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

FORM 10-Q

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

For the quarterly period ended October 3, 2009

OR

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

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)

250 Technology Park, Lake Mary, Florida
(Address of principal executive offices)

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

32746
(Zip Code)

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

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

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

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

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

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

As of November 2, 2009, there were 16,102,331 shares of the registrant's common stock outstanding.

FARO TECHNOLOGIES, INC.

Quarterly Report on Form 10-Q
Quarter Ended October 3, 2009

INDEX

	<u>PAGE NUMBER</u>
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
a) Consolidated Balance Sheets As of October 3, 2009 (Unaudited) and December 31, 2008	3
b) Consolidated Statements of Operations (Unaudited) For the Three and Nine Months Ended October 3, 2009 and September 27, 2008	4
c) Consolidated Statements of Cash Flows (Unaudited) For the Nine Months Ended October 3, 2009 and September 27, 2008	5
d) Notes to Consolidated Financial Statements (Unaudited) For the Nine Months Ended October 3, 2009 and September 27, 2008	6-14
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	15-24
Item 3. Quantitative and Qualitative Disclosures about Market Risk	24
Item 4. Controls and Procedures	25
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	26-27
Item 1A. Risk Factors	27
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	27
Item 6. Exhibits	28
SIGNATURES	29
CERTIFICATIONS	30-33

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

<u>(in thousands, except share data)</u>	<u>October 3, 2009</u>	<u>December 31, 2008</u>
	Unaudited	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 27,401	\$ 23,494
Short-term investments	64,979	81,965
Accounts receivable, net	35,697	49,713
Inventories	28,212	33,444
Deferred income taxes, net	4,541	5,581
Prepaid expenses and other current assets	12,225	7,879
Total current assets	<u>173,055</u>	<u>202,076</u>
Property and Equipment:		
Machinery and equipment	19,557	22,685
Furniture and fixtures	5,250	4,099
Leasehold improvements	9,399	3,956
Property and equipment at cost	34,206	30,740
Less: accumulated depreciation and amortization	(19,800)	(16,604)
Property and equipment, net	<u>14,406</u>	<u>14,136</u>
Goodwill	19,822	18,951
Intangible assets, net	8,199	8,580
Service inventory	12,751	12,843
Deferred income taxes, net	1,909	2,728
Total Assets	<u>\$ 230,142</u>	<u>\$ 259,314</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 5,460	\$ 10,813
Accrued liabilities	8,368	14,032
Income taxes payable	—	1,988
Current portion of unearned service revenues	11,551	11,501
Customer deposits	626	425
Current portion of obligations under capital leases	27	87
Total current liabilities	26,032	38,846
Unearned service revenues - less current portion	5,591	6,772
Deferred tax liability, net	1,152	1,107
Obligations under capital leases - less current portion	285	281
Total Liabilities	<u>33,060</u>	<u>47,006</u>
Commitments and contingencies - See Note R		
Shareholders' Equity:		
Common stock - par value \$.001, 50,000,000 shares authorized; 16,793,289 and 16,741,488 issued; 16,102,331 and 16,658,552 outstanding, respectively	17	17
Additional paid-in-capital	151,487	149,298
Retained earnings	47,537	57,497
Accumulated other comprehensive income	7,116	5,742
Common stock in treasury, at cost - 680,235 and 55,808 shares, respectively	(9,075)	(246)
Total Shareholders' Equity	<u>197,082</u>	<u>212,308</u>
Total Liabilities and Shareholders' Equity	<u>\$ 230,142</u>	<u>\$ 259,314</u>

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

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

<u>(in thousands, except share and per share data)</u>	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>Oct 3, 2009</u>	<u>Sep 27, 2008</u>	<u>Oct 3, 2009</u>	<u>Sep 27, 2008</u>
SALES				
Product	\$ 27,876	\$ 41,100	\$ 79,292	\$ 131,019
Service	<u>7,837</u>	<u>7,995</u>	<u>22,385</u>	<u>21,915</u>
Total Sales	<u>35,713</u>	<u>49,095</u>	<u>101,677</u>	<u>152,934</u>
COST OF SALES				
Product	11,261	14,223	30,647	43,804
Service	<u>4,850</u>	<u>5,863</u>	<u>15,805</u>	<u>16,176</u>
Total Cost of Sales (exclusive of depreciation and amortization, shown separately below)	<u>16,111</u>	<u>20,086</u>	<u>46,452</u>	<u>59,980</u>
GROSS PROFIT	19,602	29,009	55,225	92,954
OPERATING EXPENSES:				
Selling	11,482	15,382	36,434	46,886
General and administrative	6,158	6,614	18,591	19,274
Depreciation and amortization	1,410	1,158	4,090	3,293
Research and development	<u>2,802</u>	<u>3,237</u>	<u>9,566</u>	<u>9,122</u>
Total operating expenses	<u>21,852</u>	<u>26,391</u>	<u>68,681</u>	<u>78,575</u>
(LOSS) INCOME FROM OPERATIONS	<u>(2,250)</u>	<u>2,618</u>	<u>(13,456)</u>	<u>14,379</u>
OTHER (INCOME) EXPENSE				
Interest income	(31)	(547)	(225)	(1,624)
Other (income) expense, net	(183)	652	(359)	834
Interest expense	<u>3</u>	<u>2</u>	<u>9</u>	<u>450</u>
(LOSS) INCOME BEFORE INCOME TAX (BENEFIT) EXPENSE	<u>(2,039)</u>	<u>2,511</u>	<u>(12,881)</u>	<u>14,719</u>
INCOME TAX (BENEFIT) EXPENSE	<u>(766)</u>	<u>500</u>	<u>(2,919)</u>	<u>2,965</u>
NET (LOSS) INCOME	<u>\$ (1,273)</u>	<u>\$ 2,011</u>	<u>\$ (9,962)</u>	<u>\$ 11,754</u>
NET (LOSS) INCOME PER SHARE - BASIC	<u>\$ (0.08)</u>	<u>\$ 0.12</u>	<u>\$ (0.62)</u>	<u>\$ 0.71</u>
NET (LOSS) INCOME PER SHARE - DILUTED	<u>\$ (0.08)</u>	<u>\$ 0.12</u>	<u>\$ (0.62)</u>	<u>\$ 0.70</u>
Weighted average shares - Basic	<u>16,093,759</u>	<u>16,637,497</u>	<u>16,131,680</u>	<u>16,624,784</u>
Weighted average shares - Diluted	<u>16,093,759</u>	<u>16,731,064</u>	<u>16,131,680</u>	<u>16,751,679</u>

