate of approximately 4.3%, and grant the borrowers an option to extend the term for an additional three years. As collateral for the Loans, the former CATS shareholders pledged to the Company 177,074 shares of the Company's Common Stock. The Loans are a non-recourse obligation of the former CATS shareholders.

NOTE F - 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 September 30,			
	2001		2000	
	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	11,030,706	\$(.06)	11,020,682	\$(.03)
Effect of dilutive securities	-	-	-	-
Diluted EPS	11,030,706	\$(.06)	11,020,682	\$(.03)

	Nine months ended September 30,			
	2001		2000	
	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	11,029,321	\$(.31)	11,020,174	\$(.02)
Effect of dilutive securities	-	-	-	-
Diluted EPS	11,029,321	\$(.31)	11,020,174	\$(.02)

NOTE G - SEGMENT GEOGRAPHIC DATA

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

The following table presents information about the Company by geographic area:

	Three months ended September 30,		Nine months ended September 30,	
	2001	2000	2001	2000
SALES:				
United States	\$3,440,390	\$4,378,705	\$10,095,089	\$14,631,289
Germany	2,074,512	1,498,452	4,897,264	6,287,967
United Kingdom	418,826	411,703	2,187,825	1,993,141
France	785,616	717,477	2,658,487	2,134,405
Other foreign	1,697,542	1,804,635	5,248,882	4,537,216
Total	\$8,416,886	\$8,810,972	\$25,087,547	\$29,584,018
	=====	=====	=====	=====
			September 30,	December 31,
			2001	2000
LONG-LIVED ASSETS (NET):				
United States			\$ 2,216,706	\$ 2,326,790
Germany			2,297,556	3,385,662
Other foreign			144,854	145,167
Total			\$ 4,659,116	\$ 5,857,619
			=====	=====

The geographical information presented above represents sales to the respective countries, whereas the long-lived assets are held in the respective countries.

PART I. FINANCIAL INFORMATION

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following information should be read in conjunction with the Condensed Consolidated Financial Statements of the Company, including the notes thereto, included elsewhere in this Form 10-Q, and the Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

OVERVIEW

The Company designs, develops, markets and supports portable, software-driven, 3-D measurement systems that are used in a broad range of manufacturing and industrial applications. The Company's principal products are the FAROArm(R) articulated measuring device, the Control Station and its multi-faceted CAM2 software which provides for CAD-based inspection on portable and fixed-base CMMs, and factory-level statistical process control. Together, these products integrate the measurement and quality inspection function with CAD, CAM and computer-aided engineering ("CAE") technology to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company's products bring precision measurement, quality inspection and specification conformance capabilities, integrated with leading CAD software, to the factory floor. Historically, the Company's revenue growth has resulted from increased unit sales due to an expanded sales effort that included the addition of sales personnel at existing offices, the opening of new sales offices (including offices in international markets) and expanded promotional efforts which include a multilingual web site and Company demo CD.

During 2001, the Company's sales growth has been adversely affected by the economic slowdown currently affecting the United States and Europe to a lesser extent. We expect that the current economic slowdown will continue to adversely affect U. S. sales and the Company's growth rate in other geographic markets during the balance of 2001. Accordingly, the Company adopted a cost reduction plan during the third quarter of 2001. This plan includes reducing discretionary spending, canceling certain non-strategic product development and marketing projects, and a reduction of approximately 15% of the company's workforce, or about 30 people, primarily in administration, research and development, and manufacturing.

RESULTS OF OPERATIONS

THREE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2000

Sales. Sales decreased by \$394,000, or 4.5%, from \$8.8 million for the three months ended September 30, 2000 to \$8.4 million for three months ended September 30, 2001. The decrease primarily resulted from reduction in sales in the U.S. (\$938,000); offset in part by an increase in sales in Germany of \$576,000.

Gross profit. Gross profit decreased by \$314,000 or 5.6%, from \$5.6 million for the three months ended September 30, 2000 to \$5.3 million for the three months ended September 30, 2001. Gross margin decreased slightly to 63.0% for the three months ended September 30, 2001 from 63.7% for the three months ended September 30, 2000. The decrease in gross margin was primarily a result of more aggressive sales discounts and a shift in product mix in the three months ended September 30, 2001.

Selling expenses. Selling expenses increased by \$105,000 or 3.2%, from \$3.2 million for the three months ended September 30, 2000 to \$3.3 million for the three months ended September 30, 2001. This increase was primarily a result of higher expenses in Europe (resulting from increase in headcount and marketing efforts to develop new geographic markets) and costs associated with restructuring of the Company's domestic sales force, offset in part by lower marketing expenses in the US.

General and administrative expenses. General and administrative expenses increased by \$17,000 or 1.2%, to \$1.5 million for the three months ended September 30, 2001. The increase was due to

additional administrative expenses to support geographic growth in Japan, offset in part by lower expenses in U.S. as a result of cost cutting initiatives implemented early in the third quarter.

Depreciation and amortization expenses. Depreciation and amortization expenses increased slightly by \$33,000 or 5.2%, from \$627,000 for the three months ended September 30, 2000 to \$659,000 for the three months ended September 30, 2001 due to normal additions to fixed assets during the year.

Research and development expenses. Research and development expenses increased by \$18,000, or 2.0%, from \$877,000 for the three months ended September 30, 2000 to \$894,000 for the three months ended September 30, 2001 principally as a result of higher compensation costs in the U.S.

Interest income. Interest income decreased by \$39,000, or 17.8%, from \$220,000 for the three months ended September 30, 2000, to \$181,000 for the three months ended September 30, 2001. The decrease was primarily attributable to lower interest bearing cash balances (see Liquidity and Capital Resources below).

Other Income. Other income increased by \$289,000 or 207%, from \$140,000 for the three months ended September 30, 2000 to \$429,000 for the three months ended September 30, 2001 primarily due to higher royalty income and foreign currency gains during the current period.

Income tax expense. In the third quarter of 2001, the Company recorded a valuation allowance against certain deferred tax assets in the amount of \$879,000. Additionally, the Company recorded a current income tax benefit in the amount of \$659,000 in connection with the Company's income tax loss for U.S. federal purposes in 2001 which can be carried back to prior years. In the comparable period in 2000, the Company recorded a provision for income tax in connection with the Company's U.S. income before income taxes.

