FARO TECHNOLOGIES INC
Form 10-K
February 29, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2015

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 Number)**
250 Technology Park, Lake Mary, FL	**32746**
(Address of Principal Executive Offices)	**(Zip Code)**

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

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

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $.001	**NASDAQ Global Select Market**

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

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

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

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 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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definite proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.x

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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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	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 Act).
Yes ¨ No x

The aggregate market value of the Registrant s common stock held by non-affiliates of the Registrant on June 26, 2015 (the last business day of the Registrant s most recently completed second fiscal quarter) was $796,756,020 based on the closing price of the Registrant s common stock on such date on the NASDAQ Global Select Market, and assuming solely for the purposes of this calculation that all directors and executive officers of the Registrant are affiliates.

As of February 17, 2016, there were outstanding 16,589,618 shares of the Registrant s common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s proxy statement for the 2015 Annual Meeting of Shareholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

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PART I

CAUTIONARY STATEMENTS FOR FORWARD-LOOKING INFORMATION

FARO Technologies, Inc. (FARO, the Company, us, we or our) has made forward-looking statements in this Report on Form 10-K within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. 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, might, would, will, will be, future, strategy, believe, plan, should, could, seek, expect, anticipate, objective, project, forecast, target and similar words identify forward-looking statements.

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. We do 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:

- economic downturn in the manufacturing industry or the domestic and international economies in the regions of the world where we operate;
- our inability to further penetrate our customer base and target markets;
- development by others of new or improved products, processes or technologies that make our products less competitive or obsolete;
- our inability to maintain our technological advantage by developing new products and enhancing our existing products;
- risks associated with expanding international operations, such as fluctuations in currency exchange rates, difficulties in staffing and managing foreign operations, political and economic instability, compliance with import and export regulations, and the burdens and potential exposure of complying with a wide variety of U.S. and foreign laws and labor practices;
- the impact of geographic changes in the manufacturing or sales of our products on our tax rate;
- our inability to successfully identify and acquire target companies and achieve expected benefits from, and effectively integrate, acquisitions that are consummated;

the cyclical nature of the industries of our customers and material adverse changes in our customers access to liquidity and capital;

change in the potential for the computer-aided measurement market and the potential adoption rate for our products, which are difficult to quantify and predict;

our inability to protect our patents and other proprietary rights in the United States and foreign countries;

the material weakness in the operating effectiveness of our internal control over financial reporting and our ability to remediate this issue completely and promptly;

fluctuations in our annual and quarterly operating results and the inability to achieve our financial operating targets as a result of a number of factors including, without limitation, (i) litigation and regulatory action brought against us, (ii) quality issues with our products, (iii) excess or obsolete inventory, shrinkage or other inventory losses due to product obsolescence, change in demand for our products, scrap or material price changes, (iv) raw material price fluctuations and other inflationary pressures, (v) expansion of our manufacturing capability, (vi) the size and timing of customer orders, (vii) the amount of time that it takes to fulfill orders and ship our products, (viii) the length of our sales cycle to new customers and the time and expense incurred in further penetrating our existing customer base, (ix) increases in operating expenses required for product development and new product marketing, (x) costs associated with new product introductions, such as product development, marketing, assembly line start-up costs and low introductory period production volumes, (xi) the timing and market acceptance of new products and product enhancements, (xii) customer order deferrals in anticipation of new products and product enhancements, (xiii) the success of our sales and marketing programs, (xiv) start-up costs associated with opening new sales offices outside of the United States, (xv) fluctuations in revenue without proportionate adjustments in fixed costs, (xvi) the efficiencies achieved in managing inventories and fixed assets, and (xvii) compliance with government regulations including health, safety, and environmental matters;

changes in gross margins due to changing mix of products sold and the different gross margins on different products and sales channels;

our inability to successfully maintain the requirements of Restriction of use of Hazardous Substances (RoHS2) and Waste Electrical and Electronic Equipment (WEEE) compliance in our products;

the inability of our products to displace traditional measurement devices and attain broad market acceptance;

the impact of competitive products and pricing on our current offerings;

the effects of increased competition as a result of consolidation in the CAM2 market;

the loss of our Chief Executive Officer or other key personnel;

difficulties in recruiting research and development engineers and application engineers;

the failure to effectively manage the effects of our growth;

the impact of reductions or projected reductions in government spending, particularly in the defense sector;

variations in our 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 of time or on commercially reasonable terms;

the impact of disruption, delays, or deficiencies in the design or implementation of our new global enterprise resource planning (ERP) system;

our ability to maintain profitability;

the effect of estimates and assumptions with respect to critical accounting policies and the impact of the adoption of recently issued accounting pronouncements;

the magnitude of increased warranty costs from new product introductions and enhancements to existing products;

the continuation of our share repurchase program;

the sufficiency of our working capital and cash flow from operations to fund our long-term liquidity requirements; and

our ability to comply with the requirements for favorable tax rates in foreign jurisdictions.

as well as other risks and uncertainties discussed in Part I, Item 1A of this Annual Report on Form 10-K. Moreover, new risks and uncertainties emerge from time to time, and we undertake no obligation to update publicly or review the risks and uncertainties included in this Annual Report on Form 10-K, unless otherwise required by law.

ITEM 1. BUSINESS.

The Company was founded in 1982, and re-incorporated in Florida in 1992. Our worldwide headquarters are located at 250 Technology Park, Lake Mary, Florida 32746 and our telephone number is (407) 333-9911.

We design, develop, manufacture, market and support software driven, three-dimensional (3D) measurement, imaging and realization systems. We sell the majority of our products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building information modeling, construction, public safety, cultural heritage and other applications. Our FaroArm®, FARO Laser ScanArm®, FARO Gage, FARO Laser Tracker , FARO Cobalt Array 3D Imager, and their companion CAM2® software, provide for Computer-Aided Design, or CAD, based inspection and/or factory-level statistical process control and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. Our FARO Focus3D and FARO Freestyle3D laser scanners, and their companion SCENE, FARO public safety software and FARO 3D software, are utilized for a wide variety of 3D modeling, documentation and high-density surveying applications, including in two of our key vertical markets Building Information Modeling (BIM)/Construction Information Management (CIM) and public safety.

Industry Background

We believe four principal forces drive the need for our products and services: 1) the widespread use by manufacturers of CAD in product development, which shortens product cycles; 2) the adoption by manufacturers of quality standards such as Six Sigma and ISO-9001 (and its offshoot QS-9000), which stress the measurement of every step in a manufacturing process to reduce or eliminate defects; 3) the inability of traditional measurement devices to address many manufacturing problems such as throughput, efficiency, and accuracy, especially with respect to large components for products such as automobiles, aircraft, heavy duty construction equipment and factory retrofits; and 4) the growing demand to capture large volumes of three-dimensional data for modeling and analysis.