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

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

<u>(in thousands)</u>	<u>Nine Months Ended</u>	
	<u>October 3,</u> <u>2009</u>	<u>September 27,</u> <u>2008</u>
CASH FLOWS FROM:		
OPERATING ACTIVITIES:		
Net (loss) income	\$ (9,962)	\$ 11,754
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	4,090	3,293
Compensation for stock options and restricted stock units	1,827	1,686
Provision for bad debts	961	446
Deferred income tax expense (benefit)	1,919	(1,575)
Change in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	14,040	9,198
Inventories	6,202	(9,681)
Prepaid expenses and other current assets	(4,234)	(2,369)
Income tax benefit from exercise of stock options	(2)	(45)
Increase (decrease) in:		
Accounts payable and accrued liabilities	(11,220)	(7,654)
Income taxes payable	(1,965)	(771)
Customer deposits	186	(11)
Unearned service revenues	(1,490)	2,671
Net cash provided by operating activities	<u>352</u>	<u>6,942</u>
INVESTING ACTIVITIES:		
Purchases of property and equipment	(2,919)	(4,377)
Payments for intangible assets	(504)	(3,584)
Purchases of short-term investments	(64,979)	(4,995)
Proceeds from sales of short-term investments	81,965	—
Net cash provided by (used in) investing activities	<u>13,563</u>	<u>(12,956)</u>
FINANCING ACTIVITIES:		
Payments on capital leases	(55)	(68)
Income tax benefit from exercise of stock options	2	45
Repurchases of common stock	(8,829)	—
Proceeds from issuance of stock, net	45	128
Net cash (used in) provided by financing activities	<u>(8,837)</u>	<u>105</u>
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	<u>(1,171)</u>	<u>271</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>3,907</u>	<u>(5,638)</u>
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	<u>23,494</u>	<u>25,798</u>
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 27,401</u>	<u>\$ 20,160</u>

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Nine Months Ended October 3, 2009 and September 27, 2008
(Unaudited)
(in thousands, except share and per share data or as otherwise noted)

NOTE A – DESCRIPTION OF BUSINESS

FARO Technologies, Inc. and its subsidiaries (collectively, the “Company” or “FARO”) design, develop, manufacture, market and support software-based three-dimensional measurement devices for manufacturing, industrial, building construction and forensic applications. The Company’s principal products include the FaroArm, FARO Laser ScanArm and FARO Gage, all articulated electromechanical measuring devices, and the FARO Laser Tracker and FARO Laser Scanner LS, both laser-based measuring devices. Primary markets for the Company’s products include automobile, aerospace, heavy equipment, light manufacturing, and machine shops. The Company sells the vast majority of its products through a direct sales force located in many of the world’s largest industrialized countries.

NOTE B – PRINCIPLES OF CONSOLIDATION

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

NOTE C – BASIS OF PRESENTATION

The consolidated financial statements of the Company include all normal recurring accruals and adjustments considered necessary by management for their fair presentation in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”). Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. The consolidated results of operations for the three and nine months ended October 3, 2009 are not necessarily indicative of results that may be expected for the year ending December 31, 2009 or any future period.

The information included in this Quarterly Report on Form 10-Q, including the interim consolidated financial statements and the accompanying notes, should be read in conjunction with the audited consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

NOTE D – RECLASSIFICATIONS

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

NOTE E – IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

As of January 1, 2008, the Company adopted the Financial Accounting Standards Board (the “FASB”) Accounting Standards Codification (“ASC”) 820-10 (formerly Statement of Financial Accounting Standards “SFAS” 157), “Fair Value Measurements and Disclosures” This statement defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP 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 Company previously adopted the provisions of this pronouncement for its financial assets and liabilities as of January 1, 2008. Effective January 1, 2009, the Company adopted ASC 820-10 for all non-financial assets and liabilities measured at fair value on a non-recurring basis. The adoption of ASC 820-10 did not have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

As of January 1, 2009, the Company adopted FASB ASC 805-20 (formerly SFAS 141 and 141 Revised), “Business Combinations - Identifiable Assets and Liabilities, and Any Noncontrolling Interest” (“ASC 805-20”). ASC 805-20 establishes that an acquirer must 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 consummated 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 ASC 805-20 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 adoption of ASC 805-20 had no impact on the Company’s financial position or results of operations.

As of January 1, 2009, the Company adopted FASB ASC 810-10 (formerly SFAS No. 160), “Consolidation” (“ASC 810-10”). ASC 810-10 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. ASC 810-10 is effective prospectively, except for certain retrospective disclosure requirements, for fiscal years beginning after December 15, 2008. The adoption of ASC 810-10 had no impact on the Company’s financial position or results of operations.

As of January 1, 2009, the Company adopted FASB ASC 815-10 (formerly SFAS No. 161), “Derivatives and Hedging” (“ASC 815-10”). This statement requires enhanced disclosures about an entity’s derivative and hedging activities. ASC 815-10 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of ASC 815-10 had no impact on the Company’s consolidated financial statements.

In April 2009, FASB issued FASB Staff Position (“FSP”) FAS 107-1 and Accounting Principles Board (“APB”) APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments” which is now codified in ASC 825-10. ASC 825-10 superseded FAS No. 107-1, “Disclosures About Fair Value of Financial Instruments,” to require disclosures about fair value of financial instruments of publicly traded companies for interim reporting, as well as in annual financial statements. ASC 825-10 also superseded APB Opinion No. 28, “Interim Financial Reporting,” to require those disclosures in summarized financial information at interim reporting periods. ASC 825-10 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. ASC 825-10 does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, ASC 825-10 requires comparative disclosures only for periods ending after initial adoption. The adoption of ASC 825-10 had no impact on the Company’s consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, now codified in ASC 855-10, “Subsequent Events”, which addresses the types and timing of events that should be reported in the financial statements for events occurring between the balance sheet date and the date the financial statements are issued or available to be issued. ASC 855-10 was effective for the Company on July 4, 2009. The Company reviewed events for inclusion in the financial statements through November 4, 2009, the date that the accompanying financial statements were issued. The adoption of ASC 855-10 had no impact on the Company’s consolidated financial statements.

[Table of Contents](#)

In June 2009, the FASB issued SFAS 168, which is now codified in ASC 105-10, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles”. ASC 105-10 establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with U.S. GAAP. ASC 105-10 is effective for financial statements issued for interim and annual periods ending after September 15, 2009 and was adopted, accordingly, for the current fiscal reporting period. The adoption of ASC 105-10 supersedes all references to pre-codification standards and had no impact on the Company’s consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update (“ASU”) 2009-13, which amends ASC Topic 605, “Revenue Recognition”. The guidance relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting and modifies the manner in which the transaction consideration is allocated across the individual deliverables. Also, the guidance expands the disclosure requirements for revenue arrangements with multiple deliverables. ASU 2009-13 will be effective beginning on January 1, 2011, and may be applied retrospectively for all periods presented or prospectively to arrangements entered into or materially modified after the adoption date. The Company does not expect this amendment to have a material impact on the Company’s consolidated financial statements.

NOTE F – SHARE-BASED COMPENSATION

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

The Company used the following assumptions for the Black-Scholes option-pricing model to determine the fair value of options granted during the nine months ended October 3, 2009 and September 27, 2008:

	For the Nine Months Ended	
	October 3, 2009	September 27, 2008
Risk-free interest rate	1.38% and 1.44%	2.15 - 3.04%
Expected dividend yield	0%	0%
Expected option life	4 years	4 years
Expected volatility	48.3%	54.7% and 58%

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

The Company recorded total share-based compensation expense of \$626 and \$626 for the three months ended October 3, 2009 and September 27, 2008, respectively, and \$1,827 and \$1,686 for the nine months ended October 3, 2009 and September 27, 2008, respectively.

