

THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

FARO - Q1 2016 FARO Technologies Inc Earnings Call

EVENT DATE/TIME: MAY 04, 2016 / 12:30PM GMT



MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

## CORPORATE PARTICIPANTS

**Bob Seidel** *FARO Technologies, Inc. - VP of Finance and IR*

**Simon Raab** *FARO Technologies, Inc. - CEO and Chairman*

## CONFERENCE CALL PARTICIPANTS

**Vic Allgeier** *TTC Group - IR*

**Patrick Newton** *Stifel Nicolaus - Analyst*

**Richard Eastman** *Robert W. Baird & Company, Inc. - Analyst*

**Mark Jordan** *Noble Financial Group - Analyst*

**Josh Sullivan** *Sterne Agee Capital - Analyst*

**Hendi Susanto** *Gabelli & Co. - Analyst*

## PRESENTATION

### Operator

Good day, everyone, and welcome to today's FARO Technologies first-quarter 2016 earnings release conference call. (Operator Instructions) Please note this call may be recorded. I will be standing by should you need any assistance. It is now my pleasure to turn today's program over to Mr. Vic Allgeier. Please go ahead, sir.

### Vic Allgeier - TTC Group - IR

Thank you, and good morning, everyone. My name is Vic Allgeier of the TTC Group, FARO's investor relations firm. Yesterday after the market closed, FARO released its first-quarter results. By now you should have received a copy of the press release. If you have not received a release, please call Nancy Setteducati at 407-333-9911. Press release is also available on FARO's website at [www.FARO.com](http://www.FARO.com).

Representing the Company today are Dr. Simon Rabb, President and Chief Executive Officer; and Bob Seidel, Vice President of Finance and Investor Relations. Simon and Bob will deliver prepared remarks first and then will be available for questions.

I would like to remind you that in order to help you understand the Company and its results, management may make some forward-looking statements during the course of this call. Statements can be identified by words such as expect, will, believe, anticipate, plans, potential, continue, goals, objectives and similar words. It is possible that the Company's actual results may differ materially from those projected in these forward-looking statements. Important factors that may cause actual results to differ materially are set forth in yesterday's press release and in the Company's Form 10-K for the year ended December 31, 2015. I will now turn the call over to Bob.

### Bob Seidel - FARO Technologies, Inc. - VP of Finance and IR

Thank you, Vic, and good morning, everyone. Sales for the first quarter of 2016 were \$75.7 million, an increase of \$5.8 million, or 8%, compared to \$69.9 million for the first quarter of 2015. The Americas led the way at 13% sales growth, while Asia delivered a modest recovery from a challenging 2015 at 9% sales growth. Product sales increased by \$4.3 million, or 8%, to \$59.3 million for the first quarter of 2016 from \$55 million for the same prior-year period, driven mostly by higher metrology sales in the Americas and Asia.

Service revenue increased by \$1.5 million, or 10%, to \$16.4 million for the first quarter of 2016 from \$14.9 million for the same prior-year period, mostly because of higher warranty revenue.



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

In the Americas, sales for the first quarter of 2016 increased by \$4.1 million, or 13%, to \$34.5 million, compared with \$30.4 million for the first quarter of last year, primarily driven by an increase in metrology sales and higher warranty revenue.

Despite softness in China, Asia sales increased by \$1.5 million, or 9%, to \$18.8 million for the first quarter of 2016 from \$17.3 million for the same prior-year period. Similar to the Americas, our sales growth in Asia was primarily a result of higher metrology sales.

In Europe, sales in the first quarter of 2016 were \$22.4 million, an increase of \$0.2 million, or 1%, compared with \$22.2 million for the first quarter last year, mostly due to an increase in service revenue partially offset by lower product sales.

Gross margin was 56.3% in the quarter, compared with 56.6% for the same prior-year period. Product and service margin remain relatively unchanged.

Selling and marketing expenses decreased by \$1.5 million, or 8%, to \$17.6 million, or 23.3% of sales for the first quarter of 2016, compared with \$19.1 million, or 27.3% of sales, for the first quarter of 2015. This decrease of \$1.5 million, or 4.0% of sales, was related mostly to not having an annual sales meeting previously held in January. General and administrative expenses for the first quarter of 2016 were \$10.5 million, compared with \$9.8 million for the first quarter last year. This increase of \$0.7 million was mostly due to higher stock-based compensation and certain employee separation costs.