CAD improves the manufacturing process. The creation of physical products involves the processes of design, engineering, production, and measurement and quality inspection. These basic processes have been profoundly affected by the computer hardware and software revolution that began in the 1980s. CAD software was developed to automate the design process, providing manufacturers with computerized 3D design capability and shortening the time between design changes. Today, most manufacturers use some form of CAD software to create designs and engineering specifications for new products and to quantify and modify designs and specifications for existing products. While manufacturers previously designed their products to remain in production for longer periods of time,

current

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manufacturing practices must accommodate more frequent product introductions and modifications, while satisfying more stringent quality and safety standards. Assembly fixtures and measurement tools must be linked to the CAD design to enable production to keep up with the rate of design change.

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

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

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

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

The market demands three-dimensional data. Various factors contribute to market demand for FARO products and services. Conventional surveying equipment is limited to single-point measurements and does not have the capacity to capture and analyze large volumes of three-dimensional data. As data requirements for construction, civil engineering and public safety projects become more complex, single-point measurement devices will become increasingly more difficult to utilize in those applications.

Escalating global competition has created a demand for higher quality products with shorter life cycles. Customers require more rapid design, greater control of the manufacturing process, tools to compare components to their CAD specifications, the ability to precisely measure components that cannot be measured or inspected by conventional devices, and the

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ability to capture and analyze large volumes of three-dimensional data. Moreover, they increasingly require measurement capabilities to be integrated into manufacturing processes and to be available on the factory floor. These changing demands have driven the demand for FARO s products and services.

FARO Products

FaroArm. The FaroArm is a combination of a portable, six or seven-axis, articulated measurement arm, a computer, and CAM2 software programs, which are described below under CAM2 Software .

Articulated Arm The articulated arm is comprised of three major joints, each of which may consist of one, two or three axes of motion. The articulated arm is available in a variety of sizes, configurations and precision levels suitable for a broad range of applications. To take a measurement, the operator simply touches the object to be measured with a probe at the end of the arm and presses a button. Data can be captured at either individual points or a series of points. Optical encoders located at each of the joints of the arm measure the angles at those joints, and this rotational measurement data is transmitted to an on-board controller that converts the arm angles to precise locations in 3D space using xyz position coordinates and ijk orientation coordinates.

Computer We pre-install our CAM2 software on either a notebook or desktop style computer or Microsoft Windows -based Touch PC or Touch Pad, depending on the customer s need, and the measurement arm, computer and installed software are sold as a system. We purchase the computers sold with our products from various suppliers.

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

FARO Gage. The FARO Gage is a smaller, higher-accuracy version of the FaroArm that is sold as a combination of an articulated arm device with a computer and software. The FARO Gage is also distinguished from the FaroArm by the special mounting features and software unique to the FARO Gage. The FARO Gage is targeted at machine tools and bench tops around machine tools, where basic measurements of smaller machined parts must be taken. The CAM2 FARO Gage software developed for this device, described below, features basic 2D and 3D measurements common to these applications.

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

Laser Tracker Vantage The FARO Laser Tracker Vantage utilizes an ultra-precise laser beam to measure objects of up to 260 feet. It enables manufacturing, engineering, and quality control professionals to measure and inspect large parts, machine tools and other large objects on-site and in-process. With our high angular resolution, repeatability, and accuracy, the FARO Laser Tracker Vantage advances already-proven tracker technology. Among our many enhanced features is TruADM , which improves upon existing Absolute

Distance Measurement (ADM) technology by providing the time-saving ability to reacquire the laser beam without the need to return to a known reference point or the need to hold the target stationary.

Laser Tracker ION The FARO Laser Tracker ION is an interferometer (IFM)-based measurement system that provides the high accuracy and range to complete measurement tasks, such as in-line measurements, high-speed dynamic measurements, or high-accuracy machine calibration. The FARO Laser Tracker ION features Dual Distancing Systems, enabling the Tracker to catch the beam in the air and set the distance instantly with Agile ADM.

Computer The FARO Laser Tracker includes a notebook or desktop style computer or Microsoft Windows -based Touch PC or Touch Pad, depending on the customer s requirements, that includes the pre-installed CAM2 Software.

FARO Cobalt Array 3D Imager. The FARO Cobalt Array 3D Imager, released in January 2016, is our next generation FARO 3D Imager product offering replacing the FARO 3D Imager AMP. The FARO Cobalt Array 3D Imager is a metrology-grade non-contact scanner that utilizes blue light technology to capture millions of high resolution 3D coordinate measurements in seconds. FARO Cobalt s versatility supports a variety of deployment options including rotary table, robot, industrial inspection cells and multiple imager arrays. This technology is used in quality control to improve product quality and reduce scrap, as well as for reverse engineering and rapid manufacturing.

FARO Focus^{3D}. The FARO Focus^{3D} laser scanner utilizes laser technology to measure and collect a cloud of data points, allowing for the detailed and precise three-dimensional rendering of an object or an area as large as an industrial facility. This technology is currently used for factory planning, facility life-cycle management, quality control, forensic analysis and capturing large volumes of three-dimensional data. The FARO Focus^{3D} simplifies modeling, reduces project time and maintains or increases the accuracy of the image. The resulting data is used with major CAD systems or FARO s own proprietary SCENE software.

FARO Freestyle^{3D}. The FARO Freestyle^{3D} is a top-quality, high-precision, handheld scanner that quickly documents rooms, structures and objects in 3D and creates high-definition point clouds. The applications of the FARO Freestyle^{3D} include architecture, construction, industrial production and forensics. The FARO Freestyle^{3D} s durable carbon fiber design equips the user with a versatile and ergonomic tool for performing accurate scanning in confined spaces. The FARO Freestyle^{3D} can be used independently or as a complement to the FARO Focus^{3D}. The FARO Freestyle^{3D} comes with two software applications in addition to FARO s proprietary SCENE software: SCENE Capture, which is installed on a tablet computer to record and visualize the capturing of 3D data, and SCENE Process, which processes the captured 3D data.

FARO Software. We provide a family of proprietary CAD-based measurement and laser scanner software used with our measurement and scanning devices.

CAM2 Measure 10 allows customers to complete measurement jobs quickly and gives customers the freedom to measure as required by the application. State-of-the-art functionalities improve every process where measuring is needed.