[Table of Contents](#)

A summary of stock option activity and weighted average exercise prices for the nine months ended October 3, 2009 follows:

	<u>Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value as of October 3, 2009</u>
Outstanding at beginning of period	949,572	\$ 22.48		
Granted	258,607	13.06		
Forfeited	(128,160)	18.83		
Exercised	(5,750)	7.78		
Outstanding at October 3, 2009	<u>1,074,269</u>	<u>\$ 20.73</u>	<u>5.53</u>	<u>\$ 1,937</u>
Options exercisable at October 3, 2009	<u>724,508</u>	<u>\$ 20.92</u>	<u>5.18</u>	<u>\$ 1,191</u>

The weighted-average grant-date fair value of the stock options granted during the nine months ended October 3, 2009 and September 27, 2008 was \$5.08 and \$14.06 per option, respectively. The total intrinsic value of stock options exercised and the fair value of stock options vested during the three months ended October 3, 2009 and September 27, 2008 were less than \$0.1 million respectively. The total intrinsic value of stock options exercised during the nine months ended October 3, 2009 and September 27, 2008 was \$0.0 million and \$0.1 million, respectively. The total fair value of stock options vested during the nine months ended October 3, 2009 and September 27, 2008 was \$1.7 million and \$0.8 million, respectively.

The following table summarizes the restricted stock and restricted stock unit activity and weighted average grant-date fair values for the nine months ended October 3, 2009:

	<u>Shares</u>	<u>Weighted-Average Grant Date Fair Value</u>
Non-vested at beginning of period	52,660	\$ 26.69
Granted	57,955	14.45
Forfeited	(24,121)	18.83
Vested	(22,999)	26.12
Non-vested at October 3, 2009	<u>63,495</u>	<u>\$ 18.61</u>

As of October 3, 2009, there was \$2.9 million of total unrecognized stock-based compensation expense related to non-vested stock-based compensation arrangements. The expense is expected to be recognized over a weighted average period of 1.6 years.

NOTE G – SUPPLEMENTAL CASH FLOW INFORMATION

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

	<u>Nine Months Ended</u>	
	<u>October 3, 2009</u>	<u>September 27, 2008</u>
Cash paid for interest	\$ 9	\$ 4
Cash paid for income taxes	\$ 2,090	\$ 6,600
Non-Cash Activity:		
Value of Shares issued for acquisition of iQvolution	\$ 317	\$ 433

[Table of Contents](#)**NOTE H – CASH AND CASH EQUIVALENTS**

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

NOTE I – SHORT TERM INVESTMENTS

Short-term investments at October 3, 2009 include U.S. Treasury Bills totaling \$65.0 million that mature through March 18, 2010. The interest rate on the U.S. Treasury Bills is less than one percent. The investments are classified as held-to-maturity and recorded at cost. The fair value of the U.S. Treasury Bills at October 3, 2009 approximated cost.

NOTE J – ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	As of October 3, 2009	As of December 31, 2008
Accounts receivable	\$ 38,039	\$ 51,440
Allowance for doubtful accounts	(2,342)	(1,727)
Total	\$ 35,697	\$ 49,713

NOTE K – INVENTORIES

Inventories consist of the following:

	As of October 3, 2009	As of December 31, 2008
Raw materials	\$ 9,718	\$ 11,997
Finished goods	3,129	6,597
Sales demonstration inventory	17,184	16,321
Reserve for excess and obsolete	(1,819)	(1,471)
Inventory	\$ 28,212	\$ 33,444
Service inventory	\$ 12,751	\$ 12,843

NOTE L – EARNINGS PER SHARE

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

	Three Months Ended				Nine Months Ended			
	October 3, 2009		September 27, 2008		October 3, 2009		September 27, 2008	
	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	16,093,759	\$ (0.08)	16,637,497	\$ 0.12	16,131,680	\$ (0.62)	16,624,784	\$ 0.71
Effect of dilutive securities	—	—	93,567	—	—	—	126,895	(0.01)
Diluted EPS	16,093,759	\$ (0.08)	16,731,064	\$ 0.12	16,131,680	\$ (0.62)	16,751,679	\$ 0.70

[Table of Contents](#)

The effect of 1,074,269 and 293,402 shares were not included for the three months ended October 3, 2009 and September 27, 2008, respectively, and 1,074,269 and 285,936 shares were not included for the nine months ended October 3, 2009 and September 27, 2008, respectively, as they were antidilutive.

NOTE M – ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	As of <u>October 3, 2009</u>	As of <u>December 31, 2008</u>
Accrued compensation and benefits	\$ 4,558	\$ 7,533
Accrued warranties	1,117	2,381
Professional and legal fees	1,071	742
Other accrued liabilities	1,622	3,376
	<u>\$ 8,368</u>	<u>\$ 14,032</u>

NOTE N – INCOME TAXES

Total deferred tax assets for the Company's foreign subsidiaries relating to net operating loss carryforwards were \$11.6 million and \$10.2 million at October 3, 2009 and December 31, 2008, respectively. The related valuation allowance was \$10.1 million and \$8.7 million at October 3, 2009 and December 31, 2008, respectively. The Company's effective tax benefit rate was 22.7% for the nine months ended October 3, 2009 compared with an effective tax rate of 20.1% for the nine months ended September 27, 2008. The Company's tax rate continues to be lower than the statutory tax rate in the United States, primarily as a result of favorable tax rates in foreign jurisdictions. Significant judgment is required in determining the Company's worldwide provision for income taxes. In the ordinary course of a global business, there are many transactions for which the ultimate tax outcome is uncertain. The Company reviews its tax contingencies on a regular basis and makes appropriate accruals as necessary.

The effective income tax rates for 2009 and 2008 include a reduction in the statutory corporate tax rates for the Company's operations in Switzerland, as a result of a favorable income tax rate commitment from the Swiss government as an incentive to establish a manufacturing plant there. The favorable tax rate ruling requires the Company to maintain a certain level of manufacturing operations in Switzerland. The aggregate dollar effect of this favorable tax rate was approximately \$0.3 million, or \$0.02 per share, in the nine month period ended October 3, 2009, and \$1.8 million, or \$0.11 per share, in the nine month period ended September 27, 2008.

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, with 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 \$0.8 million, or \$0.04 per share, during the nine month period ended October 3, 2009, and \$1.2 million, or \$0.07 per share, in the nine month period ended September 27, 2008.

NOTE O – 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.

