

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

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

For the fiscal year ended December 31, 2007
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

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 Number)

125 Technology Park, Lake Mary, FL
(Address of principal executive offices)

32746
(Zip code)

(Registrant's telephone number, including area code): (407) 333-9911

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class</u>	<u>Name of Each Exchange on Which Registered</u>
Common Stock, par value \$.001	NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definite proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the Registrant's common stock held by non-affiliates of the Registrant on June 30, 2007, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$428 million (based on the last sale on such date on the NASDAQ Global Market).

As of March 5, 2008, there were outstanding 16,662,004 shares of the Registrant's common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's proxy statement for the 2008 Annual Meeting of Shareholders are incorporated by reference in Parts II and III of this Report.

TABLE OF CONTENTS

	<u>Page</u>
PART I	1
Item 1. Business.	2
Item 1A. Risk Factors.	9
Item 1B. Unresolved Staff Comments.	15
Item 2. Properties.	16
Item 3. Legal Proceedings.	16
Item 4. Submission of Matters to a Vote of Security Holders.	19
PART II	20
Item 5. Market For Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity.	20
Item 6. Selected Financial Data.	22
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.	22
Item 7A. Quantitative and Qualitative Disclosures About Market Risk.	33
Item 8. Financial Statements and Supplementary Data.	34
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.	61
Item 9A. Controls and Procedures.	61
Item 9B. Other Information.	62
PART III	63
Item 10. Directors, Executive Officers, and Corporate Governance.	63
Item 11. Executive Compensation.	63
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.	63
Item 13. Certain Relationships and Related Transactions and Director Independence.	63
Item 14. Principal Accountant Fees and Services.	63
PART IV	64
Item 15. Exhibits and Financial Statement Schedules.	64

PART I

CAUTIONARY STATEMENTS FOR FORWARD-LOOKING INFORMATION

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

Forward-looking statements are not guarantees of future performance and are subject to a number of known and unknown risks, uncertainties, and other factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements. Consequently, undue reliance should not be placed on these forward-looking statements. 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 a material difference in the actual results from those contemplated in such forward-looking statements include, among others, and those elsewhere in this report and the following:

- the Company’s inability to further penetrate its customer base;
- development by others of new or improved products, processes or technologies that make the Company’s products obsolete or less competitive;
- 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 the financial condition of its customers;
- the fact that 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

Table of Contents

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, (xxi) the ultimate costs of the Company's monitoring obligations in respect of the Foreign Corrupt Practices Act ("FCPA") matter; and (xxii) other factors noted herein;

- changes in gross margins due to changing product mix of products sold and the different gross margins on different products;
- the Company's inability to successfully implement the requirements of Restriction of use of Hazardous Substances ("RoHS") and Waste Electrical and Electronic Equipment ("WEEE") compliance into 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 inability to reach a final resolution of the FCPA matter with the DOJ or the SEC or reaching a resolution on the FCPA matter that differs from the resolution currently anticipated by the Company whether with respect to monetary sanctions ultimately paid by the Company to the SEC or DOJ or otherwise;
- the amount of monetary sanctions ultimately paid by the Company to the SEC and the DOJ in connection with the FCPA matter;
- 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 Company's growth;
- variations in the effective income tax rate and the difficulty in predicting the tax rate on a quarterly and annual basis; and
- the loss of key suppliers and the inability to find sufficient alternative suppliers in a reasonable period or on commercially reasonable terms.

ITEM 1. BUSINESS.

The Company designs, develops, manufactures, markets and supports portable, software driven, 3-D measurement systems that are used in a broad range of manufacturing, industrial, building construction and forensic applications. The Company's FaroArm, FARO Scan Arm and FARO Gage articulated measuring devices, the FARO Laser Scanner LS, the FARO Laser Tracker, and their companion CAM2 software, provide for Computer-Aided Design ("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 December 2007, our products have been purchased by approximately 7,400 customers worldwide, ranging from small machine shops to such large manufacturing and industrial companies as Audi, Bell Helicopter, Boeing, British Aerospace, Caterpillar, Daimler Chrysler, General Electric, General Motors, Honda, Johnson Controls, Komatsu Dresser, Lockheed Martin, Nissan, Siemens and Volkswagen, among many others.

[Table of Contents](#)

The Company was founded in 1982 and re-incorporated in Florida in 1992. The Company's worldwide headquarters are located at 125 Technology Park, Lake Mary, Florida 32746, and its telephone number is (407) 333-9911.

Industry Background

The Company believes that there are four principal forces driving the need for its products and services: 1) the widespread use by manufacturers of CAD in product development which shortens product cycles; 2) the adoption by manufacturers of quality standards such as Six Sigma and ISO-9000 (and its offshoot QS-9000), which stress the measurement of every step in a manufacturing process to reduce or eliminate defects, 3) the inability of traditional measurement devices to address many manufacturing problems such as throughput, efficiency, and accuracy, especially those related to large components for products such as automobiles, aircraft, heavy duty construction equipment, and factory retrofits, and 4) the growing demand to capture large volumes of three-dimensional data for modeling and analysis.

CAD changes the manufacturing process. The creation of physical products involves the processes of design, engineering, production and measurement and quality inspection. These basic processes have been profoundly affected by the computer hardware and software revolution that began in the 1980s. CAD software was developed to automate the design process, providing manufacturers with computerized 3-D design capability. Today, most manufacturers use some form of CAD software to create designs and engineering specifications for new products and to quantify and modify designs and specifications for existing products. The use of CAD can shorten the time between design changes. While manufacturers previously designed their products to be in production for longer periods of time, current manufacturing practices must accommodate more frequent product introductions and modifications, while satisfying more stringent quality and safety standards. Assembly fixtures and measurement tools must be linked to the CAD design to enable production to keep up with the rate of design change.

Quality standards dictate measurement to reduce defects. QS-9000 is the name given to the Quality System Requirements of the automotive industry that were developed by Chrysler, Ford, General Motors and major truck manufacturers and issued in late 1994. Companies that become registered under QS-9000 are considered to have higher standards and better quality products. Six Sigma embodies the principles of total quality management that focus on measuring results and reducing product or service failure rates to 3.4 per million. All aspects of a Six Sigma company's infrastructure must be analyzed, and if necessary, restructured to increase revenues and raise customer satisfaction levels. The all-encompassing nature of these and other quality standards has resulted in manufacturers measuring every aspect of their process, including stages of product assembly that may never have been measured before, in part because of the lack of suitable measurement equipment.

Traditional products do not measure up. A significant aspect of the manufacturing process, which traditionally has not benefited from computer-aided technology, is measurement and quality inspection. Historically, manufacturers have measured and inspected products using hand-measurement tools such as scales, calipers, micrometers and plumb lines for simple measuring tasks, test (or check) fixtures for certain large manufactured products and traditional coordinate measurement machines ("CMM") for objects that require higher precision measurement. However, the broader utility of each of these measurement methods is limited.

Although hand-measurement tools are often appropriate for simple geometric measurements, including hole diameters or length and width of a rectangular component, their use for complex part measurements, such as the fender of a car, is limited. Also these devices do not allow for the measurements to be directly compared to the CAD model of the part. Test fixtures (customized fixed tools used to make comparative measurements of complex production parts to "master parts") are relatively expensive and must be reworked or discarded each time a dimensional change is made in the part being measured. In addition, these manual measuring devices do not permit the manufacturer to compare the dimensions of an object with its CAD model.

[Table of Contents](#)

Conventional CMMs are generally large, fixed-base machines that provide very high levels of precision and provide a link to the CAD model of the object being measured. However, fixed-base CMMs require the object being measured be brought to the CMM and the object fit within the CMMs measurement grid. As manufactured subassemblies increase in size and become integrated into even larger assemblies, they become less transportable, thus diminishing the utility of a conventional CMM. Consequently, manufacturers must continue to use hand-measuring tools, or expensive customized test fixtures, in order to measure large or unconventionally shaped objects. Some parts or assemblies are not easily accessible and cannot be measured at all using traditional devices.

Conventional surveying equipment is limited to single-point measurements and does not have the capacity to capture and analyze large volumes of three-dimensional data. As data requirements for construction, civil engineering and forensic inspection projects become more complex, single-point measurement devices will become increasingly more difficult to utilize in those applications.

Escalating global competition has created a demand for higher quality products with shorter life cycles. Customers require more rapid design, greater control of the manufacturing process, tools to compare components to their CAD specifications and the ability to precisely measure components that cannot be measured or inspected by conventional devices, and the ability to capture and analyze large volumes of three-dimensional data. Moreover, they increasingly require measurement capabilities to be integrated into manufacturing processes and to be available on the factory floor.

FARO Products

The FaroArm. The FaroArm is a combination of a portable, six or seven-axis, instrumented articulated measurement arm, a computer, and software programs under the acronym CAM2.

- **Articulated Arm**—Each articulated arm is comprised of three major joints, each of which may consist of one, two or three axes of motion. The articulated arm is available in a variety of sizes, configurations and precision levels that are suitable for a broad range of applications. To take a measurement, the operator simply touches the object to be measured with a probe at the end of the arm and presses a button. Data can be captured at either individual points or a series of points. Digital rotational transducers located at each of the joints of the arm measure the angles at those joints. This rotational measurement data is transmitted to an on-board controller that converts the arm angles to precise locations in 3-D space using “xyz” position coordinates and “ijk” orientation coordinates.
- **Computer**—The Company pre-installs its CAM2 software on either a notebook or desktop style computer, depending on the customer’s need, and the measuring device, computer and installed software are sold as a system. The computers are not manufactured by the Company, but are purchased from various suppliers.
- **CAM2 Software**—See separate section on CAM2 Software below.

The Faro Scan Arm. The Faro Scan Arm is a FaroArm equipped with a combination of a hard probe (like that in the Faro Arm) and a non-contact line laser probe. This product provides our customers the ability to measure their products without touching them and offers a seven-axis contact/non-contact measurement device with a fully integrated laser scanner. The Scan Arm is used for non-contact measurement applications, including inspection, cloud-to-CAD comparison, rapid prototyping, reverse engineering and 3-D modeling.

The FARO Gage. Sold as a combination of an articulated arm device with a computer and software, the FARO Gage is a smaller, higher accuracy version of the FaroArm product. What distinguishes the FARO Gage from the FaroArm are the special mounting features and the basic software which are unique to the FARO Gage. The FARO Gage is targeted at machine tools, and bench tops around machine tools, where basic measurements of smaller machined parts must be measured. As such, the CAM2 software developed for this device features basic 2-D and 3-D measurements common to these applications. (See also “FARO Gage Software” below.)

The FARO Laser Tracker. A combination of a portable, large-volume laser measurement tool, a computer, and CAM2 software programs.

- **Laser Tracker**—The FARO Laser Tracker utilizes an ultra-precise laser beam to measure objects of up to 230 feet. It enables manufacturing, engineering, and quality control professionals to measure and inspect large parts, machine tools and other large objects on-site and/or in-process. With its greater angular resolution, repeatability, and accuracy, the FARO Laser Tracker advances already-proven tracker technology. Among its many enhanced features is SuperADM, which improves upon existing Absolute Distance Measurement technology by providing the time-saving ability to reacquire the laser beam without the need to return to a known reference point or the need to hold the target stationary.
- **Computer**—See description under FaroArm above.
- **CAM2 Software**—See separate section on CAM2 software below.

The FARO Laser Scanner LS. The FARO Laser Scanner LS utilizes laser technology to measure and collect a cloud of data points, allowing for the detailed and precise three-dimensional rendering of an object or an area as large as a factory. This technology is currently used for factory planning, facility life-cycle management, quality control, forensic analysis and in general, capturing large volumes of three-dimensional data. Laser scanning technology simplifies modeling, reduces project time and maintains or increases the accuracy of the image. The resulting data is used with major CAD systems or FARO's own proprietary software for the applications listed above.

CAM2 Software. CAM2 is the Company's family of proprietary CAD-based measurement and statistical process control software. The CAM2 product line includes the following software programs, many of which are translated into multiple languages:

- **CAM2 Measure X** allows users to compare measurements of manufactured components or assemblies with the corresponding CAD data for the components or assemblies. CAM2 Measure X is offered with the FaroArm and the FARO Laser Tracker.
- **CAM2 SPC Process** allows for the collection, organization, and presentation of measurement data factory-wide. Not limited to measurements from the FaroArm or FARO Laser Tracker, CAM2 SPC Process accepts data from CMM and other computer-based measurement devices from many different measurement applications along the production line.
- **Soft Check Tool** is a custom software program designed to lead an operator through a measurement process on the FaroArm or FARO Laser Tracker with minimal training. These programs are created by the Company from specifications provided by the customer.
- **FARO Gage Software** includes a dedicated graphical interface designed for the ease of use of the operator. Capable of producing graphical and tabular reports, the software runs a library of gauging and Soft Check tools.
- **Laser Scanner LS Software.** The Company has a number of programs available for its Laser Scanner LS product, as follows:
 - **FARO Scout** is a powerful software tool for displaying 3-D measurements and navigation in huge pointclouds.
 - **FARO Scene** is software for displaying, analyzing, administration and editing of 3-D measurements in huge pointclouds including registration of multiple pointclouds.
 - **FaroCloud for AutoCAD** supports the visualization and analysis of millions of 3-D points in the well known AutoCAD software environment. As-built documentation of industrial structures, historic buildings or many more applications are possible.
 - **Faroworks** is a web-based tool for the administration of complex projects and navigation from floorplan to scan with links to measurements.
 - **Walkinside** is a high performance 3-D viewer with full room measurement and other features.

[Table of Contents](#)

Customers

As of December 2007, the Company's products have been purchased by approximately 7,400 customers worldwide, including small machine shops, large manufacturing and industrial companies, universities and law enforcement agencies. The Company's ten largest customers by revenue represented an aggregate of 5.8% of the Company's total revenues in 2007. No customer represented more than 2.0% of the Company's sales in 2007.

Sales and Marketing

The Company directs its sales and marketing efforts on a decentralized basis in three main regions around the world: Americas, Europe/Africa and Asia/Pacific. The regional headquarters for the Americas is located in the Company's headquarters in Lake Mary, Florida; the Europe/Africa regional headquarters is located in Stuttgart, Germany; and the regional headquarters for the Asia/Pacific region is located in Singapore. At December 31, 2007 the Company employed 118, 123, and 80 sales and marketing specialists in the Americas, Europe/Africa, and Asia/Pacific regions, respectively. The Company has direct sales representation in the United States, Canada, Brazil, Germany, United Kingdom, France, Spain, Italy, Poland, Netherlands, India, China, Singapore, Malaysia, Vietnam, Thailand, and Japan. See Footnote 19 to the Notes to Consolidated Financial Statements, incorporated herein by reference to Item 8 hereof, for financial information about the Company's foreign and domestic operations and export sales required by this Item.

The Company uses a process of integrated lead qualification and sales demonstration. Once a customer opportunity is identified, the Company employs a team-based sales approach involving inside and outside sales personnel who are supported by application engineers. Each product has a separate sales force who report to regional sales managers for all products. The Company employs a variety of marketing techniques to promote brand awareness and customer identification.

Research and Development

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

The Company's research and development efforts are directed primarily at enhancing the functional adaptability of its current products and developing new and innovative products that respond to specific requirements of the emerging market for 3-D measurement systems. The Company's research and development efforts have been devoted primarily to mechanical hardware, electronics and software. The Company's engineering development efforts will continue to focus on enhancing our existing products and developing new products for the CAM2 market.

At December 31, 2007, the Company employed 67 scientists and technicians in its research and development efforts. Research and development expenses were approximately \$10.3 million in 2007 compared to \$7.2 million in 2006 and \$6.4 million in 2005. The Company believes that the continual development or acquisition of innovative new products is critical to its future success. The field of CAM2 and more broadly, 3-D measurement, continues to expand and new technologies and applications will be essential to competing in this market. Research and development activities, especially with respect to new products and technologies, are subject to significant risks, and there can be no assurance that any of the Company's research and development activities will be completed successfully or on schedule, or, if so completed, will be commercially accepted.

Intellectual Property

The Company holds or has pending 74 patents in the United States and related patents worldwide. The Company also has 27 registered or pending trademarks in the United States and worldwide.

[Table of Contents](#)

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

Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of the Company's products or to obtain and use information that the Company regards as proprietary. The Company intends to vigorously defend its proprietary rights against infringement by third parties. However, policing unauthorized use of the Company's products is difficult, particularly overseas, and the Company is unable to determine the extent to which piracy of its software products exists. In addition, the laws of some foreign countries do not protect the Company's proprietary rights to the same extent as the laws of the United States.

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

Manufacturing and Assembly

The Company manufactures its FaroArm, FARO Gage, and FARO Laser Tracker 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 Laser Scanner LS product in its facility located in Stuttgart, Germany. The Company expects all its existing plants to have the production capacity necessary to support its growth through 2008.

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

The Company's manufacturing, engineering, and design headquarters have been registered to the ISO-9001 standard since July 1998. Semi-annual surveillance audits have documented continuous improvement to this multinational standard. The Company continues to examine its scope of registration as the business evolves and has chosen English as the standard business language for its operations. This decision is expected to significantly influence the Company's operations and documentation globally.

This has been done in concert with the ISO9001:2000 Quality Management System Certification, and is expected to increase customer confidence in the Company's processes, products and services worldwide. Additionally, the Company takes a global approach to ISO17025:2005 Calibration Laboratory recognition, seeking to have all locations registered with identical scopes of accreditation and capabilities for the products generated and serviced.

Currently the Company's manufacturing sites in Lake Mary, Kennett Square, Stuttgart, Schaffhausen and Singapore are jointly registered to ISO-9001 and ISO17025. In addition, its service sites in the United States, Germany, India, Japan, China, Singapore and Brazil also have joint certification and accreditation to these key standards.

Competition

The Company's portable measurement systems compete in the broad market for measurement devices for manufacturing and industrial applications which, in addition to portable articulated arms, laser tracker and laser scanner products, consist of fixed-base CMMs, templates and go/no-go gages, check fixtures, handheld measurement tools, and various categories of surveying equipment. The broad market for measurement devices is highly competitive. In the Faro Gage product line, the Company competes with manufacturers of handheld measurement tools and fixed-base CMMs, including some large, well-established companies. In the Faro Arm, Faro Scan Arm, Faro Laser Tracker, and Faro Laser Scanner LS product lines, the Company competes primarily with Hexagon Metrology, a division of Hexagon. The Company also competes in these product lines with a number of other smaller competitors.

The Company will be required to make continued investments in technology and product development to maintain the technological advantage that it believes it currently has over its competition. Some of the Company's competitors, including some manufacturers of fixed based CMMs and Hexagon, possess substantially greater financial, technical, and marketing resources than it possesses. Moreover, the Company cannot be certain that its technology or its product development efforts will allow it to successfully compete as the industry evolves. As the market for the Company's portable measurement systems expands, additional competition may emerge and the Company's existing and future competitors may commit more resources to the markets in which the Company participates.

Government Regulation

The Company's operations are subject to numerous governmental laws and regulations, including those governing antitrust and competition, the environment, securities transactions and disclosures, import and export of products, currency conversions and repatriation, taxation of foreign earnings and earnings of expatriate personnel and use of local employees and suppliers. The Company's foreign operations are subject to the U.S. FCPA, which makes illegal any payments to foreign officials or employees of foreign governments that are intended to induce them to use their influence to assist the Company or to gain any improper advantage for the Company. The Company operates in certain regions that are more highly prone to risk under the FCPA.

Manufacturers of electrical goods have become subject to the European Union's RoHS and WEEE directives, which took effect during 2006. Parallel initiatives are being proposed in other jurisdictions, including several states in the United States and China. RoHS prohibits the use of lead, mercury and certain other specified substances in electronics products, and WEEE makes producers of electrical goods financially responsible for specified collection, recycling, treatment, and disposal of covered electronic products and components.

The Company expects that it will have its products in compliance with the RoHS directive in time. However, if the Company is unable to do so, it would be unable to sell its products in European Union countries, as well as possible several states in the United States and China, which would have a material adverse effect on its sales and results of operation.

Backlog

At December 31, 2007, the Company had orders representing approximately \$19.1 million in product sales outstanding. The majority of these specific orders were shipped by February 20, 2008, and, as of February 20, 2008, the Company had orders representing approximately \$13.0 million in product sales outstanding. At December 31, 2006 and 2005, the Company had orders representing approximately \$10.3 million and \$7.3 million in product sales outstanding, respectively.

The Company's increase in backlog at December 31, 2007 is consistent with the Company's overall sales growth and includes planned customer delivery dates in early 2008. The Company believes that substantially all of the outstanding sales orders as of February 20, 2008 will be shipped during 2008.

[Table of Contents](#)

Employees

At December 31, 2007, the Company had 780 full-time employees, consisting of 321 sales and marketing professionals, 144 production staff, 67 research and development staff, 112 administrative staff, and 136 customer service/application engineering specialists. The Company is not a party to any collective bargaining agreements and believes its employee relations are good. Management believes that its future growth and success will depend in part on its ability to retain and continue to attract highly skilled personnel. The Company anticipates that it will be able to obtain the additional personnel required to satisfy its staffing requirements over the foreseeable future.

Geographic Information

The information regarding net sales, operating income, and long-lived assets set forth in Note 19 to the Consolidated Financial Statements is hereby incorporated by reference into this Part I, Item 1.

Available Information

The Company maintains a web site with the address www.faro.com. Information contained on its web site is not a part of, or incorporated by reference into, this Annual Report on Form 10-K. The Company makes available free of charge through its web site its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy statements and amendments to these reports, as soon as reasonably practicable after it electronically files these reports with, or furnishes these reports to, the Securities and Exchange Commission.

ITEM 1A. RISK FACTORS.

The Company discusses expectations regarding its future performance and makes other forward-looking statements in its annual and quarterly reports, press releases and other written and oral statements. These forward-looking statements are based on currently available competitive, financial and economic data and its operating plans. 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. They are inherently uncertain, and investors must recognize that events could turn out to be significantly different from the Company's expectations. The following discussion of risks and uncertainties include, but are not limited to, some important factors to consider when evaluating the Company's trends and future results.

The Company's customers' buying process for its products is highly decentralized, and therefore, it typically requires significant time and expense for the Company to further penetrate the potential market of a specific customer, which may delay its ability to generate additional revenue.

The Company's success will depend, in part, on its ability to further penetrate its customer base. During 2007, 48.0% of the Company's revenue was attributable to sales to its existing customers, compared to 45.1% in 2006. If the Company is not able to continue to penetrate its existing customer base, its sales growth will be impaired. Most of its customers have a decentralized buying process for measurement devices. Thus, the Company must spend significant time and resources to increase revenues from a specific customer. For example, the Company may provide products to only one of its customer's manufacturing facilities or for a specific product line within a manufacturing facility. The Company cannot be certain that it will be able to maintain or increase the amount of sales to its existing customers.

Others may develop products that make the Company's products obsolete or less competitive.

The CAM2 market is emerging and could be characterized by rapid technological change. Others may develop new or improved products, processes or technologies that may make the Company's products obsolete or less competitive. The Company cannot assure you that it will be able to adapt to evolving markets and technologies or maintain its technological advantage.

The Company's success will depend, in part, on its ability to maintain its technological advantage by developing new products and applications and enhancing its existing products. Developing new products and applications and enhancing its existing products can be complex and time-consuming and will require substantial investment by the Company. Significant delays in new product releases or difficulties in developing new products could adversely affect the Company's revenues and results of operations. Because its customers are concentrated in a few industries, a reduction in sales to any one of these industries could cause a significant decline in the Company's revenues.

An economic slowdown in manufacturing will affect the Company's growth and profitability.

A significant portion of the Company's sales are to manufacturers in the automotive, aerospace and heavy equipment industries. The Company is dependent upon the continued growth, viability and financial stability of its customers in these industries, which are highly cyclical and dependent upon the general health of the economy and consumer spending. The cyclical nature of these industries may exert significant influence on the Company's revenues and results of operations. In addition, the volume of orders from its customers and the prices of its products may be adversely impacted by decreases in capital spending by a significant portion of its customers during recessionary periods. If one or more of its significant customers were to become insolvent or otherwise were unable to pay for the products provided by the Company, its operating results and financial condition would be adversely affected.

The Company's inability to protect its patents and proprietary rights in the United States and foreign countries could adversely affect its revenues.

The Company's success depends in large part on its ability to obtain and maintain patent and other proprietary right protection for its processes and products in the United States and other countries. The Company also relies upon trade secrets, technical know-how and continuing inventions to maintain its competitive position. The Company seeks to protect its technology and trade secrets, in part, by confidentiality agreements with its employees and contractors. The Company's employees may breach these agreements or the Company's trade secrets may otherwise become known or be independently discovered by inventors. If the Company is unable to obtain or maintain protection of its patents, trade secrets and other proprietary rights, it may not be able to prevent third parties from using its proprietary rights.

The Company's patent protection involves complex legal and technical questions. Its patents may be challenged, narrowed, invalidated or circumvented. The Company may be able to protect its proprietary rights from infringement by third parties only to the extent that its proprietary processes and products are covered by valid and enforceable patents or are effectively maintained as trade secrets. Furthermore, others may independently develop similar or alternative technologies or design around the Company's patented technologies. Litigation or other proceedings to defend or enforce its intellectual property rights could require the Company to spend significant time and money and could otherwise adversely affect its business.

Claims from others that the Company infringes their intellectual property rights may adversely affect its operations.

From time to time the Company receives notices from others claiming it infringes their intellectual property rights. The number of these claims may grow. Responding to these claims may require the Company to enter into royalty or licensing agreements on unfavorable terms, require it to stop selling or to redesign affected products or require it to pay damages. Any litigation or interference proceedings, regardless of their outcome, may be costly and may require significant time and attention of the Company's management and technical personnel.

[Table of Contents](#)

Potential product failures or product availability and performance issues could result in lost sales, loss of customers and possible delays in new product introductions and enhancements and increased warranty costs.

The Company has a history of new product introductions and enhancements to existing products. Potential product failures in new or existing products of the Company could result in delays in new product introductions, which could lead to a loss of sales, and increased warranty costs.

The Company may not be able to achieve financial results within its target goals, and its operating results may fluctuate due to a number of factors, many of which are beyond its control.

The Company's ability to achieve financial results that are within its goals is subject to a number of factors, some of which are beyond its control. Moreover, the Company's annual and quarterly operating results have varied significantly in the past and likely will vary significantly in the future. Factors that cause the Company's financial results to fluctuate include those set forth elsewhere in this report and the following:

- the effectiveness of sales promotions and sales of demonstration equipment;
- geographic expansion in the Asia/Pacific region and other regions;
- training and ramp-up time for new sales people;
- investments in potential acquisitions or strategic sales, product or other initiatives;
- investments in technologies and new products;
- quality issues with the Company's products;
- shrinkage or other inventory losses due to product obsolescence, scrap or material price changes;
- the efficiencies achieved in managing inventories and fixed assets;
- expansion of the Company's manufacturing capability and other inflationary pressures;
- the size and timing of customer orders, many of which are received towards the end of the quarter;
- the amount of time that it takes to fulfill orders and ship the Company's products;
- the length of the Company's sales cycle to new customers and the time and expense incurred in further penetrating its existing customer base;
- increases in operating expenses for product development and new product marketing;
- costs associated with new product introductions, such as assembly line start-up costs and low introductory period production volumes;
- the timing and market acceptance of new products and product enhancements;
- customer order deferrals in anticipation of new products and product enhancements;
- the Company's success in expanding its sales and marketing programs;
- start-up costs and ramp-up time associated with opening new sales offices outside of the United States;
- potential decreases in revenue without proportionate adjustments in fixed costs;
- changes in gross margins due to: lower average selling prices, changing product mix of products sold and the different gross margins on different products;
- variations in the effective income tax rate and the difficulty in predicting the tax rate on a quarterly and annual basis;
- compliance with government regulations including health, safety, and environmental matters;
- the ultimate costs of the Company's monitoring obligations in respect of the FCPA matter and the amount of monetary sanctions ultimately paid by the Company to the SEC and DOJ in connection with the FCPA matter;
- litigation and regulatory action brought against the Company; and
- adverse changes in the manufacturing industry and general economic conditions.

[Table of Contents](#)

Any one or a combination of these factors could adversely affect the Company's annual and quarterly operating results in the future and could cause it to fail to achieve its target financial results.

The CAM2 market is an emerging market and the Company's growth depends on the ability of the Company's products to attain broad market acceptance.

The market for traditional fixed-base CMMs, check fixtures, handheld measurement tools, and surveying equipment is mature. Part of the Company's strategy is to continue to displace these traditional measurement devices. Displacing traditional measurement devices and achieving broad market acceptance of the Company's products requires significant effort to convince manufacturers to reevaluate their historical measurement procedures and methodologies.

Because the CAM2 market is emerging, the potential size and growth rate of the CAM2 market is uncertain and difficult to quantify. If the CAM2 market does not continue to expand or does not expand at least as quickly as the Company anticipates, it may not be able to continue its sales growth, which also may affect its profitability.

The Company markets five closely interdependent products (FaroArm, Scan Arm, FARO Laser Scanner LS, FARO Laser Tracker and FARO Gage) and related software for use in measurement, inspection, and high density surveying applications. Substantially all of the Company's revenues are currently derived from sales of these products and software and it plans to continue its business strategy of focusing on the portable software-driven, 3-D measurement and inspection market. Consequently, the Company's financial performance will depend in large part on portable, computer-based measurement, inspection, and high density surveying products achieving broad market acceptance. If its products cannot attain broad market acceptance, the Company will not grow as anticipated and may be required to make increased expenditures on research and development for new applications or new products.