Net Loss. Net loss increased by \$339,000 from \$360,000 for the three months ended September 30, 2000 to \$699,000 for the three months ended September 30, 2001 due to the factors stated above.

NINE MONTHS ENDED SEPTEMBER 30, 2001 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2000

Sales. Sales decreased by \$4.5 million, or 15.2%, from \$29.6 million for the nine months ended September 30, 2000 to \$25.1 million for nine months ended September 30, 2001. The decrease primarily resulted from reduction in product sales in the U.S. (\$4.5 million) and Germany (\$1.4 million), offset in part by increase in sales in other foreign locations (\$712,000).

Gross profit. Gross profit decreased by \$3.4 million or 18.3%, from \$18.5 million for the nine months ended September 30, 2000 to \$15.1 million for the nine months ended September 30, 2001. Gross margin decreased to 60.1% for the nine months ended September 30, 2001 from 62.4% for the nine months ended September 30, 2000 primarily a result of more aggressive sales discounts in the nine months ended September 30, 2001.

Selling expenses. Selling expenses increased by \$267,000, or 2.6%, from \$10.3 million for the nine months ended September 30, 2000 to \$10.5 million for the nine months ended September 30, 2001. This increase was primarily a result of higher selling expenses in Europe and U.S. (resulting from increase in headcount and marketing efforts to develop new geographic markets) and costs associated with restructuring of the Company's domestic sales force.

General and administrative expenses. General and administrative expenses increased by \$275,000 or 6.7%, from \$4.1 million for the nine months ended September 30, 2000 to \$4.4 million for the nine months ended September 30, 2001. The increase was primarily due to a one-time consulting fee and additional administrative expenses to support geographic growth in Europe and Japan, partially offset by lower expenses in U.S. as a result of cost cutting initiatives implemented early in the third quarter.

Depreciation and amortization expenses. Depreciation and amortization expenses decreased by \$84,000 or 4.1%, from \$2.1 million for the nine months ended September 30, 2000 to \$2.0 million for the nine months ended September 30, 2001 due in part to fully amortized intangible assets in the U.S.

Research and development expenses. Research and development expenses decreased by \$86,000, or 3.2%, from \$2.7 million, for the nine months ended September 30, 2000 to \$2.6 million for the nine months ended September 30, 2001 principally as a result of lower R&D activities in Europe.

Interest income. Interest income increased by \$100,000, or 17.1%, from \$585,000 for the nine months ended September 30, 2000, to \$685,000 for the nine months ended September 30, 2001. The increase was primarily attributable to efforts to invest in higher yielding cash equivalents, and investments during the first six months in 2001 (see Liquidity and Capital Resources below).

Other Income. Other income increased by \$327,000 or 129%, from \$253,000 for the nine months ended September 30, 2000 to \$579,000 for the nine months ended September 30, 2001 primarily due to higher royalty income during the year.

Income tax expense. In the third quarter of 2001, the Company recorded a valuation allowance against certain deferred tax assets in the amount of \$879,000. Additionally, the Company recorded a current income tax benefit in the amount of \$659,000 in connection with the Company's income tax loss for U.S. federal purposes in 2001 which can be carried back to prior years. In the comparable period in 2000, the Company recorded a provision for income tax in connection with the Company's U.S. income before income taxes.

Net Loss. Net loss increased by \$3.2 million from \$187,000 for the nine months ended September 30, 2000 to \$3.4 million for the nine months ended September 30, 2001 due to the factors stated above.

LIQUIDITY AND CAPITAL RESOURCES

During the nine months ended September 30, 2001, cash decreased by \$2.6 million from \$8.0 million at December 31, 2000 to \$5.5 million at September 30, 2001. For the nine months ended September 30, 2001, net cash used in operating activities was \$2.4 million compared to cash provided by operating activities of \$3.3 million for the nine months ended September 30, 2000. The decrease was principally due to the net operating loss in 2001. Net cash provided by investing activities was \$42,000 for the nine months ended September 30, 2001, compared to cash used in investing activities of \$3.0 million for the nine months ended September 30, 2000. The increase in net cash provided by investing activities is primarily attributable to proceeds from investments of \$2.4 million in 2001 versus payments for investments of \$723,000 in 2000. Currency exchange rate changes resulted in a \$193,000 reduction on the Company's reported cash at September 30, 2001.

In April 2001, the Company and SpatialMetrix Corporation ("SMX") entered into an agreement pursuant to which the Company provided to SMX \$1.5 million in financing. SMX Corp. is a manufacturer and worldwide supplier of laser trackers and targets, as well as metrology software and contract inspection services. The Company provided the \$1.5 million in financing to SMX by entering into a Participation Agreement with SMX's bank pursuant to which the Company funded and simultaneously acquired a \$1.5 million interest in SMX's \$3.8 million bank line of credit.

In October 2001, the Company and SMX entered into an additional agreement pursuant to which the Company would provide to SMX up to an additional \$1.5 million in financing. The Company amended its Participation Agreement with SMX's bank so that the additional financing to SMX also would be made through an additional participation with SMX's bank line of credit. Consequently, SMX's bank line of credit can increase to a maximum of \$5.3 million, of which FARO would own up to \$3 million. In October 2001, the Company provided \$750,000 of this additional financing to SMX. The Company has agreed to make additional advances to SMX from the remaining \$750,000 in financing upon the attainment by SMX of product development benchmarks to the satisfaction of the Company.

In addition to the financing provided to SMX, the Company and SMX entered into an agreement in September 2001 pursuant to which the Company has an option to acquire SMX. The acquisition agreement is exercisable by the Company at the end of any calendar quarter until the option expires on December 31, 2002 or later depending on certain conditions

SMX's line of credit bears interest at a rate of 3% in excess of SMX's bank's prime rate, which increases by an additional 5% during any default on the line of credit. The line of credit matures on December 28, 2001, which will be accelerated if the Company exercises its option to acquire SMX before that date.

Additionally, the Company has commitments at September 30, 2001 resulting from leases on its headquarters and regional offices and from leases on motor vehicles and office equipment. There were no other material commitments for capital expenditures at that date.

The Company believes that its cash, investments, cash flows from operations and funds available from its credit facility will be sufficient to satisfy its working capital, loan commitment and capital expenditure needs through the foreseeable future.