NOTE P – SEGMENT REPORTING

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

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

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

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>October 3, 2009</u>	<u>September 27, 2008</u>	<u>October 3, 2009</u>	<u>September 27, 2008</u>
Americas Region				
Net sales to external customers	\$ 13,713	\$ 18,386	\$ 38,506	\$ 57,721
Operating loss	(2,718)	(2,913)	(12,280)	(3,134)
Long-lived assets	21,925	17,677	21,925	17,677
Capital expenditures	312	1,899	2,492	3,034
Total assets	135,774	153,948	135,774	153,948
Europe/Africa Region				
Net sales to external customers	\$ 14,594	\$ 21,530	\$ 42,032	\$ 67,411
Operating (loss) income	(82)	3,294	(3,502)	10,841
Long-lived assets	18,521	18,846	18,521	18,846
Capital expenditures	105	424	444	1,297
Total assets	66,873	72,670	66,873	72,670
Asia Pacific Region				
Net sales to external customers	\$ 7,406	\$ 9,179	\$ 21,139	\$ 27,802
Operating income	550	2,237	2,326	6,672
Long-lived assets	1,981	1,399	1,981	1,399
Capital expenditures	45	158	489	246
Total assets	27,495	26,169	27,495	26,169
Totals				
Net sales to external customers	\$ 35,713	\$ 49,095	\$ 101,677	\$ 152,934
Operating (loss) income	(2,250)	2,618	(13,456)	14,379
Long-lived assets	42,427	37,922	42,427	37,922
Capital expenditures	462	2,481	3,425	4,577
Total assets	230,142	252,787	230,142	252,787

NOTE Q – COMPREHENSIVE INCOME (LOSS)

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>Oct 3, 2009</u>	<u>Sep 27, 2008</u>	<u>Oct 3, 2009</u>	<u>Sep 27, 2008</u>
NET INCOME (LOSS)	\$ (1,273)	\$ 2,011	\$ (9,962)	\$ 11,754
OTHER COMPREHENSIVE INCOME (LOSS):				
Currency translation adjustments	2,247	(3,621)	1,374	847
COMPREHENSIVE INCOME (LOSS)	<u>\$ 974</u>	<u>\$ (1,610)</u>	<u>\$ (8,588)</u>	<u>\$ 12,601</u>

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

NOTE R – COMMITMENTS AND CONTINGENCIES

Leases—The Company is a party to leases arising in the normal course of business that expire on or before 2014. Total obligations under these leases are approximately \$5.4 million for 2009.

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 October 3, 2009, the Company does not have any long-term commitments for purchases.

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. The Lead Plaintiff sought 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 sought 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.

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. On April 9, 2008, the parties filed a detailed Stipulation 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 paid \$6.875 million into a settlement fund for the Securities Litigation. That sum is within the coverage limit of the policy and, accordingly, has no effect on the Company’s financial results. On October 3, 2008, the court entered a Final Judgment and Order of Dismissal With Prejudice, whereby the court certified the Class for purposes of the settlement, approved the settlement, and dismissed the Securities Litigation, with prejudice, as against each defendant.

Derivative Action—On January 10, 2008, a Verified Shareholder 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 Action”). The Derivative Action 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. In February 2008 and April 2008, the Company received two demands by other alleged shareholders against seven of the Company’s current and former directors that asserted substantially the same claims as set forth in the Derivative Action. Both of those demands subsequently were withdrawn.

[Table of Contents](#)

On November 12, 2008, the parties to the Derivative Action executed a Memorandum of Understanding of the material terms of a proposed settlement of the Derivative Action. On January 21, 2009, the parties filed with the court a Stipulation of Settlement seeking the court's preliminary and final approval of the terms of the proposed settlement. On February 13, 2009, the court granted preliminary approval of the settlement. On April 23, 2009, the court granted final approval of the settlement and entered an Order and Final Judgment directing the consummation of the settlement and dismissing the Derivative Action, with prejudice, as against each defendant. Pursuant to the terms of the settlement, the Company has adopted certain corporate governance policies for a period of three years, and the issuer of the Company's Executive Liability and Entity Securities Liability insurance policy applicable to the Derivative Action has paid \$400,000 to the plaintiff's counsel for their fees and expenses. That sum is within the coverage limit of the policy and accordingly has no effect on the Company's financial results.

Patent Matters—On July 11, 2008, a complaint for patent infringement was filed against the Company in the U.S. District Court for the District of Massachusetts by Metris USA, Inc. and certain of its affiliates (collectively, "Metris") concerning U.S. Patent Nos. 6,611,617 and 7,313,264. The patents are generally directed to laser scanning devices. The complaint was served on November 5, 2008. The Company responded with counterclaims alleging that the asserted patents are invalid, non-infringed, and unenforceable due to fraud during prosecution of the patents in the U.S. Patent and Trademark Office. On August 31, 2009, the Court granted the Company's motion to add counterclaims and defenses for violation of federal and state antitrust and unfair competition laws based on the alleged knowing assertion of invalid and fraudulent patents. Discovery in the case is ongoing, and no trial date has been set. On October 8, 2009, the Court held a "Markman" hearing for the purpose of construing the claim language of the asserted patents. No final order on claim construction has yet issued. The Company believes that it does not infringe the asserted patents and/or that the patents are invalid. The Company currently does not anticipate this lawsuit will have a material impact on the Company's business, financial condition or results of operations. However, the outcome is difficult to predict and an adverse determination may have a material impact on the Company's business, financial condition or results of operations.

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, none of which the Company believes will have a material adverse effect on the Company's business, financial condition or results of operations.

NOTE S – LINE OF CREDIT

On July 11, 2006, the Company entered into a loan agreement providing for an available line of credit of \$30.0 million, which was most recently amended on June 18, 2009. Loans under the Amended and Restated Loan Agreement, as amended, bear interest at the rate of LIBOR plus a fixed percentage between 2.25% and 2.50%, and require the Company to maintain a minimum cash balance and tangible net worth, measured at the end of each of the Company's fiscal quarters. As of October 3, 2009, the Company was in compliance with all of the covenants under the Amended and Restated Loan Agreement, as amended. The term of the Amended and Restated Loan Agreement, as amended, extends to March 31, 2012. The Company has not drawn on this line of credit.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following information should be read in conjunction with the Financial Statements, including the notes thereto, included elsewhere in this Quarterly Report on Form 10-Q, and Management’s Discussion and Analysis of Financial Condition and Results of Operations included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2008.

Forward Looking Statements

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. Specifically, this Quarterly Report on Form 10-Q contains, among others, forward-looking statements regarding:

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

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

- the slowdown in the manufacturing industry or the domestic and international economies in the regions of the world where the Company operates;
- the Company’s inability to further penetrate its customer base;

[Table of Contents](#)

- development by others of new or improved products, processes or technologies that make the Company's products obsolete or less competitive;
- the cyclical nature of the industries of the Company's customers and material adverse changes in its customers access to liquidity and capital;
- 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;
- 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 maintain 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;
- 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;
- variations in the effective income tax rate and the difficulty in predicting the tax rate on a quarterly and annual basis;
- the loss of key suppliers and the inability to find sufficient alternative suppliers in a reasonable period or on commercially reasonable terms; and
- other risks and uncertainties discussed in Part I, Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

Overview

The Company designs, develops, manufactures, markets and supports portable, software driven, 3-D measurement and imaging systems used in a broad range of manufacturing, industrial, building construction and forensic applications. The Company's FaroArm, FARO Laser ScanArm and FARO Gage articulated measuring devices, the FARO Laser 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. 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 October 3, 2009, the Company's products have been purchased by approximately 9,800 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 America International, Lockheed Martin, Nissan, Siemens and Volkswagen, among many others.