The Company competes with manufacturers of portable measurement systems and traditional measurement devices, many of which have more resources than the Company and may develop new products and technologies.

The broad market for measurement devices is highly competitive. In the FARO Gage product line, the Company competes with manufacturers of handheld measurement tools and fixed-base CMMs, including some large, well-established companies. In the FaroArm, FARO Scan Arm, FARO Laser Tracker, and FARO Laser Scanner LS product lines, the Company competes primarily with Hexagon Metrology, a division of Hexagon. The Company also competes in these product lines with a number of other smaller competitors.

The Company will be required to make continued investments in technology and product development to maintain the technological advantage that it believes it currently has over its competition. Some of its competitors, including some manufacturers of fixed based CMMs and Hexagon, possess substantially greater financial, technical, and marketing resources than it possesses. Moreover, the Company cannot be certain that its technology or its product development efforts will allow it to successfully compete as the industry evolves. As the market for its portable measurement systems expands, additional competition may emerge and the Company's existing and future competitors may commit more resources to the markets in which the Company participates.

The Company derives a substantial part of its revenues from its international operations, which are subject to greater volatility and often require more management time and expense to achieve profitability than its domestic operations.

Since 2000, the Company has derived approximately half of its sales from international operations. In the Company's experience, entry into new international markets requires considerable management time as well as start-up expenses for market development, hiring and establishing office facilities before any significant revenues are generated. As a result, initial operations in a new market may operate at low margins or may be unprofitable.

[Table of Contents](#)

The Company's international operations are subject to various risks, including:

- difficulties in staffing and managing foreign operations;
- political and economic instability;
- unexpected changes in regulatory requirements and laws;
- longer customer payment cycles and difficulty collecting accounts receivable;
- compliance with export and import regulations and trade restrictions;
- governmental restrictions on the transfer of funds to the Company from its operations outside the United States;
- burdens of complying with a wide variety of foreign laws and labor practices; and
- fluctuations in currency exchange rates.

The Company's foreign subsidiaries maintain their financial records and statements in their respective local currencies and the Company's consolidated financial results are affected by foreign currency translation adjustments. Moreover, several of the countries where the Company operates have emerging or developing economies, which may be subject to greater currency volatility, negative growth, high inflation, limited availability of foreign exchange and other risks. These factors may harm the Company's results of operations and any measures that it may implement to reduce the effect of volatile currencies and other risks of its international operations may not be effective.

The Company has not finally resolved the FCPA matter with the DOJ and the SEC.

As previously reported on the Company's Form 8-K dated March 15, 2006, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company has engaged in settlement discussions with both the SEC and the DOJ concerning the FCPA matter and has determined that the settlement discussions are likely to result in a resolution that will include a fine and disgorgement of associated profits. The Company recorded in the third quarter of 2007 a reserve of \$2.65 million in anticipation of the amount that could be necessary to satisfy its financial obligations to the SEC and the DOJ in resolving this matter. However, there is no assurance that such discussions will result in a resolution of the FCPA matter. Predicting at this time when the FCPA matter will be finally resolved with the SEC and the DOJ is not possible.

The monetary sanctions ultimately paid by the Company to the SEC and DOJ in resolving this matter, whether imposed on the Company or agreed to by settlement, may exceed the amount that has been reserved by the Company. In addition, the ultimate costs of the Company's continuing monitoring obligations in respect of the FCPA matter are uncertain and may vary from the Company's preliminary estimates of such amount as a result of a number of factors, including without limitation the fact that neither the scope of the monitoring obligation nor the identity of outside monitoring firm have been determined.

The Company may not be able to identify, consummate or achieve expected benefits from acquisitions.

The Company has completed three significant acquisitions since its initial public offering in 1997. The Company may pursue access to additional technologies, complementary product lines and sales channels through selective acquisitions and strategic investments. The Company may not be able to identify and successfully negotiate suitable acquisitions, obtain financing for future acquisitions on satisfactory terms or otherwise complete acquisitions in the future. In the past the Company has used its stock as consideration for acquisitions. The Company's common stock may not remain at a price at which it can be used as consideration for acquisitions without diluting its existing shareholders, and potential acquisition candidates may not view its stock attractively.

[Table of Contents](#)

Realization of the benefits of acquisitions often requires integration of some or all of the sales and marketing, distribution, manufacturing, engineering, finance and administrative organizations of the acquired companies. The integration of acquisitions demands substantial attention from senior management and the management of the acquired companies. Any acquisition may be subject to a variety of risks and uncertainties including:

- the inability to assimilate effectively the operations, products, technologies and personnel of the acquired companies (some of which may be located in diverse geographic regions);
- the inability to maintain uniform standards, controls, procedures and policies;
- the need or obligation to divest portions of the acquired companies; and
- the potential impairment of relationships with customers.

The Company cannot assure you that it will be able to integrate successfully any acquisitions, that any acquired companies will operate profitably or that it will realize the expected benefits from any acquisition.

The Company may face difficulties managing growth.

If its business continues to grow rapidly in the future, the Company expects it to result in:

- increased complexity;
- increased responsibility for existing and new management personnel; and
- incremental strain on its operations and financial and management systems.

If the Company is not able to manage future growth, its business, financial condition and operating results may be harmed.

The Company's dependence on suppliers for materials could impair its ability to manufacture its products.

Outside vendors provide key components used by the Company in the manufacture of its products. Although the Company believes that alternative sources for these components are available, any supply interruption in a limited source component would harm its ability to manufacture its products until a new source of supply is identified. In addition, an uncorrected defect or supplier's variation in a component, either known or unknown to the Company, or incompatible with its manufacturing processes, could harm its ability to manufacture its products. The Company may not be able to find a sufficient alternative supplier in a reasonable period, or on commercially reasonable terms, if at all. If the Company fails to obtain a supplier for the manufacture of components of its potential products, it may experience delays or interruptions in its operations, which would adversely affect its results of operations and financial condition.

The Company's failure to attract and retain qualified personnel could lead to a loss of sales or decreased profitability or growth. Required compensation levels including equity based compensation to attract and retain personnel could result in increased compensation expense.

The Company may not be able to attract and retain enough qualified personnel to support its growth. In addition, the loss of the Company's Chief Executive Officer, Chief Technology Officer, or Chief Financial Officer, or other key personnel could adversely effect its sales, profitability, or growth. Moreover, the Company continues to rely in part on equity awards to attract and retain qualified personnel. Because of new accounting regulations requiring the expensing of stock options, if the Company continues to rely on equity compensation to attract and retain qualified personnel, its compensation expenses may increase.

[Table of Contents](#)

The Company may experience volatility in its stock price.

The price of the Company's common stock has been, and may continue to be, highly volatile in response to various factors, many of which are beyond its control, including:

- developments in the industries in which it operates;
- actual or anticipated variations in quarterly or annual operating results;
- speculation in the press or investment community; and
- announcements of technological innovations or new products by the Company or its competitors.

The market price of the Company's common stock may also be affected by its inability to meet analyst and investor expectations and failure to achieve projected financial results. Any failure to meet such expectations or projected financial results, even if minor, could cause the market price of the Company's common stock to decline. Volatility in its stock price may result in your inability to sell your shares at or above the price at which you purchased them.

In addition, stock markets have generally experienced a high level of price and volume volatility, and the market prices of equity securities of many companies have experienced wide price fluctuations not necessarily related to the operating performance of such companies. These broad market fluctuations may adversely affect the market price of the Company's common stock. In the past, securities class action lawsuits frequently have been instituted against such companies following periods of volatility in the market price of such companies' securities. If any such litigation is instigated against the Company, it could result in substantial costs and a diversion of management's attention and resources, which could have a material adverse effect on its business, results of operations and financial condition.

Anti-takeover provisions in the Company's articles of incorporation, its bylaws and provisions of Florida law could delay or prevent a change of control that you may favor.

The Company's articles of incorporation, its bylaws and provisions of Florida law could make it more difficult for a third party to acquire the Company, even if doing so would be beneficial to you. These provisions could discourage potential takeover attempts and could adversely affect the market price of the Company's shares. Because of these provisions, you might not be able to receive a premium on your investment. These provisions include:

- a limitation on shareholders' ability to call a special meeting of the Company's shareholders;
- advance notice requirements to nominate directors for election to the Company's board of directors or to propose matters that can be acted on by shareholders at shareholder meetings;
- the Company's classified board of directors, which means that approximately one-third of its directors are elected each year; and
- the authority of the board of directors to issue, without shareholder approval, preferred stock with such terms as the board of directors may determine.

The provisions described above could delay or make more difficult transactions involving a change in control of the Company, or its management.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

The Company had no comments from the Securities and Exchange Commission staff regarding the Company's periodic or current reports under the Securities Exchange Act of 1934 that were unresolved as of the date of filing of this report.

[Table of Contents](#)

ITEM 2. PROPERTIES.

The Americas

The Company's headquarters are located in a leased building in Lake Mary, Florida containing approximately 35,000 square feet. This facility houses the Company's U.S. production, research and development, administrative staff and customer service/application operations. The Company's U.S. sales and marketing headquarters is in a leased building in Lake Mary, Florida consisting of approximately 8,200 square feet. In October 2007, the Company leased a building in Lake Mary consisting of approximately 46,000 square feet to provide for consolidation of its sales, marketing, and administrative staff and expansion of its existing production operations. Additionally, the Company has a leased facility consisting of two buildings totaling approximately 37,000 square feet located in Kennett Square, Pennsylvania containing research and development, manufacturing and service operations of the laser tracker product lines.

Europe/Africa

The Company's European headquarters are located in a leased building in Stuttgart, Germany containing approximately 62,000 square feet. This facility houses the manufacturing, administration, sales, marketing and service management personnel for the Company's European operations. Additionally the Company has a leased facility consisting of approximately 16,000 square feet located in Schaffhausen, Switzerland containing manufacturing operations for the Company's products, which are shipped to customers in Europe, Africa and Asia.

Asia/Pacific

The Company's Asian headquarters are located in a leased building in Singapore containing approximately 22,000 square feet. This facility houses the administration, sales, marketing, production and service management personnel for the Company's Asian operations. The Company's Japan headquarters are located in a leased building in Nagoya, Japan containing approximately 5,000 square feet. This facility houses the Company's Japan sales, marketing and service operations. The Company's China headquarters are located in a leased building in Shanghai, China containing approximately 11,000 square feet for sales, marketing and service operations.

The Company believes that its current facilities will be adequate for its foreseeable needs and that it will be able to locate suitable space for additional regional offices or enhanced production needs as necessary.

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

ITEM 3. LEGAL PROCEEDINGS.

Securities Litigation—On December 6, 2005, the first of four essentially identical class action securities fraud lawsuits were filed against the Company and certain officers of the Company (the "Securities Litigation") in the U.S. District Court for the Middle District of Florida. On April 19, 2006, the four lawsuits were consolidated, and Kornitzer Capital Management, Inc. (the "Lead Plaintiff") was appointed as the lead plaintiff. On May 16, 2006, the Lead Plaintiff filed its Consolidated Amended Class Action Complaint against the Company and the individual defendants (the "Amended Complaint"). On February 3, 2007, the Court dismissed the Amended Complaint, without prejudice. On February 22, 2007, the Lead Plaintiff filed its Consolidated Second Amended Class Action Complaint (the "Second Amended Complaint") against the Company and the individual defendants.

In the Second Amended Complaint, as in the Amended Complaint, the Lead Plaintiff seeks to include in the class all persons who purchased or otherwise acquired the Company's common stock between April 15, 2004 and March 15, 2006 (the "Class"), and seeks an unspecified amount of damages, premised on allegations that each

[Table of Contents](#)

defendant made misrepresentations and omissions of material fact during the class period in violation of the Securities Exchange Act of 1934. Among other things, the Lead Plaintiff alleges that the Company's reported inventory, gross margins and profits were false and misleading during a portion of the class period because the Company consciously overstated the value of its inventory; that the Company misstated during 2005 certain of the selling expenses it had accrued and had expected to incur; that certain Asian sales that the Company had reported during the class period had been the product of unlawful payments made in violation of the FCPA, and that the Company failed to disclose that it was utilizing unlawful means to achieve such sales; and that certain of the Company's statements regarding the Company's systems of internal controls had been false and misleading, in light of the above and other circumstances.

On February 26, 2008, the parties to the Securities Litigation entered into a Memorandum of Understanding stating the principal terms of their agreement to settle the Securities Litigation. Pursuant to the Memorandum of Understanding, which is subject to certain conditions, the parties to the Securities Litigation will prepare and file a detailed Stipulation and Agreement of Settlement with the court seeking the court's preliminary and final approval of the terms of the proposed settlement. Pursuant to those terms, the issuer of the Company's Executive Liability and Entity Securities Liability insurance policy applicable to the Securities Litigation will pay \$6.875 million into a settlement fund for the Securities Litigation. That sum is within the coverage limit of the policy.

The proceeds of the settlement fund will be distributed to members of the Class and to the Lead Plaintiff's counsel. The balance of the settlement fund will be used to pay various costs associated with providing notice of the terms of the proposed settlement to the Class and with administering the settlement. If the court approves the settlement, a judgment will be entered dismissing the Securities Litigation, with prejudice, as against each defendant.

Derivative Action—On January 10, 2008, a Verified Shareholder Derivative Complaint (the "Derivative Complaint") was filed by an alleged shareholder of the Company in the U.S. District Court for the Middle District of Florida against six of the Company's current and former directors, as defendants, and against the Company, as a nominal defendant. The Derivative Complaint alleges breach of fiduciary duty and other claims against the individual defendants principally in connection with the alleged acts and omissions asserted in the Securities Litigation. The plaintiff alleges that the individual defendants caused the Company's stock price to be falsely inflated, and subjected the Company to costs, fines and other damages, as well as a loss of goodwill. The plaintiff purports to seek an unspecified amount of damages, together with other relief, on behalf of the Company and against the individual defendants. Prior to filing the Derivative Complaint, the plaintiff had requested that the Company assert certain of such claims against some of the individual defendants. In February 2008, the Company received another demand by another alleged shareholder that the Company assert substantially the same claims as set forth in the Derivative Complaint against seven of the Company's current and former directors.

The Company has formed a committee of independent directors to review and investigate the shareholder demands and the allegations made in the Derivative Complaint and the other shareholder demand. The committee has not yet made a recommendation with respect to those matters. To the Company's knowledge, no defendant has been served with the Derivative Complaint.

Voluntary Disclosure of Foreign Corrupt Practices Act Matter to the Securities and Exchange Commissions and Department of Justice—As previously reported by the Company, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company's Audit Committee instituted an internal investigation into this matter in February 2006, and the Company voluntarily notified the SEC and the DOJ of this matter in March 2006. The Company's internal investigation into this matter has been completed. The Company's internal investigation identified certain improper payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA.

[Table of Contents](#)

Results of the investigation revealed that referral fee payments in possible violation of the FCPA were \$165,000 and \$265,000 in 2004 and 2005, respectively, which were recorded in selling expenses in its statements of income. The related sales to customers to which payment of these referral fees had been made totaled approximately \$1.3 million and \$3.24 million in 2004 and 2005, respectively. Additional improper referral fee payments of \$122,000 were made in January and February 2006 related to sales contracts in 2005. The Company had sales in China of \$9.0 million in 2005 and \$4.2 million in 2004, approximately 7% and 4% of total sales, respectively. The Company incurred expenses of \$3.8 million in 2006 and \$3.1 million in 2007, relating to the FCPA matter, including \$2.65 million for estimated fines and penalties to the DOJ and SEC.

The Company has provided to the SEC and the DOJ information obtained during the course of this investigation and is cooperating with both agencies. The SEC and the DOJ have a broad range of civil and criminal remedies that they may seek to impose against corporations and individuals in appropriate circumstances, including without limitation disgorgement, fines, penalties, and other injunctive and equitable relief, as well as additional changes to the Company's business practices and compliance programs.

The Company has engaged in settlement discussions with both the SEC and the DOJ concerning the FCPA matter. Although there is no assurance that such discussions will result in a resolution of the FCPA matter, the Company has determined that the settlement discussions are likely to result in a resolution that will include a fine and disgorgement of associated profits. The Company recorded in the third quarter of 2007 a reserve of \$2.65 million in anticipation of the amount that could be necessary to satisfy its financial obligations to the SEC and the DOJ in resolving this matter. Predicting at this time when the FCPA matter will be finally resolved with the SEC and the DOJ is not possible. The monetary sanctions ultimately paid by the Company to the SEC and the DOJ in resolving this matter, whether imposed on the Company or agreed to by settlement, may exceed the amount that has been reserved by the Company.

The Company anticipates that resolution of the matter will not result in formal criminal charges being filed against it by the DOJ. The Company expects that as part of the final resolution of the FCPA matter with the SEC and the DOJ, in addition to monetary sanctions, the Company will have continuing obligations with the SEC and the DOJ with respect to monitoring, compliance with the FCPA and other laws, full cooperation with the government, and the adoption of a compliance code containing specific provisions intended to prevent violations of the FCPA. The Company expects that the failure to comply with any such continuing obligations could result in the SEC and the DOJ seeking to impose penalties against the Company in the future.

The Company terminated, in March 2006, certain personnel in the Asia-Pacific Region and re-assigned the duties of other personnel in both the Asia-Pacific Region and the U.S. as a result of the internal investigation. Additionally, the Company instituted the following remedial measures:

- Contracted with a third party forensics accounting team to conduct an in-depth audit of the operations in China and in other countries in the Asia-Pacific region and to make recommendations for improvement to the internal control systems.
- Reviewed third party distributor arrangements in an effort to assure that all contracts include adherence to the FCPA.
- Performed due diligence on all third party distributors and implemented a process to assess potential new distributors.
- Established an in-house internal audit function including hiring a Director of Internal Audit.
- Consolidated the human resources, financial accounting and reporting functions for the Asia region into the Singapore operations.
- Implemented an internal certification process to ascertain whether similar issues may exist elsewhere in the Company.

[Table of Contents](#)

- Implemented a quarterly internal certification process to confirm adherence to company policy and all applicable laws and regulations that will include all regional leadership, country management and other sales management.
- Implemented additional training on FCPA and other matters for employees and a confidential compliance reporting system.

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

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

No matters were submitted to a vote of security holders during the fourth quarter of 2007.

PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

The Company's common stock is listed and traded on the NASDAQ Global Market.

The following table sets forth, for the calendar points indicated, the high and low sales prices of the Company's common stock as reported by the NASDAQ Global Market:

	2007		2006	
	High	Low	High	Low
First Quarter	29.45	23.65	20.74	13.00
Second Quarter	34.81	28.21	17.00	11.85
Third Quarter	45.37	28.65	19.72	14.76
Fourth Quarter	50.27	24.28	24.29	16.93

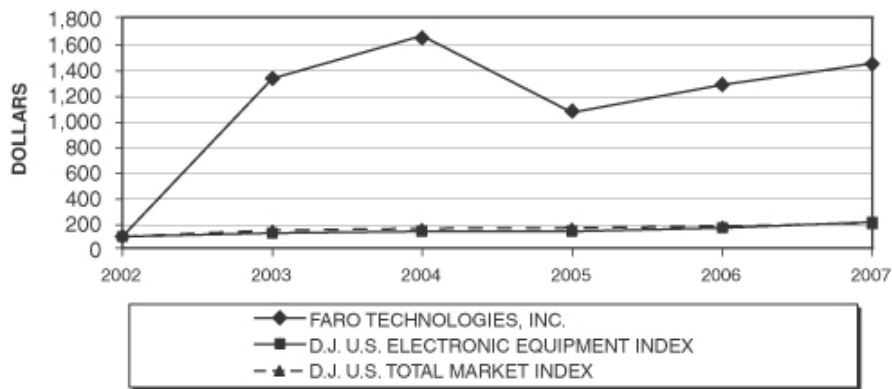
The Company has not paid any cash dividends on its common stock to date. The Company expects to retain future earnings for use in operating and expanding its business and does not anticipate paying any cash dividends in the reasonably foreseeable future.

As of March 5, 2008, the last sale price of the Company's common stock was \$32.37, and there were 73 holders of record of common stock.

During the year ended December 31, 2007, no equity securities of the Company were sold by the Company that were not registered under the Securities Act of 1933, as amended.

PERFORMANCE GRAPH

The following line graph compares the cumulative five-year Common Stock returns with the cumulative returns of the Dow Jones U.S. Total Market Index and the Dow Jones U.S. Electronic Equipment Index.



Date	FARO	Dow	Dow Elec Eqmt
31-Dec-2002	\$ 100.00	\$100.00	\$ 100.00
31-Dec-2003	\$1,321.69	\$150.36	\$ 126.52
31-Dec-2004	\$1,649.74	\$163.00	\$ 143.46
31-Dec-2005	\$1,058.20	\$166.58	\$ 140.27
31-Dec-2006	\$1,271.96	\$183.68	\$ 166.38
31-Dec-2007	\$1,438.10	\$201.91	\$ 214.22

* Assumes \$100 invested on December 31, 2002

[Table of Contents](#)

The information under the heading “EQUITY COMPENSATION PLAN INFORMATION” in the Company’s definitive Proxy Statement for its 2008 Annual Meeting of Shareholders, to be filed with the SEC is incorporated herein by reference.

ITEM 6. SELECTED FINANCIAL DATA.

in thousands, except share and per-share data	Historical—Year ended December 31,				
	2007	2006	2005	2004	2003
Consolidated Statement of Income Data:					
Sales	\$ 191,617	\$ 152,405	\$ 125,590	\$ 97,020	\$ 71,786
Gross profit	115,043	89,458	72,932	59,996	42,266
Income from operations	19,111	8,259	10,226	14,584	7,440
Income before income taxes	23,036	9,776	9,898	15,289	9,436 ⁽¹⁾
Net income	18,093	8,196	8,179	14,931	8,278
Net income per common share:					
Basic	\$ 1.17	\$ 0.57	\$ 0.58	\$ 1.08	\$ 0.68
Diluted	\$ 1.15	\$ 0.56	\$ 0.57	\$ 1.06	\$ 0.64
Weighted average common shares outstanding:					
Basic	15,443,259	14,397,050	14,169,140	13,833,590	12,181,221
Diluted	15,722,215	14,560,331	14,442,248	14,023,159	12,845,992
Consolidated Balance Sheet Data:					
Historical—as at December 31,					
	2007	2006	2005	2004	2003
Working capital	\$ 154,946	\$ 73,692	\$ 86,624	\$ 65,686	\$ 51,368
Total assets	243,539	144,276	122,648	105,078	81,914
Total debt	240	205	340	250	107
Total shareholders’ equity	194,499	111,055	98,860	89,158	68,921

(1) Includes a favorable legal settlement of \$1.1 million in other income.

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

The following information should be read in conjunction with the Consolidated Financial Statements of the Company, including the notes thereto, included elsewhere in this document.

Overview

The Company designs, develops, manufactures, markets and supports portable, software driven, 3-D measurement systems that are used in a broad range of manufacturing, industrial, building construction and forensic applications. The Company’s FaroArm, FARO Scan Arm and FARO Gage articulated measuring devices, the FARO Laser Scanner LS, the FARO Laser Tracker, and their companion CAM2 software, provide for Computer-Aided Design (“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 December 2007, the Company’s products have been purchased by approximately 7,400 customers worldwide, ranging from small machine shops to such large manufacturing and industrial companies as Audi, Bell Helicopter, Boeing, British Aerospace, Caterpillar, Daimler Chrysler, General Electric, General Motors, Honda, Johnson Controls, Komatsu Dresser, Lockheed Martin, Nissan, Siemens and Volkswagen, among many others.

[Table of Contents](#)

The Company operates in international markets throughout the world. It maintains sales offices in France, Germany, Great Britain, Japan, Spain, Italy, China, India, Poland, Netherlands, Malaysia and Vietnam. The Company added a new regional headquarters in Singapore in the third quarter of 2005 along with a new manufacturing and service facility there in the fourth quarter of 2005. In 2006 the Company closed its South Korean office and established a third party distributor relationship for serving that market, and in December 2006, the Company established a sales office in Thailand. The Company manages and reports its global sales in three regions: the Americas, Europe/Africa and Asia/Pacific. In 2007, 41.7% of the Company's sales were in the Americas compared to 41.3% in 2006, 40.9% were in the Europe/Africa region compared to 39.9% in 2006 and 17.4% were in the Asia/Pacific region, compared to 18.8% in 2006 (see also Note 19 to the Consolidated Financial Statements).

The Company derives revenues primarily from the sale of its FaroArm, FARO Scan Arm, FARO Gage, FARO Laser Tracker and FARO Laser Scanner LS 3-D measurement equipment, and their related multi-faceted software. Revenue related to these products is 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, and FARO Laser Tracker products 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 FaroArm, FARO Gage, and FARO Laser Tracker products in the Company's manufacturing facilities located in Florida and Pennsylvania for customer orders from the Americas. The Company manufactures its FARO Laser Scanner LS product in its facility located in Stuttgart, Germany. The Company expects all its existing plants to have the production capacity necessary to support its growth through 2008.

With respect to the financial performance in 2007, cost of sales consists primarily of material, labor and production overhead. Gross margin for fiscal 2007 was 60.0%

Selling expenses as a percentage of sales was 29.3% in 2007 compared to 29.7% in 2006. This percentage has decreased to 28.7% in the second half of 2007 from 30.0% in the first half of 2007 as new sales personnel became more productive.

General and administrative expenses consist primarily of salaries for administrative personnel, rent, utilities and professional and legal expenses. General and administrative expenses were 13.3% of sales in 2007 and included the accrual of \$2.65 million for the estimated fines and penalties related to the FCPA matter and \$1.1 million in professional fees related to the FCPA matter and resolution of the patent litigation which was settled in 2007. General and administrative expenses were 16.1% of sales in 2006 and included \$6.8 million in professional and legal expenses related to the FCPA matter and patent litigation costs.

Research and development expenses represent salaries, equipment and third-party services. The Company expects to support ongoing research and development and intends to continue to fund these efforts at the level of 5%-7% of sales going forward.

The Company incurred minimal expenses in 2006 as calculated under the Black-Scholes method of SFAS 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), related to its adoption of SFAS No. 123R, "Share-Based Payment" ("SFAS 123(R)") for the expensing of stock options as it vested substantially all of its unvested options in the fourth quarter of 2005. The reduction in pre-tax charges estimated by the Company as a result of the acceleration amounts to approximately \$7.7 million over the course of the original vesting periods. Options to purchase approximately 704,310 shares of the Company's stock or 52.5% of the Company's outstanding options were accelerated. The weighted average exercise price of the options subject to acceleration

[Table of Contents](#)

was \$21.30. The aggregate pretax expense for the shares subject to acceleration that would have been reflected in the Company's consolidated financial statements beginning in 2006 is approximately \$7.7 million, including \$4.3 million in 2006, \$2.7 million in 2007, and \$0.7 million in 2008. The fair value for any future grants will be included in expense over the vesting periods. These expenses will be apportioned according to the classification of the recipients who have received stock options into cost of sales, selling, general and administrative or research and development costs.

In 2007, the Company's worldwide effective tax rate was 21.5%. The Company has received a favorable income tax rate commitment from the Swiss government as an incentive to establish a manufacturing plant in Switzerland, and in 2006 received approval from the Singapore Economic Development Board for a favorable multi-year income tax holiday for our Singapore headquarters and manufacturing operations subject to certain terms and conditions including employment, spending, and capital investment. (See Critical Accounting Policies—Income Taxes below).

Accounting for wholly owned foreign subsidiaries is maintained in the currency of the respective foreign jurisdiction and, therefore, fluctuations in exchange rates may have an impact on inter-company accounts reflected in 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, the Company does not regularly use such instruments, and none were utilized in 2007, 2006, or 2005.

The Company has had twenty-two consecutive profitable quarters through December 31, 2007. Its sales and earnings growth have been 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 Gage and Laser Scanner; and the effect of acquisitions. The Company's worldwide sales and marketing headcount in 2007, 2006 and 2005 was 321, 265, and 289, respectively.

On January 10, 2005, the Company filed a Registration Statement on Form S-3 with the Securities and Exchange Commission allowing it to raise proceeds of up to \$125 million. The proceeds from any offerings with respect to this registration statement, if any, would be used for either repayment or refinancing of debt, acquisition of additional businesses or technologies or for working capital and general corporate purposes. On August 14, 2007, the Company sold 1,650,000 shares of common stock in a registered direct offering pursuant to its Form S-3 Registration Statement to certain institutional investors at \$34.00 per share. The net proceeds after deducting placement fees and other offering expenses were approximately \$53.0 million. (See also Liquidity and Capital Resources below).

FCPA Update

As previously reported by the Company, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company's Audit Committee instituted an internal investigation into this matter in February 2006, and the Company voluntarily notified the SEC and the DOJ of this matter in March 2006. The Company's internal investigation into this matter has been completed. The Company's internal investigation identified certain improper payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA.