FOREIGN EXCHANGE EXPOSURE

Sales outside the United States represent a significant portion of the Company's total revenues. At present, the majority of the Company's revenues and expenses are invoiced and paid in U.S. dollars. In the future, the Company expects a greater portion of its revenues to be denominated in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on the Company's business, results of operations and financial condition, and could specifically result in foreign exchange losses. The impact of future exchange rate fluctuations on the results of operations cannot be accurately predicted. To the extent that the percentage of the Company's non-U.S. dollar revenues derived from international sales increases in the future, the Company's exposure to risks associated with fluctuations in foreign exchange rates will increase. Historically, the Company has not hedged against the risks associated with fluctuations in exchange rates. The Company at present is evaluating its exposure, and may use foreign exchange contracts and/or foreign currency options to hedge these risks in the future.

INFLATION

The Company believes that inflation has not had a material impact on its results of operations in recent years and it does not expect inflation to have a material impact on its operations in 2001.

CONVERSION TO THE EURO

On January 1, 1999, certain member countries of the European Union established fixed conversion rates between their existing currencies and the European Union's common currency (Euro). The transition period for the introduction of the Euro ends June 30, 2002. After the transition period certain member countries of the European Union are expected to adopt the Euro as their national currency. Issues facing the Company as a result of the introduction of the Euro include converting information technology systems, reassessing currency risk, amending lease agreements and other contracts, and processing tax and accounting records. The Company is addressing these issues and does not expect the adoption of the Euro to have a material effect on the Company's financial condition or results of operations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this item is incorporated by reference herein to the information contained in this report in Part I, Item 2, under the captions "Foreign Exchange Exposure" and "Inflation."

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a.) Exhibits

- 10.17 Amended Participation Agreement, dated October 31, 2001, between the Registrant and PNC Bank, National Association relating to the loan to SpatialMetrix Corporation. (Filed herewith)
- 10.20 Agreement Regarding Additional Advances, dated October 31, 2001, between the Registrant and SpatialMetrix Corporation. (Filed herewith)

b.) Reports on Form 8-K

None.

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.

Date: November 13, 2001

FARO TECHNOLOGIES, INC.
(Registrant)

By: /s/ Gregory A. Fraser

Gregory A. Fraser
Executive Vice President,
Secretary and Treasurer
(Duly Authorized Officer and
Principal Financial Officer)

AMENDED PARTICIPATION AGREEMENT

This Amended Participation Agreement (the "Agreement") is made and executed this 31st day of October, 2001 by and between PNC BANK, NATIONAL ASSOCIATION ("Lender") with an office at 1600 Market Street, Philadelphia, Pennsylvania 19103, Attn: Frank Devine, Assistant Vice President, and FARO TECHNOLOGIES, INC., with an office at 125 Technology Park, Lake Mary, FL 32746 Attn: Dr. Simon Raab ("Participant").

BACKGROUND

A. Pursuant to the terms and conditions of a certain Loan Agreement ("Loan Agreement") dated January 28, 1998 and related agreements, instruments and documents, all as amended from time to time (collectively called the "Credit Documents"), Lender has made loans, advances, and extensions of credit ("Line of Credit") to Spatialmetrix Corporation ("Borrower") up to a current maximum principal outstanding amount of \$2,300,000 at any one time.

B. Participant acknowledges receipt of copies of the Credit Documents. All capitalized terms used herein without definition shall have the respective meanings ascribed thereto in the Credit Documents.

C. On April 13, 2001, Lender increased the maximum principal among of the Line of Credit to Three Million Eight Hundred Thousand Dollars (\$3,800,000.00) and Lender and Participant entered into a Participation Agreement whereby Lender sold and transferred to Participant a participating interest in the Line of Credit subject to the terms and conditions set forth in the Participation Agreement.

D. Contemporaneously herewith, Lender is further increasing the maximum principal amount of the Line of Credit to Five Million Three Hundred Thousand (\$5,300,000) Dollars. Participant has agreed to purchase and accept and Lender is willing to sell and transfer to Participant an increased participating interest in the Line of Credit subject to the terms and conditions hereinafter set forth.

NOW, THEREFORE, with the foregoing Background deemed incorporated herein and made a part hereof, for good and valuable consideration the receipt of which is hereby acknowledged, and intending to be legally bound, the parties hereby covenant and agree as follows:

1. Pursuant and subject to the terms hereof, Lender hereby sells, extends and transfers to Participant and Participant hereby purchases and accepts from Lender an undivided participating interest in the Line of Credit ("Participation Share") in an amount equal to the lesser of: (i) fifty six and sixty one hundredths percent (56.60%) ("Participation Percentage") of the principal amount of the Line of Credit outstanding on the books of Lender, or (ii) \$3,000,000. Participant's Participation Share shall be sold on a "last out" basis, meaning the Participant's Participation Share shall only be paid after Lender's share of the Line of Credit is paid and satisfied in full.

2. INTENTIONALLY DELETED.

3. Lender shall pay over to Participant from and promptly after payment to Lender of, the interest actually received by Lender from Borrower, a sum equal to interest calculated on Participant's actual outstanding daily Participation Share of the Line of Credit for the period covered by the interest payment at the per-annum rate equal to PNC Bank's Prime Rate plus two and one-quarters of one (2.25 %) percent. Participant shall not share in any prepayment premiums or fees set forth in the Loan Agreement. If Lender should, for any reason, receive less than the full amount of interest or other compensation due under the Credit Documents, Participant's share of such interest or compensation set forth herein shall abate ratably.

4. Except as set forth in Section 3 hereof, all amounts paid to and credited by Lender to the outstanding balance of the Line of Credit including, without limitation, principal, interest and expenses and including the proceeds or collections resulting from the realization from or disposition of any Collateral Security for the Line of Credit shall be applied first (to be applied to principal, interest and expenses in such order as Lender may elect) for the benefit of Lender and then second, to Participant. The term "Collateral Security" as used herein includes Lender's lien on or security interest in all of Borrower's Collateral (as defined in the Credit Documents) and the amounts payable under and the proceeds of all other agreements under which any party other than Borrower becomes liable in any capacity in connection with the Line of Credit; balances in any bank account (including proceeds of any setoff), or loss reserve account or other reserve account of Borrower which Lender or Participant appropriates and applies to or toward the satisfaction of any liability of Borrower to Lender; and all other property, real or personal, tangible or intangible, of Borrower or any third party which secures payment of the Line of Credit. Lender shall hold title to and possession of all Collateral Security and Credit Documents in its name. Upon payment in full of Lender's share of the Line of Credit, Participant shall be the full and sole owner of the Line of Credit, the Credit Documents and all rights and obligations thereunder in its sole name.