The Company derives revenues primarily from the sale of its FaroArm, FARO Laser ScanArm, FARO Gage, FARO Laser Tracker and FARO 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.

[Table of Contents](#)

The Company operates in international markets throughout the world. It maintains sales offices in China, France, Germany, Great Britain, Italy, India, Japan, Malaysia, Netherlands, Poland, Spain, Singapore and Vietnam. The Company manages and reports its global sales in three regions: the Americas, Europe/Africa and Asia/Pacific. In the nine months ended October 3, 2009, 37.9% of the Company's sales were in the Americas compared to 37.7% in the first nine months of 2008, 41.3% were in the Europe/Africa region compared to 44.1% in the first nine months of 2008, and 20.8% were in the Asia/Pacific region compared to 18.2% in the same prior year period. In the third quarter of 2009, new order bookings decreased \$13.4 million, or 27.2%, to \$35.8 million from \$49.2 million in the prior year period. New orders decreased \$3.6 million, or 20.5%, in the Americas to \$14.0 million from \$17.6 million in the prior year period. New orders decreased \$7.0 million, or 32.1%, to \$14.8 million in Europe/Africa from \$21.8 in the third quarter of 2008. In Asia/Pacific, new orders decreased \$2.8 million, or 28.6%, to \$7.0 million from \$9.8 million in the third quarter of 2008.

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 volume requirements through 2009.

The Company's effective tax benefit rate was 22.7% for the nine months ended October 3, 2009 compared with an effective tax rate of 20.1% in the prior year period. The Company's tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company's tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products. The Company has received a favorable income tax rate commitment from the Swiss government as an incentive to establish a manufacturing plant in Switzerland. In addition, in 2006, the Company received approval from the Singapore Economic Development Board for a favorable multi-year income tax holiday for its Singapore headquarters and manufacturing operations, subject to certain terms and conditions including employment, spending and capital investment.

The Company accounts for wholly owned foreign subsidiaries 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 Item 3. Foreign Exchange Exposure below). However, it does not regularly use such instruments, and none were utilized in 2008 or the nine months ended October 3, 2009.

The Company implemented three reductions-in-force during the nine month period ended October 3, 2009 to lower costs in view of the effects of deteriorating global economic conditions. The first reduction-in-force was announced on February 20, 2009, and affected approximately 7% of the Company's workforce. As a result of this first reduction-in-force, the Company expects to save approximately \$4.5 million in compensation costs on an annualized basis. Severance costs related to the first reduction-in-force equaled \$0.7 million. The second reduction-in-force, effective April 3, 2009, was announced on April 6, 2009, and affected approximately 14% of the Company's workforce. As a result of this second reduction-in-force, the Company expects to save \$7.4 million in compensation costs on an annualized basis. Severance costs for the second reduction-in-force were \$1.0 million. The third reduction-in-force was effective August 24, 2009, and affected approximately 8% of the Company's workforce. As a result of this third reduction-in-force, the Company expects to save approximately \$4.1 million in compensation costs on an annualized basis. Severance costs for the third reduction-in-force were \$0.6 million.

[Table of Contents](#)

The Company incurred a net loss in the quarter and nine months ended October 3, 2009, primarily as a result of a decrease in product sales. The Company attributes the decrease in product sales principally to the deterioration of the global economy. Prior to 2009, the Company had a history of sales and earnings growth and 26 consecutive profitable quarters through December 31, 2008. Its sales and earnings growth were the result of a number of factors, including: continuing market demand for and acceptance of the Company's products; increased sales activity in part through additional sales staff worldwide, new products and product enhancements such as the FARO Gage and FARO Laser Scanner LS; and the effect of acquisitions. However, the Company's historical financial performance is not indicative of its future financial performance and the Company can offer no assurance as to when or if it will be profitable again in the future.

FCPA Update

As previously reported by the Company, the Company conducted an internal investigation in 2006 into certain payments made by its China subsidiary that may have violated the Foreign Corrupt Practices Act ("FCPA") and other applicable laws (the "FCPA Matter") and entered into settlement agreements and documents with the U.S. Securities and Exchange Commission (the "SEC") and the U.S. Department of Justice (the "DOJ") in 2008 related to the FCPA Matter. The Company incurred expenses of \$3.8 million in 2006, \$3.1 million in 2007, and \$0.3 million in 2008 relating to the FCPA Matter and paid \$2.95 million in fines, penalties, and interest to the DOJ and SEC in 2008 related to the FCPA Matter. The Company has a two-year monitoring obligation and other continuing obligations with the SEC and the DOJ with respect to compliance with the FCPA and other laws, including full cooperation with the government and the adoption of a compliance code containing specific provisions intended to prevent violations of the FCPA. The selection process of the monitor is not yet complete. 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.

Results of Operations

Three Months Ended October 3, 2009 Compared to the Three Months Ended September 27, 2008

Total sales decreased by \$13.4 million, or 27.3%, to \$35.7 million in the three months ended October 3, 2009 from \$49.1 million for the three months ended September 27, 2008. This decrease resulted primarily from a decrease in unit sales in all regions related to the weakness in the global economy. Product sales decreased by \$13.2 million, or 32.1%, to \$27.9 million for the three months ended October 3, 2009 from \$41.1 million in the third quarter of the prior year. Service revenue decreased by \$0.2 million, or 2.5%, to \$7.8 million for the three months ended October 3, 2009 from \$8.0 million in the same period during the prior year, primarily due to a decrease in training revenue in Europe and the Americas regions.

Sales in the Americas region decreased \$4.7 million, or 25.5%, to \$13.7 million for the three months ended October 3, 2009 from \$18.4 million in the three months ended September 27, 2008. Product sales in the Americas region decreased by \$4.8 million, or 31.4%, to \$10.5 million for the three months ended October 3, 2009 from \$15.3 million in the third quarter of the prior year. Service revenue in the Americas region increased by \$0.1 million, or 3.2%, to \$3.2 million for the three months ended October 3, 2009 from \$3.1 million in the same period during the prior year.

Sales in the Europe/Africa region decreased \$6.9 million, or 32.1%, to \$14.6 million for the three months ended October 3, 2009 from \$21.5 million in the three months ended September 27, 2008. Product sales in the Europe/Africa region decreased by \$6.2 million, or 34.8%, to \$11.6 million for the three months ended October 3, 2009 from \$17.8 million in the third quarter of the prior year. Service revenue in the Europe/Africa region decreased by \$0.7 million, or 18.9%, to \$3.0 million for the three months ended October 3, 2009 from \$3.7 million in the same period during the prior year, primarily due to a decrease in customer service and training revenue.

Sales in the Asia/Pacific region decreased \$1.8 million, or 19.6%, to \$7.4 million for the three months ended October 3, 2009 from \$9.2 million in the three months ended September 27, 2008. Product sales in the Asia/Pacific region decreased by \$2.2 million, or 27.5%, to \$5.8 million for the three months ended October 3, 2009 from \$8.0 million in the third quarter of the prior year.