Results of the investigation revealed that referral fee payments in possible violation of the FCPA were \$165,000 and \$265,000 in 2004 and 2005, respectively, which were recorded in selling expenses in its statements of income. The related sales to customers to which payment of these referral fees had been made totaled approximately \$1.3 million and \$3.24 million in 2004 and 2005, respectively. Additional improper referral fee payments of \$122,000 were made in January and February 2006 related to sales contracts in 2005. The Company had sales in China of \$9.0 million in 2005 and \$4.2 million in 2004, approximately 7% and 4% of total sales,

[Table of Contents](#)

respectively. The Company incurred expenses of \$3.1 million in 2007, including \$2.65 million for estimated fines and penalties to the DOJ and SEC, and \$3.8 million in the 2006, relating to the FCPA matter.

The Company has provided to the SEC and the DOJ information obtained during the course of this investigation and is cooperating with both agencies. The SEC and the DOJ have a broad range of civil and criminal remedies that they may seek to impose against corporations and individuals in appropriate circumstances, including without limitation disgorgement, fines, penalties, and other injunctive and equitable relief, as well as additional changes to the Company's business practices and compliance programs.

The Company has engaged in settlement discussions with both the SEC and the DOJ concerning the FCPA matter. Although there is no assurance that such discussions will result in a resolution of the FCPA matter, the Company has determined that the settlement discussions are likely to result in a resolution that will include a fine and disgorgement of associated profits. The Company recorded in the third quarter of 2007 a reserve of \$2.65 million in anticipation of the amount that could be necessary to satisfy its financial obligations to the SEC and the DOJ in resolving this matter. Predicting at this time when the FCPA matter will be finally resolved with the SEC and the DOJ is not possible. The monetary sanctions ultimately paid by the Company to the SEC and the DOJ in resolving this matter, whether imposed on the Company or agreed to by settlement, may exceed the amount that has been reserved by the Company.

The Company anticipates that resolution of the matter will not result in formal criminal charges being filed against it by the DOJ. The Company expects that as part of the final resolution of the FCPA matter with the SEC and the DOJ, in addition to monetary sanctions, the Company will have continuing obligations with the SEC and the DOJ with respect to monitoring, compliance with the FCPA and other laws, full cooperation with the government, and the adoption of a compliance code containing specific provisions intended to prevent violations of the FCPA. The Company expects that the failure to comply with any such continuing obligations could result in the SEC and the DOJ seeking to impose penalties against the Company in the future.

The Company terminated, in March 2006, certain personnel in the Asia-Pacific Region and re-assigned the duties of other personnel in both the Asia-Pacific Region and the U.S. as a result of the internal investigation. Additionally, the Company instituted the following remedial measures:

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

[Table of Contents](#)

Results of Operations

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

	Years ended December 31,		
	2007	2006	2005
Statement of Operations Data:			
Sales	100.0%	100.0%	100.0%
Cost of sales	40.0%	41.3%	41.9%
Gross margin	60.0%	58.7%	58.1%
Operating expenses:			
Selling	29.3%	29.7%	29.7%
General and administrative	13.3%	16.1%	12.4%
Depreciation and amortization	2.1%	2.7%	2.7%
Research and development	5.4%	4.7%	5.1%
Total operating expenses	50.1%	53.2%	49.9%
Income from operations	9.9%	5.5%	8.2%
Interest income	1.1%	0.5%	0.6%
Other (expense) income, net	1.0%	0.5%	(0.6%)
Interest expense	0.0%	(0.0%)	(0.1%)
Income before income taxes	12.0%	6.5%	8.1%
Income tax expense	2.6%	1.0%	1.5%
Net income	9.4%	5.5%	6.6%

2007 Compared to 2006

Sales. Sales increased by \$39.2 million, or 25.7%, to \$191.6 million in the year ended December 31, 2007, from \$152.4 million for the year ended December 31, 2006. This increase resulted primarily from an increase in unit sales. Sales in the Americas region increased \$17.1 million, or 27.0%, to \$80.0 million in the year ended December 31, 2007, from \$62.9 million in the year ended December 31, 2006. Sales in the Europe/Africa region increased \$17.4 million, or 28.6%, to \$78.3 million for the year ended December 31, 2007, from \$60.9 million in the year ended December 31, 2006. Sales in the Asia/Pacific region increased \$4.7 million, or 16.7%, to \$33.3 million for the year ended December 31, 2007, from \$28.6 million in the year ended December 31, 2006.

Gross Profit. Gross profit increased by \$25.5 million, or 28.6%, to \$115.0 million for year ended December 31, 2007, from \$89.5 million for the year ended December 31, 2006. Gross margin increased to 60.0% for the year ended December 31, 2007, from 58.7% for the year ended December 31, 2006. The increase in gross margin is primarily due to a change in the sales mix resulting in an increase in unit sales in product lines with lower unit costs than the prior year period and as a result of continuing productivity improvements. The Company expects the trend of changes in the sales mix to result in gross margins in the range of approximately 58% to 60% in 2008.

Selling Expenses. Selling expenses increased by \$10.8 million, or 24.0%, to \$56.1 million for the year ended December 31, 2007, from \$45.3 million for the year ended December 31, 2006. This increase was primarily due to an increase in commission and compensation expense of \$6.8 million, an increase in marketing and advertising costs of \$1.4 million, an increase in travel related expenses of \$1.4 million and an increase in recruiting and hiring expense of \$0.6 million. As a percentage of sales, selling expenses decreased to 29.3% of sales in the year ended December 31, 2007 from 29.7% in the year ended December 31, 2006.

[Table of Contents](#)

General and administrative expenses. General and administrative expenses increased by \$0.9 million, or 3.9%, to \$25.5 million for the year ended December 31, 2007, from \$24.6 million for the year ended December 31, 2006. General and administrative expenses for fiscal 2007 include the accrual of \$2.65 million for the estimated fines and penalties related to the FCPA matter and \$1.1 million in professional fees related to the FCPA matter and resolution of the patent litigation which was settled in 2007. General and administrative expenses for fiscal 2006 included \$6.8 million in professional and legal expenses related to the FCPA matter and patent litigation costs. General and administrative expenses decreased to 13.3% of sales for 2007 from 16.1% for 2006. Excluding the effects of the penalty accrual and the professional fees related to the FCPA matter and patent litigation, general and administrative expenses increased by \$4.0 million primarily as a result of increases in compensation costs of \$2.3 million, including equity based compensation, and other professional fees of \$0.9 million.

Depreciation and amortization expenses. Depreciation and amortization expenses decreased by \$0.1 million to \$4.0 million for the year ended December 31, 2007 from \$4.1 million for the year ended December 31, 2006.

Research and development expenses. Research and development expenses increased by \$3.1 million to \$10.3 million for year ended December 31, 2007, from \$7.2 million for the year ended December 31, 2006, primarily as a result of an increase in compensation and third party R&D expense related to new product releases. Research and development expenses as a percentage of sales increased to 5.4% for the year ended December 31, 2007, from 4.7% for the year ended December 31, 2006.

Interest income / expense. Interest income, net, increased by \$1.3 million to \$2.0 million for the year ended December 31, 2007 from \$0.7 million for the year ended December 31, 2006, due to an increase in short term investments.

Other income (expense), net. Other (income) expense, net, increased by \$1.1 million to \$1.9 million of income for the year ended December 31, 2007, from income of \$0.8 million for the year ended December 31, 2006, primarily as a result of an increase in foreign exchange transaction gains.

Income tax expense. Income tax expense increased by \$3.3 million to \$4.9 million for the year ended December 31, 2007 from \$1.6 million for the year ended December 31, 2006. This increase was primarily due to an increase in pretax income. The Company's effective tax rate increased to 21.5% for the year ended December 31, 2007, from 16.2% primarily as a result of an increase in expenses that are non-deductible for U.S. income tax purposes of \$2.65 million related to an accrual for penalties in connection with the resolution of the FCPA matter. The Company's effective income tax rate, excluding this effect, would have been 17.0% for the year ended December 31, 2007. The Company believes that calculating its effective tax rate without the impact of the FCPA charge is useful to management and investors to provide greater clarity and to facilitate internal and external comparisons to the Company's historical tax rate. 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. The Company currently estimates the effective tax rate, excluding the effects of the FCPA matter, will approximate 18%-22% for fiscal 2008. 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. The Company has \$5.2 million in net deferred tax assets remaining, which will, more likely than not, be realized in 2008 and thereafter if the Company remains consistently profitable (See also Note 14 to the Consolidated Financial Statements). Separate from income tax expenses, the Company recorded an addition to shareholders' equity of \$1.0 million in 2007 for the income tax benefit received from the non-qualified disposition of incentive stock options by employees.

Total deferred taxes for the Company's foreign subsidiaries relating to net operating loss carryforwards were \$7.7 million and \$6.3 million at December 31, 2007 and December 31, 2006, respectively. The related valuation allowance was \$6.3 million and \$4.4 million at December 31, 2007 and December 31, 2006, respectively.

[Table of Contents](#)

Net income. Net income increased by \$9.9 million to \$18.1 million for the year ended December 31, 2007 from \$8.2 million for the year ended December 31, 2006 as a result of the factors described above.

2006 Compared to 2005

Sales. Sales increased \$26.8 million, or 21.3%, to \$152.4 million in the year ended December 31, 2006, from \$125.6 million for the year ended December 31, 2005. This increase resulted primarily from an increase in unit sales. The Company's sales growth is driven by increased product sales resulting from continuing market demand for and acceptance of its products. Sales in the Americas region increased \$7.0 million or 12.5%, to \$62.9 million in the year ended December 31, 2006 from \$55.9 million in the year ended December 31, 2005. Sales in the Europe/Africa region increased \$16.0 million, or 35.6%, to \$60.9 million in the year ended December 31, 2006 from \$44.9 million in the year ended December 31, 2005. Sales in the Asia/Pacific region increased \$3.8 million, or 15.3% to \$28.6 million in the year ended December 31, 2006 from \$24.8 million in the year ended December 31, 2005. In 2006 the Company's sales and marketing headcount decreased to 83 from 88 in the Americas, increased to 118 from 117 in Europe/Africa, and decreased to 64 from 84 in the Asia/Pacific region.

Gross profit. Gross profit increased \$16.6 million, or 22.8%, to \$89.5 million for the year ended December 31, 2006 from \$72.9 million for the year ended December 31, 2005. Gross margin increased to 58.7% in the year ended December 31, 2006, from 58.1% for the year ended December 31, 2005 primarily due to a change in the sales mix resulting in an increase in unit sales of product lines with a lower than average cost of sales.

Selling expenses. Selling expenses increased by \$8.0 million or 21.4%, to \$45.3 million for the year ended December 31, 2006 from \$37.3 million for the year ended December 31, 2005. This increase was primarily due to higher compensation and commission expense of \$4.5 million related to the increase in sales, higher marketing costs of \$2.9 million and higher product demonstration costs of \$0.6 million. As a percentage of sales, selling expenses were unchanged at 29.7% in 2006 and 2005.

General and administrative expenses. General and administrative expenses increased by \$9.1 million or 58.7%, to \$24.6 million for the year ended December 31, 2006 from \$15.5 million for the year ended December 31, 2005. This increase was primarily due to increased professional and legal fees of \$5.4 million, of which \$3.8 million was related to the Company's investigation of possible violations of the Foreign Corrupt Practices Act by its Chinese subsidiary, and \$1.4 million for ongoing patent litigation. In addition, compensation costs increased \$1.7 million and expenses related to the Singapore facility, which opened in September 2005, increased by \$0.3 million. General and administrative expenses as percentage of sales increased to 16.1% of sales in 2006 from 12.4% of sales in 2005.

Depreciation and amortization expenses. Depreciation and amortization expenses increased by \$0.6 million or 17.1%, to \$4.1 million for the year ended December 31, 2006 from \$3.5 million in 2005, primarily due to an increase in depreciation of new equipment from the Company's Asia/Pacific expansion and additions to its leased space in the U.S.

Research and development expenses. Research and development expenses increased by \$0.8 million or 12.5%, to \$7.2 million for the year ended December 31, 2006 from \$6.4 million for the year ended December 31, 2005. This resulted primarily from an increase in salaries and subcontractors expense of \$0.7 million related to the addition of the Laser Scanner product line. Research and development expenses as a percentage of sales were 4.7% in 2006 compared to 5.1% in 2005.

Interest income / expense. Interest income increased by \$0.1 million or 16.7%, to \$0.7 million for the year ended December 31, 2006 from \$0.6 million for the year ended December 31, 2005, primarily due to an increase in interest rates and short term investments. Interest expense decreased slightly due to the purchase of iQvolution in 2005 and subsequent retirement of their debt obligations.

[Table of Contents](#)

Other income (expense), net. Other income (expense), net increased by \$1.6 million, to income of \$0.8 million for the year ended December 31, 2006 from an expense of \$0.8 million for the year ended December 31, 2005. Other income includes foreign exchange gains of \$0.8 million in 2006.

Income tax expense. Income tax expense decreased to \$1.6 million in the year ended December 31, 2006, from \$1.7 million for the year ended December 31, 2005. The effective tax rate in 2006 was 16.2% compared to 17.4% in 2005. The primary reason for the lower tax rate was the effect of the receipt of approval of the tax holiday for the Company's operations in Singapore effective January 1, 2006 for a period of four years and an additional six year extension at a favorable tax rate subject to certain terms and conditions including employment, spending, and capital investment. The Company has \$4.6 million in net deferred tax assets remaining, which will, more likely than not, be realized in 2007 and thereafter if the Company remains consistently profitable (See also Note 14-Income Taxes). Separate from income tax expenses, the Company recorded an addition to shareholders' equity of \$0.01 million in 2006 for the income tax benefit received from the exercise of unqualified stock options by employees.

Net income. Net income was \$8.2 million for the year ended December 31, 2006 and for the year ended December 31, 2005 as a result of the factors described above.

Liquidity and Capital Resources

The Company has financed its operations primarily from cash provided by operating activities, proceeds of its 1997 initial public offering of common stock of approximately \$31.5 million and, its 2003 private placement of its common stock with various institutional investors totaling approximately \$24.9 million.

On January 10, 2005, the Company filed a Registration Statement on Form S-3 with the Securities and Exchange Commission allowing it to raise proceeds of up to \$125 million. The proceeds from any offerings with respect to this registration statement, if any, would be used for either repayment or refinancing of debt, acquisition of additional businesses or technologies or for working capital and general corporate purposes.

On August 14, 2007, the Company sold 1,650,000 shares of common stock in a registered direct offering pursuant to its Form S-3 Registration Statement to certain institutional investors at \$34.00 per share. The net proceeds after deducting placement fees and other offering expenses were approximately \$53.0 million.

Cash and cash equivalents increased by \$10.1 million to \$25.8 million at December 31, 2007 from \$15.7 million at December 31, 2006. The increase resulted from cash provided by operating activities of \$21.6 million and \$5.3 million from the issuance of common stock related to the exercise of stock options and \$1.0 million of related income tax benefit, partially offset by purchases of short term investments of \$8.6 million, purchases of equipment and intangible assets of \$3.3 million, and \$5.9 million related to the effects of foreign exchange rate changes on cash. In addition, the Company increased its short term investments by \$61.6 million to \$77.4 million at December 31, 2007 from \$15.8 million at December 31, 2006. The increase was primarily attributable to cash provided by the net proceeds from the registered direct offering of \$53.0 million and \$8.6 million from cash provided by operations.

On July 11, 2006, the Company entered into a loan agreement providing for an available line of credit of \$30.0 million. Loans under the agreement bear interest at the rate of LIBOR plus 1.75% and require the Company to maintain certain ratios with respect to a debt covenant agreement, including current ratio, consolidated EBITDA, and senior funded debt to EBITDA. As of December 31, 2007, the Company was in compliance with all of the covenants under the Amended Loan Agreement. The term of the Amended Loan Agreement extends to April 30, 2009. The Company has not drawn on this line of credit.

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.

[Table of Contents](#)

Off Balance Sheet Items

The Company is not party to any off-balance sheet items that have not already been appropriately disclosed in these financial statements.

Contractual Obligations and Commercial Commitments

The Company is party to capital leases on equipment with an initial term of 36 to 60 months and other non-cancelable operating leases. These obligations are presented below as of December 31, 2007:

	Payments Due by Period				
	Total	< 1 Year	1-3 Years	3-5 Years	> 5 Years
Contractual Obligations					
Capital lease obligations	\$ 240	\$ 18	\$ 98	\$ 124	\$ —
Operating lease obligations	12,587	4,397	5,534	2,419	237
Purchase obligations	21,775	21,775	—	—	—
Total	<u>\$34,602</u>	<u>\$26,190</u>	<u>\$5,632</u>	<u>\$2,543</u>	<u>\$ 237</u>

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 December 31, 2007, the Company does not have any long-term commitments for purchases.

Critical Accounting Policies

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 the 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, and the reserve for warranties. 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 create an adverse impact on the Company's operations and financial position.

The preparation of these 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 that are 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.

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 substantially complete as of the shipping date. Revenue from sales of software only is recognized when no further significant production, modification or customization of the software is required and where the following criteria are met: persuasive evidence of a sales agreement exists, delivery has occurred, and the sales price is fixed or determinable and deemed collectible. Revenues resulting from sales of comprehensive support, training and technology consulting services are recognized as such services are performed. Extended maintenance plan revenues are recognized on a straight-line basis 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 technology for medical applications is recognized as licensees use the technology.

The 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 remaining usage. The resulting obsolete and excess parts are then reviewed to determine if a substitute usage or a future need exists. Items without an identified current or future usage will be reserved in an amount equal to 100% of the FIFO cost of such inventory. 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.

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 described in Financial Accounting Standards Board Statement No. 109, "Accounting for Income Taxes", 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.

The Company operates in a number of different countries around the world and considers the statutory rates within each jurisdiction to determine the overall effective tax rate. In 2003, the Company began to manufacture its products in Switzerland, where it has received a favorable income tax rate commitment from the Swiss government as an incentive to establish a manufacturing plant there. The aggregate dollar effect of this favorable tax rate was approximately \$2.0 million, or \$0.13 per share for the year ended December 31, 2007, and \$1.7 million, or \$0.12 per share for the year ended December 31, 2006.

In 2005, the Company opened a regional headquarters and began to manufacture its products in Singapore, where it received approval for a four year tax holiday from the Singapore Economic Development Board as an incentive to establish a manufacturing plant and regional headquarters. The aggregate dollar effect of this favorable tax rate was approximately \$2.0 million, or \$0.13 per share for the year ended December 31, 2007, and \$0.9 million, or \$0.06 per share for the year ended December 31, 2006.

The Company is subject to certain terms and conditions including employment, spending, and capital investment in each of these countries in order to receive these favorable tax rates or be subject to the statutory rates. Significant judgment is required in determining the Company's worldwide provision for income taxes. In the ordinary course of global business, there are many transactions for which the ultimate tax outcome is uncertain. The Company has appropriately reserved for its tax uncertainties based on the criteria established by Interpretation No. 48. "Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109".

The 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 the 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. 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

[Table of Contents](#)

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 may increase its warranty costs. While such expenses have historically been within expectations, the Company cannot guarantee this will continue in the future.

Foreign Exchange Exposure

The Company conducts a significant portion of its business outside the United States. At present, 58% of its revenues are 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 business, results of operations and financial condition, and could specifically result in foreign exchange gains and losses. The impact of future exchange rate fluctuations on the results of 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).

Inflation

The Company believes that inflation has not had a material impact on its results of operations in recent years and does not expect inflation to have a material impact on its operations in 2008.

Impact of Recently Issued Accounting Standards

In February 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities*" ("SFAS 159"). SFAS 159 permits entities to choose to measure certain financial instruments and other eligible items at fair value when the items are not otherwise currently required to be measured at fair value. Under SFAS 159, the decision to measure items at fair value is made at specified election dates on an irrevocable instrument-by-instrument basis. Entities electing the fair value option would be required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. Entities electing the fair value option are required to distinguish, on the face of the statement of financial position, the fair value of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. If elected, SFAS 159 will be effective as of the beginning of the first fiscal year that begins after November 15, 2007, with earlier adoption permitted if all of the requirements of SFAS 159 are adopted. The impact of the adoption of SFAS 159 will be dependent on the extent to which the Company chooses to elect to measure eligible items at fair value.

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies to other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007 except for non-financial assets and liabilities recognized or disclosed at fair value on a recurring basis, for which the effective date is fiscal years beginning after November 15, 2008. The Company has not determined the effect, if any, that the adoption of this statement will have on its financial condition or results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), "*Business Combinations*" ("SFAS 141 (revised)"). SFAS 141 (revised) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date,

[Table of Contents](#)

measured at their fair values as of that date. The statement also requires the acquirer in a business combination achieved in stages to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values. The provisions of SFAS 141 (revised) are effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company has not determined the effect, if any, that the adoption of this statement will have on its financial condition or results of operations.

In December 2007, the FASB issued SFAS 160, “*Noncontrolling Interests in Consolidated Financial Statements — an amendment to ARB No. 51.*” This statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective prospectively, except for certain retrospective disclosure requirements, for fiscal years beginning after December 15, 2008. The Company has not determined the effect, if any, that the adoption of this statement will have on its financial condition or results of operations.

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

Foreign Exchange Exposure

The Company conducts a significant portion of its business outside the United States. At present, 58% of its revenues are 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 business, results of operations and financial condition, and could specifically result in foreign exchange gains and losses. The impact of future exchange rate fluctuations on the results of 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).

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of FARO Technologies, Inc. (a Florida corporation) and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007. Our audits of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FARO Technologies, Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company adopted Statement No. 123 (revised 2004), *Share-Based Payment*, as of January 1, 2006 and Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – An Interpretation of FASB Statement No. 109*, as of January 1, 2007.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), FARO Technologies, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control–Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 10, 2008 expressed an unqualified opinion.

Orlando, Florida
March 10, 2008

/s/ GRANT THORNTON LLP

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders of FARO Technologies, Inc. and Subsidiaries:

We have audited FARO Technologies, Inc. (a Florida Corporation) and subsidiaries' internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). FARO Technologies, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on FARO Technologies, Inc. and subsidiaries' internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, FARO Technologies, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by COSO.

We have also audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of FARO Technologies, Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007 and our report dated March 10, 2008 expressed an unqualified opinion.

Orlando, Florida
March 10, 2008

/s/ GRANT THORNTON LLP

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

<u>(in thousands, except share data)</u>	<u>December 31,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 25,798	\$ 15,689
Short-term investments	77,375	15,790
Accounts receivable, net	54,767	42,706
Inventories	29,100	23,429
Deferred income taxes, net	2,841	1,845
Prepaid expenses and other current assets	6,719	3,222
Total current assets	196,600	102,681
Property and Equipment:		
Machinery and equipment	12,895	9,131
Furniture and fixtures	5,008	3,988
Leasehold improvements	3,296	2,615
Property and equipment at cost	21,199	15,734
Less: accumulated depreciation and amortization	(13,672)	(8,889)
Property and equipment, net	7,527	6,845
Goodwill	19,117	17,266
Intangible assets, net	5,970	6,221
Service inventory	10,865	7,278
Deferred income taxes, net	3,460	3,985
Total Assets	\$ 243,539	\$ 144,276
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 12,450	\$ 11,182
Accrued liabilities	17,989	10,379
Income taxes payable	2,266	2,151
Current portion of unearned service revenues	8,594	4,569
Customer deposits	337	618
Current portion of obligations under capital leases	18	90
Total current liabilities	41,654	28,989
Unearned service revenues—less current portion	6,091	2,917
Deferred tax liability, net	1,073	1,200
Obligations under capital leases—less current portion	222	115
Total Liabilities	49,040	33,221
Commitments and contingencies—See Note 15		
Shareholders' Equity:		
Common stock—par value \$.001, 50,000,000 shares authorized; 16,700,966 and 14,586,402 issued; 16,604,052 and 14,464,715 outstanding, respectively	17	14
Additional paid-in-capital	146,489	85,160
Retained earnings	43,545	25,452
Accumulated other comprehensive income	4,599	580
Common stock in treasury, at cost—40,000 shares	(151)	(151)
Total Shareholders' Equity	194,499	111,055
Total Liabilities and Shareholders' Equity	\$ 243,539	\$ 144,276

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

<u>(in thousands, except share and per share data)</u>	Years ended December 31,		
	2007	2006	2005
SALES	\$ 191,617	\$ 152,405	\$ 125,590
COST OF SALES (exclusive of depreciation and amortization, shown separately below)	76,574	62,947	52,658
GROSS PROFIT	115,043	89,458	72,932
OPERATING EXPENSES:			
Selling	56,134	45,282	37,274
General and administrative	25,508	24,554	15,539
Depreciation and amortization	4,034	4,135	3,453
Research and development	10,256	7,228	6,440
Total operating expenses	95,932	81,199	62,706
INCOME FROM OPERATIONS	19,111	8,259	10,226
OTHER (INCOME) EXPENSE			
Interest income	(2,036)	(743)	(567)
Other (income) expense, net	(1,898)	(790)	806
Interest expense	9	16	89
INCOME BEFORE INCOME TAX EXPENSE	23,036	9,776	9,898
INCOME TAX EXPENSE	4,943	1,580	1,719
NET INCOME	\$ 18,093	\$ 8,196	\$ 8,179
NET INCOME PER SHARE—BASIC	\$ 1.17	\$ 0.57	\$ 0.58
NET INCOME PER SHARE—DILUTED	\$ 1.15	\$ 0.56	\$ 0.57
Weighted average shares—Basic	15,443,259	14,397,050	14,169,140
Weighted average shares—Diluted	15,722,215	14,560,331	14,442,248

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2007, 2006, AND 2005

(in thousands except share data)	Common Stock		Additional Paid-in Capital	Unearned Compensation	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Common Stock in Treasury	Total
	Shares	Amounts						
BALANCE DECEMBER 31, 2004	14,004,092	\$ 14	\$ 78,282	\$ 505	\$ 9,077	\$ 1,431	\$ (151)	\$ 89,158
Net income					8,179			8,179
Currency translation adjustment						(3,630)		(3,630)
Comprehensive income								4,549
Options subject to variable accounting			207	(207)				—
Amortization of unearned compensation				(150)				(150)
Amortization of restricted stock units			93					93
Accrual for iQvolution milestone earn-outs			675					675
Stock issued for iQvolution milestone earn-outs	12,183		252					252
Stock options exercised	137,499		340					340
Tax benefit from employee stock option exercises			382					382
Stock issued for iQvolution purchase	152,292		3,499					3,499
Board compensation	24,851		62					62
BALANCE DECEMBER 31, 2005	14,330,917	\$ 14	\$ 83,792	\$ 148	\$ 17,256	\$ (2,199)	\$ (151)	\$ 98,860
Net income					8,196			8,196
Currency translation adjustment						2,779		2,779
Comprehensive income								10,975
Reclassification related to SFAS 123R			148	(148)				—
Stock option expense			236					236
Issuance of restricted stock	43,826		215					215
Stock issued for iQvolution milestone earn-outs	68,574		408					408
Stock options exercised	61,398		351					351
Tax benefit from employee stock option exercises			10					10
BALANCE DECEMBER 31, 2006	14,504,715	\$ 14	\$ 85,160	\$ —	\$ 25,452	\$ 580	\$ (151)	\$ 111,055
Net income					18,093			18,093
Currency translation adjustment						4,019		4,019
Comprehensive income								22,112
Stock option expense			1,041					1,041
Issuance of restricted stock	23,553		176					176
Stock issued for iQvolution milestone earn-outs	24,773		730					730
Stock options exercised	441,011	1	5,381					5,382
Tax benefit from employee stock option exercises			963					963
Issuance of stock	1,650,000	2	53,038					53,040
BALANCE DECEMBER 31, 2007	16,644,052	\$ 17	\$ 146,489	\$ —	\$ 43,545	\$ 4,599	\$ (151)	\$ 194,499

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

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

(in thousands)	Year Ended December 31,		
	2007	2006	2005
CASH FLOWS FROM:			
OPERATING ACTIVITIES:			
Net income	\$ 18,093	\$ 8,196	\$ 8,179
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	4,034	4,135	3,453
Amortization of stock options and restricted stock units	1,216	401	(57)
Provision for bad debts	373	230	112
Deferred income tax (benefit) expense	(464)	20	(854)
Change in operating assets and liabilities:			
Decrease (increase) in:			
Accounts receivable	(9,121)	(12,173)	(7,830)
Inventories	(7,265)	2,804	(13,788)
Prepaid expenses and other current assets	(3,208)	(933)	508
Income tax (benefit) expense from exercise of stock options	(963)	(102)	382
Increase (decrease) in:			
Accounts payable and accrued liabilities	9,884	3,062	4,309
Income taxes payable	1,278	526	1,454
Customer deposits	(269)	399	(302)
Unearned service revenues	8,007	3,189	1,030
Net cash provided by (used in) operating activities	21,595	9,754	(3,404)
INVESTING ACTIVITIES:			
Acquisition of iQVolution	—	—	(6,385)
Purchases of property and equipment	(2,930)	(3,357)	(3,937)
Payments for intangible assets	(359)	(820)	(937)
(Purchases of) proceeds from short-term investments	(61,585)	700	5,995
Net cash used in investing activities	(64,874)	(3,477)	(5,264)
FINANCING ACTIVITIES:			
Payments of capital leases	(92)	(204)	(34)
Income tax benefit (expense) from exercise of stock options	963	102	(382)
Proceeds from issuance of stock, net	58,421	361	784
Net cash provided by financing activities	59,292	259	368
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(5,904)	(125)	1,221
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	10,109	6,411	(7,079)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	15,689	9,278	16,357
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 25,798	\$ 15,689	\$ 9,278

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2007, 2006 and 2005
(in thousands, except share and per share data, or as otherwise noted)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business—FARO Technologies, Inc. and subsidiaries (collectively the “Company” or “FARO”) design, develop, manufacture, market and support software-based three-dimensional measurement devices for manufacturing, industrial, building construction and forensic applications. The Company’s principal products include the Faro Arm, Faro Scan Arm and Faro Gage, all articulated electromechanical measuring devices, and the Faro Laser Tracker and the Faro Laser Scanner LS, both laser-based measuring devices. Markets for the Company’s products include automobile, aerospace, heavy equipment, 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.