FARO CAM2 Smartinspect is our CAM2 solution for measuring geometry and building dimensions. The software allows customers to quickly measure geometric features and report dimensions for control.

FARO SCENE software combines ease-of-use, networking, and an enhanced 3D experience to deliver a complete scan processing solution. With SCENE, customers can display, analyze, administer and edit 3D measurements in point clouds.

FARO Public Safety Software makes diagramming and pre-planning easier for law enforcement officers, firefighters and loss control engineers by allowing the users who need to draw site plans or crash or crime scene diagrams to be able to do so in a fast and efficient manner.

FARO 3D Software offers field-proven software products to enable and simplify the use of real world objects in CAD applications. Primarily serving the Surveying and Architecture, Engineering and Construction spaces, the offering allows the user to integrate 3D laser scan data with CAD environments.

To support our product line, we also offer extended warranties and comprehensive support, training and technology consulting services to our customers.

In February 2015, we completed the acquisition of ARAS 360 Technologies Inc. (ARAS). ARAS, a privately held business headquartered in Canada, produces a full suite of accident and crime reconstruction software tools that offer advanced graphics, analytical tools, and the ability to work with large point cloud data. These products are part of our FARO Public Safety Software product offerings discussed above and are expected to complement our portfolio of software products within the public safety market.

In March 2015, we completed the acquisition of kubit GmbH and substantially all of the assets of kubit GmbH s U.S. distributor kubit USA, Inc. (collectively kubit). Kubit, a privately held business with operating facilities in Germany and the United States, develops software for surveying and as-built documentation. These products are part of our FARO 3D Software product offerings discussed above and are expected to complement our portfolio of software products specifically in the Building Information Modeling (BIM)/Construction Information Management (CIM) market.

Customers

Our sales are diversified across a broad number of over 15,000 customers worldwide in a range of metrology, reverse engineering, factory automation, Building Information Modeling (BIM)/Construction Information Management (CIM), public safety and other applications. The FARO metrology product lines (e.g. Arm, Gage, Laser ScanArm, Laser Tracker, and Cobalt Array Imager) are purchased primarily by customers in the automotive and aerospace markets and a diverse array of manufacturing customers from small machine shops to large industrials. Our Focus^{3D} and Freestyle^{3D} product lines provide precise three-dimensional renderings primarily to architecture, engineering, construction, and public safety customers. Our ten largest customers by revenue represented an aggregate of approximately 4.3% of our total sales in 2015. No customer represented more than 2.0% of our sales in 2015.

Sales and Marketing

We conduct our sales and marketing efforts on a decentralized basis in three main regions around the world: Americas, Europe/Africa and Asia-Pacific. The regional headquarters for the Americas, which is also our global headquarters, is located in Lake Mary, Florida; the Europe/Africa regional headquarters is located in Stuttgart, Germany; and the regional headquarters for the Asia-Pacific region is located in Singapore. At December 31, 2015, we employed 171, 172, and 169 sales and marketing specialists in the Americas, Europe/Africa, and Asia-Pacific regions, respectively. We sell most of our products through direct sales representation in Brazil, Canada, China, France, Germany, India, Italy, Japan Malaysia, Mexico, the Netherlands, Poland, Singapore, South Korea, Spain, Switzerland, Thailand, Turkey, the United Kingdom, the United States, and Vietnam. We also sell our products through distributors, although this channel has historically represented a small percentage of total sales, and in 2015 represented 9.3% of total sales, compared with 9.9% in 2014. Note 17 to the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K includes financial information about our

foreign and domestic operations.

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Our sales and marketing efforts use a process of integrated lead qualification and sales demonstration. Once a customer opportunity is identified, we employ a team-based sales approach involving inside and outside sales personnel who are supported by application engineers. Each team has the ability to sell multiple product lines. We employ a variety of marketing techniques to promote brand awareness and customer identification.

Research and Development

We believe that our future success depends, in part, on our ability to maintain technological leadership, which will require ongoing enhancements of our products and the development of new applications and products that provide 3D measurement solutions. The field of 3D measurement continues to expand, and new technologies and applications will be essential to competing in this market. Accordingly, we intend to continue to make substantial investments in the development of new technologies, the commercialization of new products that build on our existing technological base, and the enhancement and development of additional applications for our products.

Our research and development efforts are directed primarily at enhancing the functional adaptability of our current products and developing new and innovative products that respond to specific requirements of the emerging market for 3D measurement and documentation systems. Our engineering development efforts will continue to focus on enhancing the mechanical hardware, electronics, and software in our existing products and developing new products for the CAM2 market. Research and development activities, especially with respect to new products and technologies, are subject to significant risks, and there can be no assurance that any of our research and development activities will be completed successfully or on schedule, or, if completed, will be commercially accepted.

At December 31, 2015, we employed 181 scientists and technicians in our research and development efforts. Research and development expenses were approximately $26.6 million in 2015, compared to $27.5 million in 2014 and $22.4 million in 2013.

Intellectual Property

We own approximately 900 patents and pending patent applications worldwide, which generally expire on a rolling basis between 2016 and 2040. We also own approximately 65 trademark registrations worldwide.

Our success and ability to maintain a competitive position depends, in large part, on our ability to protect our intellectual property. We rely on a combination of contractual provisions and trade secret laws to protect our proprietary information. However, there can be no assurance that the steps taken by us to protect our trade secrets and proprietary information will be sufficient to prevent misappropriation of our proprietary information or preclude third-party development of similar intellectual property.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. We intend to vigorously defend our proprietary rights against infringement by third parties. However, policing unauthorized use of our products is difficult, particularly in foreign countries, and we may be unable to determine the extent, if any, to which unauthorized use of our products exist. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States.

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

Manufacturing and Assembly

We manufacture our FaroArm, FARO Gage, FARO Laser ScanArm, FARO Cobalt Array 3D Imager and FARO Laser Tracker products in our manufacturing facilities located in Florida and Pennsylvania for customer orders from the Americas, in our manufacturing facility located in Schaffhausen, Switzerland for customer orders from the Europe/Africa region, and in our manufacturing facility located in Singapore for customer orders from the Asia-Pacific region. We manufacture our FARO Focus^{3D} and FARO Freestyle^{3D} products in our facilities located in Stuttgart, Germany and Schaffhausen, Switzerland. In 2014, we relocated our facility in Kennett Square, Pennsylvania to a leased facility consisting of approximately 90,400 square feet in Exton, Pennsylvania.

We expect all of our existing plants to have the production capacity necessary to support our volume requirements through 2016.