[Table of Contents](#)

Service revenue in the Asia/Pacific region increased by \$0.4 million, or 33.3%, to \$1.6 million for the three months ended October 3, 2009 from \$1.2 million in the same period during the prior year, primarily due to an increase in warranty revenue.

Gross profit decreased by \$9.4 million, or 32.4%, to \$19.6 million for the three months ended October 3, 2009 from \$29.0 million for the three months ended September 27, 2008. Gross margin decreased to 54.9% for the three months ended October 3, 2009 from 59.1% for the three months ended September 27, 2008, primarily due to a change in the sales mix between product sales and service revenue resulting from a decrease in product sales. Gross margin from product sales decreased to 59.6% in the three months ended October 3, 2009 from 65.4% for the three months ended September 27, 2008, primarily due to a change in the product sales mix resulting in a decrease in average unit selling prices. Gross margin from service revenues increased to 38.1% in the three months ended October 3, 2009 from 26.7% for the three months ended September 27, 2008, primarily due to a decrease in customer service costs.

Selling expenses decreased by \$3.9 million, or 25.4%, to \$11.5 million for the three months ended October 3, 2009 from \$15.4 million for three months ended September 27, 2008. This decrease was primarily due to a decrease in commission and compensation expense of \$2.7 million, marketing and advertising expense of \$0.3 million, and travel-related costs of \$0.7 million.

Worldwide sales and marketing headcount decreased by 45, or 12.2%, to 324 at October 3, 2009 from 369 at September 27, 2008. Regionally, the Company's sales and marketing headcount decreased by 40, or 30.3%, to 92 at October 3, 2009 from 132 for the Americas; decreased by 14 or 10.7%, to 117 at October 3, 2009 from 131 in Europe/Africa; and increased by 9, or 8.5%, in Asia/Pacific to 115 at October 3, 2009 from 106 at September 27, 2008.

As a percentage of sales, selling expenses increased to 32.2% of sales in the three months ended October 3, 2009 from 31.3% in the three months ended September 27, 2008. Regionally, selling expenses were 29.0% of sales in the Americas for the quarter, compared to 32.2% of sales in the third quarter of 2008; 33.5% of sales for Europe/Africa compared to 31.7% of sales from the same period in the prior year; and 35.3% of sales for Asia/Pacific compared to 28.8% of sales from the same period in the prior year.

General and administrative expenses decreased by \$0.4 million, or 6.9%, to \$6.2 million for the three months ended October 3, 2009 from \$6.6 million for the three months ended September 27, 2008, primarily due to a decrease in compensation expense of \$0.7 million and lower travel-related costs of \$0.2 million, offset by an increase in legal and professional fees of \$0.3 million.

Depreciation and amortization expenses increased by \$0.2 million to \$1.4 million for the three months ended October 3, 2009 from \$1.2 million for the three months ended September 27, 2008, primarily due to an increase in property and equipment.

Research and development expenses decreased to \$2.8 million for the three months ended October 3, 2009 from \$3.2 million for the three months ended September 27, 2008, primarily due to a decrease in compensation costs of \$0.2 million. Research and development expenses as a percentage of sales increased to 7.8% for the three months ended October 3, 2009 from 6.6% for the three months ended September 27, 2008.

Interest income decreased by \$0.52 million to \$0.03 million for the three months ended October 3, 2009 from \$0.55 million for the three months ended September 27, 2008, due to a decrease in interest rates related to cash and short term investments.

Other (income) expense, net decreased by \$0.9 million to income of \$0.2 million for the three months ended October 3, 2009 from expense of \$0.7 million for the three months ended September 27, 2008, primarily as a result of foreign currency transaction gains.

Income tax (benefit) expense decreased by \$1.3 million to a benefit of \$0.8 million for the three months ended October 3, 2009 from expense of \$0.5 million for the three months ended September 27, 2008, primarily due to a decrease in pre-tax income. Total deferred taxes for the Company's foreign subsidiaries relating to net operating loss carryforwards were \$11.6 million and \$10.2 million at October 3, 2009 and December 31, 2008, respectively. The related valuation allowance was \$10.1 million and

\$8.7 million at October 3, 2009 and December 31, 2008, respectively. The Company's effective tax benefit rate was 37.6% for the three months ended October 3, 2009, while the Company's effective tax rate was 19.9% in the prior year period, primarily due to a taxable loss in higher tax jurisdictions. The Company's tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company's tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction.

Net income decreased by \$3.3 million to a net loss of \$1.3 million for the three months ended October 3, 2009 from net income of \$2.0 million for the three months ended September 27, 2008 as a result of the factors described above.

Nine months Ended October 3, 2009 Compared to the Nine months Ended September 27, 2008

Total sales decreased by \$51.2 million, or 33.5%, to \$101.7 million in the nine months ended October 3, 2009 from \$152.9 million for the nine months ended September 27, 2008. This decrease is attributable primarily to a decrease in unit sales in all regions as a result of the weakness in the global economy. Product sales decreased by \$51.7 million, or 39.5%, to \$79.3 million for the nine months ended October 3, 2009 from \$131.0 million for the nine months ended September 27, 2008. Service revenue increased by \$0.5 million, or 2.3%, to \$22.4 million for the nine months ended October 3, 2009 from \$21.9 million in the same period during the prior year, primarily due to an increase in warranty revenue in the Americas and the Asia/Pacific regions.

Sales in the Americas region decreased \$19.1 million, or 33.1%, to \$38.6 million for the nine months ended October 3, 2009 from \$57.7 million in the nine months ended September 27, 2008. Product sales in the Americas region decreased by \$19.8 million, or 40.4%, to \$29.2 million for the nine months ended October 3, 2009 from \$49.0 million in the third quarter of the prior year. Service revenue in the Americas region increased by \$0.7 million, or 8.0%, to \$9.4 million for the nine months ended October 3, 2009 from \$8.7 million in the same period during the prior year, due primarily to an increase in warranty revenue.

Sales in the Europe/Africa region decreased \$25.4 million, or 37.7%, to \$42.0 million for the nine months ended October 3, 2009 from \$67.4 million in the nine months ended September 27, 2008. Product sales in the Europe/Africa region decreased by \$24.4 million, or 42.5%, to \$33.0 million for the nine months ended October 3, 2009 from \$57.4 million in the third quarter of the prior year. Service revenue in the Europe/Africa region decreased by \$1.0 million, or 10.0%, to \$9.0 million for the nine months ended October 3, 2009 from \$10.0 million in the same period during the prior year primarily due to a decrease in customer service and training revenue.

Sales in the Asia/Pacific region decreased \$6.7 million, or 24.1%, to \$21.1 million for the nine months ended October 3, 2009 from \$27.8 million in the nine months ended September 27, 2008. Product sales in the Asia/Pacific region decreased by \$7.5 million, or 30.5%, to \$17.1 million for the nine months ended October 3, 2009 from \$24.6 million in the same period of the prior year. Service revenue in the Asia/Pacific region increased by \$0.8 million, or 25.0%, to \$4.0 million for the nine months ended October 3, 2009 from \$3.2 million in the same period during the prior year, due primarily to an increase in warranty revenue.