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

Revenue Recognition, Product Warranty and Extended Maintenance Contracts—Revenue related to the Company’s measurement systems (integrated combinations of a measurement device, a computer and software loaded on the computer and the measurement device) is generally recognized upon shipment as the Company considers the earnings process substantially complete as of the shipping date. 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. The Company separately sells one and three year extended warranties. Extended warranty revenues are recognized on a straight-line basis over the term of the warranty. Costs relating to extended maintenance plans are recognized as incurred. Revenue from sales of software only is recognized when no further significant production, modification or customization of the software is required and when the following criteria are met: persuasive evidence of a sales agreement exists, delivery has occurred, and the sales price is fixed or determinable and deemed collectible. Revenues resulting from sales of comprehensive support, training and technology consulting services are recognized as such services are performed and are deferred when billed in advance of the performance of services. Revenue from the licensing agreements for the use of its technology for medical applications is generally recognized as licensees use the technology. Amounts representing royalties for the current year and not received as of year-end are estimated as due based on historical data and recognized in the current year.

Cash and Cash Equivalents—The Company considers cash on hand and amounts on deposit with financial institutions which have maturities of three months or less when purchased to be cash and cash equivalents. The Company had deposits with foreign banks totaling \$15,376 and \$9,861 as of December 31, 2007 and 2006, respectively.

Accounts receivable and related allowance for doubtful accounts—Credit is extended to customers based on an evaluation of a customer’s financial condition and, generally, collateral is not required. Accounts receivable are generally due within 30-90 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due. The Company makes judgments as to the collectibility of accounts receivable based on historical trends and future expectations. Management estimates an allowance for doubtful accounts which adjusts gross trade accounts receivable to its net realizable value. The allowance for doubtful accounts is based on an analysis of all

[Table of Contents](#)

receivables for possible impairment issues and historical write-off percentages. The Company writes off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. The Company does not generally charge interest on past due receivables.

Inventories—Inventories are stated at the lower of cost or net realizable value using the first-in first-out method. Shipping and handling costs are classified as a component of cost of sales in the consolidated statements of income. Sales demonstration inventory is comprised of measuring devices utilized by sales representatives to present the Company’s products to customers. These products remain in sales demonstration inventory for approximately six to twelve months and are subsequently sold at prices that produce slightly reduced gross margins. Service inventory is comprised of inventory that is not expected to be sold within twelve months, such as training and loaned equipment.

Property and Equipment—Property and equipment purchases exceeding a thousand dollars are capitalized and recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the various classes of assets as follows:

Machinery and equipment	2 to 5 years
Furniture and fixtures	3 to 10 years

Leasehold improvements are amortized on the straight-line basis over the lesser of the life of the asset or the term of the lease, not to exceed 7 years.

Depreciation expense was \$3,319, \$2,842 and \$2,154 in 2007, 2006 and 2005, respectively. Accelerated methods of depreciation are used for income tax purposes in contrast to book purposes, and as a result, appropriate provisions are made for the related deferred income taxes.

Goodwill and Intangibles—Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 142, “*Goodwill and Other Intangible Assets*,” indefinite-life identifiable intangible assets and goodwill are not amortized. The Company periodically reviews its identifiable intangible assets and goodwill, considering factors such as projected cash flows and revenue and earnings multiples, to determine whether the value of the assets are impaired and the amortization periods are appropriate. 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.

Other acquired intangibles principally include patents, existing product technology and customer relationships that arose in connection with the acquisition of iQvolution AG (See note 2). Other acquired intangibles are recorded at fair value at the date of acquisition and are amortized over their estimated useful lives of 3 to 15 years.

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

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

The Reserve for Warranties—The Company establishes a liability for included twelve-month warranties by the creation of a warranty reserve, which is an estimate of the repair expenses likely to be incurred for the remaining period of warranty measured in installation-months in each major product group. Warranty reserve is reflected in accrued liabilities in the accompanying consolidated balance sheets. The warranty expense is estimated by determining the total repair expenses for each product group in the period and determining a rate of

[Table of Contents](#)

repair expense per installation month. The rate is multiplied by the number of machine-months of warranty for each product group sold during the period to determine the provision for warranty expenses for the period. The Company reevaluates its exposure to warranty costs at the end of each period using the estimated expense per installation month for each major product group, the number of machines remaining under warranty and the remaining number of months each machine will be under warranty. While such expenses have historically been within its expectations, the Company cannot guarantee this will continue in the future.

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, and tax planning strategies that the Company might employ to utilize such assets, including net operating loss carryforwards. Based on the positive and negative evidence described in SFAS No. 109, “*Accounting for Income Taxes*” (“SFAS 109”), the Company establishes a valuation allowance against the net deferred assets of a taxing jurisdiction in which the Company operates unless it is “more likely than not” that the Company 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 the Company’s ability to achieve profitability and the Company’s ability to predict and achieve future projections of taxable income over a two year period.

The Company operates in a number of different countries around the world. In 2003, the Company began to manufacture its products in Switzerland, where it has received a permanent income tax rate commitment from the Swiss government as an incentive to establish a manufacturing plant there. In 2005, the Company opened a regional headquarters and began to manufacture its products in Singapore, where it received in 2006 a favorable multi-year income tax rate commitment from the Singapore Economic Development Board as an incentive to establish a manufacturing plant and regional headquarters there.

On July 13, 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation No. 48 “*Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109*” (“FIN 48”) which clarifies the accounting for uncertainty in income taxes recognized in an entity’s financial statements in accordance with SFAS 109 and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted the provisions of FIN 48 on January 1, 2007.

Significant judgment is required in determining the Company’s worldwide provision for income taxes. In the ordinary course of global business, there are many transactions for which the ultimate tax outcome is uncertain. The Company has appropriately reserved for its tax uncertainties based on the criteria established by FIN 48.

Fair Value of Financial Instruments—The Company’s financial instruments include cash and cash equivalents, short-term investments, accounts receivable 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.

Earnings Per Share—Basic earnings per share (“EPS”) is computed by dividing earnings available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS includes the effect of all dilutive stock options and equity instruments. A reconciliation of the number of common shares used in calculation of basic and diluted EPS is presented in Note 17. Earnings Per Share.

Concentration of Credit Risk—Financial instruments which potentially expose the Company to concentrations of credit risk consist principally of short-term investments and operating demand deposit

[Table of Contents](#)

accounts. The Company's policy is to place its operating demand deposit accounts with high credit quality financial institutions.

Stock-Based Compensation—In December 2004, the FASB issued SFAS No. 123R, "Share-Based Payment" ("SFAS 123R"). SFAS 123R requires employee stock options and rights to purchase shares under stock participation plans to be accounted for under the fair value method, and eliminates the ability to account for these instruments under the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employers", as allowed under the original provisions of SFAS 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). Under the intrinsic value based method, compensation cost is measured by the excess, if any, of the quoted market price of the stock at the grant date over the amount an employee must pay to acquire the stock. Under the fair value based method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period, which is usually the vesting period, which is generally three years. The Company adopted the provisions of SFAS 123R on January 1, 2006 using the modified prospective application transition method. The Company uses the Black-Scholes option pricing model to determine the fair value of stock option grants. In order to determine the fair value of restricted stock awards the Company uses the closing market price of its common stock on the date of grant.

Had compensation expense for the Company's stock based compensation plans been determined consistent with SFAS 123, the Company's net income and earnings per share would have been as follows:

	Year Ended December 31, 2005
Net income, as reported	\$ 8,179
Deduct: Stock-based employee compensation income included in reported net income, net of related tax effects*	(94)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(7,468)
Pro forma net income	<u>\$ 617</u>
Earnings per share:	
Basic—as reported	\$ 0.58
Basic—pro forma	\$ 0.04
Diluted—as reported	\$ 0.57
Diluted—pro forma	<u>\$ 0.04</u>

* The year ended 2005 assume a U.S. tax rate of 37.6%.

The Company used the Black-Scholes option-pricing model to determine the fair value of grants made. The following assumptions were applied in determining the pro forma compensation cost:

	Year Ended December 31, 2005
Risk-free interest rate	3.30% to 4.47%
Expected dividend yield	0%
Expected option life	4 years
Stock price volatility	62.7%

The Company incurred minimal expenses in 2006 as calculated under the Black-Scholes method of SFAS 123, related to its adoption of SFAS 123(R) for the expensing of stock options as it vested substantially all of its unvested options in the fourth quarter of 2005. The reduction in pre-tax charges estimated by the Company as a result of the acceleration amounts to approximately \$7.7 million over the course of the original vesting periods.

[Table of Contents](#)

Options to purchase approximately 704,310 shares of the Company's stock or 52.5% of the Company's outstanding options were accelerated. The weighted average exercise price of the options subject to acceleration was \$21.30. The aggregate pretax expense for the shares subject to acceleration that would have been reflected in the Company's consolidated financial statements beginning in 2006 is approximately \$7.7 million, including \$4.3 million in 2006, \$2.7 million in 2007, and \$0.7 million in 2008. The fair value for any future grants will be included in expense over the vesting periods. These expenses will be apportioned according to the classification of the employees who have received stock options into cost of sales, selling, general and administrative or research and development costs.

Long-Lived Assets—Effective January 1, 2002, the Company adopted SFAS No. 144, "*Accounting for the Impairment or Disposal of Long-Lived Assets*" ("SFAS 144"). SFAS 144 supersedes SFAS No. 121, "*Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to Be Disposed of*", and requires that one accounting impairment model be used for long-lived assets to be held and used and to be disposed of by sale, whether previously held and used or newly acquired, and broadens the presentation of discontinued operations to include more disposal transactions. The adoption of SFAS 144 had no financial impact on the results of operations or financial position of the Company. During the fourth quarter of 2007, 2006 and 2005, management reviewed the Company's long-lived assets and concluded that there was no impairment of these assets for the years ended December 31, 2007, 2006 and 2005.

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

Impact of Recently Issued Accounting Standards

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities*" ("SFAS 159"). SFAS 159 permits entities to choose to measure certain financial instruments and other eligible items at fair value when the items are not otherwise currently required to be measured at fair value. Under SFAS 159, the decision to measure items at fair value is made at specified election dates on an irrevocable instrument-by-instrument basis. Entities electing the fair value option would be required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. Entities electing the fair value option are required to distinguish, on the face of the statement of financial position, the fair value of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. If elected, SFAS 159 will be effective as of the beginning of the first fiscal year that begins after November 15, 2007, with earlier adoption permitted if all of the requirements of SFAS 159 are adopted. The impact of the adoption of SFAS 159 will be dependent on the extent to which the Company chooses to elect to measure eligible items at fair value.

In September 2006, the FASB issued SFAS No. 157, "*Fair Value Measurements*" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies to other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS 157 are

[Table of Contents](#)

effective for fiscal years beginning after November 15, 2007 except for non-financial assets and liabilities recognized or disclosed at fair value on a recurring basis, for which the effective date is fiscal years beginning after November 15, 2008. The Company has not determined the effect, if any, that the adoption of this statement will have on its financial condition or results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), “*Business Combinations*” (“SFAS 141 (revised)”). SFAS 141 (revised) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. The statement also requires the acquirer in a business combination achieved in stages to recognize the identifiable assets and liabilities, as well as the noncontrolling interest in the acquiree, at the full amounts of their fair values. The provisions of SFAS 141 (revised) are effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company has not determined the effect, if any, that the adoption of this statement will have on its financial condition or results of operations.

In December 2007, the FASB issued SFAS 160, “*Noncontrolling Interests in Consolidated Financial Statements — an amendment to ARB No. 51.*” This statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective prospectively, except for certain retrospective disclosure requirements, for fiscal years beginning after December 15, 2008. The Company has not determined the effect, if any, that the adoption of this statement will have on its financial condition or results of operations.

Reclassification—Certain 2006 and 2005 amounts have been reclassified to conform with the 2007 presentation.

2. ACQUISITION

iQvolution—On March 29, 2005, the Company acquired 100% of the outstanding stock of privately held iQvolution AG (“iQvolution”). iQvolution, a German company, designs, manufactures and supplies three-dimensional laser scanning products and services. This purchase was a strategic acquisition to enable the Company to enter broader three-dimensional measurement markets. The purchase price for the transaction was approximately \$13.6 million, including an initial cash payment of approximately \$3.8 million and 314,736 shares of common stock valued at approximately \$7.2 million based on the average closing price for the three days immediately preceding the closing, 152,292 shares of which were payable immediately. The remaining 162,444 shares of common stock, valued at approximately \$3.7 million, were placed in escrow and may be paid over the following five years subject to achieving predetermined milestones with respect to purchased assets. Subsequent to the purchase, approximately \$1.8 million in cash was paid out for the repayment of loans and approximately \$0.4 million was paid in fees associated with the purchase. Additionally, the purchase price was adjusted downward by \$0.1 million, and these funds were repaid to the Company in the third quarter relating to the settlement of a purchase price adjustment clause within the purchase agreement. In the fourth quarter of 2005, 12,183 shares were issued as a result of the successful qualification of milestones, with a corresponding addition to goodwill of \$252. In February of 2006, 43,871 shares were issued as a result of milestones met, for which \$675 was accrued into goodwill and additional paid-in capital at December 31, 2005. An additional 1,288 shares were returned to the Company in February 2006 for cancellation as a result of milestone disqualification. During 2006, 25,991 shares were released from escrow with a corresponding addition to Goodwill of \$408. During 2007, 24,773 shares were released from escrow with a corresponding addition to goodwill of \$730. At December 31, 2007, there were 56,914 shares being held in escrow.

During the third quarter of 2005, approximately \$3.8 million of the purchase price was allocated to intangible assets reflecting the Company’s preliminary estimate of the fair value of technology and software assets acquired. The hardware assets acquired were valued at approximately \$2.3 million with an estimated life of 17 years, while the software assets were valued at approximately \$1.6 million with an estimated life of 10 years. As of December 31, 2005, these estimates were in the process of being reviewed and validated by a third party. The Company completed in the first quarter of 2006 the third party valuation of the assets acquired. The

[Table of Contents](#)

Company made an adjustment to the purchase price to reflect a deferred tax liability of approximately \$1.5 million. The following table represents the fair value of the assets acquired and liabilities assumed and includes the final determination of the estimated fair values of deferred tax assets, non-compete, and intangible assets, which were preliminary as of December 31, 2005.

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

The operating results of iQvolution have been included in the consolidated statements of income since the date of acquisition. The following unaudited pro-forma results of operations for the year ended December 31, 2005 is presented for informational purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisition occurred on the date indicated, or the results of operations which may result in the future.

	<u>Year ended Dec 31, 2005 (unaudited)</u>
Revenues	\$ 125,961
Net income	\$ 7,463
Income per share:	
Basic	\$ 0.53
Diluted	\$ 0.52

3. SUPPLEMENTAL CASH FLOW INFORMATION

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

	<u>Years ended December 31,</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Cash paid for interest	\$ 9	\$ 16	\$ 91
Cash paid for income taxes	4,302	976	2,027
Cash received from income tax refund	—	—	1,161
Non-cash investing and financing activities:			
Value of shares issued for acquisition of iQvolution	730	408	3,756

4. ALLOWANCE FOR DOUBTFUL ACCOUNTS

The allowance for doubtful accounts is as follows:

	<u>Years ended December 31,</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Balance, beginning of year	\$458	\$214	\$ 339
Provision	373	257	112
Amounts written off, net of recoveries	(92)	(13)	(237)
Balance, end of year	<u>\$739</u>	<u>\$458</u>	<u>\$ 214</u>

[Table of Contents](#)

5. SHORT-TERM INVESTMENTS

The underlying investments of the Company are variable rate, long-term, tax-exempt municipal bonds. The interest rate on these variable rate municipal bonds resets every seven days to adjust to current market conditions. The Company can redeem these investments at cost at any time with five business days notice. Therefore, the investments are held at cost and are classified as short-term investments on the accompanying consolidated balance sheets. The Company holds these investments as available for sale.

6. INVENTORIES

Inventories consist of the following:

	December 31,	
	2007	2006
Raw materials	\$12,614	\$ 9,754
Finished goods	4,903	2,160
Sales demonstration inventory	13,448	11,919
Reserve for excess and obsolete	(1,865)	(404)
Inventory	29,100	23,429
Service inventory	10,865	7,278
Total	<u>\$39,965</u>	<u>\$30,707</u>

7. GOODWILL

The Company's goodwill at December 31, 2007 and 2006 is related to its acquisition of three previous businesses. The Company tests for goodwill impairment in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." The Company evaluates each reporting unit's fair value versus its carrying value in the fourth quarter of each year or more frequently if events or changes in circumstances indicate that the carrying value may exceed the fair value. The Company prepares a discounted cash flow model to estimate the fair value of the reporting unit and compares this amount against the carrying value. Impairments to goodwill are charged against earnings in the period the impairment is identified. The Company has three reporting units for which goodwill was tested on December 31, 2007, the Americas Region, the Europe/Asia Region, and the Asia Pacific Region, as shown in the table. As of December 31, 2007 and 2006, the Company did not have any goodwill that was identified as impaired. The increase in goodwill of \$1.9 million in 2007 and \$2.7 million in 2006 relates primarily to the purchase of iQvolution.

	Beginning Balance	Additions	Foreign Currency Translation	Ending Balance
December 31, 2007				
Americas Region	\$ 6,994	\$ —	\$ —	\$ 6,994
Europe/Africa region	10,272	730	1,121	12,123
Asia Pacific Region	—	—	—	—
Total	<u>\$ 17,266</u>	<u>\$ 730</u>	<u>\$ 1,121</u>	<u>\$ 19,117</u>
December 31, 2006				
Americas Region	\$ 6,994	\$ —	\$ —	\$ 6,994
Europe/Africa region	7,580	1,625	1,067	10,272
Asia Pacific Region	—	—	—	—
Total	<u>\$ 14,574</u>	<u>\$ 1,625</u>	<u>\$ 1,067</u>	<u>\$ 17,266</u>

8. INTANGIBLE ASSETS

Intangible assets consist of the following:

	December 31,	
	2007	2006
Amortizable intangible assets		
Existing product technology	\$ 11,837	\$ 10,273
Patents	3,312	2,984
Other	5,871	6,791
Total	21,020	20,048
Accumulated amortization	(15,050)	(13,827)
Intangible assets—net	<u>\$ 5,970</u>	<u>\$ 6,221</u>

In 2005, the Company wrote off patents with an original cost of \$503 and a net book value of \$334 which had been abandoned. Amortization expense was \$715, \$1,293 and \$1,299 in 2007, 2006 and 2005, respectively. The estimated amortization expense for each of the five succeeding fiscal years is as follows:

Years ending December 31,	Amount
2008	\$ 551
2009	529
2010	529
2011	529
2012	527
Thereafter	3,055
	<u>\$5,720</u>

9. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	As of December 31,	
	2007	2006
Accrued compensation and benefits	\$10,689	\$ 7,195
Accrued warranties	1,980	1,369
Professional and legal fees	1,140	972
Accrued penalties	2,650	—
Other accrued liabilities	1,530	843
	<u>\$17,989</u>	<u>\$ 10,379</u>

Activity related to accrued warranties was as follows:

	December 31,	
	2007	2006
Beginning Balance	\$ 1,369	\$ 861
Provision for warranty expense	1,984	1,326
Warranty expired	(1,373)	(818)
Ending Balance	<u>\$ 1,980</u>	<u>\$ 1,369</u>

10. 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. Loans under the loan agreement bear interest at the rate of LIBOR plus 1.75% and require the Company to maintain certain ratios with respect to a debt covenant agreement, including current ratio, consolidated EBITDA, and senior funded debt to EBITDA. As of December 31, 2007, the Company is in compliance with all of the covenants under the loan agreement. The term of the loan agreement extends to April 30, 2009. The Company has not drawn on this line of credit.

11. CAPITAL LEASES AND LONG-TERM DEBT

Required future payments of obligations under capital leases are as follows:

<u>Year ending December 31,</u>	<u>Capital Lease Obligations</u>
2008	\$ 18
2009	73
2010	25
2011	25
2012	99
Total future minimum lease payments	240
Less—Current maturities	(18)
	<u>\$ 222</u>

Assets under capital leases were \$409 and \$559 at December 31, 2007 and 2006, respectively. Accumulated depreciation of assets under capital leases was \$150 and \$366 at December 31, 2007 and 2006, respectively.

12. RELATED PARTY TRANSACTIONS

Related party lease—The Company leased its headquarters in Lake Mary, Florida from Xenon Research, Inc., a company owned by Simon Raab, the Company's Chairman, and Diana Raab, his spouse. On May 22, 2007, Xenon Research, Inc. sold the property and assigned the lease agreement to Emma Investments, LLC, an unrelated third party. Rent expense under this lease was \$166, \$398 and \$398 in 2007, 2006 and 2005, respectively.

13. OTHER INCOME (EXPENSE), NET

Other (income) expense, net consists of the following:

	<u>Years ended December 31,</u>		
	<u>2007</u>	<u>2006</u>	<u>2005</u>
Foreign exchange (gains) losses	\$(1,559)	\$(827)	\$ 794
Disposal of patents	—	—	334
Other	(339)	37	(322)
Total other (income) expense, net	<u>\$(1,898)</u>	<u>\$(790)</u>	<u>\$ 806</u>

14. INCOME TAXES

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation, the Company did not recognize an adjustment to its liability for unrecognized tax benefits. The Company has a \$0.5 million liability recorded for unrecognized tax benefits as of January 1, 2007 and December 31, 2007, which includes interest and penalties of \$0.05 million.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2007	\$ 468
Additions based on tax positions related to the current year	19
Additions for tax positions of prior years	23
Reductions for tax positions of prior years	—
Settlements	—
Balance at December 31, 2007	<u>\$ 510</u>

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. The table below summarizes the open tax years and ongoing tax examinations in major jurisdictions as of December 31, 2007:

<u>Jurisdiction</u>	<u>Open Years</u>	<u>Examination in Process</u>
United States—Federal Income Tax	2004 - 2007	2005
United States—various states	2004 - 2007	2004-2007
Germany	1999 - 2007	1999 - 2003
Switzerland	2002 - 2007	N/A
Singapore	2001 - 2007	N/A
United Kingdom	2005 - 2007	N/A

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in tax expense. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$0.5 million. The Company does not currently anticipate that the total amount of unrecognized tax benefits will result in material changes to its financial position. The Company is subject to income taxes at the federal, state and foreign country level. The Company's tax returns are subject to examination at the U.S. federal level from 2004 forward and at the state level subject to a three to five year statute of limitations.

The United States Internal Revenue Service ("IRS") commenced an examination of the Company's 2005 income tax return in late 2007. It is anticipated that this exam will be completed by the end of 2008. The Company also received notice from a state in early 2008 of the commencement of an examination of its tax returns for the period 2004 through 2007. In addition, the Company's tax returns are currently under examination by the taxing authorities in Germany for the years 1999 through 2003. This audit began in 2005 and is anticipated to close by the end of 2008. The Company does not currently anticipate that the total amount of unrecognized tax benefits will significantly increase or decrease within the next 12 months.

[Table of Contents](#)

The effective income tax rate for 2007, 2006, and 2005, includes a reduction in the statutory corporate tax rates 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 \$2.0 million, or \$0.13 per share, in the year ended December 31, 2007, \$1.7 million, or \$0.12 per share, in the year ended December 31, 2006, and \$3.0 million, or \$0.21 per share, in the year ended December 31, 2005.

In 2005, the Company opened a regional headquarters and began to manufacture 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 a favorable tax rate subject to certain terms and conditions including employment, spending, and capital investment. The aggregate dollar effect of this favorable tax rate was approximately \$2.0 million, or \$0.13 per share, during the year ended December 31, 2007, and \$0.9 million, or \$0.06 per share, during the year ended December 31, 2006.

At December 31, 2007 and 2006, the Company's domestic entities had deferred income tax assets in the amount of \$4,928 and \$3,996, respectively. The Company has determined that these amounts are fully realizable and has not established any valuation allowance based on the assessment that they are more-likely-than-not to be utilized.

At December 31, 2007 and 2006, the Company's foreign subsidiaries had deferred income tax assets relating to net operating loss carry forwards, which do not expire, of \$7,677 and \$6,251, respectively. For financial reporting purposes, a valuation allowance of \$6,304 and \$4,417, respectively has been recognized to offset the deferred tax assets relating to net operating losses. The Company continues to maintain a valuation allowance on net operating losses in jurisdictions for which it does not have a history of earnings over the last three years and where the Company believes that the deferred tax assets are not more-likely-than-not to be realized based upon two-year projections of taxable income. The Company increased the overall valuation allowance in 2007 on its deferred tax assets in the amount of \$1,887.

At December 31, 2006, the Company had \$279 in tax credit carryforwards. These credits are related to the Company's research and development activities and were fully utilized during 2007.

The Company has not recognized any U.S. tax expense on undistributed international earnings since it intends to reinvest the earnings outside the U.S. for the foreseeable future. The Company's net undistributed international earnings were approximately \$25.6 million and \$10.8 million at December 31, 2007, and 2006, respectively.

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.

Income before income taxes consists of the following:

	Years ended December 31,		
	2007	2006	2005
Domestic	\$ 7,081	\$ 932	\$ 5,304
Foreign	\$ 15,955	8,844	4,594
Income before income taxes	\$ 23,036	\$ 9,776	\$ 9,898

[Table of Contents](#)

The components of the income tax expense are as follows:

	Years ended December 31,		
	2007	2006	2005
Current:			
Federal	\$ 3,925	\$ 517	\$ 1,792
State	381	50	173
Foreign	1,235	1,028	1,317
	<u>5,541</u>	<u>1,595</u>	<u>3,282</u>
Deferred:			
Federal	(721)	(470)	(395)
State	(70)	(46)	(38)
Foreign	193	501	(1,130)
	<u>(598)</u>	<u>(15)</u>	<u>(1,563)</u>
	<u>\$ 4,943</u>	<u>\$ 1,580</u>	<u>\$ 1,719</u>

Income tax expense for the years ended December 31, 2007, 2006, and 2005 differ from the amount computed by applying the federal statutory corporate rate to income before income taxes. The differences are reconciled as follows:

	Years ended December 31,		
	2007	2006	2005
Tax expense at statutory rate of 35%	\$ 8,063	\$ 3,422	\$ 3,464
State income taxes, net of federal benefit	234	36	84
Foreign tax rate difference	(6,042)	(3,064)	(2,771)
Research and development credit	(77)	(121)	(274)
Change in valuation allowance	1,887	1,411	1,247
Change in foreign tax rate	164	—	—
Penalties	988	—	—
Other	(274)	(104)	(31)
Total income tax expense	<u>\$ 4,943</u>	<u>\$ 1,580</u>	<u>\$ 1,719</u>

[Table of Contents](#)

The components of the Company's net deferred income tax asset are as follows:

	December 31,	
	2007	2006
Net deferred income tax asset—Current		
Intercompany profit in inventory	\$ 1,676	\$ 1,592
Warranty costs	292	268
Bad debt reserve	130	87
Inventory reserve	209	(38)
Unearned service revenue	1,318	1,436
Other	258	(102)
Deferred income tax asset—Current	<u>3,883</u>	<u>3,243</u>
Valuation Allowance	(1,042)	(1,398)
Net deferred income tax asset—Current	<u>\$ 2,841</u>	<u>\$ 1,845</u>
Net deferred income tax asset—Non-current		
Depreciation	\$ 1,256	\$ 1,228
Goodwill amortization	(842)	(847)
Product design costs	(56)	(59)
Employee stock options	8	100
Unearned service revenue	679	52
Tax credits	—	279
Loss carryforwards	7,677	6,251
Deferred income tax asset—Non-current	<u>8,722</u>	<u>7,004</u>
Valuation Allowance	(5,262)	(3,019)
Net deferred income tax asset—Non-current	<u>\$ 3,460</u>	<u>\$ 3,985</u>
Net deferred income tax liability—Non-current Intangible assets	<u>\$(1,073)</u>	<u>\$(1,200)</u>

15. COMMITMENTS AND CONTINGENCIES

Leases—The Company leases buildings and equipment under operating leases. The following is a schedule of future minimum lease payments required under non-cancelable operating leases with initial terms in excess of one year, in effect at December 31, 2007:

<u>Years ending December 31,</u>	<u>Amount</u>
2008	\$ 4,397
2009	3,583
2010	1,951
2011	1,316
2012	1,103
Thereafter	237
Total future minimum lease payments	<u>\$ 12,587</u>

Rent expense for 2007, 2006 and 2005 was approximately \$3,662, \$3,291 and \$2,306, respectively.

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 December 31, 2007, the Company does not have any long-term commitments for purchases.