Manufacturing consists primarily of assembling and integrating components and subassemblies purchased from suppliers into finished products. The primary components, which include machined parts and electronic circuit boards, are produced by subcontractors according to our specifications. Products are assembled, calibrated and tested for accuracy and functionality before shipment. We perform limited in-house circuit board assembly and component part machining. Typically, we enter into purchase commitments for manufacturing components to cover production requirements for 60 to 120 days. We may enter into longer agreements to purchase sufficient inventory to satisfy warranty commitments or to ensure adequate component availability.

Our manufacturing, engineering, and design headquarters have been registered to the ISO-9001 standard since July 1998. Semi-annual surveillance audits have documented continuous improvement to this multinational standard. Currently, our manufacturing sites in Lake Mary, Florida; Exton, Pennsylvania; Stuttgart, Germany; Schaffhausen, Switzerland; and Singapore are jointly registered to ISO-9001. Our FARO Laser Tracker, FaroArm, FARO Gage, and FARO Cobalt Array 3D Imager products are all registered to ISO-17025:2005. We continue to examine our scope of registration as our business evolves and we have chosen English as the standard business language for our operations.

Our efforts to register our manufacturing, engineering and design headquarters to the ISO-9001 standard in concert with the ISO9001:2008 Quality Management System Certification verifies our commitment to quality through an internationally recognized standard. Additionally, we take a global approach to ISO-17025:2005 regarding the recognition of the Competence of Calibration and Testing Laboratories, seeking to have all locations registered with similar scopes of accreditation and capabilities for the products generated and serviced.

Competition

Our measurement systems compete in the broad and highly competitive market for measurement devices for manufacturing and industrial applications, which, in addition to portable articulated arms, laser tracker, 3D imaging and laser scanner products, consist of fixed-base CMMs, templates and go/no-go gages, check fixtures, handheld measurement tools, and various categories of surveying equipment. In the FARO Gage product line, we compete with a number of manufacturers of handheld measurement tools and fixed-base

CMMs, including some large, well-established companies. In the FaroArm, FARO Laser ScanArm, FARO Laser Tracker, FARO Focus^{3D} and FARO Cobalt Array 3D Imager product lines, we compete primarily with Hexagon Metrology, a division of Hexagon AB, and with Steinbichler Optotechnik GmbH and GOM GmbH in the 3D Imager product lines. We also compete in these product lines with a number of other smaller companies. We compete on the basis of technical innovation, product performance, quality and price with respect to all of our products.

We will be required to make continued investments in technology and product development to maintain and extend the technological advantage that we believe we currently have over our competition. However, we cannot be certain that our technology or our product development efforts will allow us to successfully compete as the industry evolves. As the market for our measurement systems expands, additional competition may emerge and our existing and future competitors may commit more resources to the markets in which we participate.

Government Regulation

Our operations are subject to numerous governmental laws and regulations, including those governing antitrust and competition, the environment, import and export of products, currency conversions and repatriation, taxation of foreign earnings and earnings of expatriate personnel, and use of local employees and suppliers. Our foreign operations are subject to the U.S. Foreign Corrupt Practices Act, or FCPA, and similar foreign anti-corruption laws, which makes illegal any payments to government officials or government employees that are intended to induce their influence to assist us or to gain any improper advantage for us. We operate in certain regions in the Middle East, Africa, Latin America, and Asia-Pacific that are more prone to risk under these anti-corruption laws.

Manufacturers of electrical goods are subject to the European Union s RoHS2 and WEEE directives, which took effect during 2006. RoHS2 prohibits the use of lead, mercury and certain other specified substances in electronics products, and WEEE makes producers of electrical goods financially responsible for specified collection, recycling, treatment, and disposal of covered electronic products and components. Parallel initiatives are being proposed in other jurisdictions, including several states in the United States and China.

We currently hold WEEE registration and are in compliance with the directives of the European Union. Under the classification of Industrial Monitoring and Control Instruments, our products have until July 22, 2017 to become compliant with the RoHS2 directive. Currently, only the FARO Laser Tracker ION does not meet the RoHS2 directive. However, if we are unable to bring the FARO Laser Tracker ION into compliance with the RoHS2 directive by July 22, 2017, we would be unable to sell the FARO Laser Tracker ION in the European Union countries and China, and potentially in several states in the United States, which could have a material adverse effect on our sales and results of operations.

Backlog and Seasonality

At December 31, 2015, we had orders representing approximately $9.1 million in sales outstanding. The majority of these specific orders were shipped by February 18, 2016, and, as of February 18, 2016, we had orders representing approximately $8.5 million in sales outstanding. We believe that substantially all of the outstanding sales orders as of February 18, 2016 will be shipped during 2016. At December 31, 2014 and 2013, we had orders representing approximately $14.1 million and $18.7 million in sales outstanding, respectively.

We typically experience greater order volume during the fourth quarter as customers spend the remaining balances of their capital expenditure budgets.

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Employees

At December 31, 2015, we had 1,288 full-time employees, consisting of 512 sales and marketing professionals, 201 production staff, 181 research and development staff, 166 administrative staff, and 228 customer service/training/application engineering specialists. We are not a party to any collective bargaining agreements and believe our employee relations are satisfactory. Management believes that our future growth and success will depend in part on our ability to retain and continue to attract highly skilled personnel. We anticipate that we will be able to obtain the additional personnel required to satisfy our staffing requirements over the foreseeable future.

Geographic Information

We have three reportable segments based upon geographic regions: Americas, Europe/Africa and Asia-Pacific. We develop, manufacture, market, support and sell CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software and three-dimensional documentation systems in each of these regions. These activities represent more than 99% of our consolidated sales. We evaluate performance and allocate resources based upon profitable growth and assets deployed. Information regarding our net sales, operating income, and long-lived assets by geographic region is set forth in Note 17 to the Consolidated Financial Statements under Part II, Item 8 of this Annual Report on Form 10-K.

Available Information

We make available, free of charge on our Internet website at http://www.faro.com, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission, or the SEC. You can find these reports on our website at www.faro.com by first clicking Investor Relations and then SEC Filings . The information on, or accessible through, our website is not a part of this Annual Report on Form 10-K.

These reports may also be obtained at the SEC s Public Reference Room at 100 F Street NE, Washington, DC 20549. Information on the operation of the Public Reference Room is available by calling the SEC at (800) SEC-0330. You may also access this information at the SEC s website at http://www.sec.gov. This site contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

ITEM 1A. RISK FACTORS.