As a percentage of sales, general administrative expenses decreased to 13.9% for the first quarter of 2016, compared with 14.0% for the same prior-year period. We continue to invest in research and development, in line with our initiative of establishing a new product drumbeat. As a result, research and development expenses increased by \$0.7 million, or 12%, to \$7.1 million, or 9.4% of sales, for the first quarter of 2016, compared with \$6.4 million, or 9.1% of sales, for the first quarter of last year.

Operating income for the first quarter of 2016 increased by \$2.4 million or \$4.3 million compared with \$1.9 million for the prior-year period, translating to an operating margin increase of 3.0 percentage points to 5.7%.

For the first quarter of 2016, income tax expense is \$0.5 million for an effective income tax rate of 15%, compared with an income tax benefit of \$0.1 million for the same prior-year period.

Net income for the first quarter of 2016 was \$3.1 million, or \$0.19 per share, compared with \$0.7 million, or \$0.04 per share, for the first quarter last year.

I will now briefly discuss a few balance sheet items. Cash and short-term investments increased by \$12.8 million, or 13%, to \$163.2 million as of March 31, 2016, compared with \$150.4 million as of December 31, 2015, primarily driven by strong cash flow from operations of \$13.1 million. Accounts receivables decreased by \$9.8 million to \$60.1 million as of March 31, 2016, compared with \$69.9 million as of December 31, 2015. DSO was 72 days at the end of the first quarter 2016, down nine days from the first quarter last year. Total inventories increased to \$83.5 million as of March 31, 2016 from \$79.3 million as of December 31, 2015, mostly driven by new products releases.

Finally, I will conclude with our headcount numbers. We had 1,298 employees at the end of first-quarter 2016, representing a year-over-year decrease of 10 employees, or 0.8%. Geographically, we had 516 employees in the Americas, 494 in Europe and 288 in Asia.

I will now hand the call over to Simon.

---

**Simon Raab - FARO Technologies, Inc. - CEO and Chairman**

Thanks, Bob, and good morning, everyone. I was encouraged by our first-quarter sales growth and increased EPS. We started our planned product drumbeat by releasing several new and revised hardware and software products since the beginning of the year. We made significant progress on our initiatives to better target specific vertical markets, better leverage our sales organization through process modernization and harmonize global functions to improve efficiencies to reduce SG&A as a percentage of sales. Essential to the product drumbeat, we will also begin our reorganization of R&D and product management to ensure that our products meet the needs of the vertical markets on which we are focused.



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

As mentioned, we made a good start in Q1 of establishing a drumbeat of new and improved software and hardware products. In order to facilitate and enhance these product introductions, we've introduced an early-adopter program. Early-adopter registrants will have access to new product concepts and provide FARO a unique and accelerated access to the marketplace and critical feedback in certain limited geographies. We hope that most early adopter products will quickly evolve into full global product releases.

In January, we released a new class of automated metrology imagery technology with the FARO Factory Array Imager, formally known as the Cobalt. This product is targeted to penetrate in-line and near-line industrial manufacturing applications with its unique combination of high resolution, fast processing speed and multi-sensor scalability, which both enhances and, in some cases, eliminates the need for robots.

In March, we launched the FARO early-adopter program by announcing the world's first 3-D scan localizer. This product mounts under a FARO Focus laser scanner and makes continuous 2-D scans while tracking the laser scanner's location in order to stitch together a complete building interior. This innovative product provides building and construction information management, or BIM-CIM, customers with efficiency gains of up to 2.5 times over alternative solutions of setting up targets or using overlapping scans. The FARO Focus laser scanner, soon to be renamed FARO BIM-CIM laser scanner, is already best in class and is dramatically enhanced by the scan localizer.

In April, we announced the release of our second early adopter product, the Factory Robo-Imager. This new product pairs our recently released factory array imager with a human collaborative robot to provide highly adaptable, safe, and automated in-line and near-line inspection for manufacturing processes. It has always been one of FARO's primary philosophies that small and medium-size businesses can benefit from 3-D technology, which in the past has only been available to large manufacturers. The Robo-Imager, which sells for the price of a small CMM, makes the adaptability of the robot and high-resolution measurement tool accessible to all.