[Table of Contents](#)

Securities Litigation—On December 6, 2005, the first of four essentially identical class action securities fraud lawsuits were filed against the Company and certain officers of the Company (the “Securities Litigation”) in the U.S. District Court for the Middle District of Florida. On April 19, 2006, the four lawsuits were consolidated, and Kornitzer Capital Management, Inc. (the “Lead Plaintiff”) was appointed as the lead plaintiff. On May 16, 2006, the Lead Plaintiff filed its Consolidated Amended Class Action Complaint against the Company and the individual defendants (the “Amended Complaint”). On February 3, 2007, the Court dismissed the Amended Complaint, without prejudice. On February 22, 2007, the Lead Plaintiff filed its Consolidated Second Amended Class Action Complaint (the “Second Amended Complaint”) against the Company and the individual defendants.

In the Second Amended Complaint, as in the Amended Complaint, the Lead Plaintiff seeks to include in the class all persons who purchased or otherwise acquired the Company’s common stock between April 15, 2004 and March 15, 2006 (the “Class”), and seeks an unspecified amount of damages, premised on allegations that each defendant made misrepresentations and omissions of material fact during the class period in violation of the Securities Exchange Act of 1934. Among other things, the Lead Plaintiff alleges that the Company’s reported inventory, gross margins and profits were false and misleading during a portion of the class period because the Company consciously overstated the value of its inventory; that the Company misstated during 2005 certain of the selling expenses it had accrued and had expected to incur; that certain Asian sales that the Company had reported during the class period had been the product of unlawful payments made in violation of the Foreign Corrupt Practices Act, and that the Company failed to disclose that it was utilizing unlawful means to achieve such sales; and that certain of the Company’s statements regarding the Company’s systems of internal controls had been false and misleading, in light of the above and other circumstances.

On February 26, 2008, the parties to the Securities Litigation entered into a Memorandum of Understanding stating the principal terms of their agreement to settle the Securities Litigation. Pursuant to the Memorandum of Understanding, which is subject to certain conditions, the parties to the Securities Litigation will prepare and file a detailed Stipulation and Agreement of Settlement with the court seeking the court’s preliminary and final approval of the terms of the proposed settlement. Pursuant to those terms, the issuer of the Company’s Executive Liability and Entity Securities Liability insurance policy applicable to the Securities Litigation will pay \$6.875 million into a settlement fund for the Securities Litigation. That sum is within the coverage limit of the policy.

The proceeds of the settlement fund will be distributed to members of the Class and to the Lead Plaintiff’s counsel. The balance of the settlement fund will be used to pay various costs associated with providing notice of the terms of the proposed settlement to the Class and with administering the settlement. If the court approves the settlement, a judgment will be entered dismissing the Securities Litigation, with prejudice, as against each defendant.

Derivative Action—On January 10, 2008, a Verified Shareholder Derivative Complaint (the “Derivative Complaint”) was filed by an alleged shareholder of the Company in the U.S. District Court for the Middle District of Florida against six of the Company’s current and former directors, as defendants, and against the Company, as a nominal defendant. The Derivative Complaint alleges breach of fiduciary duty and other claims against the individual defendants principally in connection with the alleged acts and omissions asserted in the Securities Litigation. The plaintiff alleges that the individual defendants caused the Company’s stock price to be falsely inflated, and subjected the Company to costs, fines and other damages, as well as a loss of good will. The plaintiff purports to seek an unspecified amount of damages, together with other relief, on behalf of the Company and against the individual defendants. Prior to filing the Derivative Complaint, the plaintiff had requested that the Company assert certain of such claims against some of the individual defendants. In February 2008, the Company received another demand by another alleged shareholder that the Company assert substantially the same claims as set forth in the Derivative Complaint against seven of the Company’s current and former directors.

[Table of Contents](#)

The Company has formed a committee of independent directors to review and investigate the shareholder's demand, and the allegations made in the Derivative Complaint and the other shareholder demand. The committee has not yet made a recommendation with respect to those matters. To the Company's knowledge, no defendant has been served with the Derivative Complaint.

Voluntary Disclosure of Foreign Corrupt Practices Act Matter to the Securities and Exchange Commission and Department of Justice.—As previously reported by the Company, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the Foreign Corrupt Practices Act ("FCPA") and other applicable laws. The Company's Audit Committee instituted an internal investigation into this matter in February 2006, and the Company voluntarily notified the Securities and Exchange Commission ("SEC") and the Department of Justice ("DOJ") of this matter in March 2006. The Company's internal investigation into this matter has been completed. The Company's internal investigation identified certain improper payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA.

Results of the investigation revealed that referral fee payments in possible violation of the FCPA were \$165,000 and \$265,000 in 2004 and 2005, respectively, which were recorded in selling expenses in its statements of income. The related sales to customers to which payment of these referral fees had been made totaled approximately \$1.3 million and \$3.24 million in 2004 and 2005, respectively. Additional improper referral fee payments of \$122,000 were made in January and February 2006 related to sales contracts in 2005. The Company had sales in China of \$9.0 million in 2005 and \$4.2 million in 2004, approximately 7% and 4% of total sales, respectively. The Company incurred expenses of \$3.8 million in 2006 and \$3.1 million in 2007, relating to the FCPA matter, including \$2.65 million for estimated fines and penalties to the DOJ and SEC.

The Company has provided to the SEC and the DOJ information obtained during the course of this investigation and is cooperating with both agencies. The SEC and the DOJ have a broad range of civil and criminal remedies that they may seek to impose against corporations and individuals in appropriate circumstances, including without limitation disgorgement, fines, penalties, and other injunctive and equitable relief, as well as additional changes to the Company's business practices and compliance programs.

The Company has engaged in settlement discussions with both the SEC and the DOJ concerning the FCPA matter. Although there is no assurance that such discussions will result in a resolution of the FCPA matter, the Company has determined that the settlement discussions are likely to result in a resolution that will include a fine and disgorgement of associated profits. The Company recorded a reserve of \$2.65 million in anticipation of the amount that could be necessary to satisfy its financial obligations to the SEC and the DOJ in resolving this matter. Predicting at this time when the FCPA matter will be finally resolved with the SEC and the DOJ is not possible. The monetary sanctions ultimately paid by the Company to the SEC and the DOJ in resolving this matter, whether imposed on the Company or agreed to by settlement, may exceed the amount that has been reserved by the Company.

The Company anticipates that resolution of the matter will not result in formal criminal charges being filed against it by the DOJ. The Company expects that as part of the final resolution of the FCPA matter with the SEC and the DOJ, in addition to monetary sanctions, the Company will have continuing obligations with the SEC and the DOJ with respect to monitoring, compliance with the FCPA and other laws, full cooperation with the government, and the adoption of a compliance code containing specific provisions intended to prevent violations of the FCPA. The Company expects that the failure to comply with any such continuing obligations could result in the SEC and the DOJ seeking to impose penalties against the Company in the future.

[Table of Contents](#)

The Company terminated, in March 2006, certain personnel in the Asia-Pacific Region and re-assigned the duties of other personnel in both the Asia-Pacific Region and the U.S. as a result of the internal investigation. Additionally, the Company instituted the following remedial measures:

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

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

16. STOCK COMPENSATION PLANS

The Company has four stock option plans that provide for the granting of stock options to key employees and non-employee members of the Board of Directors. The 1993 Stock Option Plan ("1993 Plan") and the 1997 Employee Stock Option Plan ("1997 Plan") provide for granting incentive stock options and nonqualified stock options to officers and key employees of the Company. The 1997 Non-employee Director Plan provides for granting nonqualified stock options and formula options to non-employee directors. The 2004 Equity Incentive Plan ("2004 Plan") provides for granting options or stock appreciation rights to employees and non-employee directors.

The Company is authorized to grant options for up to 703,100 shares of common stock under the 1993 Plan, of which there are none outstanding. The Company is also authorized to grant options for up to 1,400,000 shares of common stock under the 1997 Plan, of which 97,659 options are currently outstanding at exercise prices between \$1.50 and \$27.40. These options have a 10 year term and vest over a 3-year period. The Company is also authorized to grant up to 250,000 shares of common stock under the 1997 Non-employee Director Plan of which 63,000 options are currently outstanding at exercise prices between \$1.61 and \$21.56. Each non-employee director is granted 3,400 restricted shares of common stock that vest ratably over three years, and then annually on the day following the Annual Meeting of Shareholders, each non-employee director is granted 2,200 restricted shares of common stock that vest ratably over three years. The Company is also authorized to grant options for up to 1,750,000 shares of common stock under the 2004 Plan, of which 625,205 options are currently outstanding at exercise prices between \$14.06 to \$33.21, and 23,834 restricted stock units are outstanding at a stock price of \$19.49 to \$24.36. These options and restricted stock units have a 10 year term and vest over a 3-year period.

[Table of Contents](#)

The restricted stock unit grants have a performance-based annual vesting on the anniversary date over their respective terms. The Company records compensation cost associated with its restricted stock unit grants on a straight-line basis over the vesting term.

In addition to the four stock option plans, the Company has the 1997 Non-Employee Directors Fee Plan (1997 Fee Plan) under which the Company is authorized to issue up to 250,000 shares of Common Stock and permits non-employee directors to elect to receive directors' fees in the form of common stock rather than cash. Common stock issued in lieu of cash directors' fees is issued at the end of the quarter in which the fees are earned, with the number of shares being based on the fair market value of the common stock for the five trading days immediately preceding the last business day of the quarter. The 1997 Fee Plan also permits non-employee directors to irrevocably elect to defer receipt of all or any portion of the shares of common stock which would otherwise be payable. As of December 31, 2005 there were 11,090 shares which were accrued but not yet issued in connection with director's elections. These shares were issued as of December 31, 2006. There were no shares issued under this plan during 2007.

In the fourth quarter of 2005, the Company accelerated the vesting for substantially all of its outstanding options, and recorded minimal expenses for its remaining unvested stock options during 2006. The pre-tax charge estimated by the Company to be avoided as a result of the acceleration amounts to approximately \$7.7 million over the course of the original vesting periods. The fair value for any future grants will be included in expense over the vesting periods.

Compensation (income) costs charged to operations associated with the Company's stock option plans were \$1,217, \$210, and (\$150) in 2007, 2006, and 2005, respectively. The changes in stock option associated compensation cost were due to the vesting of options combined with market price fluctuations in the Company's common stock under variable accounting and the accrual of expenses relating to the issuance of restricted stock.

The Company used the Black-Scholes option-pricing model to determine the fair value of grants made using the following assumptions:

	<u>Years Ended December 31,</u>	
	<u>2007</u>	<u>2006</u>
Risk-free interest rate	3.26 - 4.5%	5.00%
Expected dividend yield	0%	0%
Expected option life	4 years	4 years
Expected volatility	58.0 - 62.8%	63.2%
Weighted-average expected volatility	62.6%	63.2%

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.

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

	<u>Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at beginning of year	1,058,440	\$ 16.04		
Granted	201,445	24.86		
Forfeited	(33,010)	18.19		
Exercised	(441,011)	12.20		
Outstanding at December 31, 2007	<u>785,864</u>	<u>\$ 20.34</u>	<u>7.07</u>	<u>\$ 9,905</u>
Options exercisable at December 31, 2007	<u>592,903</u>	<u>\$ 18.92</u>	<u>6.38</u>	<u>\$ 8,313</u>

[Table of Contents](#)

The weighted-average grant-date fair value of the stock options granted during the years ended December 31, 2007 and 2006 was \$12.80 and \$7.32, respectively. The aggregate intrinsic value of stock options exercised during the years ended December 31, 2007, and 2006 was \$8.0 million and \$0.7 million, respectively. The total fair value of stock options vested during the years ended December 31, 2007 and 2006 was \$0.05 million and \$0.03 million, respectively.

The following table summarizes the restricted stock activity and weighted average grant-date fair values for the year ended December 31, 2007:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at beginning of year	40,524	\$ 19.95
Granted	27,496	26.93
Forfeited	(726)	19.49
Vested	(19,353)	20.60
Non-vested at December 31, 2007	<u>47,941</u>	<u>\$ 24.03</u>

As of December 31, 2007, there was \$2.7 million in 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 2.1 years.

17. 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:

	Years Ended					
	December 31, 2007		December 31, 2006		December 31, 2005	
	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	15,443,259	\$ 1.17	14,397,050	\$ 0.57	14,169,140	\$ 0.58
Effect of dilutive securities	278,956	(0.02)	163,281	(0.01)	273,108	(0.01)
Diluted EPS	<u>15,722,215</u>	<u>\$ 1.15</u>	<u>14,560,331</u>	<u>\$ 0.56</u>	<u>14,442,248</u>	<u>\$ 0.57</u>

The effect of 10,000, 745,841 and 237,419 dilutive securities were not included for 2007, 2006 and 2005, as they were antidilutive.

18. EMPLOYEE RETIREMENT BENEFIT PLAN

The Company maintains a 401(k) defined contribution retirement plan for its U.S. employees, which provides benefits for all employees meeting certain age and service requirements. The Company may make a discretionary contribution each plan year, as determined by its Board of Directors. Discretionary contributions or employer matches can be made to the participant's account but cannot exceed 100% of compensation. Costs charged to operations in connection with the Plan during 2007, 2006, and 2005 aggregated \$569, \$247 and \$201, respectively.

[Table of Contents](#)**19. SEGMENT REPORTING**

The Company has three reportable segments based upon geographic regions: Americas, Europe/Africa and Asia Pacific. The company develops, manufactures, markets, supports and sells 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.

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

	2007	2006	2005
Americas Region			
Net sales to external customers	\$ 79,984	\$ 62,967	\$ 55,884
Operating loss	(1,554)	(6,191)	(6,640)
Long-lived assets	12,594	12,278	12,825
Capital expenditures	1,879	1,684	1,251
Total assets	\$ 144,865	\$ 69,607	\$ 68,304
Europe/Africa Region			
Net sales to external customers	\$ 78,299	\$ 60,869	\$ 44,940
Operating income	11,716	8,130	8,322
Long-lived assets	18,423	16,397	12,461
Capital expenditures	1,079	1,333	1,931
Total assets	\$ 75,279	\$ 55,041	\$ 39,112
Asia Pacific Region			
Net sales to external customers	\$ 33,334	\$ 28,569	\$ 24,766
Operating income	8,949	6,320	8,544
Long-lived assets	1,597	1,657	1,747
Capital expenditures	439	1,038	1,583
Total assets	\$ 23,395	\$ 19,628	\$ 15,232
Totals			
Net sales to external customers	\$ 191,617	\$ 152,405	\$ 125,590
Operating income	19,111	8,259	10,226
Long-lived assets	32,614	30,332	27,033
Capital expenditures	3,397	4,055	4,765
Total assets	\$ 243,539	\$ 144,276	\$ 122,648

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.

20. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

<u>Quarter ended</u>	<u>March 31,</u> <u>2007</u>	<u>June 30,</u> <u>2007</u>	<u>September 29,</u> <u>2007</u>	<u>December 31,</u> <u>2007</u>
Sales	\$ 40,289	\$ 47,579	\$ 44,521	\$ 59,228
Gross profit	23,836	29,224	26,456	35,527
Net income	3,198	5,786	705	8,404
Net income per share:				
Basic	\$ 0.22	\$ 0.39	\$ 0.04	\$ 0.51
Diluted	\$ 0.22	\$ 0.39	\$ 0.04	\$ 0.50

<u>Quarter ended</u>	<u>April 1,</u> <u>2006</u>	<u>July 1,</u> <u>2006</u>	<u>September</u> <u>30,</u> <u>2006</u>	<u>December 31,</u> <u>2006</u>
Sales	\$ 32,056	\$ 38,042	\$ 38,365	\$ 43,942
Gross profit	18,835	22,562	22,244	25,817
Net income	496	853	3,189	3,658
Net income per share:				
Basic	\$ 0.03	\$ 0.06	\$ 0.22	\$ 0.25
Diluted	\$ 0.03	\$ 0.06	\$ 0.22	\$ 0.25

During the fourth quarter of 2006, the Company identified certain shipments to customers containing the freight term FOB Destination as exceptions to the standard terms and conditions of sale that had been included in sales when shipped and not when delivered. Also during the fourth quarter, the Company noted that freight and duty was not included in the cost of inventory at certain international locations but was improperly expensed as incurred.

The Company recorded an adjustment to decrease sales and cost of sales of \$1.4 million and \$0.7 million, respectively, resulting in a decrease in pre-tax income of \$0.7 million in the fourth quarter of fiscal 2006. The pre-tax effect of these items was not material to any previous quarters.

[Table of Contents](#)

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

None.

ITEM 9A. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

The Company's management, under the supervision and with the participation of its Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's "disclosure controls and procedures" (as defined under Securities Exchange Act of 1934, as amended (the "Exchange Act") Rule 13a-15(e)) as of the end of the period covered by this report. Based on this evaluation, management has concluded that as of December 31, 2007, such disclosure controls and procedures were effective to provide reasonable assurance that the Company records, processes, summarizes and reports the information the Company must disclose in the reports the Company files or submits under the Exchange Act within the time periods specified in the SEC's rules and forms.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the fourth quarter ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is the process designed under the Chief Executive Officer's and the Chief Financial Officer's supervision, and effected by the Company's Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of its financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America.

Under the supervision and with the participation of the Company's management, including its Chief Executive Officer and Chief Financial Officer, the Company conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2007 as required by the Securities Exchange Act of 1934 Rule 13a-15(c). In making this assessment, the Company used the criteria set forth in the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on the Company's evaluation under the framework in *Internal Control – Integrated Framework*, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2007.

There are inherent limitations in the effectiveness of internal control over financial reporting, including the possibility that misstatements may not be prevented or detected. Accordingly, an effective control system, no matter how well designed and operated, can provide only reasonable assurance of achieving the designed control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

[Table of Contents](#)

FARO Technologies, Inc.
Lake Mary, Florida
March 10, 2008

ITEM 9B. OTHER INFORMATION.

None.

PART III

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

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE.

The information to be set forth under the captions “Election of Directors,” “Corporate Governance and Board Matters,” “Executive Officers,” and “Section 16 (a) Beneficial Ownership Reporting Compliance” in the Proxy Statement is incorporated herein by reference.

Code of Business Conduct and Ethics

The Board of Directors has adopted a Code of Ethics, entitled “Code of Ethics for Senior Financial Officers,” that is applicable to its principal executive officer, principal financial officer, principal accounting officer or controller, and persons performing similar functions. The Board of Directors has also adopted a Global Ethics Policy which is applicable to those officers as well as all of the Company’s employees. Both the Code of Ethics for Senior Financial Officers and the Global Ethics Policy are available on the Internet web site at http://www.faro.com/Company/Corporate_Governance.asp. The Company is not including the information contained on or available through its website as a part of, or incorporating such information by reference into, this Form 10-K. The Company will post any amendments to or waivers from the Code of Ethics for Senior Financial Officers at that location.

ITEM 11. EXECUTIVE COMPENSATION.

The information to be set forth under the captions “Executive Compensation” and “Director of Compensation” in the Proxy Statement is incorporated herein by reference.”

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Security ownership of certain beneficial owners and management to be set forth under the captions “Security Ownership of Beneficial Owners and Management” and “Equity Compensation Plan Information” in the Proxy Statement is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE.

The information to be set forth under the captions “Certain Relationships and Related Transactions” and “Corporate Governance and Board Matters” in the Proxy Statement is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by this Item is incorporated herein by reference from information included under the caption entitled “Independent Public Accountants” set forth in our Proxy Statement.

PART IV**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.**

(a) Documents Filed as Part of this Report. The following documents are filed as part of this Report:

(1) Consolidated Financial Statements. Included in Part II, Item 8 are the consolidated financial statements, the notes thereto and the report of the Independent Registered Public Accounting Firm.

(2) Financial Statement Schedules. Schedule II—Valuation and Qualifying Accounts is filed as a part hereof along with the related report of the Independent Registered Public Accounting Firm on the Company's financial statement schedule. All other schedules have been omitted because the information required to be set forth therein is not applicable or is included in the consolidated financial statements or notes thereto.

(3) Exhibits.

<u>Exhibit No.</u>	<u>Description</u>
3.1	Articles of Incorporation, as amended (<i>Filed as Exhibit 3.1 to Registrant's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference</i>)
3.2	Bylaws, as amended (<i>Filed as Exhibit 3.2 to Registrant's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference</i>)
4.1	Specimen Stock Certificate (<i>Filed as Exhibit 4.1 to Registrant's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference</i>)
10.1	1993 Stock Option Plan, as amended (<i>Filed as Exhibit 10.1 to Registrant's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference</i>)*
10.2	1997 Amended and Restated Employee Stock Option Plan (<i>Filed as Exhibit 4. 2 to Registrant's Registration Statement on Form S-8, No. 333-125021, and incorporated herein by reference</i>)*
10.3	2004 Equity Incentive Plan (<i>Filed as Exhibit 4.1 to Registrant's Registration Statement on Form S-8, No. 333-125021, and incorporated herein by reference</i>)*
10.4	1997 Non-Employee Director Stock Option Plan (<i>Filed as Exhibit 10.3 to Registrant's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference</i>)*
10.5	1997 Non-Employee Directors Fee Plan (<i>Filed as Exhibit 10.4 to Registrant's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference</i>)*
10.6	Form of Patent and Confidentiality Agreement between the Company and each of its employees (<i>Filed as Exhibit 10.10 to Registrant's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference</i>)
10.7	Form of Restricted Stock Grant Agreement under the 2004 Equity Incentive Plan* (<i>Filed as Exhibit 10.7 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2006</i>)
10.8	Form of Restricted Stock Unit Grant Agreement under the 2004 Equity Incentive Plan* (<i>Filed as Exhibit 10.8 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2006</i>)
10.9	Form of Stock Option Grant Agreement under the 2004 Equity Incentive Plan* (<i>Filed as Exhibit 10.9 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2006</i>)
10.10	Amended and Restated Loan Agreement, dated as of July 11, 2006, between the Company and SunTrust Bank. (<i>Filed as Exhibit 10.1 to Registrant's Current report on Form 8-K dated July 11, 2006</i>)
10.11	Employment Agreement dated October 20, 2006, by and between the Company and Jay Freeland (<i>Filed as Exhibit 10.1 to Registrant's Current report on Form 8-K dated October 20, 2006, and incorporated herein by reference</i>)*
10.12	Employment Agreement dated December 5, 2006, by and between the Company and Keith Bair (<i>Filed as Exhibit 10.1 to Registrant's Current report on Form 8-K dated December 5, 2006 and incorporated herein by reference</i>) *

Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
10.13	Employment Agreement dated January 30, 2006 by and between the Company and Simon Raab (<i>Filed as Exhibit 10.1 to Registrant's Current report on Form 8-K dated January 30, 2006 and incorporated herein by reference</i>)*
10.14	Sublease Agreement dated September 30, 2007 between the Company and Priority Healthcare Corporation
10.15	Lease Agreement dated September 26, 2007, by and between the Company and Sun Life Assurance Company of Canada
21.1	List of Subsidiaries
23.1	Consent of Grant Thornton LLP
24.1	Power of Attorney relating to subsequent amendments (included on the signature page(s) of this report).
31-A	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31-B	Certification of the Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32-A	Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32-B	Certification of the Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Properties

* Indicates management contracts and compensatory plans and arrangements

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

Valuation and Qualifying Accounts were as follows for the three years ended December 31, 2007:

Description	Balance at beginning of period	Additions charged to costs and expenses or revenues	Deductions for purposes for which accounts were set up	Balance at end of period
Year ended December 31, 2007				
Deducted from assets which apply				
Uncollectible accounts	\$ 458	\$ 373	\$ 92	\$ 739
Reserve for inventory obsolescence	404	1,841	380	1,865
Total	<u>\$ 862</u>	<u>\$ 2,214</u>	<u>\$ 472</u>	<u>\$ 2,604</u>
Year ended December 31, 2006				
Deducted from assets which apply				
Uncollectible accounts	\$ 214	\$ 257	\$ 13	\$ 458
Reserve for inventory obsolescence	373	1,053	1,022	404
Total	<u>\$ 587</u>	<u>\$ 1,310</u>	<u>\$ 1,035</u>	<u>\$ 862</u>
Year ended December 31, 2005				
Deducted from assets which apply				
Uncollectible accounts	\$ 339	\$ 112	\$ 237	\$ 214
Reserve for inventory obsolescence	191	1,314	1,132	373
Total	<u>\$ 530</u>	<u>\$ 1,426</u>	<u>\$ 1,369</u>	<u>\$ 587</u>

SUBLEASE

THIS SUBLEASE (this "Sublease") is made as of the 30 day of September, 2007, by and between **FARO Technologies, Inc.** ("Tenant") and "Sublandlord") and **Priority HealthCare Corporation, an Indiana corporation** ("Subtenant").

WITNESSETH:

WHEREAS, Sun Life Assurance Company of Canada, a Canadian corporation, as landlord (the "Landlord"), and Tenant, as tenant, entered into that certain Lease (as amended, the "Lease"), dated as of September __, 2007, and demising certain premises (the "Leased Premises") located in the building (the "Building") commonly known as 250 Technology Parkway [a copy of the Lease is attached hereto as Exhibit A and incorporated herein for all purposes];

WHEREAS, Tenant desires to sublet unto Subtenant, and Subtenant desires to take and sublease from Tenant, certain space comprising the Leased Premises; and

NOW, THEREFORE, in consideration of the mutual covenants and agreements contained herein, Tenant has agreed to sublease and does hereby demise and sublet unto the Subtenant, and Subtenant does hereby sublet from the Tenant, the Subleased Premises (as hereinafter defined), to have and to hold all of the same unto the Subtenant, subject to the Lease, and for the term, at the rentals, and upon the conditions hereinafter set forth:

1. Demise and Description of Property. Tenant hereby subleases to Subtenant a portion of the Building consisting of the server room (the "Subleased Premises") as shown on the floor plan attached hereto as Exhibit B and incorporated herein by reference. The Subleased Premises constitute a portion of the Leased Premises further described in the Lease. Subtenant shall further have the right, during the term of this Sublease, to use such portions of the Leased Premises as are necessary for ingress and egress to and from the Subleased Premises.

2. Term. The term of this Sublease shall commence on 10/1/07 (the "Commencement Date"), and shall terminate on 4/30/08, or on such earlier date as the Lease may otherwise expire or terminate.

3. Terms of the Lease Govern. Subtenant understands that occupancy of the Subleased Premises is subject to, in addition to the provisions of this Sublease, the Lease. Subtenant has read and understands the Lease, including the rules and regulations governing the Lease, and Tenant and Subtenant shall each perform and comply with all terms, provisions, covenants, conditions, rules, regulations and policies (as may be changed from time to time) contained in, and required of Tenant under, the Lease. Notwithstanding anything in this Sublease to the contrary, Subtenant shall not be responsible for any obligations of Tenant to the extent such obligations are inconsistent with the express terms of this Sublease, and without limiting the generality of the foregoing, except for the Subtenant's payment of rental and

Subtenant's pro rata share of services and operating expenses set forth in Section 4 of this Sublease, Subtenant shall not be responsible for the payment of, and shall not be deemed to assume, any of the rental obligations of Tenant to Landlord under the Lease or any obligations of Tenant to Landlord relating to that portion of the Leased Premises which is not the Subleased Premises.

4. Rental.

(a) Subtenant shall pay as monthly base rental (the "Base Rental") for the Subleased Premises an amount equal \$1,833.33, and such amount shall be due and payable in equal monthly installments directly to Tenant, or Landlord if Landlord elects otherwise in writing delivered to Tenant and Subtenant, in advance, on or before the first day of each calendar month during the term of this Sublease. Any rental amounts paid directly from Subtenant to Landlord at Landlord's direction shall be deemed rental payments made under this Sublease.

(b) In addition to the Base Rental, Subtenant shall pay as additional rental Subtenant's pro rata share of services provided by Landlord as described in Paragraph 3.2 of the Lease and Tenant's proportionate share of operating expenses pursuant to and as calculated under the terms of the Lease. Subtenant's proportionate share shall be the fraction, the numerator of which shall be the total number of square feet occupied by Subtenant, and the denominator of which shall be the total number of square feet in the Leased Premises.

(c) All rental payable under this Sublease shall be paid without any setoff or deduction whatsoever. Should the term of this Sublease commence on a day other than the first day of the calendar month or end on a day other than the last day of calendar month, the rent for such partial month shall be prorated.

(d) All rental payable under this Sublease shall be paid to Tenant unless Tenant defaults and/or Landlord notifies Subtenant in writing of its election to require rental payments to be paid directly to Landlord (at Landlord's address set forth on the Lease or as Landlord directs from time to time).

5. Parking. Subtenant shall be entitled to 2 of Tenant's parking spaces for 2 vehicles during the term of this Sublease subject to the provisions set forth in the Lease.

6. Use. The Subleased Premises shall be used by Subtenant only for the permitted use described in the Lease and for no other purpose.

7. Assignment and Subletting. Subtenant may not assign this Sublease or sublease the Subleased Premises without the prior written consent of Tenant and Landlord, which may be refused in Landlord's sole and absolute discretion.

8. Default. If Subtenant fails to pay any sum payable under the Sublease when due and fails to remedy such failure within five (5) days of Subtenant's receipt of written notice from Landlord or Tenant, or if Subtenant fails to perform or comply with any other term, covenant or condition under this Sublease, and fails to remedy such failure within fifteen (15) days of

Subtenant's receipt of written notice from Landlord or Tenant (or such lesser time as may be provided for cure under the Lease), then Landlord or Tenant will have the right, upon written notice to Subtenant and in addition to other available remedies, to terminate this Sublease. If this Sublease is so terminated, Landlord or Tenant may take possession of the Subleased Premises, and Subtenant will remain liable for all accrued obligations of Subtenant through the date of termination.