The statements under this heading describe the most significant risks to our business identified by management and should be considered carefully in conjunction with the discussion in Management s Discussion and Analysis of Financial Condition and Results of Operations included in Part II, Item 7 of this Annual Report on Form 10-K and in our Consolidated Financial Statements and notes thereto included in Part II, Item 8 of this Annual Report on Form 10-K before deciding to invest in, or retain, shares of our common stock.

Any of the following risks and uncertainties could materially and adversely affect our business, results of operations, liquidity, and financial condition. These are not the only risks we face. Our operations could also be affected by additional factors that are not presently known by us or by factors that we currently do not consider material to our business.

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Competitors may develop products that make our products obsolete or less competitive.

The CAM2 market is characterized by rapid technological change. Competitors may develop new or improved products, processes or technologies that may make our products obsolete or less competitive.

As a result, our success depends, in part, on our ability to maintain our technological advantage by developing new products and applications and enhancing our existing products, which can be complex and time-consuming and require substantial investment. Significant delays in new product releases or difficulties in developing new products could adversely affect our business and results of operations. We can provide no assurance that we will be able to adapt to evolving markets and technologies or maintain our technological advantage.

Our financial performance is dependent on the conditions of various industries, including the automotive, aerospace, and heavy equipment industries, which have from time to time experienced, and may again experience, significant disruptions in the economic environment.

A significant portion of our sales are to manufacturers in the automotive, aerospace, and heavy equipment industries. We are dependent upon the continued viability and financial stability of our customers in these industries, which are highly cyclical and dependent upon the general health of the economy and consumer spending.

Because a significant portion of our revenues and expenses are denominated in foreign currencies, we face significant exposure to foreign exchange rate risk.

Our results of operations are affected by fluctuations in exchange rates, which has caused, and may continue to cause, significant fluctuations in our quarterly and annual results of operations. Fluctuations in exchange rates may have a material adverse effect on our results of operations and financial condition, and could result in potentially significant foreign exchange gains and losses. To the extent that the percentage of our non-U.S. dollar revenues derived from international sales increases in the future, our exposure to risks associated with fluctuations in foreign exchange rates will increase.

We may be unable to recognize the anticipated benefits of our reorganization initiatives.

On February 24, 2016, we announced our intention to pursue various reorganization initiatives targeting certain vertical markets, modernizing our sales process, harmonizing our global functions and accelerating our product development efforts. Management expects to derive certain benefits from these reorganization initiatives, including accelerating sales growth, improving the leverage of our sales organization and optimizing management and operations. A variety of known and unknown risks, uncertainties and other factors could cause actual results and experience to differ materially from those anticipated, resulting in an inability to realize the expected benefits of the reorganization initiatives and our ability to execute our plans and strategies.

The buying process for most of our customers for our measurement products is highly decentralized and typically requires significant time and expense for us to further penetrate the potential market of a specific customer, which may delay our ability to generate additional revenue.

Our success depends, in part, on our ability to further penetrate our customer base. During 2015, approximately 73% of our revenue was attributable to sales to our existing customers. If we are not able to continue to further penetrate our existing customer base, our sales growth may further decline. However, most of our customers have a decentralized

buying process for measurement devices, and we must spend significant time and resources to increase revenues from a specific customer. For example, we may provide products to only one of our customer s manufacturing facilities or for a specific product line within a manufacturing facility. We cannot offer any assurance that we will be able to maintain or increase the amount of sales to our existing customers, which could adversely affect our financial results.

Our ability to protect our patents and proprietary rights in the United States and foreign countries could adversely affect our revenues.

Our success depends, in large part, on our ability to obtain and maintain patents and other proprietary right protection for our processes and products in the United States and other countries. We also rely upon trade secrets, technical know-how and continuing inventions to maintain our competitive position. We seek to protect our technology and trade secrets, in part, by confidentiality agreements with our employees and contractors. However, our employees may breach these agreements; or, our trade secrets may otherwise become known or be independently discovered by inventors. If we are unable to obtain or maintain protection of our patents, trade secrets and other proprietary rights, we may not be able to prevent third parties from using our proprietary rights, which could have a material adverse effect on our results of operations.

Our patent protection involves complex legal and technical questions. Our patents may be challenged, narrowed, invalidated or circumvented. Further, we may be able to protect our proprietary rights from infringement by third parties only to the extent that our proprietary processes and products are covered by valid and enforceable patents or are effectively maintained as trade secrets. Furthermore, others may independently develop similar or alternative technologies or design around our patented technologies. Litigation or other proceedings to defend or enforce our intellectual property rights could require us to spend significant time and money, which could have an adverse impact on our financial condition.

Claims from others that we infringed on their intellectual property rights may adversely affect our business and financial condition.

From time to time, we receive notices from others claiming that we infringed on their intellectual property rights. Resolving these claims may require us to enter into royalty or licensing agreements on unfavorable terms, require us to stop selling or to redesign affected products, or require us to pay damages. In addition, from time to time, we are involved in intellectual property lawsuits. We could, in the future, incur judgments or enter into settlements of lawsuits and claims that could have a material adverse effect on our financial condition. Any litigation or interference proceedings, regardless of their outcome, may be costly and may require significant time and attention of our management and technical personnel.

Product failures or product availability and performance issues could result in increased warranty costs, delays in new product introductions and enhancements, and could adversely affect our business and financial condition.

We regularly introduce new products and enhance existing products. Failures in our new or existing products could result in increased warranty costs, delays in new product introductions, and a loss of sales and customers, and have an adverse effect on our business and financial condition.

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

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Our ability to achieve financial results that are within our goals is subject to a number of factors beyond our control. Moreover, our annual and quarterly operating results have varied significantly in the past and likely will vary significantly in the future. Factors that cause our financial results to fluctuate include, but are not limited to, the following:

- adverse changes in the manufacturing industry and general economic conditions;
- the effectiveness of sales promotions;
- geographic expansion in our regions;
- training and ramp-up time for new sales people;
- investments in strategic sales, product or other initiatives;
- investments in technologies and new products and product enhancements, including costs associated with new development and product introductions, and the timing and market acceptance of new products and product enhancements;
- excess or obsolete inventory, shrinkage or other inventory losses due to product obsolescence, change in demand for our products, scrap or material price changes;
- expansion of our manufacturing capability;
- the size and timing of customer orders, many of which are received towards the end of the quarter;
- the amount of time that it takes to fulfill orders and ship our products;
- the length of our sales cycle to new customers;
- customer order deferrals in anticipation of new products and product enhancements;
- start-up costs and ramp-up time associated with opening new sales offices outside of the United States;

- variations in the effective income tax rate and difficulty in predicting the tax rate on a quarterly and annual basis; and

- litigation and regulatory action brought against us.