5. Lender shall, at all times, have the sole and exclusive right to service, administer and monitor the Line of Credit, the Collateral Security and Credit Documents, including without limitation the rights to: (i) exercise all rights, privileges and options under the Credit Documents, including the credit judgment with respect to the making of advances and the determinations to the basis on which and the extent to which advances may be made, (ii) amend the Credit Documents, (iii) modify or terminate the Line of Credit or accelerate the Line of Credit, (iv) release, substitute or exchange any of the Collateral Security, (v) waive nonperformance by Borrower or other Events of Default, or enforce or refrain from enforcing its rights or remedies under the Credit Documents, and (vi) compromise claims by or against Borrower or with respect to any Collateral Security. Participant shall have no right or vote in connection with Lender's rights set forth above. Notwithstanding the foregoing, Lender and Participant agree as follows:

(a) Participant shall not make any payments directly to Borrower but shall forward all additional funds to be advanced under this Agreement to Lender by wire transfer to PNC Bank, ABA 043000096, SL #19603-0010890 for further advance to Spatialmetrix Corporation, Note Number 601246497, contact Frank Devine at 215-585-4483 when wire is sent;

(b) Lender shall permit Borrower to draw upon the Line of Credit after the date for up to a maximum of \$1,500,000;

(c) Lender shall not make any further increases in the maximum principal amount of the Line of Credit beyond \$5,300,000 without the Participant's prior written consent;

(d) Participant acknowledges that it has received and approved Borrower's first draw request of Seven Hundred Fifty Thousand Dollars (\$750,000) and that Participant shall, at the time of execution of this Agreement, wire to the Lender Seven Hundred and Fifty Thousand Dollars (\$750,000) for further credit to the Borrower. No portion of the funds advanced by the Participant shall be used to pay down the Lender's portion of the Line of Credit;

(e) Lender agrees that draw requests by the Borrower in excess of the first draw request of Seven Hundred Fifty Thousand Dollars (\$750,000) shall not be made without the prior approval of Participant. No portion of the funds advanced by the Participant shall be used to pay down the Lender's portion of the Line of Credit;

(f) Lender shall not release, substitute or exchange any of the Collateral Security without the Participant's prior written consent;

(g) Lender shall not extend the time for repayment of the principal balance of the Line of Credit beyond December 28, 2001 without the Participant's prior written consent,

(h) The parties hereto acknowledge that until such time as the Lender's portion of the Line of Credit is paid in full, Borrower shall remit forty percent (40%) of all gross receipts received by Borrower from the collection of accounts receivable or the sale of inventory immediately to Lender, to be applied as a direct repayment of the Lender's portion of the Line of Credit.

(i) Participant previously purchased from Borrower a LaserTracker system, serial no. _____ (the "Equipment") for which Participant has paid to Borrower the sum of \$250,000. Lender consents to the re-purchase of the Equipment by the Borrower and agrees that Borrower may pay to the Participant the re-purchase price of \$250,000 from the proceeds of the initial Advance hereunder.

6. Lender shall have the right to deduct from payments on the Line of Credit, or collections from or proceeds of Collateral Security, such funds as may be necessary to pay or reimburse Lender for costs and expenses incurred by it and not reimbursed by Borrower. All out-of-pocket costs and out-of-pocket expenses incurred by Lender and not reimbursed by Borrower after the date hereof in connection with the amendment, administration and enforcement of the Line of Credit and Lender's rights in the Collateral Security (including, without limitation, reasonable counsel fees and expenditures to preserve and protect the Collateral Security under, and preserve and defend Lender's rights and interest under, the Credit Documents shall be shared by Participant pro rata with Lender based on Participant's Participation Percentage, however, Participant shall only be required to reimburse Lender for such out-of-pocket costs and expenses

to the extent Participant has received monies from Lender for application against its Participation Share. Lender shall not be responsible to Participant for any of Participant's costs and expenses arising from the interpretation of, amendment to or enforcement of this Agreement, and neither Participant nor Lender shall be entitled to share, on a pro rata basis with the other, any costs and expenses arising from any actions or proceedings brought by Lender or Participant against the other party.

7. Participant has entered into this Agreement solely upon its own independent investigation and credit analysis and is not relying upon any information supplied by or any representations made by Lender. Participant shall continue to make its own analysis and evaluation of Borrower. Lender makes no representation or warranty and assumes no responsibility with respect to (a) the financial condition of Borrower, any guarantor or other obligor, or any account debtor of Borrower; (b) the accuracy, sufficiency or currency of any information concerning the financial condition, prospects or results of operations of Borrower; (c) the sufficiency, authenticity, legal effect, validity or enforceability of the Credit Documents; or (d) the value, condition, location or quality to the Collateral Security. Lender assumes no responsibility or liability with respect to the collectibility of the Line of Credit or the performance by Borrower of any obligation under the Credit Documents.

8. During the term of this Agreement, Lender will furnish Participant with copies of all financial statements and field examination reports of Borrower and such other financial statements and reports as Participant may reasonably request. Lender shall promptly provide Participant with a copy of all correspondence from Lender to Borrower, including without limitation, demands for payment, notices of default, notices of acceleration, summons and complaints, and all notices relating to the sale of the Collateral Security. Lender will promptly notify Participant when it receives notice of or has actual knowledge of any Event of Default under the Credit Documents.

9. (a) Lender shall exercise the same care in accordance with commercially reasonable practices in administering, servicing and monitoring the Loan as it exercises with respect to similar transactions involving no participation. Lender shall exercise its right and options hereunder in a manner deemed by Lender to be in the best interests of Lender and Participant. Without limiting the foregoing, Lender may rely on the advice of counsel concerning legal matters and upon any written statements which it believes to be genuine or to have been presented by a proper person or entity and shall not be required to make any inquiry concerning the performance by Borrower of any of its obligations and liabilities under the Credit Documents or under any other document or agreement. Lender shall be entitled to rely on any notice, consent, certificate, affidavit, letter, telegram, teletype message, statement, order or other document believed by it to be genuine and correct and to have been signed and sent by the proper person or persons and, in respect of legal matters, upon an opinion of counsel selected by Lender.