Gross profit decreased by \$37.8 million, or 40.6%, to \$55.2 million for the nine months ended October 3, 2009 from \$93.0 million for the nine months ended September 27, 2008. Gross margin decreased to 54.3% for the nine months ended October 3, 2009 from 60.8% for the nine months ended September 27, 2008. The decrease in gross margin is primarily due to a change in the sales mix between product sales and service revenue resulting from a decrease in product sales. Gross margin from product sales decreased to 61.3% in the nine months ended October 3, 2009 from 66.6% for the nine months ended September 27, 2008 primarily due to a change in the product sales mix resulting in a decrease in average unit selling prices. Gross margin from service revenue increased to 29.4% in the nine months ended October 3, 2009 from 26.2% for the nine months ended September 27, 2008, primarily due to a decrease in customer service costs.

[Table of Contents](#)

Selling expenses decreased by \$10.5 million, or 22.3%, to \$36.4 million for the nine months ended October 3, 2009 from \$46.9 million for nine months ended September 27, 2008, primarily due to a decrease in commission and compensation expense of \$6.4 million, a decrease in travel related expenses of \$1.8 million, and a decrease in marketing and advertising expenses of \$0.8 million.

Worldwide sales and marketing headcount decreased by 45, or 12.2%, to 324 at October 3, 2009 from 369 at September 27, 2008. Regionally, the Company's sales and marketing headcount decreased by 40, or 30.3%, to 92 at October 3, 2009 from 132 for the Americas; decreased by 14 or 10.7%, to 117 at October 3, 2009 from 131 in Europe/Africa; and increased by 9, or 8.5%, in Asia/Pacific to 115 at October 3, 2009 from 106 at September 27, 2008.

As a percentage of sales, selling expenses increased to 35.8% of sales in the nine months ended October 3, 2009 from 30.7% in the nine months ended September 27, 2008. Regionally, selling expenses were 33.4% of sales in the Americas for the nine months ended October 3, 2009 compared to 30.2% of sales in the prior year period; 38.1% of sales for Europe/Africa compared to 31.5% of sales from the same period in the prior year; and 35.8% of sales compared to 29.6% of sales for Asia/Pacific from the same period in the prior year.

General and administrative expenses decreased by \$0.7 million, or 3.5%, to \$18.6 million for the nine months ended October 3, 2009 from \$19.3 million for the nine months ended September 27, 2008, mostly due to decreases in compensation expenses of \$0.9 million and travel costs of \$0.7 million, offset by increases in legal and professional fees of \$0.8 million.

Depreciation and amortization expenses increased by \$0.8 million to \$4.1 million for the nine months ended October 3, 2009 from \$3.3 million for the nine months ended September 27, 2008, primarily due to an increase in property and equipment.

Research and development expenses increased to \$9.6 million for the nine months ended October 3, 2009 from \$9.1 million for the nine months ended September 27, 2008, primarily as a result of an increase in material costs of \$0.5 million. Research and development expenses as a percentage of sales increased to 9.4% for the nine months ended October 3, 2009 from 6.0% for the nine months ended September 27, 2008.

Interest income decreased by \$1.4 million to \$0.2 million for the nine months ended October 3, 2009 from \$1.6 million for the nine months ended September 27, 2008, due to a decrease in interest rates related to cash and short term investments.

Interest expense decreased by \$0.5 million to \$0.0 million for the nine months ended October 3, 2009 from \$0.5 million for the nine months ended September 27, 2008, due to interest accrued on the estimated fines and penalties to the SEC and DOJ related to the FCPA Matter.

Other (income) expense, net decreased by \$1.2 million to income of \$0.4 million for the nine months ended October 3, 2009 from expense of \$0.8 million for the nine months ended September 27, 2008, primarily as a result of foreign currency transaction gains.

Income tax (benefit) expense decreased by \$5.9 million to a benefit of \$2.9 million for the nine months ended October 3, 2009 from an expense of \$3.0 million for the nine months ended September 27, 2008. This change was primarily due to a decrease in pretax income. Total deferred taxes for the Company's foreign subsidiaries relating to net operating loss carryforwards were \$11.6 million and \$10.2 million at October 3, 2009 and December 31, 2008, respectively. The related valuation allowance was \$10.1 million and \$8.7 million at October 3, 2009 and December 31, 2008, respectively. The Company's effective tax benefit rate was 22.7% for the nine months ended October 3, 2009 while the Company's effective tax rate was 20.1% in the prior year period. The Company's tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company's tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction.

[Table of Contents](#)

Net income decreased by \$21.8 million to a net loss of \$10.0 million for the nine months ended October 3, 2009 from net income of \$11.8 million for the nine months ended September 27, 2008 as a result of the factors described above.

Liquidity and Capital Resources

Cash and cash equivalents increased by \$3.9 million to \$27.4 million at October 3, 2009 from \$23.5 million at December 31, 2008. The increase was primarily attributable to net proceeds of \$17.0 million from the sale of \$82.0 million of the Company's variable rate demand bonds, net of purchases of \$65.0 million of U.S. Treasury Bills, offset by purchases of \$8.8 million of the Company's common stock as part of the Company's share repurchase program, a net loss and non-cash expenses of \$0.3 million, \$3.4 million in purchases of equipment and intangible assets, and the negative effect of exchange rate changes on cash of \$1.2 million.

On July 11, 2006, the Company entered into a loan agreement providing for an available line of credit of \$30.0 million, which was most recently amended on June 18, 2009. Loans under the Amended and Restated Loan Agreement, as amended, bear interest at the rate of LIBOR plus a fixed percentage between 2.25% and 2.50%, and require the Company to maintain a minimum cash balance and tangible net worth measured at the end of each of the Company's fiscal quarters. As of October 3, 2009, the Company was in compliance with all of the covenants under the Amended and Restated Loan Agreement, as amended. The term of the Amended and Restated Loan Agreement, as amended, extends to March 31, 2012. 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.

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 Company’s calculations, 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 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 Company’s 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 is only 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. 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 when the technology is sold by the licensees.

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. 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. 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.

[Table of Contents](#)

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 \$0.3 million, or \$0.02 per share, for the nine months ended October 3, 2009 and \$1.8 million, or \$0.11 per share, for the nine months ended September 27, 2008.

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 \$0.8 million, or \$0.04 per share, for the nine months ended October 3, 2009, and \$1.2 million, or \$0.07 per share, for the nine months ended September 27, 2008.

