UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended APRIL 3, 2004

OR

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

For the transition period from _________ to __________

Commission File Number: 0-23081

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

| | |
|---|---|
| FLORIDA | 59-3157093 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| | |
|---|---|
| 125 TECHNOLOGY PARK DRIVE, LAKE MARY, FLORIDA | 32746 |
| (Address of Principal Executive Offices) | (Zip Code) |

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: 407-333-9911

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

The number of shares outstanding of the registrant's common stock as of May 12, 2004 was 13,654,512.



FARO TECHNOLOGIES, INC.

Form 10-Q
For the Quarter Ended April 3, 2004

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| | April 3, 2004 | December 31, 2003 |
|---|---|---|
| ASSETS | (unaudited) | |
| Current Assets: | | |
| Cash and cash equivalents | $ 10,855,321 | $ 17,424,901 |
| Short-term investments | 22,085,000 | 16,037,208 |
| Accounts receivable, net of allowance for doubtful receivables of $ 445,698 and $ 254,915 | 14,240,455 | 16,312,978 |
| Inventories, net | 16,868,645 | 14,771,792 |
| Deferred tax asset - Current | 564,841 | 564,841 |
| Prepaid expenses and other current assets | 1,734,173 | 1,465,690 |
| Total current assets | 66,348,435 | 66,577,410 |
| PROPERTY AND EQUIPMENT | | |
| Machinery and equipment | 6,090,906 | 5,612,391 |
| Furniture and fixtures | 2,597,152 | 2,552,766 |
| Leasehold improvements | 838,881 | 626,858 |
| Property, plant and equipment at cost | 9,526,939 | 8,792,015 |
| Less accumulated depreciation and amortization | (6,324,203) | (6,038,658) |
| Property, plant and equipment, net | 3,202,736 | 2,753,357 |
| Intangible assets | 24,557,897 | 25,130,684 |
| Less accumulated amortization | (13,205,040) | (13,691,309) |
| Intangible assets, net | 11,352,857 | 11,439,375 |
| Deferred tax asset-net | 1,212,944 | 1,143,746 |
| Total Assets | $ 82,116,972 | $ 81,913,888 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Current portion of long-term debt | $ 40,807 | $ 42,584 |
| Accounts payable | 3,851,723 | 4,713,512 |
| Accrued liabilities | 3,853,826 | 4,776,778 |
| Income taxes payable | 125,469 | 605,456 |
| Current portion of unearned service revenues | 2,223,964 | 2,206,167 |
| Customer deposits | 111,719 | 363,346 |
| Total current liabilities | 10,207,508 | 12,707,843 |
| Unearned Service Revenues - less current portion | 409,620 | 220,296 |
| Long-term debt - less current portion | 59,007 | 64,650 |
| Total Liabilities | 10,676,135 | 12,992,789 |
| Shareholders Equity: | | |
| Common stock - par value $.001, 50,000,000 shares authorized; 13,595,070 and 13,518,998 issued 13,555,070 and 13,478,998 outstanding, respectively | 13,595 | 13,519 |
| Additional paid-in-capital | 76,460,381 | 75,133,219 |
| Unearned compensation | (731,553) | (226,954) |
| Accumulated deficit | (3,005,521) | (5,853,929) |
| Other comprehensive loss | (1,145,440) | 5,869 |
| Common stock in treasury, at cost - 40,000 shares | (150,625) | (150,625) |
| Total shareholders' equity | 71,440,837 | 68,921,099 |
| Total Liabilities and Shareholders Equity | $ 82,116,972 | $ 81,913,888 |

See accompanying notes to consolidated financial statements

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

| | THREE MONTHS ENDED | |
|---|---|---|
| | APR 3, 2004 | MAR 29, 2003 |
| SALES | $ 21,025,192 | $ 13,404,265 |
| COST OF SALES | 7,561,357 | 5,899,580 |
| Gross profit | 13,463,835 | 7,504,685 |
| OPERATING EXPENSES: | | |
| Selling | 5,562,695 | 3,787,438 |
| General and administrative | 2,529,383 | 1,750,566 |
| Depreciation and amortization | 556,759 | 588,653 |
| Research and development | 1,441,412 | 877,468 |
| Employee stock options | 37,477 | 41,448 |
| Total operating expenses | 10,127,726 | 7,045,573 |
| INCOME (LOSS) FROM OPERATIONS | 3,336,109 | 459,112 |
| OTHER INCOME (EXPENSES) | | |
| Interest income | 73,564 | 2,665 |
| Other income, net | 206,129 | 115,739 |
| Interest expense | (2,142) | (15,897) |
| NET INCOME BEFORE INCOME TAX | 3,613,660 | 561,619 |
| INCOME TAX EXPENSE | 765,252 | 72,255 |
| NET INCOME | $ 2,848,408 | $ 489,364 |
| NET INCOME PER SHARE - BASIC | $ 0.21 | $ 0.04 |
| NET INCOME PER SHARE - DILUTED | $ 0.20 | $ 0.04 |