(b) Notwithstanding Paragraph 9(a) above, Lender shall not in any event have any liability whatsoever to Participant except for Lender's negligence, willful misconduct or bad faith.

10. (a) In the event that: (a) Lender is required to refund or repay to Borrower or any other party all or any portion of any principal, interest or other payment which was paid to Lender after the date of this Agreement, and (b) Lender remitted all or a portion of such principal, interest or other payment to Participant pursuant to this Agreement, then Participant shall remit to Lender, on demand of Lender, such refunded or repaid amounts actually received by Participant.

(b) Participant hereby indemnifies, ratably according to its Participation Percentage, from and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements of any kind or nature whatsoever arising after the date hereof, which may be imposed on, incurred by or asserted against the Bank in any way relating to or arising out of Lender's execution of, or compliance with this Agreement or actions taken or omitted by Lender at the direction of or with the consent of Participant in connection with the terms hereof, provided that Participant shall not be liable for any portion of such liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements resulting from the willful misconduct or gross negligence of Lender. Participant's obligations under this Section shall survive the termination of the Credit Documents and this Agreement.

11. (a) Participant acknowledges and agrees that this Agreement merely sets forth the terms and conditions under which it is acquiring an interest in certain loans and extensions of credit made and to be made by Lender in a commercial loan transaction entered into between Lender and Borrower, and that this Agreement is therefore not intended to represent and shall not be deemed to constitute a security. This Agreement and the participation of Participant in the Line of Credit are not intended to and shall not be deemed to create or constitute any joint venture or partnership between Participant and Lender.

(b) No amounts paid by Participant hereunder shall be considered as a loan by Participant to Lender. It is expressly agreed that the participation herein described is a full-risk, non-recourse participation and that Participant shall look only to payments received and collected by Lender from Borrower or from Collateral Security or from any guarantor or other obligor for repayment of the participation.

12. (a) Participant shall not sell, subparticipate, assign, transfer or pledge all or any portion of its Participation Share in the Line of Credit, or its rights or obligations hereunder, without the prior written consent of Lender.

(b) Subject to the provisions of Section 13 hereof, nothing herein contained shall prohibit or restrict Lender from granting other participations in the Line of Credit to any other party as Lender may, in its sole discretion, elect. Lender shall provide Participant with prior written notice of the grant of other participations in the Line of Credit.

13. (a) At any time after the date of this Agreement, Participant may, but is not obligated to, on ten (10) days' prior written notice to Lender, terminate this Agreement and tender to Lender, on the effective date of such termination, an amount of cash or Federal Funds or other funds immediately available in Philadelphia, Pennsylvania equal to 100% of Lender's Share in the outstanding balance of the Line of Credit, plus accrued interest as of the date of such

tender. If such tender is duly made, Participant shall thereupon be deemed to have acquired Lender's entire Share for which such tender was made and this Agreement shall be terminated, except for obligations existing under paragraph 10(b) hereof on the date of tender.

(b) If Lender has granted a participation in this Line of Credit to any person other than the Participant (an "Other Participant"), at any time after the date of this Agreement, Participant may, but is not obligated to, on ten (10) days' prior written notice to the Other Participant, terminate this Agreement and tender to the Other Participant, on the effective date of termination, an amount of cash or Federal Funds or other funds immediately available in Philadelphia, Pennsylvania, equal to 100% of such Other Participant's Share in the outstanding balance of the Line of Credit, plus accrued interest as of the date of such tender. If such tender is duly made, Participant shall thereupon be deemed to have acquired such Other Participant's entire Share for which such tender was made and the Participation Agreement entered into between the Other Participant and Lender shall be terminated. Each participation agreement entered into by the Lender in which a participation in the Line of Credit is granted to any Other Participant shall incorporate the provisions of this Section 13.

(c) From and after receipt of written notice from the Participant of its intention to exercise its option under Section 13(a) hereof, the Lender shall not take any of the actions described in Section 5(i) through (vi) without the prior written consent of Participant.

14. During the term of this Agreement, Participant shall not with respect to Borrower, without the prior written consent of Lender, offer, solicit, negotiate, or otherwise contact Borrower in any manner regarding the Line of Credit, the Credit Documents, this Agreement or any of the terms of any of the above; provided however, that nothing in this Paragraph is intended to restrict Participant's discussions, negotiations or contacts with Borrower solely regarding Borrower's product development or matters arising from or relating to the proposed acquisition of the Borrower by the Participant.

15. This Agreement may be executed in counterpart copies, each of which shall be deemed a duplicate original hereof.

16. No modification or waiver of any provision of this Agreement shall be binding or enforceable unless in writing and signed by the party against whom enforcement is sought. No rights are intended to be created hereunder for the benefit of Borrower or any other third party beneficiary. Notices required or given hereunder shall be sent to the addresses set forth above either by telecopy, hand delivery against receipt or by a nationally-recognized overnight courier service on an overnight or next business day basis and sent to the addresses described on the first page of this Agreement. Notices shall be effective either immediately upon hand delivery or one business day after pick-up by express courier.

17. This Agreement shall inure to the benefit of Lender and Participant and their respective successors and assigns. This Agreement shall be governed by the laws of the Commonwealth of Pennsylvania.

THE PARTICIPANT HEREBY IRREVOCABLY WAIVES ANY AND ALL RIGHT IT MAY HAVE TO A TRIAL BY JURY IN ANY ACTION,

PROCEEDING OR CLAIM OF ANY NATURE RELATING TO THIS AGREEMENT, ANY DOCUMENTS EXECUTED IN CONNECTION WITH THIS AGREEMENT OR ANY TRANSACTION CONTEMPLATED IN ANY OF SUCH DOCUMENTS. THE PARTICIPANT ACKNOWLEDGES THAT THE FOREGOING WAIVER IS KNOWING AND VOLUNTARY.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed the day and year first above written.