We also introduced important product enhancements. In April, we announced the release of new 3-D laser scanners with high dynamic range, HDR. The new FARO BIM-CIM HDR laser scanner improves the quality of detailed images in bright and dark lighting conditions as well as provides increased resolution for superior color depth.

Simultaneously with the new scanner enhancement, we introduced the latest version of SCENE, which provides nearly instant rendering of scan images that substantially enhance the user experience. We also introduced a new version of FireZone with important reporting improvements for our public safety users.

In addition, late last year, we announced the development and introduction of short-range scanners and software bundles breaking the 30K barrier, compared to the typical 60K long-range scanner and software bundle. In Q1 of this year, we started to see important responses in market specificity of these products, and the early interest in certain applications underlines the importance of products designed, packaged and priced for their verticals. We are very proud of the technical achievements which allow us to profitably price and package products with substantively different vertical requirements.

Beyond driving a new product drumbeat, we took steps forward on FARO renewal by realigning the roles of two of our leaders. Kathleen Hall has now officially assumed her new role as Chief Operating Officer, with responsibility for leading our global operations teams. She is directing the focus of the team on the identification, harmonization and optimization of processes around the globe in order to deliver the long-term efficiency gains required to increase margin.

In addition, Joe Arezone has now officially transitioned into his new role as Chief Commercial Officer. Uniting all sales teams under a single leader is the first step to allowing the organization to leverage the expertise, knowledge and processes of three diverse regional teams to develop a best-in-class sales force and successfully drive Company-wide growth. The sales leadership team under Joe's direction will now be focused on the definition of the end-customer market, the unique needs of running a global organization and the ways in which we can best address the needs of our chosen verticals.

In the first quarter, I visited FARO locations across all three geographic regions, and I'm excited now our global team is embracing the core tenets of FARO's reorganization. From the new product drumbeat, the sales modernization to refocusing on vertical applications, FARO's renewal is



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

fundamental to our long-term growth. We are taking the first steps by unifying our core functions under global leadership, which represents a crucial step to leverage best practices, increase efficiency and to drive innovation.

While we are still early in the overall implementation of a new organization, the strides taken since its original announcement have already shown positive signs. Reinvigorating the entrepreneurial spirit that FARO was founded on and its building the desired agility in interacting with our organization, customers and market is our immediate goal.

As the renewed organization takes form, we will continue to provide updates on the progress and exciting new initiatives that will reaffirm FARO as a market leader.

I want to thank all FARO employees for their continued focus on driving the Company forward even as we are changing the way we do business. And I will now open the call for questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Patrick Newton, Stifel.

### Patrick Newton - Stifel Nicolaus - Analyst

Congratulations on the nice quarter. I think the thing that stands out the most is the services side of the business. Record revenue quarter and the second highest gross margin through our model. So I'm curious if you could discuss what drove the increase in warranty. And is this a new focus of the Company's? And then can you talk to the sustainability of revenue for the gross margin given both are at peak relative to historical levels?

### Simon Raab - FARO Technologies, Inc. - CEO and Chairman

Okay. Good morning, Patrick. Thanks for joining the call. First of all, I talk about our service, as you indicated. Customer service revenues for us in Europe was up just based on customer requirements. So that was certainly one driver year over year for us.

Number two is, more broadly speaking, is that at the point of sale, all our regions are really focusing on trying to drive warranty revenue. So that is really one of the major other drivers of it. So I would say two pieces. One is the customer service in Europe, which is timing, customer requirements; but really speaking broadly, the strategic of the warranties.

Going forward, certainly that is going to be a strategic priority for us across all our sales regions and as we harmonize is to drive that warranty revenue because it's a nice stream of recurring business for us.

### Patrick Newton - Stifel Nicolaus - Analyst

Great. And then I guess on a couple of housekeeping questions -- and I'm sorry if I missed this -- is did you provide bookings in the quarter, distribution as a percentage of total sales and then distribution as a percentage of scanner revenue?



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

**Simon Raab** - FARO Technologies, Inc. - CEO and Chairman

No. First of all, Patrick, on the orders. In the past year, our book-to-bill ratio, as you know, has been near one, reflecting that our customers place the order in the quarter and we ship in the quarter. Therefore, we believe that order performance is not materially different than our sales performance that we reported. So going forward, we are not disclosing orders. Those are not materially different than our sales generally.