9. Insurance. Subtenant shall obtain and maintain, at its own expense, all property and liability insurance for the Subleased Premises which Tenant is required to obtain and maintain for the Leased Premises under the Lease.

10. Liability and Indemnity. Subtenant agrees to indemnify and hold Tenant and Landlord and Landlord's managing agent harmless against all claims (including costs and expenses of defending such claims) arising from any act or omission of Subtenant or Subtenant's agents, employees, invitees or contractors arising from any injury to any person or damage to the property of any person in or about the Subleased Premises. Subtenant agrees to use and occupy the Subleased Premises and other facilities of the Building at Subtenant's own risk and hereby releases Tenant, Landlord and their respective agents and employees from all claims for any damage or injury, to the full extent permitted by law, unless such claims result from the breach of Tenant's or Landlord's respective obligations under the Lease or this Sublease. No party shall have any right or claim against Tenant, Landlord or their respective agents and employees for property damage by way of subrogation or assignment, Subtenant hereby waiving and relinquishing any such right.

11. Attornment. In the event of the occurrence of an event of default by Tenant under the Lease, if Landlord elects to terminate the Lease or terminate Tenant's right to occupy the Leased Premises, then provided Subtenant is not in default under this Sublease, this Sublease shall continue as a direct lease between Landlord and Subtenant, in which event Subtenant shall attorn to and recognize Landlord as the landlord hereunder. Subtenant agrees to execute any documents or instruments necessary to facilitate Subtenant's attornment upon Landlord's request.

12. Tenant's Liability Under the Lease. This Sublease shall not release, relieve or in any manner modify the obligations of Tenant under the terms and conditions of the Lease. Tenant shall remain fully liable to Landlord for its rental obligations under the Lease.

13. No Expansion Right or Right of First Refusal. Subtenant shall have no right to exercise any expansion right or right of first refusal granted to Tenant under the Lease.

14. Amendments of Lease. Tenant agrees not to amend the Lease in any manner which adversely affects Tenant's right of use and occupancy of the Subleased Premises or Tenant's obligations under this Sublease, without Subtenant's prior written consent.

15. Notices. Any notice, tender or delivery to be given hereunder shall be personally delivered in writing or be sent by registered or certified mail, postage prepaid, return receipt requested, addressed to the respective party at its address set forth on the signature page hereto. Tenant and Subtenant shall copy Landlord, in the manner set forth above, on all notices which they send to one another. In addition, a copy of any notice sent to Landlord shall be sent to the address specified in the Lease or as directed by Landlord from time to time.

16. Generator. Contemporaneously with the execution of this Lease, Subtenant agrees to sell to Tenant that certain building generator being more fully described on Exhibit C (the "Generator"). Tenant shall pay to Subtenant the sum of \$150,000 for the Generator, which sum shall be payable in 7 equal monthly installments of \$21,428.57 per month. Upon the payment of the final installment, Subtenant shall deliver a bill of sale for the Generator assigning and conveying the Generator to Tenant. With respect to the Generator and any other equipment which Tenant agrees to purchase from Subtenant, Tenant agrees to remain responsible to Landlord to remove such equipment at such times and upon such terms as required by the Lease.

TENANT:

ADDRESS:

125 Technology Park
Lake Mary, Florida 32746

FARO Technologies, Inc.

By: /s/ Keith S. Bair
Name: Keith S. Bair
Title: CFO

SUBTENANT:

ADDRESS:

255 Technology Park
Lake Mary, Florida 32746

Priority HealthCare Corporation

By: /s/ Keith J. Ebling
Name: Keith J. Ebling
Title: Secretary

Attn: Charlie Hummel
With a copy to:
Thomas A. Rocheford
Express Scripts
6625 West 78th Street
Bloomington, MN 55439

OFFICE FLEX LEASE
[TRIPLE NET]
250 Technology Parkway
Lake Mary, Florida

Landlord: Sun Life Assurance Company of Canada,
a Canadian corporation

Tenant: FARO Technologies, Inc.,
a Florida corporation

Date: September __, 2007

This Lease consists of four parts:

- Part I Cover Sheet
- Part II Standard Lease Provisions
- Part III Additional Provisions (if any) and
- Part IV Exhibits

- EXHIBIT A - Floor Plan of Premises
- EXHIBIT B - Legal Description of Lot
- EXHIBIT C - Landlord's Notice of Lease Term Dates
- EXHIBIT D - Tenant Improvements
- EXHIBIT E - Rules and Regulations

PART I

COVER SHEET

The terms listed below shall have the following meanings throughout this Lease:

DATE OF LEASE: September __, 2007, the date on which Landlord has signed this Lease

LANDLORD: Sun Life Assurance Company of Canada,
a Canadian corporation

TENANT: FARO Technologies, Inc.,
a Florida corporation

TENANT'S ADDRESS: 525 Technology Parkway
Lake Mary, Florida 32746

MANAGER: Crescent Resources, LLC

MANAGER'S ADDRESS: Crescent Resources, LLC, 300 Primera Boulevard, Suite 140, Lake Mary, Florida 32746, Attention: Diane S. Crouse,
Senior Property Manager

PREMISES: The area consisting of approximately 46,481 rentable square feet of the Building, as shown on Exhibit A attached hereto

BUILDING: The building in which the Premises are located at 250 Technology Parkway, Lake Mary, Florida 32746, and consisting of a total of approximately 46,481 square feet of space

PROPERTY: The Building and land located on a parcel in the legal description of which is shown on Exhibit B attached hereto

TENANT'S PERCENTAGE: 100% (46,481 rentable square feet in the Premises divided by 46,481 rentable square feet in the Building)

PERMITTED USES: Office purposes and uses ancillary to office use, such as a kitchen, cafeteria and work out room; Tenant shall not be permitted to use as a call center or other high-intensity uses or for manufacturing or assembly.

TENANT IMPROVEMENTS: See Exhibit D attached hereto

SCHEDULED October 1, 2007
COMMENCEMENT DATE:

TERM: Sixty-five (65) full calendar months (“Expiration Date”).

BASE RENT
(TRIPLE NET): Tenant shall pay Base Rent for the Premises in accordance with the following schedule:

<u>Months</u>	<u>Annual Rent p.r.s.f.</u>	<u>Rent Per Month</u>
Commencement Date – 9/30/08	\$ 9.75 NNN	\$37,765.81 NNN
10/1/08 – 9/30/09	\$10.05 NNN	\$38,927.84 NNN
10/1/09 – 9/30/10	\$10.35 NNN	\$40,089.86 NNN
10/1/10 – 9/30/11	\$10.65 NNN	\$41,251.89 NNN
10/1/11 – 9/30/12	\$10.95 NNN	\$42,413.91 NNN
10/1/12 – Expiration Date	\$11.25 NNN	\$43,575.94 NNN

SALES TAX: Tenant shall pay to Landlord, simultaneously with Tenant’s payments of such Base Rent, all Florida sales or rental taxes due on such rents. The current rate for such taxes in Seminole County is seven percent (7%).

PREPAID RENT: First (1st) month Base Rent, Operating Expenses, Taxes and Capital Costs

SECURITY DEPOSIT: \$54,963.79

PUBLIC LIABILITY
INSURANCE AMOUNT: \$3,000,000 combined single limit

BROKER(S): Crescent Resources, LLC

GUARANTOR(S): None

CONTINGENCY: Tenant acknowledges there are currently existing tenants (the “Existing Tenants”) occupying portions of the Premises under an existing leases (the “Existing Leases”). This Lease is contingent upon Landlord entering into a termination agreement with the Existing Tenants of the Existing Leases on terms and conditions acceptable to Landlord, in Landlord’s sole discretion. Landlord agrees to use its reasonable efforts to obtain the termination agreement with the Existing Tenant, but shall not be liable to Tenant for any such failure. If this contingency is not satisfied on or before September 30, 2007, Landlord may at any time thereafter terminate this Lease upon prior written notice to Tenant and this Lease shall be deemed null and void and neither party shall have any further obligation to the other under this Lease.

ARTICLE I: PREMISES

- 1.1 *Premises*
- 1.2 *Common Areas*

ARTICLE II: TERM

- 2.1 *Commencement Without Tenant Improvements*
- 2.2 *Commencement With Tenant Improvements*

ARTICLE III: RENT

- 3.1 *Base Rent*
- 3.2 *Additional Rent for Operating Expenses, Taxes, and Capital Costs*

ARTICLE IV: DELIVERY OF PREMISES AND TENANT IMPROVEMENTS

- 4.1 *Condition of Premises*
- 4.2 *Delay in Possession*
- 4.3 *Delivery and Acceptance of Possession*
- 4.4 *Early Occupancy*

ARTICLE V: ALTERATIONS AND TENANT'S PERSONAL PROPERTY

- 5.1 *Alterations*
- 5.2 *Tenant's Personal Property*

ARTICLE VI: LANDLORD'S COVENANTS

- 6.1 *Services Provided by Landlord*
- 6.2 *Repairs and Maintenance*
- 6.3 *Quiet Enjoyment*
- 6.4 *Insurance*

ARTICLE VII: TENANT'S COVENANTS

- 7.1 *Repairs, Maintenance and Surrender*
- 7.2 *Use*
- 7.3 *Assignment; Sublease*
- 7.4 *Indemnities*
- 7.5 *Tenant's Insurance*
- 7.6 *Payment of Taxes*
- 7.7 *Environmental Assurances*
- 7.8 *Americans With Disabilities Act*

ARTICLE VIII: DEFAULT

- 8.1 *Default*
- 8.2 *Remedies of Landlord and Calculation of Damages*

ARTICLE IX: CASUALTY AND EMINENT DOMAIN

- 9.1 *Casualty*
- 9.2 *Eminent Domain*

ARTICLE X: RIGHTS OF PARTIES HOLDING SENIOR INTERESTS

- 10.1 *Subordination*
- 10.2 *Mortgagee's Consent*

ARTICLE XI: GENERAL

- 11.1 *Representations by Tenant*
- 11.2 *Notices*
- 11.3 *No Waiver or Oral Modification*
- 11.4 *Severability*
- 11.5 *Requests by Tenant*
- 11.6 *Estoppel Certificate and Financial Statements*
- 11.7 *Waiver of Liability*
- 11.8 *Execution; Prior Agreements and No Representations*
- 11.9 *Brokers*
- 11.10 *Successors and Assigns*
- 11.11 *Applicable Law and Lease Interpretation*
- 11.12 *Costs of Collection, Enforcement and Disputes*
- 11.13 *Holdover*
- 11.14 *Force Majeure*
- 11.15 *Limitation On Liability*
- 11.16 *Notice of Landlord's Default*
- 11.17 *Lease not to be Recorded*
- 11.18 *Security Deposit*
- 11.19 *Generator*
- 11.20 *Radon*

PART II STANDARD LEASE PROVISIONS

ARTICLE I PREMISES

1.1 Premises.

(a) *Demise of Premises.* This Lease (the "Lease") is made and entered into by and between Landlord and Tenant and shall become effective as of the Date of Lease. In consideration of the mutual covenants made herein, Landlord hereby leases to Tenant, and Tenant hereby leases from Landlord, the Premises, on all of the terms and conditions set forth in this Lease.

(b) *Intentionally Omitted.*

(c) *Access to Premises.* Landlord shall have reasonable access to the Premises, at any time during the Term, to inspect Tenant's performance hereunder and to perform any acts required of or permitted to Landlord herein, including, without limitation, (i) the right to make any repairs or replacements Landlord deems necessary, (ii) the right to show the Premises to prospective purchasers and mortgagees, and (iii) during the last nine (9) months of the Term, the right to show the Premises to prospective tenants. Landlord shall at all times have a key to the Premises, and Tenant shall not change any existing lock(s), nor install any additional lock(s) without Landlord's prior consent. Except in the case of any emergency, any entry into the Premises by Landlord shall be on reasonable advance notice, and if available, Tenant shall have the right to accompany Landlord and/or its representatives during any such entry.

1.2 Common Areas. Tenant shall have the right to use, in common with other tenants, the Building's common walkways and driveways necessary for access to the Building and the parking areas for the Building ("Common Areas"). Tenant's use of the Building parking areas shall be on an unreserved, non-exclusive basis and solely for Tenant's employees and visitors. Landlord shall not be liable to Tenant, and this Lease shall not be affected, if any parking rights of Tenant hereunder are impaired by any law, ordinance or other governmental regulation imposed after the Date of Lease. If Landlord grants to any other tenant the exclusive right to use any particular parking spaces, neither Tenant nor its visitors shall use such spaces. Use of the Common Areas shall be only upon the terms set forth at any time by Landlord. Landlord may at any time and in any manner make any changes, additions, improvements, repairs or replacements to the Common Areas that it considers desirable, provided that Landlord shall use reasonable efforts to minimize interference with Tenant's normal activities. Such actions of Landlord shall not constitute constructive eviction or give rise to any rent abatement or liability of Landlord to Tenant.

ARTICLE II TERM

2.1 Intentionally Deleted.

2.2 Commencement With Tenant Improvements. If Landlord is required to construct Tenant Improvements to the Premises pursuant to Exhibit D, the Scheduled Commencement Date shall be only an estimate of the beginning of the Term of this Lease and the actual commencement date (the "Commencement Date") shall be the first to occur of (i) the date the Premises are offered by Landlord for occupancy following substantial completion of the Tenant Improvements to be constructed by Landlord pursuant to Exhibit D, as reasonably determined by Landlord, and any certificate or approval required by local governmental authority for occupancy of the Premises has been obtained, or (ii) the date Tenant enters into occupancy of the Premises.

If Landlord is obligated to construct Tenant Improvements pursuant to Exhibit D, the dates upon which the Term shall commence and end shall be confirmed in Landlord's Notice of Lease Term Dates ("Notice"), substantially in the form attached as Exhibit C. Landlord shall deliver the Notice to Tenant after Landlord offers possession of the Premises to Tenant or Tenant enters into occupancy of the Premises. Tenant shall promptly return to Landlord a countersigned original of the Notice, provided that Landlord's failure to deliver the Notice shall not delay the Commencement Date.

ARTICLE III RENT

3.1 Base Rent.

(a) *Payment of Base Rent.* Tenant shall pay the Base Rent each month in advance on the first day of each calendar month during the Term. If the Commencement Date is other than the first day of the month, Tenant shall pay a proportionate part of such monthly installment on the Commencement Date. An adjustment in the Base Rent for the last month of the Term shall be made if the Term does not end on the last day of the month. All payments shall be made to Manager at Manager's Address or to such other party or to such other place as Landlord may designate in writing, without prior demand and without abatement, deduction or offset. All charges to be paid by Tenant hereunder, other than Base Rent, shall be considered additional rent for the purposes of this Lease, and the words "rent" or "Rent" as used in this Lease shall mean both Base Rent and additional rent unless the context specifically or clearly indicates that only Base Rent is referenced. The first (1st) monthly installment of Base Rent shall be paid upon Lease execution by Tenant.

(b) *Late Payments.* Tenant acknowledges that the late payment by Tenant to Landlord of any rent or other sums due under this Lease will cause Landlord to incur costs not contemplated by this Lease, the exact amount of such costs being extremely difficult and impracticable to ascertain. Therefore, if any rent or other sum due from Tenant is not received within five (5) days of the date due, Tenant shall pay to Landlord no later than ten (10) calendar days after the rental due date an additional sum equal to five percent (5%) of such overdue payment. In addition to such late charge, all such delinquent rent or other sums due to Landlord, including the late charge, shall bear interest beginning on the date such payment was due at the lesser of: (i) then maximum lawful rate permitted to be charged by Landlord or (ii) ten percent (10%) compounded monthly. The notice and cure period provided in Paragraph 8.1(a) does not apply to the foregoing late charges and interest. If payments of any kind are returned for insufficient funds Tenant shall pay to Landlord an additional handling charge of \$50.00.

3.2 Additional Rent for Operating Expenses, Taxes, and Capital Costs.

(a) *Additional Rent.* For each Lease Year, Tenant shall pay to Landlord as additional rent the sum of (1) Operating Expenses, (2) Taxes and (3) the Capital Costs, times Tenant's Percentage ("Tenant's Share of Expenses").

(b) *Definitions.* As used herein, the following terms shall have the following meanings:

- (i) *Lease Year.* Each calendar year wholly included in the Term and, if the Term does not begin on January 1st of the first year of the Term, the portion of a calendar year at the beginning and end of the Term.

- (ii) *Operating Expenses.* The total cost of operation of the Property, including, without limitation, (1) premiums and deductibles for insurance carried with respect to the Property; (2) all costs of supplies, materials, equipment, and utilities used in or related to the operation, maintenance, and repair of the Property or any part thereof (including utilities, unless the cost of any utilities is to be paid for separately by Tenant pursuant to Paragraph 6.1(b)); (3) all labor costs, including without limitation, salaries, wages, payroll and other taxes, unemployment insurance costs, and employee benefits; (4) all maintenance, management (not to exceed five percent (5%) of gross revenues of the Building), janitorial, inspection, legal, accounting, and service agreement costs related to the operation, maintenance, and repair of the Property or any part thereof, including, without limitation, service contracts with independent contractors. Any of the above services may be performed by Landlord or its affiliates, provided that fees for the performance of such services shall be reasonable and competitive with fees charged by unaffiliated entities for the performance of such services in comparable buildings in the area. Operating Expenses shall not include Taxes, leasing commissions; repair costs paid by insurance proceeds or by any tenant or third party; the initial construction cost of the Building or any depreciation thereof; costs and expenses attributable to the correction of any construction defects in the initial construction of the Building or the construction of any additions to their Building (as opposed to the cost of normal repair, maintenance and replacement expected with the construction materials and equipment installed in the Building in light of their specifications); machinery or equipment which is covered under warranty; promotional and advertising expenditures, accounting fee (other than those incurred with regard to Operating Expenses and items which benefit the property generally); fines and penalties resulting from Landlord's gross negligence or willful misconduct; fees, costs and disbursements, including, without limitation, legal fees, relating to the negotiation or enforcement of leases, the surrender, termination or modification of any lease, disputes with tenants, curing Landlord's default or performing work resulting from any violation by Landlord of the terms of any lease of space; any debt service or costs related to sale or financing of the Property; any capital expenses, except those which normally would be regarded as operating, maintenance, or repair costs; tenant improvements provided for any tenant; or any special services rendered to tenants (including Tenant) for which a separate charge is made.
- (iii) *Taxes.* Any form of assessment, rental tax, license tax, business license tax, levy, margin, charge, tax or similar imposition imposed by any authority having the power to tax, including any city, county, state or federal government, or any school, agricultural, lighting, library, drainage, or other improvement or special assessment district, as against the Property or any part thereof or any legal or equitable interest of Landlord therein, or against Landlord by virtue

of its interest therein, and any reasonable costs incurred by Landlord in any proceedings for abatement thereof, including, without limitation, attorneys' and consultants' fees, and regardless of whether any abatement is obtained. Landlord's income and franchise taxes are excluded from Taxes.

- (iv) *Capital Costs.* The annual cost of any capital improvements to the Property made by Landlord that are designed to increase safety, to reduce Operating Expenses, or to comply with any governmental law or regulation imposed after initial completion of the Building, amortized over such period as Landlord shall reasonably determine, together with a fixed annual interest rate equal to the Prime Rate plus 2% on the unamortized balance. The Prime Rate shall be the prime rate published in the Wall Street Journal on the date the construction is completed.

(c) *Estimate of Tenant's Share of Expenses.* Before each Lease Year, and from time to time as Landlord deems appropriate, Landlord shall give Tenant estimates for the coming Lease Year of Operating Expenses, Taxes, Capital Costs and Tenant's Share of Expenses. Landlord shall make reasonable efforts to provide estimates fifteen (15) days before the beginning of each Lease Year. Tenant shall pay one twelfth (1/12) of the estimated amount of Tenant's Share of Expenses with each monthly payment of Base Rent during the Lease Year. Each Lease Year, Landlord shall give Tenant a statement (the "Share of Expenses Statement") showing the Operating Expenses, Taxes, and Capital Costs for the prior Lease Year, a calculation of Tenant's Share of Expenses due for the prior Lease Year and a summary of amounts already paid by Tenant for the prior Lease Year. Landlord shall make reasonable efforts to provide the Share of Expenses Statement within one hundred twenty (120) days after the end of the prior Lease Year. Any underpayment by Tenant shall be paid to Landlord within thirty (30) days after delivery of the Share of Expenses Statement; any overpayment shall be credited against the next installment of Base Rent due, provided that any overpayment shall be paid to Tenant within thirty (30) days if the Term has ended. No delay by Landlord in providing any Share of Expenses Statement shall be deemed a waiver of Tenant's obligation to pay Tenant's Share of Expenses.

f. Audit. Tenant, at its sole expense, shall have the right, within sixty (60) days after receiving the Annual Cost Statement for a particular year to review Landlord's books and records relating to the Operating Expenses for such year. Such review shall be conducted only during regular business hours at Landlord's office and only after Tenant gives Landlord fourteen (14) days prior written notice. Tenant shall deliver to Landlord a copy of the results of such review within fifteen (15) days thereafter. If Landlord and Tenant are not able to agree on the amount of any adjustments to Operating Expense within thirty (30) days following the delivery of Tenant's results, Tenant, at its sole cost, shall hire an independent nationally recognized accounting firm mutually acceptable to both Landlord and Tenant that is not being compensated by Tenant on a contingency fee basis. The results of such audit shall be binding on the parties. All information obtained through the Tenant's audit with respect to financial matters (including, without limitation, costs, expenses, income) and any other matters pertaining to the Landlord and/or the Building as well as any compromise settlement, or adjustment reached between Landlord and Tenant relative to the results of the audit shall be held in strict confidence by the Tenant and its officers, agents, lenders and employees; and Tenant shall cause its auditor and any of its officers, agents, lenders and employees to be similarly bound. As a condition precedent to Tenant's exercise of its right to audit, Tenant must deliver to Landlord a signed covenant from the auditor selected by Landlord and Tenant in a form

reasonably satisfactory to Landlord acknowledging that all of the results of such audit as well as any compromise, settlement, or adjustment reached between Landlord and Tenant shall be held in strict confidence and shall not be revealed in any manner to any person except upon prior written consent of Landlord, which consent may be withheld in Landlord's sole discretion, if required pursuant to any litigation between Landlord and Tenant, or if required by law. If within such sixty (60) day period Tenant does not give Landlord written notice stating in reasonable detail any objection to the Annual Cost Statement, Tenant shall be deemed to have approved such statement in all respects. No subtenant shall have any right to conduct an audit and no assignee shall conduct an audit for any period during which such assignee was not in possession of the Premises. If it is ultimately determined that Landlord has overstated the Operating Expense by more than five percent (5%), Landlord agrees to pay the auditor its reasonable fees associated with such audit (not to exceed \$1,000.00). Notwithstanding anything contained in this paragraph, the total rent payable by Tenant shall in no event be less than the Base Rent.

ARTICLE IV DELIVERY OF PREMISES AND TENANT IMPROVEMENTS

4.1 Condition of Premises. Landlord shall deliver the Premises to Tenant in its "as is" condition unless Landlord is required to construct tenant improvements pursuant to and in accordance with the terms set forth in Exhibit D of this Lease ("Tenant Improvements"). If Landlord is required to construct Tenant Improvements, such Tenant Improvements shall become and remain the property of Landlord.

4.2 Delay in Possession. If Landlord is required to construct Tenant Improvements pursuant to Exhibit D, and Landlord is unable to deliver possession of the Premises to Tenant on or before the Scheduled Commencement Date for any reason whatsoever, Landlord shall not be liable to Tenant for any loss or damage resulting therefrom and this Lease shall continue in full force and effect.

4.3 Delivery and Acceptance of Possession. Tenant shall accept possession and enter in good faith occupancy of the entire Premises and commence the operation of its business therein within thirty (30) days after the Commencement Date. Tenant's taking possession of any part of the Premises shall be deemed to be an acceptance and an acknowledgment by Tenant that (i) Tenant has had an opportunity to conduct, and has conducted, such inspections of the Premises as it deems necessary to evaluate its condition, (ii) except as otherwise specifically provided herein, Tenant accepts possession of the Premises in its then existing condition, "as-is", including all patent and latent defects, (iii) Tenant Improvements have been completed in accordance with the terms of this Lease, except for defects of which Tenant has given Landlord written notice prior to the time Tenant takes possession, and (iv) neither Landlord, nor any of Landlord's agents, has made any oral or written representations or warranties with respect to such matters other than as set forth in this Lease.

4.4 Early Occupancy. If Landlord agrees in writing to allow Tenant or its contractors to enter the Premises prior to the Commencement Date, Tenant (and its contractors) shall do so upon all of the provisions of this Lease (including Tenant's obligations regarding indemnity and insurance), except those provisions regarding Tenant's obligation to pay Base Rent, which obligation shall commence on the Commencement Date.

ARTICLE V ALTERATIONS AND TENANT'S PERSONAL PROPERTY

5.1 Alterations.

(a) *Landlord's Consent.* Tenant shall not make any alterations, additions, installations, substitutes or improvements ("Alterations") in and to the Premises without first obtaining Landlord's written consent. Landlord shall not unreasonably withhold or delay its consent; provided, however, that Landlord shall have no obligation to consent to Alterations of a structural nature or Alterations that would violate the certificate of occupancy for the Premises or any applicable law, code or ordinance or the terms of any superior lease or mortgage affecting the Property. No consent given by Landlord shall be deemed as a representation or warranty that such Alterations comply with laws, regulations and rules applicable to the Property ("Laws"). Tenant shall pay Landlord's reasonable costs of reviewing or inspecting any proposed Alterations and any other costs that may be incurred by Landlord as a result of such Alterations.

(b) *Workmanship.* All Alterations shall be done at reasonable times in a first-class workmanlike manner, by contractors approved by Landlord, and according to plans and specifications previously approved by Landlord. All work shall be done in compliance with all Laws, and with all regulations of the Board of Fire Underwriters or any similar insurance body or bodies. Tenant shall be solely responsible for the effect of any Alterations on the Building's structure and systems, notwithstanding that Landlord has consented to the Alterations, and shall reimburse Landlord on demand for any costs incurred by Landlord by reason of any faulty work done by Tenant or its contractors. Upon completion of Alterations, Tenant shall provide Landlord with a complete set of "as-built" plans.

(c) *Mechanics and Other Liens.* Tenant shall keep the Property and Tenant's leasehold interest therein free of any liens or claims of liens, and shall discharge (or bond around in a manner acceptable to Landlord) any such liens within fifteen (15) days of their filing. Before commencement of any work, Tenant's contractor shall provide payment, performance and lien indemnity bonds required by Landlord (for work for which the cost exceeds \$100,000), and Tenant shall provide evidence of such insurance as Landlord may require, naming Landlord as an additional insured. Tenant shall indemnify Landlord and hold it harmless from and against any cost, claim, or liability arising from any work done by or at the direction of Tenant.

(d) *Removal of Alterations.* All Alterations affixed to the Premises shall become part thereof and remain therein at the end of the Term. However, if Landlord gives Tenant notice, at least thirty (30) days before the end of the Term, to remove any Alterations, Tenant shall remove the Alterations, make any repair required by such removal, and restore the Premises to its original condition. Notwithstanding the foregoing, Landlord acknowledges and agrees that the building generator and Tenant's Property is property of Tenant and Tenant shall be required to remove or dispose of same and repair and restore all damage caused thereby upon expiration of the Term or earlier termination of this Lease. In addition, if requested by Landlord, upon expiration of the Lease, Tenant shall return any computer/server room to Landlord in warehouse condition, including, without limitation, removal of raised flooring, wiring and cabling, and Tenant shall also be responsible for removing all other non-Building standard improvements not removed by the prior tenant consisting of the following: S. I. Baker Conveyor System, Miscellaneous Furniture and Equipment, Generator Pad, Dock High Fenced Area built for Commercial Refrigeration System, Access System and/or Alarm System, Server Room and all Equipment and cabling, Raised Floor in Server Area, Fire Suppression System in Server Room and Miscellaneous Shelving and/or Racks in Warehouse Area.

5.2 Tenant's Personal Property.

(a) *In General.* Tenant may provide and install, and shall maintain in good condition, all trade fixtures, personal property, equipment, furniture and moveable partitions

required in the conduct of its business in the Premises. All of Tenant's personal property, trade fixtures, equipment, furniture, movable partitions, and any Alterations not affixed to the Premises shall remain Tenant's property ("Tenant's Property"). Tenant's Property shall include all property purchased by Tenant from the prior tenant.

(b) *Landlord's Lien*. Tenant hereby pledges and conveys to Landlord a security interest ("Landlord's Lien") in all of Tenant's Property as collateral security for the full and prompt payment of Base Rent and any additional rent as and when due and the full and faithful performance of Tenant's covenants herein contained. Upon Landlord's request, Tenant will execute and deliver financing statements and other documents reasonably required by Landlord to perfect Landlord's Lien. Tenant also agrees that Landlord's Lien may be enforced by distress sale, foreclosure, or by any other method, and that any and all costs incurred by Landlord by enforcement of this Landlord's Lien shall be payable to Landlord by Tenant. Tenant may not remove all or substantially all of Tenant's Property from the Premises prior to the end of the Term without Landlord's prior written consent.