PNC BANK, NATIONAL ASSOCIATION

By: _____
Title: _____

FARO TECHNOLOGIES, INC.

By: _____
Title: _____

AGREEMENT REGARDING ADDITIONAL ADVANCES

THIS AGREEMENT REGARDING ADDITIONAL ADVANCES (this "Agreement") is made and effective as of October 31, 2001, by and between SPATIALMETRIX CORPORATION, a Delaware corporation (the "Borrower") and FARO TECHNOLOGIES, INC., a Florida corporation (the "Lender")

R E C I T A L S

WHEREAS, pursuant to the terms and conditions of a certain Loan Agreement (the "Credit Agreement") dated January 28, 1998 and related agreements, instruments and documents, all as amended from time to time (collectively, the "Credit Documents"), PNC Bank, National Association (the "Senior Lender") has made loans, advances and extensions of credit ("Line of Credit") to Borrower; and

WHEREAS, on April 13, 2001, the Borrower and the Lender entered into that certain Agreement (the "Initial Agreement") pursuant to which the Lender entered into a Participation Agreement with the Senior Lender for the provision of additional credit under the Line of Credit in the amount of \$1,500,000, increasing the maximum principal amount available to \$3,800,000; and

WHEREAS, contemporaneously with execution of the Initial Agreement, the Borrower and the Lender entered into letters of intent proposing (a) an additional extension of credit (the "On-Going Loan Letter of Intent") and (b) the acquisition by the Lender of all of the stock of the Borrower (the "Acquisition Letter of Intent"); and

WHEREAS, on September 14, 2001, the Lender and the Borrower entered into that certain Agreement and Plan of Merger (the "Merger Agreement") providing, at the Lender's election, for the acquisition of the Borrower by the Lender and its affiliates; and

WHEREAS, contemporaneously herewith, the Lender is entering into an Amended Participation Agreement (the "Amended Participation Agreement") with the Senior Lender pursuant to which the Lender is making available to the Borrower additional credit in the maximum amount of \$1,500,000 through an additional participation with the Senior Lender; and

WHEREAS, the Borrower and the Lender desire in this Agreement to set forth the terms and conditions under which the Lender shall make additional credit available to the Borrower through its participation with the Senior Lender; and

WHEREAS, the Borrower has determined that its entry into this Agreement is in the best interests of the Borrower, and that the additional financing made available to the Borrower by the Lender's entry into the Participation Agreement is fair and adequate consideration for this Agreement.

NOW, THEREFORE, for good and valuable consideration (the receipt and sufficiency of which are hereby acknowledged) and intending to be legally bound hereby, the Borrower and Lender hereby agree as follows:

ARTICLE 1 : REPRESENTATIONS AND WARRANTIES

Borrower hereby represents and warrants to Lender as set forth in this Article 1.

1.1. Confirmation. Except as set forth on Schedule 1.1 attached hereto, the representations and warranties made in the Initial Agreement, the Merger Agreement and the Credit Agreement are true and correct as of the date hereof.

1.2. No Defaults. Except as set forth on Schedule 1.2 attached hereto, no Event of Default under the Initial Agreement, the Merger Agreement or the Credit Agreement and no event which with the passage of time or the giving of notice or both could become an Event of Default under the Initial Agreement, the Merger Agreement or the Credit Agreement exists on the date hereof.

1.3. Authority. The execution and delivery of this Agreement and the other documents and instruments to be executed and delivered by Borrower pursuant hereto and the consummation of the transactions contemplated hereby and thereby have been duly authorized. Except for any necessary third party consents, which consents have been obtained, no other or further corporate act or proceeding on the part of Borrower is necessary to authorize this Agreement or the other documents and instruments to be executed and delivered by Borrower pursuant hereto or the consummation of the transactions contemplated hereby and thereby. This Agreement constitutes, and when executed and delivered, the other documents and instruments to be executed and delivered by Borrower pursuant hereto will constitute, valid binding agreements of Borrower, enforceable in accordance with their respective terms, except (a) as limited by applicable bankruptcy, insolvency, reorganization, moratorium or other laws of general application affecting enforcement of creditors' rights, and (b) general principles of equity that restrict the availability of equitable remedies.

1.4. No Violation. Neither the execution and delivery of this Agreement or the other documents and instruments to be executed and delivered by Borrower pursuant hereto, nor the consummation by Borrower of the transactions contemplated hereby and thereby (a) to the knowledge of Borrower will violate any applicable law, statute, regulation or order of any Official Body, (b) require any authorization, consent, approval, exemption or other action by or notice to any Official Body, or (c) subject to obtaining the consents referred to in Schedule 1.4, will violate or conflict with, or constitute a default (or an event which, with notice or lapse of time, or both, would constitute a default) under, or will result in the termination of, or accelerate the performance required by, or result in the creation of any lien upon any of the assets of Borrower under, any term or provision of the Certificate of Incorporation or Bylaws of Borrower or of any contract, commitment, understanding, arrangement, agreement or restriction of any kind or character to which Borrower is a party or by which Borrower or any of its assets or properties may be bound or affected.

1.5. No Defenses, Counterclaims or Offsets. Borrower agrees that it has no defenses or set-offs against the Lender, its officers, directors, employees, agents or attorneys with respect to the Initial Agreement and the Merger Agreement, all of which are in full force and effect and shall remain in full force and effect unless and until modified or amended in writing in accordance with their terms. Borrower hereby ratifies and confirms its obligations under the Initial Agreement and the Merger Agreement and agrees that the execution and the delivery of this Agreement does not in any way diminish or invalidate any of its obligations thereunder.

ARTICLE 2: CREDIT AVAILABILITY

2.1. Additional Advances.

(a) Lender agrees to make available to the Senior Lender under a participation agreement with the Senior Lender, additional credit (the "Additional Advances") in a maximum principal amount equal to One Million Five Hundred Thousand and 00/100 Dollars (\$1,500,000.00). The Lender agrees that the first advance of \$750,000 (the "First Advance") shall be made available promptly after execution of this Agreement, the Amended Participation Agreement and amendments to the Credit Documents. Additional Advances shall be made upon the attainment of product development benchmarks (the "Funding Hurdles") described in Schedule 2.1 satisfactory to the Lender. Additional Advances shall be made following written request by the Borrower accompanied by substantiation as to the attainment of the applicable Funding Hurdles, and shall be in increments of not less than \$100,000.