See accompanying notes to consolidated financial statements

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| | Three Months Ended | |
|---|---|---|
| | April 3, 2004 | March 29, 2003 |
| CASH FLOWS FROM: | | |
| OPERATING ACTIVITIES: | | |
| Net income | 2,848,408 | $ 489,364 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 556,759 | 588,653 |
| Provision for bad debts | 195,660 | 41,927 |
| Provision for inventory losses | 705,000 | 96,249 |
| Deferred income taxes | 69,158 | -- |
| Employee stock options | -- | 41,448 |
| Change in operating assets and liabilities: | | |
| Decrease (increase) in: | | |
| Accounts receivable | 1,976,772 | 639,144 |
| Income taxes refundable | -- | |
| Inventories | (1,566,384) | (1,614,265) |
| Prepaid expenses and other assets | (302,261) | 386,757 |
| Increase (decrease) in: | | |
| Accounts payable and accrued liabilities | (1,662,778) | (214,917) |
| Income taxes payable | (480,600) | 47,258 |
| Customer deposits | (249,260) | 181,578 |
| Deferred revenues | 272,645 | 248,685 |
| Net cash provided by operating activities | 2,363,119 | 931,881 |
| INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (810,796) | (486,251) |
| Payments for Intangible assets | (210,985) | (759,879) |
| Purchases of Investments | (6,047,792) | (29,556) |
| Net cash used in investing activities | (7,069,573) | (1,275,686) |
| FINANCING ACTIVITIES: | | |
| Borrowings under line of credit | -- | 14,733 |
| Payments of long-term debt, capital lease obligations and notes payable | (9,824) | (8,356) |
| Proceeds from issuance of stock, net | 175,246 | 20,074 |
| Net cash provided by financing activities | 165,422 | 26,451 |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | (2,028,548) | 1,214,620 |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (6,569,580) | 897,266 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 17,424,901 | 4,023,615 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $ 10,855,321 | $ 4,920,881 |

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED
FINANCIAL STATEMENTS
For the three months ended April 3, 2004 and March 29, 2003
(Unaudited)

NOTE A - DESCRIPTION OF BUSINESS

FARO Technologies, Inc. and subsidiaries develop, manufacture, market and support computer-based manufacturing measurement and inspection equipment and related software.

The consolidated financial statements include the accounts of FARO Technologies, Inc. and all wholly owned subsidiaries (collectively, the "Company"). All significant intercompany transactions and balances have been eliminated. The financial statements of foreign subsidiaries have been translated into U.S. dollars using the current exchange rates in effect at each balance sheet date, for assets and liabilities, and the average exchange rates during each reporting period, for results of operations. Adjustments resulting from translation of the financial statements are reflected as a separate component of comprehensive loss in shareholders' equity.

NOTE B - BASIS OF PRESENTATION

In the opinion of management, the accompanying consolidated balance sheets and related interim consolidated statements of operations, and cash flows include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States ("GAAP"). Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Actual results and outcomes may differ from these estimates and assumptions.

The consolidated results of operations for the three months ended April 3, 2004 are not necessarily indicative of results that may be expected for the year ending December 31, 2004. The information included in this Form 10-Q (including the interim consolidated financial statements and notes that accompany these financial statements) should be read in conjunction with the audited consolidated financial statements reported as of December 31, 2003 and 2002, and for each of the three years included in the Company's 2003 Annual Report on Form 10-K.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities." FIN 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 applies immediately to variable interest entities ("VIE's") created after January 31, 2003, and to VIE's in which an enterprise obtains an interest after that date. It applies in the first fiscal year or interim period beginning after June 15, 2003 to VIE's in which an enterprise holds a variable interest that it acquired before February 1, 2003. FIN 46 applies to public enterprises as of the beginning of the applicable interim or annual period. The Company currently has no interest in any VIE.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure (FAS 148). FAS 148 amends an earlier standard on accounting for stock-based compensation, FAS 123, Accounting for Stock-Based Compensation (FAS 123), to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, FAS 148 amends the disclosure requirements of FAS 123 to require more prominent disclosure about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The additional disclosure requirements of FAS 148 are effective for fiscal years ending after December 15, 2002.