And in terms of I believe you said laser scanners, really over the past year, we've shifted our channel to market for our laser scanner products with expansion of a direct sales force really across many of our key markets. Going forward, each of our teams will really be working to identify the optimal channels. And so we are really focusing on the end-market applications and broadening our product portfolio as we go into the verticals. Therefore, we don't really see disclosing any type of distribution as being a material item for our shareholders or our analysts.

---

**Patrick Newton** - Stifel Nicolaus - Analyst

Okay. Did you provide laser scanners as a percentage of revenue?

---

**Simon Raab** - FARO Technologies, Inc. - CEO and Chairman

No, we did not. That's what I was talking about.

---

**Patrick Newton** - Stifel Nicolaus - Analyst

I thought you were talking about distribution. Can you provide us with laser scanner revenue as a percentage of revenue?

---

**Simon Raab** - FARO Technologies, Inc. - CEO and Chairman

No. What we are focused on, if you read the Q, is we are really focused on, one, our reporting regions. So we are talking to reporting regions about our sales growth, as you know, in the Americas, Asia and Europe. But we did not really talk about anything below that. What we really see in the quarter, though, to really talk more broadly is, one, we saw in Asia and the Americas higher metrology sales. And across the -- really across most of the regions, we did see slightly lower (inaudible) sales, but we did not disclose any numbers at that point.

---

**Patrick Newton** - Stifel Nicolaus - Analyst

Okay. So in the Q, you are not disclosing ASPs by product line anymore. You are not disclosing unit volumes. You are not disclosing bookings. And you are no longer disclosing distribution and no longer disclosing laser scanner revenue?

---

**Bob Seidel** - FARO Technologies, Inc. - VP of Finance and IR

That's right. And really broadly, though, to help you understand our thought process with that is, one, is that we -- certainly at this point in time, we are reporting by our geographical region. So we are talking about the factors that drive those regions. We talked about those factors in the Americas, Europe, Asia.

But as we transition to a -- an approach of our verticals, we talked about -- Dr. Raab talked about in Q4, we have been focused more on our end-markets, number one. And number two, we will be taking really our products and trying to differentiate to our product drumbeat. You have seen in the course of the last several months just that we released either six new or revised products. Through materiality of one specific product, we've become less so. So that's why we're trying to talk more as we go forward about markets and end-market applications, and we do not see that as impacting the ability for any analysts to forecast our sales.



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

**Patrick Newton** - *Stifel Nicolaus - Analyst*

Okay. And I guess just last one for me, Simon, is on the strategy of the Web-based demos. I know it is still very early stages here, but are you seeing any indications of success or challenges associated with the strategy?

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

The basic challenge is, of course, converting an organization that was doing the sales process one way to another way. And there are several hundred salespeople and ISS, or internal sales specialists, and application engineers.

So it's really in the formative stage. We are setting up studios. We have started to define the underlying software infrastructure to deal with that, and we are expanding the different sales processes to see how we can best leverage that technology. So it's a little early for that. We have started doing a number of important demos to learn based on the Web processes that we have developed. So maybe I can report more clearly on that in terms of our close rate and other factors later in the year.

**Patrick Newton** - *Stifel Nicolaus - Analyst*

Okay. And Bob, just to circle back, just kind of chewing on your statement, just on the focus on applications and end-markets and verticals, will you as a Company be starting to disclose revenue trends as you target these markets, or are you just going to be talking about them in generic terms?

**Bob Seidel** - *FARO Technologies, Inc. - VP of Finance and IR*

Really where we are at at this point in the process is we are still internally analyzing what it's going to take us from a financial reporting structure to move to fully vertical reporting. So we are reporting by geographies now and as we continue. Once we get to that point, we will certainly provide you an update when that financial reporting will happen, number one.

Second piece is that as we talk in (inaudible) calls, you will hear more about as we -- about the end-market applications, how we are developing products for those end-market applications and trends. I think you have seen that somewhat over the past several months. One is we released the Robo-Imager. That kind of really much talks about the end-market application there. We will release an HDR scanner. We talked about what we are trying to do for a BIM-CIM market. So I would say that's how you'll see us focused.

**Patrick Newton** - *Stifel Nicolaus - Analyst*

Great. Thank you for taking my questions. Good luck.

**Operator**

Ben Hearnberger, Stephens Inc.