Any one or a combination of these factors could adversely affect our annual and quarterly operating results in the future and could cause us to fail to achieve our target financial results.

Our growth depends on the ability of our products to attain broad market acceptance.

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

The potential size and growth rate of the CAM2 market is uncertain and difficult to quantify. If the CAM2 market does not continue to expand or does not expand as quickly we anticipate, we may not be able to grow our sales, which could materially adversely affect our results of operations and financial condition.

We market seven closely interdependent products (FaroArm, FARO Laser ScanArm, FARO Gage, FARO Laser Tracker, FARO Cobalt Array 3D Imager, FARO Focus^{3D} and FARO Freestyle^{3D}) and related software for use in measurement, inspection, and high density surveying applications. Substantially all of our revenues are currently derived from sales of these products and software, and we plan to continue our business strategy of focusing on the software-driven, 3D measurement and inspection market. Consequently, our financial performance will depend, in large part, on computer-based measurement, inspection and high density surveying products achieving broad market acceptance. If our products cannot attain broad market acceptance, we will not grow as anticipated and may be required to make increased expenditures on research and development for new applications or new products.

We compete with manufacturers of measurement systems and traditional measurement devices, many of which have more resources than us and may develop new products and technologies.

The broad market for measurement devices is highly competitive. In the FARO Gage product line, we compete with manufacturers of handheld measurement tools and fixed-base CMMs, including some large, well-established companies. In the FaroArm, FARO Laser ScanArm, FARO Laser Tracker, FARO Focus^{3D} and FARO Cobalt Array 3D Imager product lines, we compete primarily with Hexagon Metrology, a division of Hexagon AB, and with Steinbichler Optotechnik GmbH and GOM GmbH in the FARO Cobalt Array 3D Imager product line. We also compete in these product lines with a number of other smaller companies. We compete on the basis of technical innovation, product performance, quality, and price with respect to all of our products.

We will be required to make continued investments in technology and product development to maintain the technological advantage that we believe we currently have over our competition. Some of our competitors possess substantially greater financial, technical, and marketing resources than we possess. Moreover, we cannot be certain that our technology or our product development efforts will allow us to successfully compete as the industry evolves. As the market for our measurement systems expands, additional competition may emerge and our existing and future competitors may commit more resources to the markets in which we participate. Our results of operations could be adversely affected by pricing strategies pursued by competitors or technological or product developments by competitors.

We have identified a material weakness in our internal control over financial reporting related to the review of certain deferred income tax accounts. If we do not remediate this material weakness and fail to establish and maintain effective internal control over financial reporting, our financial statements could contain a material misstatement, which could adversely affect our business and financial condition.

Under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules promulgated by the SEC, companies are required to conduct a comprehensive evaluation of their internal control over financial reporting. As part of this process, we are required to document and test our internal control over financial reporting; management is required to assess and issue a report concerning our internal control over financial reporting; and our independent registered public accounting firm is required to attest to the effectiveness of our internal control over financial reporting. Our internal control over financial reporting may not prevent or detect misstatements because of its inherent limitations, including the possibility of human error, the circumvention or overriding of controls, or fraud. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be prevented or detected on a timely basis. Even effective internal control over financial reporting can

provide only reasonable assurance with respect to the preparation and fair presentation of financial statements.

In connection with the audit of our financial statements as of and for the year ended December 31, 2015, we recently identified a material weakness in our internal control over financial reporting related to the review of certain deferred income tax accounts. Specifically, inaccurate unearned service revenue balances were used to calculate the deferred tax amounts in China and our internal controls over the review of the related deferred income tax accounts in foreign jurisdictions were not sufficiently designed to identify reasonably possible errors, including the lack of certain specific, documented instructions to the reviewers of the foreign income tax provisions. As a result of this material weakness, our management concluded that our disclosure controls and procedures and our internal control over financial reporting were not effective as of December 31, 2015. Notwithstanding the existence of this material weakness, our management has concluded that the consolidated financial statements in this Annual Report on Form 10-K fairly present, in all material respects, our financial position, results of operations and cash flows for all periods and dates presented. Our management team has reviewed and discussed the identified material weakness with the Audit Committee and is in the process of developing and implementing an action plan to remediate it. A more complete description of this material weakness is included in Item 9A, Controls and Procedures in this Annual Report on Form 10-K.

We cannot be certain that our remediation efforts will be successful or that our internal control over financial reporting will be effective as a result of these efforts. If the remedial measures are insufficient to address the identified material weakness or if additional material weaknesses or significant deficiencies in internal control over financial reporting are discovered or occur in the future, our financial statements may contain material misstatements and we could be required to restate our financial results. This could cause us to fail to meet our reporting obligations, lead to a loss of investor confidence and adversely affect our business, our financial condition, and the trading price of our common stock.

We derive a substantial part of our revenues from our international operations, which are subject to greater volatility and often require more management time and expense to achieve profitability than our domestic operations.

We derive more than half of our revenues from international operations. Our international operations are subject to various risks, including:

- difficulties in staffing and managing foreign operations;
- political and economic instability;
- unexpected changes in regulatory requirements and laws;
- longer customer payment cycles and difficulty collecting accounts receivable;

- compliance with export and import regulations and trade restrictions;
- governmental restrictions on the transfer of funds to us from our operations outside the United States; and
- burdens of complying with a wide variety of foreign laws and labor practices.

Several of the countries where we operate have emerging or developing economies, which may be subject to greater currency volatility, negative growth, high inflation, limited availability of foreign exchange and other risks. These factors may harm our results of operations and any measures that we may implement to reduce the effect of volatile currencies and other risks of our international operations may not be effective.

Reductions in defense spending could adversely affect our business.

Certain of our customers operate in the defense sector and depend significantly on U.S. government spending. In August 2011, Congress enacted the Budget Control Act of 2011, which imposed spending caps and certain reductions in defense spending through 2021. Automatic spending reductions, referred to as sequestration, were implemented in March 2013. Ongoing budgetary discussions in the federal government may result in other cuts to defense spending. Reductions in defense spending that impact the aerospace and defense industries could have an adverse effect on our results of operations.

We are subject to the impact of governmental and other similar certification processes and regulations, which could adversely affect our business and results of operations.

Our operations are subject to numerous governmental laws and regulations, including those governing antitrust and competition, the environment, import and export of products, currency conversions and repatriation, taxation of foreign earnings and earnings of expatriate personnel, and use of local employees and suppliers. An inability to comply with these regulations or obtain any necessary certifications in a timely manner could have an adverse effect on our business and results of operations.