The Company continues to follow the intrinsic value method of accounting as prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, to account for employee stock options issued.

The following table illustrates the effects on net income (loss) and earnings per share if the Company had applied the fair value recognition provisions of FAS 123 to stock-based employee compensation.

| | Three Months Ended | |
|---|---|---|
| | Apr 3, 2004 | Mar 29, 2003 |
| Net income, as reported | $2,848,408 | $ 489,364 |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects | 24,360 | 26,967 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (148,483) | (47,237) |
| Pro forma net income | $2,724,285 | $ 469,094 |
| Earnings Per share: | | |
| Basic - as reported | $ 0.21 | $ 0.04 |
| Basic - Pro forma | $ 0.20 | $ 0.04 |
| Diluted - as reported | $ 0.20 | $ 0.04 |
| Diluted - Pro forma | $ 0.19 | $ 0.04 |

## NOTE C - CASH AND CASH EQUIVALENTS AND INVESTMENTS

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

Investments - Short-term investments ordinarily consist of short-term debt securities acquired with cash not immediately needed in operations. Such amounts have maturities not exceeding one year. Investments ordinarily consist of debt securities acquired with cash not immediately needed in operations. Such amounts have maturities of at least one year.

Investments consisted of the following:

| | As of Apr 3, 2004 | As of Dec 31, 2003 |
|---|---|---|
| Corporate bonds | $ - | $ 432,153 |
| Money market funds | 120,000 | - |
| Commercial paper | 21,965,000 | 15,605,055 |
| | $ 22,085,000 | $ 16,037,208 |

Supplemental Cash Flow Information - Selected cash payments and non cash activities were as follows:

| | THREE MONTHS ENDED | |
|---|---|---|
| | APRIL 3, 2004 | MARCH 29, 2003 |
| Cash paid for interest | $ 2,142 | $ 14,732 |

NOTE D - INVENTORIES

Inventories consist of the following:

| | AS OF APRIL 3, 2004 | AS OF DECEMBER 31, 2003 |
|---|---|---|
| Raw materials | $ 5,288,707 | $ 5,624,061 |
| Work-in-process | 849,474 | 352,104 |
| Finished goods | 2,832,366 | 1,589,759 |
| Sales/service | 8,226,754 | 7,360,515 |
| Allowance for inventory obsolesence | (328,656) | (154,647) |
| | $ 16,868,645 | $ 14,771,792 |

NOTE E - EARNINGS (LOSS) 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 | | | |
|---|---|---|---|---|
| | APRIL 3, 2004 | | MARCH 29, 2003 | |
| | SHARES | PER-SHARE AMOUNT | SHARES | PER-SHARE AMOUNT |
| Basic EPS | 13,522,921 | $0.21 | 11,893,037 | $0.04 |
| Effect of dilutive securities | 557,182 | ($0.01) | 203,602 | $0.00 |
| Diluted EPS | 14,080,103 | $0.20 | 12,096,639 | $0.04 |

NOTE F - INCOME TAX EXPENSE

The tax provision for the three months ended April 3, 2004 differs from the tax provision for the three months ended March 29, 2003, principally due to increases in earnings. The effective tax rate of 21.2% is lower than current federal statutory corporate rates primarily due to the use of previously reserved net operating loss carry-forwards in Europe.

At April 3, 2004 the Company has deferred income tax assets of approximately $2.7 million (including $2.2 million related to the U.S. operations and $0.5 million related to foreign operations), which are offset by a valuation allowance of approximately $0.5 million. These deferred income tax assets are primarily attributable to net operating loss carry-forwards and intangible assets for which future income tax benefits may be realized.

NOTE G - SEGMENT GEOGRAPHIC DATA

The Company develops, manufactures, markets and supports computer-based manufacturing measurement and inspection equipment and related software. This one line of business represents more than 98% of consolidated sales and is the Company's only segment. The Company operates through sales teams established by geographic regions, each team is equipped to deliver the entire line of Company products to customers within its geographic area.