**Unidentified Participant**

This is Brandon in for Ben. First of all, just congrats on the quarter. And hopping right in to my first question, kind of on the top line, given the weak metrics we are seeing in the industrial economy right now, what do you think is really propelling the top line, getting you to high-single-digit growth in the quarter, and is it sustainable?



MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

**Simon Raab** - FARO Technologies, Inc. - CEO and Chairman

Well, apart from working harder and being better focused and defining targets well and working on process and efficiency, I would say that it's hard to tell whether there is a sector change or regional changes in demand. In the past, I've always found FARO sales to be a leading indicator. So maybe there is a slight resurgence, but that's hard to say. But the externally available is contrary.

So I would say that part of the reinvigoration of FARO meant a very clear focus on performance. Every process that we are going through right now is being analyzed. I have to say also that we are very underpenetrated even with an installed base of upwards over 25,000. Let's say our products that the opportunities there are actually hundreds of thousands of products -- of installation. So the lack of penetration means that, irrespective of the economies, we can contribute a lot by being very effective and efficient in how we do our work. So I would say this growth has really got a lot to do with the organization refocusing on doing what it does well, doing it better.

**Unidentified Participant**

Understood. Thanks for the color there. And then just honing in on the scanner sales, I think you kind of spoke about in the queue that maybe this is a little weak. Is that the case? And was this isolated to any particular geo?

**Simon Raab** - FARO Technologies, Inc. - CEO and Chairman

What we indicated in the queue is that we saw slightly lower laser scanner sales across the globe. It was certainly not isolated to any specific geography. One of the things we -- really two pieces of that is we primarily sell into the BIM-CIM market. Some of the sectors that we've seen there have been somewhat affected by the slowdown from the construction projects on the oil and gas side. That's the maybe one factor: the slowdown.

Number two, in parts of the US we've seen some surveying.

I would say the last piece is that we are pushing very hard on the products -- public safety side to try to shorten those lead times. But overall, it was not contained within one specific region. But certainly what you see over the last several months is how we are trying to address it. Is, one, we've come out with the HDR laser scanner and really trying to take that product to the next level. Number two, we've come out with a new version of our SCENE software. So you have seen how the product drumbeat is trying to address those market channels.

Or I should say -- and the scan localizer as well. That's really a product that's really first of its kind. So that's how we are trying to address any shortfalls we have seen over the past several quarters.

**Unidentified Participant**

Got it. That's helpful. Thanks. And then last one just on the OpEx, a couple puts and takes in the quarter there. How should we think about this playing out through the rest of the year given R&D spend for product refresh in this business model revamp? Thanks.

**Simon Raab** - FARO Technologies, Inc. - CEO and Chairman

(inaudible) under normal circumstances, you would expect on the reorganization with hiring new positions, filling all this, that that would be an expense increase. We didn't believe in the first quarter that we would have that, and we don't believe now either that we will have significant changes in that regard primarily because every process in the Company is under examination now for efficiency. You can see the headcount went down, actually, in the quarter. Yet, we have accommodated and adapt to a significant number of requirements for the new organization.

So I think the effects of efficiency evaluations and changes relating to those evaluations will have a predominant effect over any kind of increased spending that we might have to do to take care of the reorg and/or the R&D. So I see no substantive increase in the OpEx.





MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

#### Unidentified Participant

Understood. Thanks for your time.

#### Operator

Richard Eastman, Robert W. Baird.

#### Richard Eastman - Robert W. Baird & Company, Inc. - Analyst

Simon and Bob, could you -- are you willing to disclose the account manager number? I'm curious as you refocus the sales process geographically on verticals, is this -- has it and will it require more account managers? In other words, more direct sales? Could you maybe just speak to that? If you can't give us a number, at least speak to the strategy there in terms of adding more feet on the street? Or does this take less or does it take the same redirected?

#### Simon Raab - FARO Technologies, Inc. - CEO and Chairman

You have a couple of countervailing effects. You have a new process -- a sales process modernization which is intended to, of course, increase the number of demos and the effectiveness of the selling prices and the demos for the existing sales force -- for the sales force as it exists today. We have a certain close ratio over demos.

The other force that contrasts with is the one that when you are increasing them, the verticals and the specialization that you would normally add people. So I think we have two effects.