(b) Immediately upon receipt of the First Advance of \$750,000.00, the Borrower shall repurchase from the Lender the laser tracker previously sold by the Borrower to the Lender for the sum of \$250,000.00 in immediately payable funds.

(c) No Additional Advances shall be made after December 28, 2001.

2.2. Use of Proceeds. The Borrower shall not use the Additional Advances for any of the following purposes without the prior written consent of the Lender:

(a) Direct or indirect payments to any of the Borrower's stockholders, directors or executive officers (other than regular compensation to salaried employees for services actually rendered at salary rates prevailing prior to the date of this Agreement); or

(b) Payments to First Union Capital Partners or the Senior Lender; or

(c) Distributions to stockholders of the Borrower, whether as dividends or in redemption of stock of the Borrower.

ARTICLE 3: CONDITIONS PRECEDENT

3.1. Conditions Precedent to Lender's Entry into Participation Agreement. Each of the following are conditions precedent to the entry into the Participation Agreement by the Lender:

(a) Credit Agreement. The Borrower shall enter into such amendments to the Credit Agreement and to the loan documents ancillary thereto as the are required by the Senior Lender and approved by the Borrower.

(b) No Breach or Default. The Borrower shall not have breached or defaulted under any provision of the Merger Agreement or the Credit Documents.

(c) Representations and Warranties. The representations and warranties contained in this Agreement and the Merger Agreement shall be true, correct and complete.

(d) Incumbency Certificate. Lender shall have received a certificate executed by the Secretary of the Borrower setting forth the names of the directors and officers of the Borrower, the names of the officers duly authorized by the Borrower to execute this Agreement and the Credit Documents, and including a specimen of signatures of officers authorized by the Borrower to execute and deliver this Agreement and the Credit Documents, and a certified copy of the resolutions of the Borrower authorizing the transactions herein contemplated. In addition, the secretary or other appropriate officer of the Borrower shall certify that there have been no amendments to the Certificate of Incorporation of the Borrower since the date of its certification by the Secretary of State, State of Delaware, or attach a certificate setting forth all such amendments.

(e) Compliance with Laws and Other Agreements. Lender shall have determined or received assurances reasonably satisfactory to it that none of this Agreement, the Credit Documents or any of the transactions contemplated thereby violate any applicable law, court order or agreement binding upon Borrower.

3.2. Conditions Precedent to Additional Advances. Each of the following are conditions precedent to the making of Additional Advances by the Lender:

(a) No Default. There shall not have occurred any default or Event of Default under the Credit Documents, the Merger Agreement, the Initial Agreement or this Agreement.

(b) Satisfaction of Lender. The Borrower shall have provided to the Lender such substantiation as the Lender may request in order to demonstrate attainment of the Funding Hurdle.

(c) Representations and Warranties True. The representations and warranties made in the Credit Agreement, the Merger Agreement, the Initial Agreement and this Agreement shall be true and correct.

ARTICLE 4: DEFINITIONS

4.1. Certain Terms. The following terms when used in this Agreement (including the preamble and recitals hereof) have the following meanings:

(a) "Additional Advances" shall have the meaning set forth in Section 2.1(a).

(b) "Affiliate", as it relates to any Person, shall mean: (i) any parent, spouse, brother, sister, or natural or adopted lineal descendant or spouse of any such parent, brother, sister, or descendant, of such Person (any such Person hereinafter in this Agreement being referred to as a "Relative") and (ii) any other Person directly or indirectly controlling, controlled by or under common control with such Person.

(c) "Agreement" means this Agreement and all exhibits, schedules and supplemental addenda hereto, all as may be amended and otherwise modified from time to time hereafter.

(d) "Amended Participation Agreement" is defined in the Recitals hereto.

(e) "Borrower" means SPATIALMETRIX CORPORATION, a Delaware corporation.

(f) "Credit Agreement" is defined in the Recitals.

(g) "Credit Documents" mean the Credit Agreement, as amended, together with every instrument, agreement or document executed by the Borrower in connection therewith.

(h) "Funding Hurdles" shall have the meaning set forth in Section 2.1(a).

(i) "Lender" means FARO TECHNOLOGIES, INC., a Florida corporation, and any successor, assignee, transferee, or pledgee thereof.

(j) "Merger Agreement" means that certain Agreement and Plan of Merger dated as of September 14, 2001 by and among Borrower, Lender and FARO Acquisition LLC, a wholly-owned subsidiary of Lender.

(k) "Official Body" means any federal, state, local, or other government (or any political subdivision, agency, authority, bureau, commission, department or instrumentality thereof) and any court, tribunal, grand jury or arbitrator, in each instance whether foreign or domestic.

(l) "Participation Agreement" is defined in the Recitals hereto.

(m) "Person" means any natural person, corporation, partnership, limited liability company, firm, association, trust, government, governmental agency or any other entity, whether acting in an individual, fiduciary or other capacity.

(n) "Senior Lender" means PNC Bank, National Association

ARTICLE 5: MISCELLANEOUS PROVISIONS

5.1. Letters of Intent. The parties agree that the terms and provisions of the Acquisition Letter of Intent and the On-Going Loan Letter of Intent, to the extent enforceable, are merged into the Merger Agreement and this Agreement.

5.2. Amendments. No amendment to or waiver of any provision of this Agreement, nor consent to any departure by any Borrower herefrom, shall in any event be effective unless such amendment, waiver or consent is in writing and signed by Lender and Borrower. Any such waiver or consent will be effective only in the specific instance and for the specific purpose for which given.