The following table presents sales information by the geographic region of the customer:

| | THREE MONTHS ENDED | |
|---|---|---|
| | APRIL 03, 2004 | MARCH 29, 2003 |
| SALES | | |
| Americas Region | $ 8,531,042 | $ 5,395,396 |
| Europe/Africa Region | 10,091,323 | 6,087,942 |
| Asia Pacific Region | 2,402,827 | 1,920,927 |
| TOTAL | $ 21,025,192 | $ 13,404,265 |

NOTE H - COMPREHENSIVE INCOME

Comprehensive income includes the effect of currency translation adjustments on the investments in (capitalization of) foreign subsidiaries combined with the earnings (loss) from operations.

| | THREE MONTHS ENDED | |
|---|---|---|
| | APR 3 2004 | MAR 29 2003 |
| NET INCOME | 2,848,408 | 489,364 |
| OTHER COMPREHENSIVE INCOME (LOSS): | | |
| Currency translation adjustments | (1,151,309) | 663,592 |
| COMPREHENSIVE INCOME | 1,697,099 | 1,152,956 |

NOTE I - Credit Facility

On September 17, 2003 the Company established a $5 million revolving credit facility with SunTrust Bank. This agreement, due to mature on September 16, 2004, bears an interest rate, at the borrower's option, of either the bank's prime lending rate or the adjusted LIBOR rate, plus 1.75%. As of April 3, 2004, there were no borrowings under this line of credit.

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

The following information should be read in conjunction with the Consolidated Financial Statements, including the notes thereto, included elsewhere in this Form 10-Q, and the Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's 2003 Annual Report, Form 10-K, for the year ended December 31, 2003.

This report contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, about our plans, beliefs, goals, intentions, objectives, projections, expectations, assumptions, strategies, and future events are forward-looking statements. Words such as "may," "will," "believe," "plan," "should," "could," "seek," "expect," "anticipate," "intend," "estimate," "goal," "objective" and similar words, or discussions of strategy or other intentions identify forward-looking statements. Other written or oral statements, which constitute forward-looking statements, also may be made by the Company from time to time. Forward-looking statements are subject to a number of known and unknown risks, uncertainties, and other factors that could cause actual results to differ materially from those contemplated by such forward-looking statements. Consequently, you should not place undue reliance on these forward-looking statements. We do not intend to update any forward-looking statements, whether as a result of new information, future events, or otherwise.

Important factors that could cause a material difference in the actual results from those contemplated in such forward-looking statements include among others the following:

- our inability to maintain historical sales growth rates,
- our inability to maintain or reduce operating expenses or maintain our historical gross margin,
- difficulties in ramping up production in our new manufacturing facility in Switzerland and completing the opening and staffing of our sales office in China,
- our inability to further penetrate our customer base;
- development by others of new or improved products, processes or technologies that make our products obsolete or less competitive;
- our inability to maintain our technological advantage by developing new products and enhancing our existing products;
- the cyclical nature of the industries of our customers and the financial condition of our customers;
- the inability to protect our patents and other proprietary rights in the United States and foreign countries and the assertion of infringement claims against us;
- fluctuations in our annual and quarterly operating results as a result of (i) the size and timing of customer orders, (ii) the amount of time that it takes to fulfill orders and ship our products, (iii) the length of our sales cycle to new customers and the time and expense incurred in further penetrating our existing customer base, (iv) increases in operating expenses required for product development and new product marketing, (v) costs associated with new product introductions, such as assembly line start-up costs and low introductory period production volumes, (vi) the timing and market acceptance of new products and product enhancements, (vii) customer order deferrals in anticipation of new products and product enhancements, (viii) our success in expanding our sales and marketing programs, (ix) start-up costs associated with opening new sales offices outside of the United States, (x) fluctuations in revenue and without proportionate adjustments in fixed costs, (xi) the efficiencies achieved in managing inventories and fixed assets; and (xii) adverse changes in the manufacturing industry and general economic conditions;

- the inability of our products displacing traditional measurement devices and attain broad market acceptance;
- the impact of competitive products and pricing in the CAM2 market and the broad market for measurement and inspection devices;
- risks associated with expanding international operations, such as fluctuations in currency exchange rates, difficulties in staffing and managing foreign operations, political and economic instability, and the burdens of complying with a wide variety of foreign laws and labor practices;
- the loss of our Chief Executive Officer or our Executive Vice President and Chief Financial Officer or other key personnel;
- our inability to identify, consummate, or achieve expected benefits from acquisitions;
- the failure to effectively manage our growth;
- the loss of a key supplier and the inability to find a sufficient alternative supplier in a reasonable period or on commercially reasonable terms;
- other risks detailed in our Annual Report on Form 10-K and other filings from time to time with the Securities and Exchange Commission.