With regards to the increase of people, we mentioned in the last call that we would be developing emerging verticals using our cooperative management from the existing growing verticals to the emerging one. For example, metrology has been tied to factory automation. So the factory automation staffing has begun from the bottom up, including the product management -- at the product management level. But they are being managed by the metrology management organization.

So, yes, the answer yes to the question will we be adding people for the vertical. Yes, we will. They will be focused on their vertical and speaking to those customers with a particular product line. So, inevitably we were two categories before: measurement and metrology. and 3-D dot. Those have now been split into five, possibly six verticals. So we expect growth there.

At the same time, though, we expect the efficiency and effectiveness of the individuals that we do have in place to increase because of modernization. So the net effect on the sales -- the selling expenses versus sales may even out. It's hard to say at this point which effect will prevail first.

#### Richard Eastman - Robert W. Baird & Company, Inc. - Analyst

And Simon, with the promotion of Kathleen and Joel, again, it kind of effectively eliminated -- at least on paper here -- maybe the senior VP of the Americas and EMEA and AsiaPAC on the sales side. I understand we are focusing on verticals, but do we intend with the same sales management at the vertical level to reach each of the geographies?

#### Simon Raab - FARO Technologies, Inc. - CEO and Chairman

Yes, let me just describe the structure. We will have a global leader, for example, in metrology. That global leader happens to reside in Americas. And under that leadership, there will be an individual responsible for sales, management in Americas, EMEA and AIPAC. So there is now a global



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

leader for that vertical sales across the world. We have separate responsibility by sales management in each of the territories. Clearly, there are differences. There is the time zone. There is the need to be close to the ground. And so that is the current structure. So there will be global accountability, with regional accountability up to the global accountability for each of the verticals.

In addition, it's not what -- it's not specifically in response to your question, but we are -- we do believe that there are regional differences and issues of accountability in the -- each of the regions. So we have a team set up of leadership of important departments in each of the regions which represent the regional accountability issues. While sales, however, is managed globally.

---

**Richard Eastman** - *Robert W. Baird & Company, Inc. - Analyst*

Okay. And then just a -- could you just provide -- this is my last question. Thank you. But could you just provide a little bit added color on the start-up of this early-adopter program in March? Is this -- what does this entail? Does this to entail a sale? How does that look and how is that structured?

---

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

Okay, well, the concept behind it is to emulate an entrepreneurial start-up in the context of a large multinational and complex company with its own inertia. The idea is to re-attain the agility of being a small start-up with disruptive technology, yet without the encumbrances of global rollouts and significant issues of product quality and control that normally are much -- as a global Company, we would be much more vigilant about.

This allows rapid introduction into the marketplace to specific customer groups that are perhaps fault-tolerant and also extremely interested in new technologies. This gives us immediate feedback into the nature of the products that meet the vertical requirements. That allows R&D to be extremely agile in introducing those projects. And what we hope is very quickly those products transition to a global rollout in their second version. And so conceptually, it's about bringing entrepreneurialism back into a larger corporation.

The alternative, which other companies have done, is things like Skunk Works and/or M&A of smaller organizations. And clearly, Skunk Works is a -- an acknowledgment that we can't do anything original inside, so we have to sneak outside to try to do something original. We are trying to institutionalize the entrepreneurialism of small companies in the context of a large company.

---

**Richard Eastman** - *Robert W. Baird & Company, Inc. - Analyst*

And so, again, is this a product, though -- are these products, say, on the metrology side or the scanner side? Are these provided to early adopters, customers that utilize it, provide feedback? Or is this actually -- is it recorded as a sale?

---

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

Yes. These are products that are sold, absolutely. And they would apply to all the verticals. There is an internal mandate to provide early-adopter product introductions in each of the verticals. We are working on the R&D reorganization to make sure that we supply those.

---

**Richard Eastman** - *Robert W. Baird & Company, Inc. - Analyst*

I see. Okay. Okay, well, thank you, and very nice quarter to start the year. Thank you.

---

**Operator**

Mark Jordan, Noble Financial.



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

**Mark Jordan** - *Noble Financial Group - Analyst*

First, I would just like to clarify is it the new policy moving forward that you will not be releasing account reps by geographic region?

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

That is correct.

**Mark Jordan** - *Noble Financial Group - Analyst*

Okay. Second question, could you give us a flavor as to -- say, you had roughly, I think, at the year-end, 100 -- it was 239 account reps. How do you see that account rep base being broken down into the six new verticals that you will be creating on a worldwide basis?