(c) *Payment of Taxes*. Tenant shall pay before delinquency all taxes levied against Tenant's Property and any Alterations installed by or on behalf of Tenant. If any such taxes are levied against Landlord or its property, or if the assessed value of the Premises is increased by the inclusion of a value placed on Tenant's Property, Landlord may pay such taxes, and Tenant shall upon demand repay to Landlord the portion of such taxes resulting from such increase.

ARTICLE VI LANDLORD'S COVENANTS

6.1 Services Provided by Landlord.

(a) *Services*. Landlord shall provide services, utilities, facilities and supplies equal in quality to those customarily provided by landlords in buildings of a similar design in the area in which the Property is located.

(b) *Utilities*. Tenant shall pay all charges for gas, electricity, telephone and other utility services used, rendered or supplied upon or in connection with the Premises and shall indemnify Landlord against liability or damage on such account.

(c) *Graphics and Signs*. All signs, notices, graphics and decorations of every kind or character which are visible in or from the Common Areas or the exterior of the Premises shall be subject to Landlord's prior written approval, which Landlord shall have the right to withhold in its absolute and sole discretion.

(d) *Right to Cease Providing Services*. In case of Force Majeure or in connection with any repairs, alterations or additions to the Property or the Premises, or any other acts required of or permitted to Landlord herein, Landlord may reduce or suspend service of the Building's utilities, facilities or supplies, provided that Landlord shall use reasonable diligence to restore such services, facilities or supplies as soon as possible. No such reduction or suspension shall constitute an actual or constructive eviction or disturbance of Tenant's use or possession of the Premises.

6.2 Repairs and Maintenance. Landlord shall repair and maintain (i) the Common Areas, (ii) the structural portions of the Building, (iii) the exterior walls of the Building (including exterior windows and glazing), (iv) the roof, and (v) the basic plumbing, electrical, mechanical and heating, ventilating and air-conditioning systems serving the Premises, in the manner and to the

extent customarily provided by landlords in similar buildings in the area. Tenant shall pay for such repairs as set forth in Paragraph 3.2. If any maintenance, repair or replacement is required because of any act, omission or neglect of duty by Tenant or its agents, employees, invitees or contractors, the cost thereof shall be paid by Tenant to Landlord as additional rent within thirty (30) days after billing.

6.3 **Quiet Enjoyment.** Upon Tenant's paying the rent and performing its other obligations, Landlord shall permit Tenant to peacefully and quietly hold and enjoy the Premises, subject to the provisions of this Lease.

6.4 **Insurance.** Landlord shall insure the Property, including the Building and Tenant Improvements and approved Alterations, if any, against damage by fire and standard extended coverage perils, and shall carry public liability insurance, all in such reasonable amounts as would be carried by a prudent owner of a similar building in the area. Landlord may carry any other forms of insurance as it or its mortgagee may deem advisable. Insurance obtained by Landlord shall not be in lieu of any insurance required to be maintained by Tenant. Landlord shall not carry any insurance on Tenant's Property, and shall not be obligated to repair or replace any of Tenant's Property.

ARTICLE VII TENANT'S COVENANTS

7.1 Repairs, Maintenance and Surrender.

(a) *Repairs and Maintenance.* Tenant shall keep the Premises in good order and condition, and shall promptly repair any damage to the Premises excluding glass in exterior walls. Tenant shall also repair any damage to the rest of the Property, including glass in exterior walls, if such damage is attributable to Tenant's negligence or misuse caused by Tenant or its agents, employees, or invitees, licensees or independent contractors. All repairs shall be made in a workmanlike manner and any replacements or substitutions shall be of a quality, utility, value and condition similar to or better than the replaced or substituted item.

(b) *Surrender.* At the end of the Term, Tenant shall peaceably surrender the Premises in good order, repair and condition, except for reasonable wear and tear, and Tenant shall remove Tenant's Property and (if required by Landlord) any Alterations, repairing any damage caused by such removal and restoring the Premises and leaving them clean and neat. Any property not so removed shall be deemed abandoned and may be retained by Landlord or may be removed and disposed of by Landlord in such manner as Landlord shall determine. Tenant shall be responsible for costs and expenses incurred by Landlord in removing any Alterations and disposing of any such abandoned property, making any incidental repairs and replacements to the Premises, and restoring the Premises to its original condition.

7.2 Use.

(a) *General Use.* Tenant shall use the Premises only for the Permitted Uses, and shall not use or permit the Premises to be used in violation of any law or ordinance or of any certificate of occupancy issued for the Building or the Premises, or of the Rules and Regulations. Tenant shall not cause, maintain or permit any nuisance in, on or about the Property, or commit or allow any waste in or upon the Property.

(b) *Obstructions and Exterior Displays.* Tenant shall not obstruct any of the Common Areas or any portion of the Property outside the Premises, and shall not, except as otherwise previously approved by Landlord, place or permit any signs, decorations, curtains,

blinds, shades, awnings, aerials or flagpoles, or the like, that may be visible from outside the Premises. If Landlord designates a standard window covering for use throughout the Building, Tenant shall use this standard window covering to cover all windows in the Premises.

(c) *Floor Load*. Tenant shall not place a load upon the floor of the Premises exceeding the load per square foot such floor was designed to carry, as determined by applicable building code.

(d) *Compliance with Insurance Policies*. Tenant shall not keep or use any article in the Premises, or permit any activity therein, which is prohibited by any insurance policy covering the Building, or would result in an increase in the premiums thereunder.

(e) *Rules and Regulations*. Tenant shall observe and comply with the rules and regulations attached as Exhibit E (the "Rules and Regulations"), and all modifications thereto as made by Landlord and put into effect from time to time. Landlord shall not be responsible to Tenant for the violation or non-performance by any other tenant or occupant of the Building of the Rules and Regulations.

7.3 Assignment; Sublease. Tenant shall not assign its rights under this Lease nor sublet the whole or any part of the Premises without Landlord's prior written consent. In the event that Landlord grants such consent, Tenant shall remain primarily liable to Landlord for the payment of all rent and for the full performance of the obligations under this Lease and any excess rents collected by Tenant shall be paid to Landlord. Tenant shall be responsible for payment of all costs incurred by Landlord in connection with any such request for Landlord's consent to a proposed assignment or subletting, as provided in Paragraph 11.5. Any assignment or subletting which does not conform with this Paragraph 7.3 shall be void and a default hereunder. Landlord consents to Tenant's sublease of approximately 2,000 rentable square feet of the Premises to Priority Healthcare, subject to Landlord's approval of the sublease.

In addition to, but not in limitation of, the foregoing: in the event of a request by Tenant for Landlord's consent to a proposed assignment of the Lease or a proposed subletting of twenty percent (20%) or more of the floor area of the Premises, Landlord, at Landlord's sole option, may terminate the Lease; and in the event of a request by Tenant for Landlord's consent to a proposed subletting of less than twenty percent (20%) of the floor area of the Premises, Landlord, at Landlord's sole option, may cancel the Lease with respect to the area in question for the proposed term of such sublease. Landlord shall exercise any such option by written notice given to Tenant within thirty (30) days after Landlord's receipt of such request from Tenant, and in each case such termination or cancellation shall take effect as of the date set forth in Landlord's said notice, which shall be not less than sixty (60) days and not more than one hundred twenty (120) days after the date of Landlord's said notice. If Landlord exercises any such option to terminate or cancel the Lease, Tenant shall surrender possession of the portion of the Premises to which the termination or cancellation applies on or before the date set forth in Landlord's notice, in accordance with the provisions of this Lease relating to the surrender of the Premises at expiration of the Term. If the Lease is cancelled as to a portion of the Premises only, Base Rent after the date of such cancellation shall be abated on a pro-rata basis, as determined by Landlord, and Tenant's Percentage shall be proportionally reduced. Landlord's failure to exercise such option to terminate or cancel the Lease shall not be construed as Landlord's consent to the proposed assignment or subletting.

Except as provided in this last paragraph, for purposes of this Paragraph 7.3, "assignment" shall include, without limitation: (i) any transfer of Tenant's interest in this Lease by operation of law; (ii) any merger or consolidation of Tenant with or into any other firm or corporate

entity, whether in a single transaction or a series of transactions; (iii) the transfer or sale of a controlling interest in Tenant, whether by sale of its capital stock or otherwise (however, this shall not apply if Tenant is a publicly traded company); or (iv) any agreement by which Tenant agrees to enter into or execute any assignment or other transfer of the Lease at the direction of any other party, or assigns Tenant's rights in and to the income arising from any such assignment or transfer to another party.

Notwithstanding anything to the contrary set forth herein, Tenant shall be permitted to assign this Lease, or sublet all or a portion of the Premises, to an Affiliate without the prior consent of Landlord, if all of the following conditions are first satisfied: (a) Tenant shall give Landlord at least thirty (30) days prior written notice of such assignment or subletting; (b) no Event of Default (or event which, with notice or lapse of time or both, would constitute an Event of Default) has occurred and is continuing under this Lease; (c) a fully executed copy of such assignment or sublease, the assumption of this Lease by the assignee or acceptance of the sublease by the sublessee, and such other information regarding the assignment or sublease as Landlord may reasonably request, shall have been delivered to Landlord; (d) the Premises shall continue to be operated solely for the use specified in this Lease; (e) Tenant shall pay all costs reasonably incurred by Landlord in connection with such assignment or subletting, including, without limitation, attorneys' fees; (f) the Affiliate remains an Affiliate of Tenant during the Term of this Lease; and (g) the Net Worth of the Affiliate at the time of such assignment or subletting is equal to or greater than (i) the Net Worth of Tenant at the time of execution of the Lease or (ii) the Net Worth of Tenant at the time of said transfer. As used herein, the term "Affiliate" shall mean an entity which (i) directly or indirectly controls the subject party, (ii) is under the direct or indirect control of the subject party, (iii) is under common direct or indirect control with the subject party, (iv) with which the subject party is merged or consolidated, or (v) which acquires all or substantially all of the subject party's assets or stock. Control shall mean ownership of fifty-one percent (51%) or more of the voting securities or rights of the controlled entity. Tenant acknowledges and agrees (and agrees at the time of such assignment or subletting to confirm) that in each instance described above, Tenant shall remain liable for the performance of the terms and conditions of this Lease despite such assignment or subletting. "Net Worth" of Tenant as described in this Lease shall mean the unencumbered (e.g., not encumbered by any pledge, claim, lien, judgment, mortgage or other encumbrance), tangible net worth of said entity (excluding good will or the net worth of any guarantors), all as evidenced and determined in a manner reasonable satisfactory to Landlord.

7.4 Indemnity. Tenant, at Tenant's expense, shall defend (with counsel satisfactory to Landlord), indemnify and hold harmless Landlord and Landlord's agents, employees, invitees, licensees and contractors from and against any cost, claim, action, liability or damage of any kind arising from (i) Tenant's use and occupancy of the Premises or the Property, or any activity done or permitted by Tenant, in, on or about the Premises or the Property, (ii) any breach or default by Tenant of its obligations under this Lease, or (iii) any negligent, tortious or illegal act or omission of Tenant, its agents, employees, invitees, licensees or contractors. The obligations of Tenant under this paragraph shall survive the expiration or termination of this Lease. Nothing in this paragraph shall relieve Landlord from, or require Tenant to indemnify Landlord against, liability for damages to property or injury to person caused by the negligence or willful misconduct of Landlord or its agents, employees or contractors. All property kept, stored or maintained in the Premises shall be at the sole risk of Tenant. Subject to the terms and conditions of this Lease, Landlord shall indemnify, defend and hold harmless Tenant and its officers, directors, employees and agents against any claim by any third party for damage to person or property in the common areas of the Building caused solely by the gross negligence or intentional misconduct of Landlord or any of Landlord's employees or agents in the Common Areas, but specifically excluding any acts resulting from the negligence of Tenant.

7.5 Tenant's Insurance. Tenant shall maintain in responsible companies qualified to do business, in good standing in the state in which the Premises are located and otherwise acceptable to Landlord and at its sole expense the following insurance: (i) comprehensive general liability insurance covering the Premises insuring Landlord as well as Tenant with limits which shall, at the commencement of the Term, be at least equal to the Public Liability Insurance Amount and from time to time during the Term shall be for such higher limits, if any, as are customarily carried in the area in which the Premises are located with respect to similar properties, (ii) workers' compensation insurance with statutory limits covering all of Tenant's employees working in the Premises, (iii) property insurance insuring Tenant's Property for the full replacement value of such items and (iv) business interruption insurance. There shall be no deductible for liability policies and a deductible not greater than \$10,000 for property insurance policies. Tenant shall deposit promptly with Landlord certificates for such insurance, and all renewals thereof, bearing the endorsement that the policies will not be canceled until after thirty (30) days' written notice to Landlord. All policies shall be taken out with insurers with a rating of A-IX by Best's and otherwise acceptable to Landlord.

7.6 Payment of Taxes. If at any time during the Term, any political subdivision of the state in which the Property is located, or any other governmental authority, levies or assesses against Landlord a tax or excise on rents or other tax (excluding income tax), however described, including but not limited to assessments, charges or fees required to be paid, by way of substitution for or as a supplement to real estate taxes, or any other tax on rent or profits in substitution for or as a supplement to a tax levied against the Property, Building or Landlord's personal property, then Tenant will pay to Landlord as additional rent its proportionate share based on Tenant's Percentage of said tax or excise.

7.7 Environmental Assurances.

(a) Covenants.

- (i) Tenant shall not cause any Hazardous Materials to be used, generated, stored or disposed of on, under or about, or transported to or from, the Premises unless the same is specifically approved in advance by Landlord in writing other than small quantities of retail, household, generator fuel and office chemicals customarily sold over-the-counter to the public and which are related to Tenant's Permitted Uses so long as the same is compliance with all laws and codes.
- (ii) Tenant shall comply with all obligations imposed by Environmental Laws, and all other restrictions and regulations upon the use, generation, storage or disposal of Hazardous Materials at, to or from the Premises.
- (iii) Tenant shall deliver promptly to Landlord true and complete copies of all notices received by Tenant from any governmental authority with respect to the use, generation, storage or disposal by Tenant of Hazardous Materials at, to or from the Premises and shall immediately notify Landlord both by telephone and in writing of any unauthorized discharge of Hazardous Materials or of any condition that poses an imminent hazard to the Property, the public or the environment.

- (iv) Tenant shall complete fully, truthfully and promptly any questionnaires sent by Landlord with respect to Tenant's use of the Premises and its use, generation, storage and disposal of Hazardous Materials at, to or from the Premises.
- (v) Tenant shall permit entry onto the Premises by Landlord or Landlord's representatives at any reasonable time to verify and monitor Tenant's compliance with its covenants set forth in this Paragraph 7.7 and to perform other environmental inspections of the Premises.
- (vi) If Landlord conducts any environmental inspections because it has reason to believe that Tenant's activities have or are likely to result in a violation of Environmental Laws or a release of Hazardous Materials on the Property, then Tenant shall pay to Landlord, as additional rent, the costs incurred by Landlord for such inspections.
- (vii) Tenant shall cease immediately upon notice from Landlord any activity which violates or creates a risk of violation of any Environmental Laws.
- (viii) After notice to and approval by Landlord, Tenant shall promptly remove, clean-up, dispose of or otherwise remediate, in accordance with Environmental Laws and good commercial practice, any Hazardous Materials on, under or about the Property resulting from Tenant's activities on the Property.

(b) *Indemnification.* Tenant shall indemnify, defend with counsel acceptable to Landlord and hold Landlord harmless from and against any claims, damages, costs, liabilities or losses (including, without limitation, any decrease in the value of the Property, loss or restriction of any area of the Property, and adverse impact of the marketability of the Property or Premises) arising out of Tenant's use, generation, storage or disposal of Hazardous Materials at, to or from the Premises. Notwithstanding anything contained in this Lease to the contrary, Tenant has no responsibility for any: (a) Hazardous Materials existing at the Building prior to Tenant's occupancy or (b) Hazardous Materials, except those brought upon, produced, stored, transported, migrated, spilled, released, used, discharged or disposed of in the Building by (or at the direction of) Tenant or its employees, contractors, assignees, sublessees, invitees, agents and affiliates (collectively, "Tenant Party"); provided, however, Tenant shall be liable to Landlord and the indemnifications set forth in this Section and the Lease shall be applicable for all loss, cost, damage, liability or expense (as provided in this Lease) to any environmental condition or circumstance arising from Tenant's operations at the Building, Tenant's products and/or Tenant's use of the Building from any cause whatsoever, including, without limitation, those losses, liabilities and expenses caused by fire (including hostile fire) or other casualty, earthquake, acts of God, strikes, terrorism, boycotts, war, riot, insurrection, embargoes and shortages of equipment, labor or materials (by way of example, and not limitation, in the event of an earthquake that causes Tenant's products to spill or migrate into ground water, Tenant would be liable for the clean-up as well as all indemnity obligations and/or other obligations under this Lease.

(c) *Definitions.* Hazardous Materials shall include but not be limited to substances defined as "hazardous substances", "toxic substances", or "hazardous wastes" in the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, as

amended; the federal Hazardous Materials Transportation Act, as amended; and the federal Resource Conservation and Recovery Act, as amended; those substances defined as “hazardous substances”, “materials”, or “wastes” under the law of the state in which the Premises are located; and as such substances are defined in any regulations adopted and publications promulgated pursuant to said laws (“Environmental Laws”); materials containing asbestos or urea formaldehyde; gasoline and other petroleum products; flammable explosives; radon and other natural gases; and radioactive materials.

(d) *Survival*. The obligations of Tenant in this Paragraph 7.7 shall survive the expiration or termination of this Lease.

7.8 Americans With Disabilities Act. Tenant shall comply with the Americans with Disabilities Act of 1990 (“ADA”) and the regulations promulgated thereunder. Tenant hereby expressly assumes all responsibility for compliance with the ADA relating to the Premises and the activities conducted by Tenant within the Premises. Any Alterations to the Premises made by Tenant for the purpose of complying with the ADA or which otherwise require compliance with the ADA shall be done in accordance with this Lease; provided, that Landlord’s consent to such Alterations shall not constitute either Landlord’s assumption, in whole or in part, of Tenant’s responsibility for compliance with the ADA, or representation or confirmation by Landlord that such Alterations comply with the provisions of the ADA.

ARTICLE VIII DEFAULT

8.1 Default. The occurrence of any one or more of the following events shall constitute a default hereunder by Tenant:

(a) The failure by Tenant to make any payment of Base Rent or additional rent or any other payment required hereunder, as and when due, where such failure shall continue for a period of five (5) days after written notice thereof from Landlord to Tenant; provided, that Landlord shall not be required to provide such notice more than once during each consecutive 12-month period with respect to non-payment of Rent, the third such non-payment constituting a default without requirement of notice;

(b) The failure by Tenant to observe or perform any of the express or implied covenants or provisions of this Lease to be observed or performed by Tenant, other than as specified in clause (a) above, where such failure shall continue for a period of more than thirty (30) days after written notice thereof from Landlord to Tenant; provided, however, that if the nature of Tenant’s default is such that more than thirty (30) days are reasonably required for its cure, then Tenant shall not be deemed to be in default if Tenant commences such cure within said thirty (30) day period, diligently prosecutes such cure to completion, and completes such cure no later than sixty (60) days from the date of such notice from Landlord;

(c) The failure by Tenant, Guarantor (if any), or any present or future guarantor of all or any portion of Tenant’s obligations under this Lease to pay its debts as they become due, or Tenant or any such Guarantor (if any) becoming insolvent, filing or having filed against it a petition under any chapter of the United States Bankruptcy Code, 11 U.S.C. Paragraph 101 et seq. (or any similar petition under any insolvency law of any jurisdiction) and such petition is not dismissed within sixty (60) days thereafter, proposing any dissolution, liquidation, composition, financial reorganization or recapitalization with creditors, making an assignment or trust mortgage for the benefit of creditors, or if a receiver, trustee, custodian or similar agent is appointed or takes possession with respect to any property or business of Tenant or Guarantor (if any); or

(d) If the leasehold estate under this Lease or any substantial part of the property or assets of Tenant or of Guarantor of this leasehold is taken by execution, or by other process of law, or is attached or subjected to any involuntary encumbrance if such attachment or other seizure remains undismissed or undischarged for a period of ten business (10) days after the levy thereof.

8.2 Remedies of Landlord and Calculation of Damages.

(a) *Remedies.* In the event of any default by Tenant, whether or not the Term shall have begun, in addition to any other remedies available to Landlord at law or in equity, Landlord may, at its option and without further notice exercise any or all of the following remedies:

- (i) Terminate the Lease and upon notice to Tenant of termination of the Lease all rights of Tenant hereunder shall thereupon come to an end as fully and completely as if the date such notice is given were the date originally fixed for the expiration of the Term, and Tenant shall then quit and surrender the Premises to Landlord and Landlord shall have the right, without judicial process, to re-enter the Premises. No such expiration or termination of the Lease shall relieve Tenant of its liability and obligations under the Lease.
- (ii) Accelerate the payment of Base Rent and all additional rent under this Lease for the remainder of the Term and terminate the Lease in the same manner, and with the same force and effect, as provided in clause (i) above.
- (iii) Enter the Premises and cure any default by Tenant and in so doing, Landlord may make any payment of money or perform any other act. All sums so paid by Landlord, and all incidental costs and expenses, including reasonable attorneys' fees, shall be considered additional rent under this Lease and shall be payable to Landlord immediately upon demand, together with interest from the date of demand to the date of payment at the maximum lawful rate permitted to be charged by Landlord.

(b) *Calculation of Damages.* If this Lease is terminated as provided in Paragraph 8.2(a)(i) above, Tenant, until the end of the Term, or what would have been such Term in the absence of any such event, shall be liable to Landlord, as damages for Tenant's default, for the amount of the Base Rent and all additional rent and other charges which would be payable under this lease by Tenant if this Lease were still in effect, less the net proceeds of any reletting of the Premises actually collected by Landlord after deducting all Landlord's expenses in connection with such reletting, including, without limitation, all repossession costs, brokerage and management commissions, operating expenses, legal expenses, reasonable attorneys' fees, alteration costs and expenses of preparation of the Premises for such reletting. Tenant shall pay such damages to Landlord monthly on the days on which the Base Rent would have been payable as if this Lease were still in effect, and Landlord shall be entitled to recover from Tenant such damages monthly as the same shall arise.

If Base Rent and additional rent are accelerated and this Lease is terminated as provided in Paragraph 8.2(a)(ii) above, Tenant shall be liable to pay to Landlord, in one payment, as damages for Tenant's default, an amount equal to the total amount of Base Rent and additional rent reserved in this Lease from the date of default to the date of expiration of the Term discounted at a fixed annual interest rate equal to the Federal Funds Rate as published in the Wall Street Journal on the date of Landlord's election to accelerate the rents hereunder.

Whether or not the Lease is terminated, Landlord shall in no way be responsible or liable for any failure to relet the Premises or for any failure to collect any rent upon such reletting.

(c) *No Limitations*. Nothing contained in this Lease shall limit or prejudice the right of Landlord to prove for and obtain in proceedings for bankruptcy or insolvency by reason of the termination of this Lease, an amount equal to the maximum allowed by any statute or rule of law in effect at the time when, and governing the proceedings in which, the damages are to be provided, whether or not the amount be greater, equal to, or less than the amount of the loss or damages referred to above.

(d) *Cumulative Remedies*. Landlord's remedies under this Lease are cumulative and not exclusive of any other remedies to which Landlord may be entitled in case of Tenant's default or threatened default under this Lease, including, without limitation, the remedies of injunction and specific performance.

ARTICLE IX CASUALTY AND EMINENT DOMAIN

9.1 Casualty.

(a) *Casualty in General*. If, during the Term, the Premises, the Building or the Lot, are wholly or partially damaged or destroyed by fire or other casualty, and the casualty renders the Premises totally or partially inaccessible or unusable by Tenant in the ordinary conduct of Tenant's business, then Landlord shall, within sixty (60) days of the date of the damage, give Tenant a notice ("Damage Notice") stating whether, according to Landlord's good faith estimate, the damage can be repaired within three hundred sixty (360) days from the date of damage ("Repair Period"), without the payment of overtime or other premiums. The parties' rights and obligations shall then be governed according to whether the casualty is an Insured Casualty or an Uninsured Casualty as set forth in the following paragraphs.

(b) *Insured Casualty*. If the casualty results from a risk, the loss to Landlord from which is fully covered by insurance maintained by Landlord or for Landlord's benefit (except for any deductible amount), it shall be an "Insured Casualty" and governed by this Paragraph 9.1(b). In such event, if the Damage Notice states that the repairs can be completed within the Repair Period without the payment of overtime or other premiums, then Landlord shall promptly proceed to make the repairs, this Lease shall remain in full force and effect, and Base Rent shall be reduced, during the period between the casualty and completion of the repairs, in proportion to the portion of the Premises that is inaccessible or unusable during that period and which is, in fact, not utilized by Tenant. Base Rent shall not be reduced by reason of any portion of the Premises being unusable or inaccessible for a period of five (5) business days or less. If the Damage Notice states that the repairs cannot, in Landlord's estimate, be completed within the Repair Period without the payment of overtime or other premiums, then either party may, terminate this Lease by written notice given to the other within thirty (30) days after the giving of the Damage Notice. If either party elects to terminate this Lease, the lease shall terminate as of the date of the occurrence of such damage or destruction and Tenant shall vacate the Premises five (5) business days from the date of the written notice terminating the Lease. If neither party so terminates, then this Lease shall remain in effect, Landlord shall make repairs, and Base Rent shall be proportionately reduced as set forth above during the period when the Premises is inaccessible or unusable and is not used by Tenant.

(c) *Uninsured Casualty*. If the casualty is not an Insured Casualty as set forth in the previous paragraph, it shall be an “**Uninsured Casualty**” governed by this Paragraph 9.1(c). In such event, if the Damage Notice states that the repairs can be completed within the Repair Period without the payment of overtime or other premiums, Landlord may elect, by written notice given to Tenant within thirty (30) days after the Damage Notice, to make the repairs, in which event this Lease shall remain in effect and Base Rent shall be proportionately reduced as set forth above. If Landlord does not so elect to make the repairs, or if the Damage Notice states that the repairs cannot be made within the Repair Period, this Lease shall terminate as of the date of the casualty and Tenant shall vacate the Premises five (5) business days from the date of Landlord’s written notice to Tenant terminating the Lease.

(d) *Casualty within final six months of Term*. Notwithstanding anything to the contrary contained in this Paragraph 9.1, if the Premises or the Building is wholly or partially damaged or destroyed within the final six (6) months of the Term of this Lease, Landlord shall not be required to repair such casualty and either Landlord or Tenant may elect to terminate this Lease.

(e) *Tenant Improvements and Alterations*. If Landlord elects to repair after a casualty in accordance with this Paragraph 9.1, Landlord shall cause Tenant Improvements and Alterations which Landlord has approved, to be repaired and restored at Landlord’s sole expense. Landlord shall have no responsibility for any personal property placed or kept in or on the Premises or the Building by Tenant or Tenant’s agents, employees, invitees or contractors and Landlord shall not be required to repair any damage to, or make any repairs to or replacements of, such personal property.

(f) *Exclusive Remedy*. This Paragraph 9.1 shall be Tenant’s sole and exclusive remedy in the event of damage or destruction to the Premises or the Building. No damages, compensation or claim shall be payable by Landlord for any inconvenience, any interruption or cessation of Tenant’s business, or any annoyance, arising from any damage to or destruction of all or any portion of the Premises or the Building.

(g) *Waiver of Subrogation*. Landlord and Tenant shall cause each insurance policy obtained by each of them to provide that the insurer waives all right of recovery by way of subrogation against either Landlord or Tenant in connection with any loss or damage covered by such policy.

9.2 Eminent Domain.

(a) *Eminent Domain in General*. If the whole of the Premises, or so much of the Premises as to render the balance unusable by Tenant, shall be taken or appropriated under the power of eminent domain or condemnation (a “Taking”), either Landlord or Tenant may terminate this Lease and the termination date shall be the date of the Order of Taking, or the date possession is taken by the Taking authority, whichever is earlier. If any part of the Property is the subject of a Taking and such Taking materially affects the normal operation of the Building or Common Areas, Landlord may elect to terminate this Lease. A sale by Landlord under threat of a Taking shall constitute a Taking for the purpose of this Paragraph 9.2. No award for any partial or entire Taking shall be apportioned. Notwithstanding the foregoing, if any part of the Premises is permanently Taken and such Taking materially and adversely prevents Tenant from conducting its business in the Premises, then, in such event, Tenant may, as its sole remedy, terminate this Lease upon written notice to Landlord given within thirty (30) days following the Taking, unless Tenant is relocated by Landlord to other comparable space. Landlord shall receive (subject to the

rights of Landlord's mortgagees) and Tenant hereby assigns to Landlord any award which may be made and any other proceeds in connection with such Taking, together with all rights of Tenant to such award or proceeds, including, without limitation, any award or compensation for the value of all or any part of the leasehold estate; provided that nothing contained in this Paragraph 9.2(a) shall be deemed to give Landlord any interest in or to require Tenant to assign to Landlord any separate award pursued by Tenant or made to Tenant for (i) the taking of Tenant's Property, or (ii) interruption of or damage to Tenant's business, or (iii) Tenant's moving and relocation costs.