The consolidated financial statements include the accounts of FARO Technologies, Inc. and all wholly owned subsidiaries (collectively, the "Company"). All significant inter-company transactions and balances have been eliminated. The financial statements of the foreign subsidiaries have been translated into U.S. dollars using current exchange rates in effect at each balance sheet date, for assets and liabilities and average exchange rates during each reporting period for results of operations. Adjustments resulting from translation of financial statements are reflected as a separate component of accumulated comprehensive income (loss) in shareholders' equity.

## OVERVIEW

The Company designs, develops, markets and supports portable, software-driven, 3-D measurement systems that are used in a broad range of manufacturing and industrial applications. The Company's principal products are the Faro Arm and Faro Gage articulated arm measuring devices, the Faro Laser Tracker, a laser-based measuring device and their companion CAM2 software, which provide for CAD-based inspection and factory-level statistical process control. Together, these products integrate the measurement and quality inspection function with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company's products bring precision measurement, quality inspection and specification conformance capabilities, integrated with leading CAD software, to the factory floor. The Company is a pioneer in the development and marketing of 3-D measurement technology in manufacturing and industrial applications and currently holds 33 patents. The Company's products have been purchased by approximately 3,500 customers worldwide, ranging from small machine shops to such large manufacturing and industrial companies as Audi, Bell Helicopter, Boeing, British Aerospace, Caterpillar, DaimlerChrysler, General Electric, General Motors, Honda, Johnson Controls, Komatsu Dresser, Lockheed Martin, Siemens and Volkswagen among many others.

In 1995, the Company made a strategic decision to target international markets. The Company established sales offices in France and Germany in 1996, Great Britain in 1997, Japan and Spain in 2000, Italy in 2001, and China in 2003. International sales represented 47.3%, 57.0%, and 59.1% of sales in 2003, 2002, and 2001, respectively. The Company expects higher percentage sales growth in the Asia Pacific region than other regions in 2004 and 2005 as a result of opening its China sales office, and the addition of sales personnel and the opening of a service center in its Japan organization.

The Company derives revenues primarily from the sale of its Faro Arm and Faro Laser Tracker 3-D measurement equipment, and its related multi-faceted CAM2 software. Going forward, the Company also expects to generate revenue from the sale of its new Faro Gage product. Revenue related to these products is recognized upon shipment. In addition, the Company sells one, two and three-year maintenance contracts and training and technology consulting services relating to its products. The Company recognizes the revenue from extended maintenance contracts proportionately, in the same manner as costs are incurred for such revenues. The Company also receives royalties from licensing agreements for its historical medical technology and recognizes the revenue from these royalties as licensees report use of the technology. In 2003 royalties from licensing agreements were $601,000, or 0.8% of total sales.

In 2003 the Company began to manufacture its Faro Arm products in Switzerland for customer orders from Europe and Asia. It will begin to manufacture its Faro Laser Tracker and Faro Gage products in its Swiss plant by mid 2004. The production of these products for customer orders from the Americas will be done in the Company's headquarters in Florida, and its manufacturing plant in Pennsylvania. The Company expects all its existing plants to provide the necessary capacity for its growth, at least through 2005.

Cost of sales consists primarily of material, production overhead and labor. Since the Company's IPO in 1997, gross margin has been in the range 54-64%. The Company expects to maintain gross margin at or near 60% going forward. Selling expenses consist primarily of salaries and commissions to sales and marketing personnel, and promotion, advertising, travel and telecommunications. Selling expenses as a percentage of sales dropped significantly in 2003 as compared to 2002, to 25.6% from 30.0% and holding selling expenses as a percentage of sales to 25% or less will be a long-term goal of the Company, although the addition of new sales personnel in Asia may temporarily cause a rise in selling expenses as a percentage of sales in 2004 until these new sales people are fully trained and productive.

General and administrative expenses consist primarily of salaries for administrative personnel, rent, utilities and professional and legal expenses. The Company expects general and administrative expenses to drop as a percentage of sales as higher sales should not require a proportionate increase in these expenses. Research and development expenses represent salaries, equipment and third-party services. The Company has a commitment to ongoing research and development and intends to continue to fund these efforts at the level of 5-7% of sales going forward.

The Company has received a favorable income tax rate commitment from the Swiss government as an incentive for the Company to establish a manufacturing plant there. As a result the Company expects its blended (consolidated) tax rate to be in a range between 25% and 30% of consolidated taxable income for at least 2004 and 2005.