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

As you know, predominantly we are in two categories right now: three-dimensional documentation, and measurement or metrologies. Some of those individuals will be -- and it's very much in discussion right now according to their wishes. And the needs of the vertical are transitioning to some of the other verticals. So there will be some backfilling. Then there will also be some new hires in each of the verticals as a function of how we roll out the new product in the different areas.

So it's very much a bit of a jazz dance at this point. There will be a net increase and account managers overall to get the representation we need. But there is shuffling between the existing and the new verticals.

**Mark Jordan** - *Noble Financial Group - Analyst*

Okay. Final question for me. Could you make any comment as to how you see the seasonality of sales playing out this year? Would you assume that it should follow a similar pattern that you have had in prior years?

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

Yes. It should follow a pattern that we've had in prior years unless we do something extraordinary to change that trend. If you look back over the last few years by quarter as a proportion of sales, it's a fairly consistent pattern. We would suggest that that pattern would continue unless we do something dramatic to change that by a significant increase in growth rate, for example.

So that remains to be seen because we are not sure how successful or how quickly we will be successful with the various initiatives that we are undertaking. But for the moment, I would view seasonality to be consistent with the pattern you have seen in prior years.

**Mark Jordan** - *Noble Financial Group - Analyst*

Thank you.

**Operator**

Josh Sullivan, Sterne Agee Capital.



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

**Josh Sullivan** - *Sterne Agee Capital - Analyst*

I guess one on the Robo-Imager. I think you said that was a first-of-its-kind product in automation. What kind of ROI are your early adopters seeing, or any other tangential details you may have?

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

You want to be more specific, Josh? I'm not sure how to answer that.

**Josh Sullivan** - *Sterne Agee Capital - Analyst*

I'm just trying to get an idea -- you know, you have some of these new products coming out. Just trying to get some understanding on the customer feedback on the automation side. It seems like an interesting product.

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

Right. Well, clearly it was part of the idea of early adopter product introductions means we don't commit to a worldwide global introduction. We introduced at a very measured level in certain specific geographies.

With respect to Robo-Imager, it's very early in that process. We have seen, as I mentioned also in my talk, that FARO has been a Company that in the past reduced the cost and the price of access to small and medium-sized businesses; so, technology which normally could have only been afforded by larger companies.

So we imagine that there's a number of small, medium-sized businesses with serial production in various things that will need the adaptability of a robotic imager to do automated or semi-automated inspections near the line. That's our aspiration.

The very reason it's in an early-adopter introductory phase is, in fact, to find out what that interest is like. I was at the Control show in Stuttgart, Germany, last week, and there was a great deal of interest around it as well as on the Cobalt imager for the arrays and/or the arrays on larger robots.

So it is very much a new foray for us. The product is unique in that you can put multiple imagers on a single computer, which is unique in a industry, which provides you the ability to create arrangements that don't require robotics and only require one computer. So it's a bit of a new wave in factory automation. And this is all an experiment. I think that we can speak to the reception to it probably in the next couple of quarters.

**Josh Sullivan** - *Sterne Agee Capital - Analyst*

Okay. Got it. Thanks. Then I guess just one on the M&A front. What is your strategic focus as it stands?

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

Our strategic focus there is to -- as I mentioned in the last call, we have a number of opportunities which have emerged because we have now segregated our interests in a number of verticals. So I can say that our M&A process is active and bigger. And obviously we will be announcing those as they occur.

**Josh Sullivan** - *Sterne Agee Capital - Analyst*

All right. Thank you.



MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

## Operator

(Operator Instructions) Hendi Susanto, Gabelli and Company.

## Hendi Susanto - Gabelli & Co. - Analyst

Great Q1 results, by the way. With respect to strong in-service revenue, how should we think of the strength in warranty sales in Q1 among new purchases or accessing installed base?

## Bob Seidel - FARO Technologies, Inc. - VP of Finance and IR

Well, first of all, we don't necessarily provide guidance as to forward-looking quarters. But in terms of -- I would believe that if you look back over the course of our history, you will see the percentage of the total revenue service. I did mention previously that we are actively driving to sell (inaudible) sale and then, on a renewable basis, our warranties. So that is actively something that our sales team -- our inside sales team is working on each and every day. But I'm not going to provide a forward-looking guidance for you.