In addition, as a manufacturer of electrical goods, we are subject to the European Union s RoHS2 and WEEE directives, which took effect during 2006. RoHS2 prohibits the use of lead, mercury and certain other specified substances in electronics products, and WEEE makes producers of electrical goods financially responsible for specified collection, recycling, treatment, and disposal of covered electronic products and components. Parallel initiatives are being proposed in other jurisdictions, including several states in the United States and China.

We currently hold WEEE registration and are in compliance with the directives of the European Union. Under the classification of Industrial Monitoring and Control Instruments, our products have until July 22, 2017 to become compliant with the RoHS2 directive. Currently, only the FARO Laser Tracker ION does not meet the RoHS2 directive. However, if we are unable to bring the FARO Laser Tracker ION into compliance with the RoHS2 directive by July 22, 2017, we would be unable to sell the FARO Laser Tracker ION in European Union countries and China, and potentially in several states in the United States, which could have a material adverse effect on our sales and results of operations.

Any failure to comply with the Foreign Corrupt Practices Act or similar anti-corruption laws could subject us to fines and penalties.

In 2012, our monitorship expired pursuant to our settlement with the SEC and the Department of Justice, or DOJ, concerning certain payments made by our subsidiary in China that may have violated the Foreign Corrupt Practices Act, or the FCPA, and other applicable laws. We are, of course, still subject to such laws and have adopted and maintain a compliance

program designed to ensure compliance with these laws; however, in light of our prior conduct, any future failure to comply with any such continuing obligations could result in the SEC and the DOJ aggressively seeking to impose penalties against us. In addition, many countries in which we operate have increased regulation regarding anti-corruption practices generally. Compliance with such regulations could be costly and could adversely impact our results of operations or delay entry into new markets.

We may not be able to identify or consummate acquisitions or achieve expected benefits from or effectively integrate acquisitions, which could harm our growth.

Our growth strategy partly depends on our ability to obtain additional technologies, complementary product lines and sales channels through selective acquisitions and strategic investments. We may not be able to identify and successfully negotiate suitable acquisitions, obtain financing for future acquisitions, if necessary, on satisfactory terms or otherwise complete acquisitions in the future. In the past, we have used our stock as consideration for acquisitions. Our common stock may not remain at a price at which it can be used as consideration for acquisitions without diluting our existing shareholders, and potential acquisition candidates may not view our stock attractively.

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

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

We cannot offer any assurance that we will be able to identify, complete or successfully integrate any suitable acquisitions, that any acquired companies will operate profitably, or that we will realize the expected synergies and other benefits from any acquisition.

We may face difficulties managing the effects of our growth.

If our business grows rapidly in the future, we expect it to result in:

- increased complexity;

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

If we are not able to manage the effects of our future growth, our business, financial condition and operating results may be harmed.

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Our dependence on suppliers for materials could impair our ability to manufacture our products.

Outside vendors provide key components used in the manufacture of our products. Any supply interruption in a limited source component would hinder our ability to manufacture our products until a new source of supply is identified. In addition, an uncorrected defect or supplier s variation in a component, either known or unknown, or incompatibility with our manufacturing processes could hinder our ability to manufacture our products. We may not be able to find a sufficient alternative supplier in a reasonable period of time, or on commercially reasonable terms, if at all. If we fail to obtain a supplier for the manufacture of components of our potential products, we may experience delays or interruptions in our operations, which would adversely affect our business, results of operations and financial condition.

The disclosure requirements under the conflict minerals provisions of the Dodd-Frank Act could increase our costs and limit the supply of certain metals used in our products and affect our reputation with customers and shareholders.

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as amended, or the Dodd-Frank Act, the SEC adopted disclosure requirements, which became effective in 2014, for public companies using certain minerals and metals in their products. These minerals and metals are generally referred to as conflict minerals regardless of their country of origin. Under these rules, we are required to perform due diligence and disclose our efforts to prevent the sourcing of such conflict minerals from the Democratic Republic of Congo or adjoining countries. Conflict minerals are commonly used in the manufacture of electronics and may be incorporated in our products. As a result of these regulations, we have incurred, and expect to continue to incur, additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the conflict minerals used in our products. These requirements could also adversely affect the sourcing, availability and pricing of such minerals, and the pool of suppliers who provide conflict free metals may be limited. As a result, we or our suppliers may not be able to obtain materials necessary for production of our products in sufficient quantities or at competitive prices. In addition, since our supply chain is complex, we may not be able to sufficiently verify the origins of all metals used in our products and confirm that they are conflict free, which may adversely affect our reputation. Implementation of certain provisions of the rule has been delayed as a result of pending litigation challenging certain aspects of the rule. We continue to monitor these developments and their implications on us.

Our failure to attract and retain qualified personnel could lead to a loss of sales or decreased profitability.

On March 20, 2015, we announced the departure of our Chief Financial Officer, Peter Abram, and on December 7, 2015, we announced the resignation of our Chief Executive Officer, Jay Freeland. While we have subsequently hired a new Chief Financial Officer, Laura Murphy-Wolf, and have appointed our Chairman, Dr. Simon Raab, as interim President and Chief Executive Officer, these senior leadership changes could impact our ability to attract and retain sufficient qualified personnel to support our growth and could have a material adverse effect on our business reputation and results of operations.

In addition, the loss of any of our current executive officers, or other key personnel, could adversely affect our sales, profitability or growth. Moreover, we continue to rely, in part, on equity awards to attract and retain qualified personnel, which may result in an increase in compensation expense.

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Risks generally associated with our information systems could adversely affect our business reputation and results of operations.

We rely on our information systems to obtain, rapidly process, analyze and manage data to, among other things:

- facilitate the purchase and distribution of thousands of inventory items;
- receive, process and ship orders on a timely basis;
- accurately bill and collect from customers;
- process payments to suppliers and employees; and
- summarize results and manage our business.

Our primary and back-up computer systems are subject to damage or interruption from power outages, computer and telecommunication failures, computer viruses, security breaches, natural disasters and errors by employees. Though losses arising from some of these issues would be covered by insurance, interruptions of our critical business computer systems or failure of our back-up systems could lead to a loss of sales or decreased profitability.