Accounting for wholly owned foreign subsidiaries is maintained in the currency of the respective foreign jurisdiction and, therefore, fluctuations in exchange rates may have an impact on inter-company accounts reflected in the Company's consolidated financial statements. The Company is aware of the availability of off-balance sheet financial instruments to hedge exposure to foreign currency exchange rates, including cross-currency swaps, forward contracts, and foreign currency options (see Foreign Exchange Exposure below). However the Company does not regularly use such instruments.

During fiscal years 2002 and 2001, the Company's sales growth was adversely affected by the economic slowdown, which began in 2001 in the United States and Europe. This effect, however, was offset by sales growth resulting from the acquisition in January 2002 of SpatialMetrix Corporation (SMX), which manufactured the predecessor to the Faro Laser Tracker, and the introduction in September and October 2002 of the latest generation of the Company's traditional Faro Arm product. In 2003 sales growth resulted primarily from strong customer response to the new Faro Arm and Laser Tracker products, and an increase in worldwide sales and marketing activities, including an increase in headcount from 106 in 2002 to 120 at the end of 2003.

RESULTS OF OPERATIONS

THREE MONTHS ENDED APRIL 3, 2004 COMPARED TO THREE MONTHS ENDED MARCH 29, 2003

Sales increased by $7.6 million or 56.7%, from $13.4 million for the three months ended March 29, 2003 to $21 million for the three months ended April 3, 2004. This increase resulted primarily from higher unit sales of the Faro Arm and Laser Tracker products. Sales increased $3.1 million in the Americas, $4.0 million in Europe/Africa and $0.5 million in the Asia Pacific region.

Gross profit increased by $6.0 million or 80.0%, from $7.5 million for the three months ended March 29, 2003 to $13.5 million for the three months ended April 3, 2004. Gross margin percentage increased to 64.3% for the three months ended April 3, 2004 from 56.0% for the three months ended March 29, 2003. Gross margin increased primarily due to lower service costs, the effect of higher volume on fixed overhead and smaller price discounts.

Selling expenses increased by $1.8 million or 47.4%, from $3.8 million for three months ended March 29, 2003 to $5.6 million for the three months ended April 3, 2004. This increase was due primarily to increased sales commissions, salaries, and marketing expenses. As a percentage of sales, selling expenses dropped to 26.7% of sales in the three months ended April 3, 2004 from 28.3% in the three months ended March 29, 2003.

General and administrative expenses increased by $779,000 or 43.3 %, from $1.8 million for the three months ended March 29, 2003 to $2.5 million for the three months ended April 3, 2004. The increase was primarily in the United States. Increases were in accrued performance bonuses ($164,000), salary increases due to increased headcount ($114,000) and an increase in the provision for bad debts ($112,000). General and administrative expenses in Europe accounted for most of the remaining increase, due to higher professional fees in Germany ($80,000) and the beginning of the Swiss operations ($100,000). General and administrative expenses as a percentage of sales fell to 11.9% for the three months ended April 3, 2004 from 13.4% for the three months ended March 29, 2003.

Depreciation and amortization expenses decreased by $32,000 or 5.4% from $589,000 for the three months ended March 29, 2003 to $557,000 for the three months ended April 3, 2004, due to a reduction in amortization of existing product technology of $172,000, offset by an increase of $140,000 in depreciation of new equipment and amortization of newly acquired intangibles.

Research and development expenses increased by $564,000 or 64.3%, from $877,000 for the three months ended March 29, 2003 to $1.4 million for the three months ended April 3, 2004. Increased costs were due primarily to higher payroll costs and new project expenses in the U.S.

Employee Stock Option expenses decreased by $4,000 from $41,000 for the three months ended March 29, 2003 to $37,000 for the 3 months ended April 3, 2004.

Interest income increased by $71,000 from $3,000 for the three months ended March 29, 2003, to $74,000 for the three months ended April 3, 2004. The increase was primarily attributable to an increase of $20.2 million in interest bearing investments from $1.9 million at March 29, 2003 to $22.1 million at April 3, 2004.

Other income and expense increased by $90,000 from $116,000 for the three months ended March 29, 2003 to $206,000 for the three months ended April 3, 2004 due primarily to favorable foreign exchange conversion.

Income tax expense increased by $693,000 from $72,000 for the three months ended March 29, 2003 to $765,000 for the three months ended April 3, 2004. This increase is primarily due to significant increases in taxable income in the United States and Japan, partially offset by the utilization of net operating losses in Europe, for which an allowance had previously been recorded.

Net income increased by $2.4 million from $0.5 million for the three months ended March 29, 2003 to $2.9 million for the three months ended April 3, 2004 as a result of the factors described above.