(b) *Reduction in Base Rent.* In the event of a Taking which does not result in a termination of the Lease, Base Rent shall be proportionately reduced based on the portion of the Premises rendered unusable, and Landlord shall restore the Premises or the Building to the extent of available proceeds or awards from such Taking. Landlord shall not be required to repair or restore any damage to Tenant's Property or any Alterations.

(c) *Sole Remedies.* This Paragraph 9.2 sets forth Tenant's and Landlord's sole remedies for Taking. Upon termination of this Lease pursuant to this Paragraph 9.2, Tenant and Landlord hereby agree to release each other from any and all obligations and liabilities with respect to this Lease except such obligations and liabilities which arise or accrue prior to such termination.

ARTICLE X RIGHTS OF PARTIES HOLDING SENIOR INTERESTS

10.1 **Subordination.** This Lease shall be subject and subordinate to any and all mortgages, deeds of trust and other instruments in the nature of a mortgage, ground lease or other matters or record ("Senior Interests") which now or at any time hereafter encumber the Property and Tenant shall, within twenty (20) days of Landlord's request, execute and deliver to Landlord such recordable written instruments as shall be necessary to show the subordination of this Lease to such Senior Interests. Notwithstanding the foregoing, if any holder of a Senior Interest succeeds to the interest of Landlord under this Lease, then, at the option of such holder, this Lease shall continue in full force and effect and Tenant shall attorn to such holder and to recognize such holder as its landlord.

10.2 **Mortgagee's Consent.** No assignment of the Lease and no agreement to make or accept any surrender, termination or cancellation of this Lease and no agreement to modify so as to reduce the Rent, change the Term, or otherwise materially change the rights of Landlord under this Lease, or to relieve Tenant of any obligations or liability under this Lease, shall be valid unless consented to by Landlord's mortgagees of record, if any.

10.3 **Subordination, Attornment and Non-Disturbance Agreement.** In the event Landlord encumbers the Building with a mortgage, Tenant's subordination shall not be effective until Landlord obtains from the holder of a senior interest a subordination and non-disturbance agreement on said mortgagee's standard form ("SNDA").

ARTICLE XI GENERAL

11.1 **Representations by Tenant.** Tenant represents and warrants that any financial statements provided by it to Landlord were true, correct and complete when provided, and that no material adverse change has occurred since that date that would render them inaccurate or misleading. Tenant represents and warrants that those persons executing this Lease on Tenant's behalf are duly authorized to execute and deliver this Lease on its behalf, and that this Lease is binding upon Tenant in accordance with its terms, and simultaneously with the execution of this Lease, Tenant shall deliver evidence of such authority to Landlord in form satisfactory to Landlord.

11.2 **Notices.** Any notice required or permitted hereunder shall be in writing. Notices shall be addressed to Landlord c/o Manager at Manager's Address and to Tenant at Tenant's Address. Any communication so addressed shall be deemed duly given when delivered by hand, one (1) day after being sent by Federal Express (or other guaranteed one day delivery service) or three (3) days after being sent by registered or certified mail, return receipt requested. Either party may change its address by giving notice to the other.

11.3 **No Waiver or Oral Modification.** No provision of this Lease shall be deemed waived by Landlord or Tenant except by a signed written waiver. No consent to any act or waiver of any breach or default, express or implied, by Landlord or Tenant, shall be construed as a consent to any other act or waiver of any other breach or default.

11.4 **Severability.** If any provision of this Lease, or the application thereof in any circumstances, shall to any extent be invalid or unenforceable, the remainder of this Lease shall not be affected thereby, and each provision hereof shall be valid and enforceable to the fullest extent permitted by law.

11.5 **Requests by Tenant.** Tenant shall pay, on demand, all costs incurred by Landlord, including without limitation reasonable attorneys' fees, in connection with any matter requiring Landlord's review or consent or any other requests made by Tenant under this Lease, regardless of whether such request is granted by Landlord.

11.6 Estoppel Certificate and Financial Statements.

(a) *Estoppel Certificate.* Within ten (10) days after written request by Landlord, Tenant shall execute, acknowledge and deliver to Landlord a written statement certifying (i) that this Lease is unmodified and in full force and effect, or is in full force and effect as modified and stating the modifications; (ii) the amount of Base Rent currently payable by Tenant to Landlord; (iii) Tenant's Percentage and Tenant's Share of Expenses currently payable by Tenant to Landlord; (iv) the date to which Base Rent and Tenant's Share of Expenses have been paid in advance; (v) the amount of any security deposited with Landlord; (vi) that Landlord is not in default hereunder or, if Landlord is claimed to be in default, stating the nature of any claimed default, and (vii) such other matters as may be reasonably requested by Landlord. Any such statement may be relied upon by a purchaser, assignee or lender. Tenant's failure to execute and deliver such statement within the time required shall be a default under this Lease and shall also be conclusive upon Tenant that this Lease is in full force and effect and has not been modified except as represented by Landlord; and there are no uncured defaults in Landlord's performance and Tenant has no right of offset, counterclaim or deduction against rent.

(b) *Financial Statements.* Tenant shall, without charge therefor, at any time, within ten (10) days following a request by Landlord, deliver to Landlord, or to any other party designated by Landlord, a true and accurate copy of Tenant's most recent financial statements. All requests made by Tenant regarding renewals or expansions must be accompanied by Tenant's most recent financial statements. All requests made by Tenant regarding subleases, or assignments must be accompanied by Tenant's prospective subtenant's and prospective assignee's most recent financial statements.

11.7 **Waiver of Liability.** Landlord and Tenant each hereby waive all rights of recovery against the other and against the officers, employees, agents, and representatives of the other, on account of loss by or damage to the waiving party or its property or the property of others under its control, to the extent that such loss or damage is insured against under any insurance policy that either may have in force at the time of the loss or damage. Each party shall notify its insurers that the foregoing waiver is contained in this Lease.

11.8 Execution, Prior Agreements and No Representations. This Lease shall not be binding and enforceable until executed by authorized representatives of Landlord and Tenant. This Lease contains all of the agreements of the parties with respect to the subject matter hereof and supersedes all prior dealings, whether written or oral, between them with respect to such subject matter. Each party acknowledges that the other has made no representations or warranties of any kind except as may be specifically set forth in this Lease.

11.9 Brokers. Each party represents and warrants that it has not dealt with any real estate broker or agent in connection with this Lease or its negotiation except Broker. Landlord shall be responsible for any commission payable to Broker by separate written agreement. Each party shall indemnify the other and hold it harmless from any cost, expense, or liability (including costs of suit and reasonable attorneys' fees) for any compensation, commission or fees claimed by any other real estate broker or agent in connection with this Lease or its negotiation by reason of any act or statement of the indemnifying party.

11.10 Successors and Assigns. This Lease shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns; provided, however, that only the original Landlord named herein shall be liable for obligations accruing before the beginning of the Term, and thereafter the original Landlord named herein and each successive owner of the Premises shall be liable only for obligations accruing during the period of their respective ownership.

11.11 Applicable Law and Lease Interpretation. This Lease shall be construed, governed and enforced according to the laws of the state in which the Property is located. In construing this Lease, paragraph headings are for convenience only and shall be disregarded. Any recitals herein or exhibits attached hereto are hereby incorporated into this Lease by this reference. Time is of the essence of this Lease and every provision contained herein. The parties acknowledge that this Lease was freely negotiated by both parties, each of whom was represented by counsel; accordingly, this Lease shall be construed according to the fair meaning of its terms, and not against either party.

11.12 Costs of Collection, Enforcement and Disputes. Tenant shall pay all costs of collection, including reasonable attorneys' fees, incurred by Landlord in connection with any default by Tenant. If either Landlord or Tenant institutes any action to enforce the provisions of this Lease or to seek a declaration of rights hereunder, the prevailing party shall be entitled to recover its reasonable attorneys' fees and court costs as part of any award. Landlord and Tenant hereby waive trial by jury in any action, proceeding or counterclaim brought by either of the parties hereto against the other, on or in respect to any matter whatsoever arising out of or in any way connected with this Lease, the relationship of Landlord and Tenant hereunder, Tenant's use or occupancy of the Premises, and/or claim of injury or damage.

11.13 Holdover. If Tenant holds over in occupancy of the Premises after the expiration of the Term, Tenant shall, at the election of Landlord (i) become a tenant at sufferance only on a month-to-month basis subject to the terms and conditions herein specified, so far as applicable; or (ii) be deemed to have renewed this Lease for a one year period under the terms and conditions herein specified, so far as applicable. In either case, Tenant shall pay rent during the holdover period, at a base rental rate equal to one hundred fifty percent (150%) of the Base Rent in effect at the end of the Term, plus the amount of Tenant's Share of Expenses then in effect. Tenant shall also be liable for all damages sustained by Landlord on account of such holding over.

11.14 **Force Majeure.** If Landlord or Tenant is prevented from or delayed in performing any act required of it hereunder, and such prevention or delay is caused by strikes, labor disputes, inability to obtain labor, materials, or equipment, inclement weather, acts of God, governmental restrictions, regulations, or controls, judicial orders, enemy or hostile government actions, civil commotion, fire or other casualty, or other causes beyond such party's reasonable control ("Force Majeure"), the performance of such act shall be excused for a period equal to the period of prevention or delay. A party's financial inability to perform its obligations shall in no event constitute Force Majeure. Nothing in this Paragraph 11.14 shall excuse or delay Tenant's obligation to pay any rent or other charges due under this Lease.

11.15 **Limitation On Liability.** Landlord, and its partners, directors, officers, shareholders, trustees or beneficiaries, shall not be liable to Tenant for any damage to or loss of personal property in, or to any personal injury occurring in, the Premises, unless such damage, loss or injury is the result of the gross negligence of Landlord or its agents as determined by a final non-appeal judicial proceeding. The obligations of Landlord under this Lease do not constitute personal obligations of the individual partners, directors, officers, shareholders, trustees or beneficiaries of Landlord, and Tenant shall not seek recourse against the partners, directors, officers, shareholders, trustees or beneficiaries of Landlord, or any of their personal assets for satisfaction of any liability with respect to this Lease. In the event of any default by Landlord under this Lease, Tenant's sole and exclusive remedy shall be against Landlord's interest in the Property.

11.16 **Notice of Landlord's Default.** The failure by Landlord to observe or perform any of the express or implied covenants or provisions of this Lease to be observed or performed by Landlord shall not constitute a default by Landlord unless such failure shall continue for a period of more than thirty (30) days after written notice thereof from Tenant to Landlord specifying Landlord's default; provided, however, that if the nature of Landlord's default is such that more than thirty (30) days are reasonably required for its cure, then Landlord shall not be deemed to be in default if Landlord commences such cure within said thirty (30) day period and diligently prosecutes such cure to completion. Tenant shall, simultaneously with delivery to Landlord, provide written notice specifying the Landlord default to the holder of any first mortgage or deed of trust covering the Premises whose name and address have been furnished to Tenant in writing.

11.17 **Lease not to be Recorded.** Tenant agrees that it will not record this Lease. Both parties shall, upon the request of either, execute and deliver a notice or short form of this Lease in such form, if any, as may be permitted by applicable statute. If this Lease is terminated before the Term expires the parties shall execute, deliver and record an instrument acknowledging such fact and the actual date of termination of this Lease, and Tenant hereby appoints Landlord its attorney-in-fact, coupled with an interest, with full power of substitution to execute such instrument.

11.18 **Security Deposit.** Upon the execution and delivery of this Lease, Tenant shall pay to Landlord the Security Deposit, which shall be held as security for Tenant's performance as herein provided and refunded to Tenant at the end of the Term subject to Tenant's satisfactory compliance with the conditions hereof. The Security Deposit may be commingled with other funds of Landlord and no interest shall accrue thereon or be payable by Landlord with respect to the Security Deposit. If all or any part of the Security Deposit is applied to an obligation of Tenant hereunder, Tenant shall immediately upon request by Landlord restore the Security Deposit to its original amount.

11.19 **Generator.** Subject to the terms and conditions set forth herein, Tenant may, at its sole expense, install, operate, maintain and remove the emergency generator equipment (the "Emergency Generator Equipment") serving the Premises, in accordance with the following:

- (a) The Emergency Generator Equipment may only be used as a backup power supply in the event of a power outage to the Premises.

- (b) The Emergency Generator Equipment may be operated during the period from 9 p.m. through 6 a.m. for testing purposes not more than one (1) time per week, and for not more than thirty (30) minutes, provided that the same is in accordance with all applicable laws, permits, rules and regulations.
- (c) The location and amount of space of the Emergency Generator Equipment shall remain where presently located.
- (d) Intentionally Deleted.
- (e) Tenant shall, at its sole expense, obtain any municipal, state or federal permits and/or licenses required for the installation and operation of the Emergency Generator System, and copy of each permit or license shall be submitted to Landlord.
- (f) Tenant shall obtain appropriate insurance for, and such insurance required by Landlord from time to time, and assumes full responsibility for the installation, operation, engineering and maintenance of all the Emergency Generator Equipment installed by Tenant. Such insurance shall be maintained with a nationally-recognized responsible insurance carrier licensed in the State of Florida that is reasonably acceptable to Landlord, and otherwise shall be in amount and form reasonably acceptable to Landlord and shall name Landlord as an additional insured. Tenant shall indemnify, defend, and save harmless Landlord from and against any and all costs (including reasonably attorneys fees), damages, expense and liability (including statutory liability, liability under Workers Compensation laws and mechanic's liens), in connection with claims or damages as a result of injury or death of any person or property damage due to any acts or omissions or negligence of Tenant, Tenant's agents, employees, customers, invitees, contractors, and subcontractors in connection with the Emergency Generator Equipment.
- (g) All costs for such Emergency Generator Equipment installation, including without limitation, the cost of a fuel tank, fuel, batteries, piping and other ancillary equipment reasonably necessary to the operation of the Emergency Generator Equipment, will be at Tenant's sole expense and in compliance with all laws.
- (h) The Emergency Generator Equipment shall be operated in a manner to not interfere with the use or operation of other equipment installed at the Building or in the common areas.
- (i) Tenant and its contractors, agents and subcontractors, may access the Emergency Generator Equipment at any time and from time to time, at their own risk.
- (j) Intentionally Deleted.
- (k) During the Term of the Lease, Tenant shall keep the Emergency Generator Equipment in good condition and repair and allow no waste thereon. Upon termination or expiration of the Lease. Tenant will remove the Emergency Generator Equipment and all of its related equipment and reimburse Landlord for the cost of repairing any damage caused by removal of the Emergency Generator Equipment or any ancillary equipment.

(l) The rights set forth in this Section 11.19 are granted by Landlord to Tenant, are personal to Tenant and shall not be exercised or assigned, voluntarily or involuntarily, by or to anyone, except to an entity which merges into Tenant or purchases all or substantially all of Tenant's assets. Except as provided in the prior sentence, any assignment of these rights without Landlord's prior written consent, which may be withheld in Landlord's reasonable discretion, shall be void and, at Landlord's election, shall constitute a material default hereunder.

11.20 **Radon.** Radon is a naturally occurring radioactive gas, that when it has accumulated in a building in sufficient quantities, may present a health risk to persons who are exposed to it over time. Levels of radon that exceed federal and state guidelines have been found in buildings in Florida. Additional information regarding radon and radon testing may be obtained from your county public health unit.

IN WITNESS WHEREOF, Landlord and Tenant have executed this Lease, which includes the cover sheet, the foregoing Standard Provisions, Additional Provisions, if any, and Exhibits attached to this Lease, with the intent that each of the parties shall be legally bound thereby and that this Lease shall become effective as of the Date of Lease.

WITNESSES:

/s/ John Townsley

/s/ Susan Jenik

WITNESSES:

/s/ Elizabeth Robichaud

WITNESSES:

/s/ Anna-Jean Creegan

TENANT:

FARO TECHNOLOGIES, INC.,
a Florida corporation

By: /s/ Jay W. Freeland

Name: Jay W. Freeland

Title: President & CEO

Date: September 14, 2007

LANDLORD:

SUN LIFE ASSURANCE COMPANY OF CANADA,
a Canadian corporation

By: /s/ Thomas V. Pedulla

Name: Thomas V. Pedulla

Title: Senior Managing Director

Date: September 26, 2007

By: /s/ Charles S. Andes

Name: Charles S. Andes

Title: Managing Director

Date: September 26, 2007

PART III ADDITIONAL PROVISIONS

The following provisions ("Additional Provisions") identified below and attached and/or set forth below are included as part of the Lease between Landlord and Tenant. Capitalized terms used in any of the Additional Provisions and not otherwise defined shall have the meanings given such terms in Part I and Part II of this Lease. Unless express reference is made to a provision in Part I and Part II of this Lease for the purpose of modifying such provision, in the event of any conflict between the Additional Provisions and the provisions of Part I and Part II of this Lease, the provisions contained in Parts I and II shall control.

EXTERIOR SIGNAGE

Tenant shall have the non-exclusive right, at Tenant's sole cost and expense and subject to all applicable laws and codes related thereto, to install one (1) exterior sign on the façade of the Building above the main entrance to the Building (the "Exterior Signage"). The graphics, lighting, size, location, POA standards, aesthetics, material, color and installation of such signage shall be subject to the prior written consent of (a) the City of Lake Mary, (b) Landlord and/or (c) any other entity having approval rights. Tenant shall maintain the Exterior Signage at Tenant's sole cost and expense and in conformity with all applicable laws and codes. Notwithstanding the foregoing, if during the Term of the Lease, Tenant commits any uncured monetary default, abandons or vacates the Premises, assigns or subleases all or any portion of the Premises (other than to Priority Healthcare for approximately 1,000 rentable square feet), then Tenant's right to the Exterior Signage shall automatically terminate and Tenant shall remove such signage and repair any and all damage caused thereby, including, without limitation, restoring the façade to match the remaining façade. The rights of Tenant contained in this Lease shall apply only for the benefit of the undersigned Tenant and shall not apply in favor of any assignee or sublessee of Tenant. Tenant shall be required to remove the sign and repair all damages (including, without limitation, matching the façade) caused thereby after expiration or earlier termination of the Lease.

WITNESSES:

TENANT:

FARO TECHNOLOGIES, INC.,
a Florida corporation

By: /s/ Jay W. Freeland

Name: Jay W. Freeland

Title: President & CEO

Date: September 14, 2007

WITNESSES:

WITNESSES:

LANDLORD:

SUN LIFE ASSURANCE COMPANY OF CANADA,
a Canadian corporation

By: /s/ Thomas V. Pedulla

Name: Thomas V. Pedulla

Title: Senior Managing Director

Date: September 26, 2007

By: /s/ Charles S. Andes

Name: Charles S. Andes

Title: Managing Director

Date: September 26, 2007

EXHIBIT C

NOTICE OF LEASE TERM DATES

Date: _____

[Tenant]

Re: Lease dated _____ between Sun Life Assurance Company of Canada, Landlord, and FARO Technologies, Inc., Tenant, (the "Lease") concerning the Premises (as defined in the Lease) located at 250 Technology Parkway, Lake Mary, Florida 32746

Ladies and Gentlemen:

In accordance with the Lease, please confirm the following by signing below:

1. The Premises have been accepted by Tenant as being substantially complete in accordance with the Lease, and there is no deficiency in construction.

2. Tenant has possession of the Premises. The Commencement Date of the Lease is _____ and the Term shall end on _____.

Your rent checks should be made payable to _____ [Manager].

AGREED AND ACCEPTED

TENANT:

MANAGER:

FARO TECHNOLOGIES, INC.

CRESCENT RESOURCES, LLC

By: _____
Name: _____
Title: _____

By: _____
Name: _____
Title: _____

TENANT FINISH WORK: ALLOWANCE

1. Except as set forth on this Exhibit, Tenant accepts the Premises "AS-IS" and acknowledges that Landlord has no obligation to make or otherwise pay for any improvements, alterations or repairs thereto.

2. Landlord will have prepared the Working Drawings for the Premises. Tenant will review and approve the Working Drawings within five (5) business days following receipt thereof. As used herein, "Working Drawings" shall mean the final working drawings approved by Landlord, as amended from time to time by any approved changes thereto, and "Work" shall mean all improvements to be constructed in accordance with and as indicated on the Working Drawings, which shall be carpet and paint. Approval by Landlord of the Working Drawings shall not be a representation or warranty of Landlord that such drawings are adequate for any use, purpose, or condition, or that such drawings comply with any applicable law or code, but shall merely be the consent of Landlord to the performance of the Work. Tenant shall, at Landlord's request, sign the Working Drawings to evidence its review and approval thereof. All changes in the Work must receive the prior written approval of Landlord, and in the event of any such approved change Tenant shall, upon completion of the Work, furnish Landlord with an accurate, reproducible "as-built" plan (e.g., sepia) of the improvements as constructed, which plan shall be incorporated into this Lease by this reference for all purposes.

3. Landlord will cause the Work to be performed by contractors and subcontractors approved in writing by Landlord.

4. If a delay in the performance of the Work occurs (each delay being a "Tenant Delay") (a) because Tenant does not timely approve the Working Drawings; (b) because of any change by Tenant to the Working Drawings, (c) because of any specification by Tenant of materials or installations that are not available, or (d) if Tenant, any contractor or subcontractor, or Tenant's agents otherwise delays completion of the Work, then, notwithstanding any provision to the contrary in this Lease, Tenant's obligation to pay Base Rent and Tenant's share of Excess shall commence on the scheduled Commencement Date.

5. Tenant shall bear the entire cost of performing the Work (including, without limitation, space planning and construction document fees, design of the Work and preparation of the Working Drawings, costs of construction labor and materials, electrical usage during construction, additional janitorial services, approved signage, related taxes and insurance costs, all of which costs are herein collectively called the "Total Construction Costs") in excess of the Construction Allowance (hereinafter defined). Upon approval of the Working Drawings and selection of a contractor, Tenant shall promptly (a) execute a work order agreement prepared by Landlord which identifies such drawings, itemizes the Total Construction Costs and sets forth the Construction Allowance, and (b) pay to Landlord 50% of the amount by which the estimated Total Construction Costs exceed the Construction Allowance. Tenant shall pay to Landlord, within ten (10) days after Landlord's delivery to Tenant of an appropriate invoice, an amount equal to the Total Construction Costs (as adjusted for any approved changes to the Work), less (i) the amount of the payments already made by Tenant, (ii) the amount of the Construction Allowance, and (iii) the cost reasonably estimated by Landlord for completing all "punch list" items; finally, upon completion of the punch list items, Tenant shall pay to Landlord the costs incurred in completing the same.

6. Landlord shall provide to Tenant a construction allowance (the "Construction Allowance") equal to the lesser of (a) \$3.00 per rentable square foot in the Premises or (b) the Total Construction Costs, as adjusted for any approved changes to the Work. Any unspent portion of the Construction Allowance remaining as of the Commencement Date shall be retained by Landlord without credit or reimbursement to Tenant. The Construction Allowance shall only be used for one (1) initial space plan and one revision and normal hard improvement costs. All cabling and wiring shall be at Tenant's sole expense.

7. Landlord or its affiliate shall supervise the Work, make disbursements required to be made to the contractor, and act as a liaison between the contractor and Tenant and coordinate the relationship between the Work, the Building, and the Building's systems. In consideration for Landlord's construction supervision services, Tenant shall pay to Landlord a construction supervision fee equal to four percent (4%) of the Construction Allowance, which may be deducted from the Construction Allowance. In addition, Landlord's project manager shall receive a supervisory fee for review of plans, permit process supervision and overseeing the Work.

8. Tenant will be performing other improvements pursuant to which terms and conditions of the Lease shall apply.

9. To the extent not inconsistent with this Exhibit, the Lease shall govern the performance of the Work and the Landlord's and Tenant's respective rights and obligations regarding the improvements installed pursuant thereto.

EXHIBIT C

NOTICE OF LEASE TERM DATES

Date: October 1, 2007

[Tenant]
FARO Technologies, Inc.
250 Technology Parkway
Lake Mary, FL 32746

Re: Lease dated September 26, 2007 between Sun Life Assurance Company of Canada, Landlord, and FARO Technologies, Inc., Tenant, (the "Lease") concerning the Premises (as defined in the Lease) located at 250 Technology Parkway, Lake Mary, Florida 32746

Ladies and Gentlemen:

In accordance with the Lease, please confirm the following by signing below:

1. The Premises have been accepted by Tenant as being substantially complete in accordance with the Lease, and there is no deficiency in construction.
 2. Tenant has possession of the Premises. The Commencement Date of the Lease is October 1, 2007 and the Term shall end on February 28, 2013.
- Your rent checks should be made payable to Sun Life Assurance Company of Canada [Manager].

AGREED AND ACCEPTED

TENANT:

FARO TECHNOLOGIES, INC.

By: /s/ Jay W. Freeland
Name: Jay W. Freeland
Title: President & CEO

MANAGER:

CRESCENT RESOURCES, LLC

By: /s/ Whit Duncan
Name: Whit Duncan
Title: Sr. Vice President - Florida

FARO TECHNOLOGIES, INC. LIST OF SUBSIDIARIES

Antares LDA	Portugal
Cam2 SRL	Italy
Faro Benelux BV	Netherlands
Faro Business Technologies India Pvt. Ltd.	India
Faro Cayman LP	Cayman Islands
Faro Cayman Ltd	Cayman Islands
Faro Delaware Inc	Delaware, USA
Faro Deutschland Holding GmbH	Germany
Faro Europe KG	Germany
Faro FHN Netherlands BV	Netherlands
Faro Japan KK	Japan
Faro Scanning AG	Germany
Faro Scanner Production GmbH	Germany
IQ Laser—Sales (Pty)	Germany
IQ Laser—Scan (Pty)	Germany
Faro Shanghai Co. Ltd	China
Faro Singapore PTE Ltd	Singapore
Faro Spain SL	Spain
Faro Swiss Holding GmbH	Switzerland
Faro Swiss Manufacturing GmbH	Switzerland
Faro Tech Polska	Poland
Faro Verwaltungs GmbH	Germany
Faro Worldwide Inc	Florida, USA
Faro Technologies (Thailand) Ltd.	Thailand
3D Measurement Technologies, S de RL de CV	Mexico

Consent of Independent Registered Public Accounting Firm

We have issued our reports dated March 10, 2008, accompanying the consolidated financial statements and schedule (which report expressed an unqualified opinion and contains an explanatory paragraph relating to the adoption of Statement No. 123 (revised 2004) and Interpretation No. 48) and management's assessment of the effectiveness of internal control over financial reporting included in the Annual Report of FARO Technologies, Inc. and subsidiaries on Form 10-K for the year ended December 31, 2007. We hereby consent to the incorporation by reference of said reports in the Registration Statements of FARO Technologies, Inc. and subsidiaries on Forms S-3 (File No. 333-124021, effective April 21, 2005 and File No. 333-121919, effective January 14, 2005) and Forms S-8 (File No. 333-125021, effective May, 18, 2005, File No. 333-41115, effective November 26, 1997, File No. 333-41125, effective November 26, 1997, File No. 333-41131, effective November 26, 1997 and File No. 333-41135, effective, November 26, 1997).

/s/ GRANT THORNTON LLP

Orlando, Florida
March 10, 2008

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

I, Jay W. Freeland, certify that:

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

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

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

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

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

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

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

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

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

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

Date: March 10, 2008

/s/ JAY W. FREELAND

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

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

I, Keith S. Bair, certify that:

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

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

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

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

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

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

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

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

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

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

Date: March 10, 2008

/s/ KEITH S. BAIR

Name: Keith S. Bair
 Title: **Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)**

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

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, the undersigned President and Chief Executive Officer and Director of FARO Technologies, Inc., (the Company) hereby certify, based on my knowledge, that the Annual Report on Form 10-K, for the year ended December 31, 2007 (the Report) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ JAY W. FREELAND

Jay W. Freeland
March 10, 2008

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

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, I, the undersigned Senior Vice President and Chief Financial Officer of FARO Technologies, Inc., (the Company), and the principal financial officer and principal accounting officer of the Company for the period covered the Report, hereby certify, based on my knowledge, that the Annual Report on Form 10-K, for the year ended December 31, 2007 (the Report) fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ KEITH S. BAIR

Keith S. Bair
March 10, 2008

FARO TECHNOLOGIES INC. PROPERTIES

<u>No.</u>	<u>Location</u>	<u>Sq. Ft.</u>	<u>Owned/Leased</u>	<u>Purposes</u>
1	125 Technology Park, Lake Mary, Florida	35,000	Leased	Headquarters, manufacturing, research and development, service
2	525 Technology Park, Lake Mary, Florida	8,200	Leased	Sales and marketing
3	250 Technology Park, Lake Mary	46,000	Leased	Sales, Marketing and Administration
4	222 Gale Lane, Kennett Square, Pennsylvania	36,800	Leased	Manufacturing, research and development, service
5	Ingersheimer Str.12, D-70499 Stuttgart-Weilimdorf, Germany	62,300	Leased	European headquarters, manufacturing, sales, research and development, service
6	Wiesengasse 20 CH-8222 Beringen Switzerland	15,930	Leased	Manufacturing
7	1401 Wakabadai Meito-ku, Nagoya, Aichi 465-0015, Japan	5,200	Leased	Sales, service
8	798 Zhaojiabang Road, Shanghai, China	11,500	Leased	Sales, service
9	No. 3 Changi South St 2 #01-01 Xilin Districentre Building B, Singapore	22,000	Leased	Asia headquarters, manufacturing, sales, service