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 ASC 740 (formerly 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. The warranty reserve is reflected in accrued liabilities in the accompanying consolidated balance sheets. The warranty expense is estimated by applying the actual total repair expenses for each product group in the prior period and determining a rate of repair expense per installation month. This repair rate is multiplied by the number of installation-months of warranty for each product group to determine the provision for warranty expenses for the period. The Company evaluates its exposure to warranty costs at the end of each period using the estimated expense per installation-month for each major product group, the number of units remaining under warranty, and the remaining number of months each unit will be under warranty. The Company has a history of new product introductions and enhancements to existing products, which may result in unforeseen issues that may increase its warranty costs. While such expenses have historically been within expectations, the Company cannot guarantee this will continue in the future.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Exchange Exposure

The Company conducts a significant portion of its business outside the United States. At present, 61.6% of the Company's revenues are invoiced, and a significant portion of its operating expenses are paid, in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on the Company's results of operations and 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 in the future, the Company's exposure to risks associated with fluctuations in foreign exchange rates will increase.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), the Company’s management, with the participation of its Principal Executive Officer and Principal Financial Officer, has carried out an evaluation of the effectiveness of the Company’s disclosure controls and procedures (as defined under Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the Company’s Principal Executive Officer and Principal Financial Officer have concluded that its disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company’s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended October 3, 2009 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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. The Lead Plaintiff sought 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 sought 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 Exchange Act.

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. On April 9, 2008, the parties filed a detailed Stipulation 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 paid \$6.875 million into a settlement fund for the Securities Litigation. That sum is within the coverage limit of the policy and, accordingly, has no effect on the Company’s financial results. On October 3, 2008, the court entered a Final Judgment and Order of Dismissal With Prejudice, whereby the court certified the Class for purposes of the settlement, approved the settlement, and dismissed the Securities Litigation, with prejudice, as against each defendant.

Derivative Action—On January 10, 2008, a Verified Shareholder 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 Action”). The Derivative Action 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. In February 2008 and April 2008, the Company received two demands by other alleged shareholders against seven of the Company’s current and former directors that asserted substantially the same claims as set forth in the Derivative Action. Both of those demands subsequently were withdrawn.

On November 12, 2008, the parties to the Derivative Action executed a Memorandum of Understanding of the material terms of a proposed settlement of the Derivative Action. On January 21, 2009, the parties filed with the court a Stipulation of Settlement seeking the court’s preliminary and final approval of the terms of the proposed settlement. On February 13, 2009, the court granted preliminary approval of the settlement. On April 23, 2009, the court granted final approval of the settlement and entered an Order and Final Judgment directing the consummation of the settlement and dismissing the Derivative Action, with prejudice, as against each defendant. Pursuant to the terms of the settlement, the Company has adopted certain corporate governance policies for a period of three years, and the issuer of the Company’s Executive Liability and Entity Securities Liability insurance policy applicable to the Derivative Action has paid \$400,000 to the plaintiff’s counsel for their fees and expenses. That sum is within the coverage limit of the policy and accordingly has no effect on the Company’s financial results.

Patent Matters—On July 11, 2008, a complaint for patent infringement was filed against the Company in the U.S. District Court for the District of Massachusetts by Metris USA, Inc. and certain of its affiliates (collectively, “Metris”) concerning U.S. Patent Nos. 6,611,617 and 7,313,264. The patents are generally directed to laser scanning devices. The complaint was served on November 5, 2008. The Company responded with counterclaims alleging that the asserted patents are invalid, non-infringed, and unenforceable due to fraud during prosecution of the patents in the U.S. Patent and Trademark Office. On August 31, 2009, the Court granted the Company’s motion to add counterclaims and defenses for violation of federal and state antitrust and unfair competition laws based on the alleged knowing assertion of invalid and fraudulent patents. Discovery in the case is ongoing, and no trial date has been set. On October 8, 2009, the Court held a “Markman” hearing for the purpose of construing the claim language of the asserted patents.

[Table of Contents](#)

No final order on claim construction has yet issued. The Company believes that it does not infringe the asserted patents and/or that the patents are invalid. The Company currently does not anticipate this lawsuit will have a material impact on the Company's business, financial condition or results of operations. However, the outcome is difficult to predict and an adverse determination may have a material impact on the Company's business, financial condition or results of operations.

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, none of which the Company believes will have a material adverse effect on the Company's business, financial condition or results of operations.

Item 1A. Risk Factors

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the risk factors discussed under Part I, Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the SEC. These risks could materially and adversely affect the Company's business, financial condition, and results of operations. The risks described in the Company's Annual Report Form 10-K for the year ended December 31, 2008 are not the only risks the Company faces. The Company's operations could also be affected by additional factors that are not presently known to the Company or by factors that it currently considers immaterial to its business.

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

On November 24, 2008, the Company's Board of Directors approved a \$30 million share repurchase program. Acquisitions for the share repurchase program will be made from time to time at prevailing prices as permitted by securities laws and other legal requirements, and subject to market conditions and other factors. The share repurchase program may be discontinued at any time. There is no restriction date or other restriction governing the period over which the Company can repurchase shares under the program. All such purchases were open market transactions. Set forth below is information regarding the Company's stock repurchases made during the nine months ended October 3, 2009, under this program.

	Stock Purchase Program			Approximate Dollar Value that may yet be Purchased Under the Plans or Program
	Total Number of Shares	Average Price Paid Per Share	Total Number of Shares Purchased as part of Publicly Announced Plans or Programs	
January 1, 2009 - January 31, 2009	342,407	\$ 14.00	342,407	\$ 25,135,285
February 1, 2009 - February 28, 2009	282,020	\$ 14.32	282,020	\$ 21,094,621
March 1, 2009 - April 4, 2009	—	\$ —	—	\$ 21,094,621
April 5, 2009 - July 4, 2009	—	\$ —	—	\$ 21,094,621
July 5, 2009 - October 3, 2009	—	\$ —	—	\$ 21,094,621
Total	624,427		624,427	

The Company previously purchased 6,805 shares in the fourth quarter of 2008 under the repurchase program for an aggregate purchase price of \$0.1 million.

[Table of Contents](#)

Item 6. Exhibits

- 3.1 Amended and Restated Articles of Incorporation (filed as Exhibit 3.1 to the Company's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference)
- 3.2 Bylaws, as amended (filed as Exhibit 4.2 to the Company's Registration Statement on Form S-8, No. 333-160660, and incorporated herein by reference)
- 4.1 Specimen Certificate for Registrant's Common Stock (filed as Exhibit 4.1 to the Company's Registration Statement on Form S-1, No. 333-32983, and incorporated herein by reference)
- 31-A Certification of the President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31-B Certification of the Principal Financial and Accounting Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32-A Certification of the President and Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32-B Certification of the Principal Financial and Accounting Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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

I, Jay W. Freeland, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of FARO Technologies, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2009

/s/ Jay W. Freeland

Jay W. Freeland
 President and Chief Executive Officer
 (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 Quarterly Report on Form 10-Q of FARO Technologies, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2009

/s/ Keith S. Bair

 Keith S. Bair
 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 that the Quarterly Report on Form 10-Q, for the quarter ended October 3, 2009 (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 6, 2009

/s/ Jay W. Freeland

Jay W. Freeland
President and Chief Executive Officer
(Principal Executive 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 Senior Vice President and Chief Financial Officer of FARO Technologies, Inc. (the Company), hereby certify that the Quarterly Report on Form 10-Q, for the quarter ended October 3, 2009 (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 6, 2009

/s/ Keith S. Bair

Keith S. Bair

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