5.3. Addresses for Notices. Any notice, request, consent, waiver or other communication required or permitted under or in connection with this Agreement will be deemed satisfactorily given if it is in writing and is delivered either personally to the addressee thereof, or by prepaid registered or certified U.S. mail (return receipt requested), or by a nationally recognized commercial courier service with next-day delivery charges prepaid, or by telegraph, or by facsimile (voice confirmed), or by any other reasonable means of personal delivery to the party entitled thereto at its respective address set forth below its signature to this Agreement. If Borrower fails to insert an address below, then such failure shall constitute a designation of its last known address as the address for all notices, including notices of default and sale. Any party to this Agreement may change its address or facsimile number for notice purposes by giving notice thereof to the other parties hereto in accordance with this Section, provided that such change shall not be effective until 2 calendar days after notice of such change. All such notices and other communications will be deemed given and effective (a) if by mail, then upon actual receipt or 5 calendar days after mailing as provided above (whichever is earlier), or (b) if by facsimile, then upon successful transmittal to such party's designated number, or (c) if by telegraph, then upon actual receipt or 2 Business Days after delivery to the telegraph company (whichever is earlier), or (d) if by nationally recognized commercial courier service, then upon actual receipt or 2 Business Days after delivery to the courier service (whichever is earlier), or (e) if otherwise delivered, then upon actual receipt.

5.4. Severability. Wherever possible, each provision of this Agreement shall be interpreted in such manner as to be effective and valid under applicable law. If any provision of this Agreement shall be prohibited by or invalid under such law, then such provision shall be ineffective to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement.

5.5. Governing Law. This Agreement shall be governed by and construed in accordance with the internal laws of the Commonwealth of Pennsylvania.

5.6. Entire Agreement. This Agreement and the Credit Documents constitute the entire understanding among the parties hereto with respect to the subject matter hereof and supersede any prior agreements (written or oral) with respect thereto.

5.7. Waiver of Notice; Waiver of Bond. Borrower waives the posting of any bond otherwise required of Lender in connection with any judicial process or proceeding to enforce any judgment or other court order entered in favor of Lender, or to enforce by specific

performance, temporary restraining order or preliminary or permanent injunction this Agreement.

5.8. Forum Selection and Consent to Jurisdiction. Any litigation in any way related to this Agreement, or any course of conduct, course of dealing, statements (whether verbal or written), actions or inactions of Lender or Borrower will be brought and maintained exclusively in the courts of the Commonwealth of Pennsylvania of the United States District Court for the Eastern District of Pennsylvania. Borrower and Lender hereby expressly and irrevocably submit to the jurisdiction of the courts of the Commonwealth of Pennsylvania or the United States District Court for the Eastern District of Pennsylvania for the purpose of any such litigation as set forth above and irrevocably agree to be bound by any final and non-appealable judgment rendered thereby in connection with such litigation. Borrower and Lender further irrevocably consents to the service of process by registered or certified mail, postage prepaid, or by personal service within or outside the Commonwealth of Pennsylvania. Borrower and Lender hereby expressly and irrevocably waive (to the fullest extent permitted by law) any objection which they may have or hereafter may have to the laying of venue of any such litigation brought in any such court referred to above and any claim that any such litigation has been brought in an inconvenient forum.

5.9. Waiver of Jury Trial. Lender and Borrower each hereby knowingly, voluntarily and intentionally waives any rights it may have to a trial by jury in respect of any litigation (whether as claim, counter-claim, affirmative defense or otherwise) in any way related to this Agreement or any Credit Documents, or any course of conduct, course of dealing, statements (whether verbal or written), actions or inactions of Lender or Borrower. Borrower acknowledges and agrees (a) that it has received full and sufficient consideration for this provision (and each other provision of each of this Agreement and the Credit Document to which it is a party), and (b) that it has been advised by legal counsel in connection herewith, and (c) that this provision is a material inducement for Lender entering into this Agreement.

5.10. Counterparts. This Agreement may be executed in any number of counterparts with the same effect as if all the signatures on such counterparts appeared on one document. Each counterpart will be deemed to be an original, but all counterparts together will constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement, as an instrument under seal (whether or not any such seals are physically attached hereto), through their duly authorized officers, as of the date first written above.

ATTEST:

By: _____

SPATIALMETRIX CORPORATION
(Borrower)

By: _____

Name:
Title:

Name: Andrew Thomson
Title: President

[CORPORATE SEAL]

Address: 222 Gale Lane
Kennett Square, PA 19348
Facsimile No: (610) 444-2323
Attn: Andrew Thomson

FARO TECHNOLOGIES, INC.
(Lender)

By: _____
Name: Simon Raab
Title: President

Address: 125 Technology Park Drive
Lake Mary, Florida 32746
Facsimile No: (407) 333-4181
Attn: Simon Raab

Schedule 1.1

Confirmation of Representations and Warranties

NONE

Schedule 1.2

No Defaults

The Borrower is in default under the Credit Agreement. All of the defaults of the Borrower under the Credit Agreement are set forth in Section 5 of the Sixth Amendment to Loan Documents, executed by the Borrower contemporaneously herewith.

Schedule 2.2

Funding Hurdles

1. Receive Alpha Structural Components*
2. Order Alpha/Beta Cover Castings*
3. Complete Alpha Mechanical Assembly*
4. Complete Alpha Testing*
5. Order Structural Castings*
6. Receive Beta Structural Castings*
7. Receive Alpha/Beta Cast Covers*
8. Complete Assembly & In-House Testing of Beta Machines
9. Complete Beta Test in the Field
10. Release Production Circuit Boards*
11. Release Miscellaneous Mechanical Components*
12. Release Optical Parts*
13. Release Packaging*
14. Complete Production Procedures
15. Complete Production Tooling and Fixtures
16. Complete Test Procedures
17. Complete Test Fixtures*
18. Receive Circuit Boards
19. Receive Mechanical Components
20. Receive Optical Parts
21. Receive Packaging
22. Receive Firmware
23. Release Software
24. Launch Keystone Production
25. Complete Delivery Ready Status

*Items marked with an asterisk are represented by the Borrower by its letter to Simon Raab dated October 15, 2001 to be completed.

For greater certainty, Complete Delivery Ready Status means successful completion of all the items below:

- . Stock of 20 units including all parts with supply lead time greater than thirty (30) days,
- . Completed assembly of 3 units the foregoing inventory of parts, that meets delivery specifications,
- . Tested and confirmed 50 man-hours or less of assembly labor,

- . Bill of Materials costed with supporting Quantity of 100 quotes and purchased stock invoices, and
- . Targeted Cost range either ADM or IFM option confirmed to be in the range of \$25,000 to \$28,000 or lower, including manufacturing labor. Current targets for the components are:
 - . Tracker Head and Master Control Unit \$17,000
 - . ADM Components \$ 5,000
 - . IFN Components \$ 7,000