LIQUIDITY AND CAPITAL RESOURCES

On November 12, 2003, the Company sold 1,158,000 shares of its common stock to certain institutional investors in a private placement. The shares were sold for $21.50 per share, resulting in total proceeds before placement agent fees and other offering expenses of $24.9 million. Total marketable securities (cash and cash equivalents, short-term investments and investments) were approximately $32.9 million at April 3, 2004 compared with approximately $33.5 million on December 31, 2003.

Cash flow from operations was approximately $2.4 million in the first three months of 2004, an increase of approximately $1.4 million from the first three months of the prior year. The increase reflects strong growth in sales and operating income, partially offset by decreases in inventories, accounts payable, and taxes.

Cash used in investing activities was approximately $7.1 million in the first three months of 2004, an increase of approximately $5.8 million from the first three months of the prior year, primarily reflecting the purchase of capital equipment ($800,000) and the deployment of cash balances to short-term commercial paper ($6.1 million) in the first quarter of 2004.

Cash provided by financing activities was approximately $165,000 in the first three months of 2004, an increase of approximately $139,000 from the first three months of the prior year, reflecting the proceeds from the exercise of stock options.

Principal commitments at April 3, 2004 consisted of leases on the Company's offices and manufacturing facilities, and purchase orders for goods related to manufacturing. There were no material commitments for capital expenditures as of that date.

The Company believes that its cash, investments, borrowings and cash flows from operations should be sufficient to satisfy its working capital and capital expenditure needs for the foreseeable future. The Company has no material long-term debt. On September 17, 2003 the Company established a new $5 million revolving credit facility with SunTrust Bank. This agreement is due to mature on September 16, 2004 and bears an interest rate, at the borrower's option, of either the bank's Base rate or the adjusted LIBOR rate, plus 1.75%. No amounts were outstanding under this line of credit on April 3, 2004.

CRITICAL ACCOUNTING POLICIES

In response to the SEC'S financial reporting release, FR-60, Cautionary Advice Regarding Disclosure About Critical Accounting Policies, we have selected our most subjective accounting estimation processes for purposes of explaining the methodology used in calculating the estimate in addition to any inherent uncertainties pertaining to the estimate and the possible effects on the Company's financial condition. The estimation processes discussed below are the Company's process of recognizing research and development expenditures, the allowance for obsolete and slow-moving inventory, the allowance for doubtful accounts, and the reserve for warranties. These estimation processes affect current assets and operating results and are therefore critical in assessing the financial and operating status of the Company. These estimates involve certain assumptions that if incorrect, could create an adverse impact on the Company's operations and financial position.

RESEARCH AND DEVELOPMENT

Costs are incurred in the discovery of new knowledge and the resulting translation of this new knowledge into plans and designs for new products. Prior to the attainment of the related products' technological feasibility, these costs are recorded as expenses in the period incurred. Product design costs incurred in the development of products after technological feasibility is attained are capitalized and amortized using the straight-line method over the estimated economic lives of the related products, not to exceed three years. The Company considers technological feasibility to be established when the Company has completed all planning, designing, coding and testing activities that are necessary to establish design specifications including function, features and technical performance requirements. Capitalization of product design costs ceases and amortization of such costs begins when the product is available for general release to customers. The Company periodically assesses the value of capitalized product design costs and records a reserve for obsolescence or impairment when, in the circumstances (including the discontinuance or probable discontinuance of the related products from the market), it deems the asset to be obsolete or impaired.

THE RESERVE FOR OBSOLETE AND SLOW-MOVING INVENTORY

Since the amount of inventoriable cost that the Company will truly recoup through sales cannot be known with exact certainty, the Company relies upon both past sales experience and future sales forecasts. Inventory is considered obsolete if the Company has withdrawn those products from the market or if the Company has had no sales of the product for the past 12 months, and has no sales forecasted for the next 12 months. Accordingly, an allowance in an amount equal to 100% of the average cost of such inventory is recorded. The Company classifies as "slow-moving", inventory with on-hand quantities greater than the amounts sold in the past 12 months or which have been forecasted to sell in the next 12 months, and reserves such an amount adequate to reduce the carrying value to net realizable value.

THE RESERVE FOR DOUBTFUL ACCOUNTS

The Company performs ongoing evaluations of its customers and adjusts their credit ratings accordingly. The Company continuously monitors collections and payments from its customers and maintains a provision for un-collectible amounts based on its historical experience and any other issues it has identified. While such credit losses have historically been within its expectations, the Company cannot guarantee this will continue in the future.