## Hendi Susanto - Gabelli & Co. - Analyst

Okay. I didn't mean the forward-looking guidance. Is it reasonable to assume that your strategic focus on warranty is more geared toward renewal and new purchases?

## Bob Seidel - FARO Technologies, Inc. - VP of Finance and IR

It is absolutely. We have initiatives across our Company that we make sure that we reach out to those customers whose warranties after the plan of sale are expiring, that we reach out. We remind them that -- and try to renew their contracts. So there's absolutely a piece of revenue that we do not want to leave off the table. We want to bring that forward. And we have inside sales working actively every day to do that.

## Hendi Susanto - Gabelli & Co. - Analyst

And I have one question for Simon. What is your assessment on your key verticals for 2016?

## Simon Raab - FARO Technologies, Inc. - CEO and Chairman

How do you mean assessment?

## Hendi Susanto - Gabelli & Co. - Analyst

What are you seeing in the market?

## Simon Raab - FARO Technologies, Inc. - CEO and Chairman

Okay. Well, it's kind of a passive situation right now because we try to deduce from our installed base where primary interest lies. So the verticals we've selected are metrology, obviously. We have expanded metrology to clearly include both the building and verifying, so it's metrology build and verify. We also have factory automation, which is an outgrowth of that. Something that we started to touch on with the new product introduction. So, factory automation would be number two, and it is also build and verify.



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

Then we have the AEC market, which was, in our opinion, a little bit too broad and conflicted with the idea of surveying. So we are not a surveying Company, but we are building information and modeling companies. So, we have focused that on the BIM-CIM side of the AEC market.

In addition, you find public safety is one of our primary verticals. And we've done, as you know, acquisitions and product introductions around that. We've also had the -- of course, the product design, which is one of the areas that a lot of our products have been used for for reverse engineering. But, clearly, differentiated from the demand of the metrology market. So we find product design is one of those verticals.

If you want to review the script from the year-end conference call, in there I give a fairly detailed review of how the verticals are decided upon.

And the sixth one would be the services market. As you can see, our service revenue and warranty revenue increase. As part of expanding that, we want to do specific product development, 3-D services and provide access to early product concepts through that.

---

**Hendi Susanto** - *Gabelli & Co. - Analyst*

Okay. And then would you be able to share more colors on weaknesses in 3-D documentation sales in Q1 and the higher ASP?

---

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

In terms of really the -- let me start by the ASP side. First of all, it was (inaudible) for several different models out there in the marketplace. One is our X30, one is our X130, the other is our higher-priced model X330. So one of the things certainly we tried to do on our sales approach is try to correctly fit that -- our product key application. One of the things we have seen over the course of the last several quarters, we have seen a shift to that X330 based on the needs of the external market. So that does help our average selling price because it's about \$10,000 or so higher than our X130. That's the ASP side.

And also as we shift away from distribution, what you will see is that you will see an increase in our average selling price. But then that is somewhat offset by the commissions and the sales and marketing lines. So I would say two factors. One is a model shift, and then number two is just the movement towards the direct.

In terms of the demand side, we are trying to actively address that in terms of scanning localizer, in terms of the HDR. But one of the things we are impacted is certainly by macro conditions. We are certainly impacted by some sector conditions. As I said before, there were parts of our EMEA business that were affected by oil and gas. They are somewhat affected in the US by surveying. But certainly what we are trying to do to address that is find other places in the market for this early-adopter technology, really. And in there's a lot of applications out there that we will be looking at to really penetrate further those applications.

---

**Hendi Susanto** - *Gabelli & Co. - Analyst*

That's helpful. Thank you.

---

**Operator**

(Operator Instructions) And it appears we have no further questions at this time. I would like to turn the call over to our presenters for any additional or closing remarks.

---

**Simon Raab** - *FARO Technologies, Inc. - CEO and Chairman*

Okay. We just wanted to say thank you very much for all the attendees, your questions, and we look forward to talk to you in Q2.



## MAY 04, 2016 / 12:30PM, FARO - Q1 2016 FARO Technologies Inc Earnings Call

**Operator**

This does conclude today's call. We appreciate your participation. You may disconnect at any time and have (technical difficulty).

**DISCLAIMER**

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2016, Thomson Reuters. All Rights Reserved.