THE RESERVE FOR WARRANTIES

The Company relies upon its service data to determine the adequacy of its warranty reserve. The Company uses the service frequencies and history to evaluate the future service requirements. The Company continuously monitors this data to ensure that the reserve is sufficient. While such expenses have historically been within its expectations, the Company cannot guarantee this will continue in the future.

## TRANSACTIONS WITH RELATED AND OTHER PARTIES

The Company leases its headquarters from Xenon Research, Inc. ("Xenon"), all of the issued and outstanding capital stock of which is owned by Simon Raab, the Company's President and Chief Executive Officer, and Diana Raab, his spouse. The term of the lease expires on February 28, 2006, with two five-year renewal options. The base rent during renewal periods will reflect changes in the U.S. Bureau of Labor Statistics, Consumer Price Index for all Urban Consumers.

## INFLATION

The Company believes that inflation has not had a material impact on its results of operations in recent years and it does not expect inflation to have a material impact on its operations in 2004.

## FOREIGN EXCHANGE EXPOSURE

The Company conducts a significant portion of its business outside the United States. At present, approximately 50% of the Company's revenues are invoiced, and a significant portion of its operating expenses paid, in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on the Company's business, results of operations and financial condition, and could specifically result in foreign exchange gains and losses. The impact of future exchange rate fluctuations on the results of the Company's operations cannot be accurately predicted. To the extent that the percentage of the Company's non-U.S. dollar revenues derived from international sales increases (or decreases) in the future, the Company's exposure to risks associated with fluctuations in foreign exchange rates may increase (or decrease).

## ITEM 3. - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this item is incorporated by reference herein from the section of this Report in Part I, Item 2, under the captions "Inflation" and "Foreign Exchange Exposure", above.

ITEM 4. - CONTROLS AND PROCEDURES

As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic SEC reports.

## PART II. OTHER INFORMATION

### ITEM 1. - LEGAL PROCEEDINGS

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

ITEM 6. - EXHIBITS AND REPORTS ON FORM 8-K

a.) Exhibits:

31(a) Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31(b) Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32(a) Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32(b) Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

b.) Reports on Form 8-K

On January 13, 2004, the Company filed a Current Report on Form 8-K in connection with a press release announcing its sales results for the year ended December 31, 2003.

On March 15, 2004, the Company filed a Current Report on Form 8-K in connection with a press release announcing its results of operations for the quarter and year ended December 31, 2003.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 14, 2004

FARO TECHNOLOGIES, INC.
(Registrant)

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

EXHIBIT 31(A)

FARO TECHNOLOGIES, INC.
CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Simon Raab, Chairman of the Board, Chief Executive Officer, and President of FARO Technologies, Inc., 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 and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) 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

c) 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.

5. The registrant's other certifying officer 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:

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

b) any fraud, whether or not material, that involves management or other employees who have a significant role in FARO Technologies, Inc.'s internal controls over financial reporting.

Date: May 14, 2004

/S/ Simon Raab
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Name: Simon Raab
Title: President and Chief Executive Officer-Director
(Principal Executive Officer)

FARO TECHNOLOGIES, INC.
CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Gregory A. Fraser, Chief Financial Officer and Executive Vice President, Secretary, and Treasurer of FARO Technologies, Inc., 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 and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) 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

c) 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.

5. The registrant's other certifying officer 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:

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

b) any fraud, whether or not material, that involves management or other employees who have a significant role in FARO Technologies, Inc.'s internal controls over financial reporting.

Date: May 14, 2004

/S/ Gregory A. Fraser
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Name: Gregory A. Fraser
Title: Chief Financial Officer and Executive Vice President,
Secretary, Treasurer and Director
(Principal Financial and Accounting Officer)

EXHIBIT 32(A)

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 Chairman of the Board, President, Chief Executive Officer and Director of FARO Technologies, Inc., (the "Company") hereby certify, based on my knowledge, that the Quarterly Report on Form 10-Q, for the three months ended April 3, 2004 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/S/ Simon Raab

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Simon Raab
May 14, 2004

EXHIBIT 32(B)

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 Chief Financial Officer and Executive Vice President, Secretary, Treasurer and Director of FARO Technologies, Inc. (the "Company"), hereby certify, based on my knowledge, that the Quarterly Report on Form 10-Q of the Company for the three months ended April 3, 2004 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/S/ Gregory A. Fraser
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Gregory A. Fraser
May 14, 2004