A cyberattack or security breach of our systems may compromise the confidentiality, integrity, or availability of our internal data and the availability of our products and websites designed to support our customers or their data. Computer hackers, foreign governments or cyber terrorists may attempt to penetrate our network security and our website. Unauthorized access to our proprietary business information or customer data may be obtained through break-ins, sabotage, breach of our secure network by an unauthorized party, computer viruses, computer denial-of-service attacks, employee theft or misuse or other misconduct. Because the techniques used by computer programmers who may attempt to penetrate and sabotage our network security or our website change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques. It is also possible that unauthorized access to customer data may be obtained through inadequate use of security controls by customers, suppliers or other vendors. Any security breach, cyberattack or cyber security breach, and any incident involving the misappropriation, loss or other unauthorized disclosure of, or access to, sensitive or confidential customer information, whether by us or by one of our vendors, could require us to expend significant resources to remediate any damage, could interrupt our operations and damage our reputation, and could also result in regulatory enforcement actions, material fines and penalties, litigation or other actions which could have a material adverse effect on our business, reputation and results of operations.

We are subject to risks of natural disasters.

We have manufacturing facilities in each of our regions. The occurrence of one or more natural disasters, such as tornadoes, hurricanes, earthquakes, floods and other forms of severe weather where we have a manufacturing facility could result in physical damage to, and complete or partial closure of, our manufacturing facilities, which could adversely affect our business, operations and financial performance. Interruptions in our manufacturing operations or damage to our manufacturing facilities could reduce our revenues and increase our costs, and the extent of losses from

natural disasters and severe weather will be a function of both the severity of the event and the total amount of insured exposure. Although we maintain insurance coverage, we can offer no assurance that our insurance coverage will be adequate to cover any losses or that we will be able to maintain insurance at a reasonable cost in the future. If losses from business interruption or property damage exceed the amounts for which we are insured, our business, results of operations and financial condition could be adversely affected.

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We may experience volatility in our stock price.

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

- fluctuations in demand for, and sales of, our products or prolonged downturns in the industries that we serve;
- actual or anticipated variations in quarterly or annual operating results;
- general economic uncertainties;
- speculation in the press or investment community; and
- announcements of technological innovations or new products by us or our competitors.

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

Our relatively small public float and daily trading volume have in the past caused, and may in the future result in, significant volatility in our stock price. At December 31, 2015, we had approximately 16.3 million shares outstanding held by non-affiliates. Our daily trading volume for the year ended December 31, 2015 averaged approximately 186,005 shares.

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

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

Our articles of incorporation, bylaws and provisions of Florida law could make it more difficult for a third party to acquire us. Although we believe such provisions are appropriate to protect long-term value for our shareholders, these provisions could discourage potential takeover attempts and could adversely affect the market price of our shares. Because of these provisions, you might not be able to receive a premium on your investment. These provisions include:

a limitation on shareholders ability to call a special meeting of our shareholders;

advance notice requirements to nominate directors for election to our board of directors or to propose matters that can be acted on by shareholders at shareholder meetings;

our classified board of directors, which means that approximately one-third of our directors are elected each year; and

the authority of the board of directors to issue, without shareholder approval, preferred stock with such terms as the board of directors may determine.

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

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

The Americas

Our headquarters are located in a leased building in Lake Mary, Florida containing approximately 46,000 square feet. This facility houses our sales, marketing, customer service/application operations and administrative staff. Our U.S. production, research and development, service operations and manufacturing are located in another leased building in Lake Mary, Florida, which consists of approximately 35,000 square feet, and a new leased facility consisting of approximately 90,400 square feet located in Exton, Pennsylvania containing research and development, manufacturing and service operations of our FARO Laser Tracker™ and FARO Cobalt Array 3D Imager product lines. In 2014, we relocated to our Exton facility from our Kennett Square, Pennsylvania facility, which consisted of two leased buildings totaling approximately 36,800 square feet.

Europe/Africa

Our European headquarters are located in a leased building in Stuttgart, Germany containing approximately 103,600 square feet. This facility houses the manufacturing, administration, sales, marketing and service management personnel for our European operations. Additionally, we have a leased facility consisting of approximately 15,900 square feet located in Schaffhausen, Switzerland containing manufacturing operations for our products shipped to customers in Europe and Africa.

Asia-Pacific

Our Asian headquarters are located in a leased building in Singapore containing approximately 22,000 square feet. This facility houses the administration, sales, marketing, production, service management personnel and manufacturing for our Asia-Pacific operations. Our Japan operations are located in a leased building in Nagoya, Japan containing approximately 17,200 square feet. This facility houses our Japanese sales, marketing and service operations. Our China operations are located in a leased building in Shanghai, China containing approximately 25,500 square feet for sales, marketing and service operations.

We believe our current facilities will be adequate for our foreseeable needs and that we will be able to locate suitable space for additional regional offices or enhanced production needs as necessary.

The information required by the remainder of this Item is incorporated herein by reference to Exhibit 99.1 to this Annual Report on Form 10-K.

ITEM 3. LEGAL PROCEEDINGS.

We are not involved in any legal proceedings other than routine litigation arising in the normal course of business, none of which we believe will have a material adverse effect on our business, financial condition or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

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

Market Information and Holders

Our common stock is listed and traded on the NASDAQ Global Select Market under the symbol FARO .

The following table sets forth, for the periods indicated, the high and low sales prices of our common stock as reported by the NASDAQ Stock Market:

	2015		2014	
	High	Low	High	Low
First Quarter	$ 63.21	$ 51.79	$ 59.90	$ 48.70
Second Quarter	64.00	38.75	54.84	39.75
Third Quarter	47.22	32.95	59.35	44.52
Fourth Quarter	40.51	24.25	65.63	47.31

As of February 10, 2016, we had 49 holders of record of common stock.

Dividends

To date, we have not paid any cash dividends on our common stock. We expect to retain future earnings for use in operating and expanding our business and we do not anticipate paying any cash dividends in the reasonably foreseeable future.

Recent Sales of Unregistered Securities

During the year ended December 31, 2015, we did not sell any equity securities that were not registered under the Securities Act.

Purchases of Equity Securities

On November 24, 2008, our Board of Directors approved a $30 million share repurchase program. Acquisitions for the share repurchase program may 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 expiration date or other restriction governing the period over which we can repurchase shares under the program. In October 2015, our Board of

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Directors authorized an increase to the existing share repurchase program from $30 million to $50 million. The following table summarizes the repurchase activity during the three months ended December 31, 2015:

Period	Total Number of Shares Purchased	Average Price per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
September 27 - October 24		$		$ 41,094,621
October 25 - November 21	521,116	$ 27.21	521,116	$ 26,914,001
November 22 - December 31	288,125	$ 29.79	288,125	$ 18,331,103

Performance Graph

The following performance graph and related information shall not be deemed soliciting material or to be filed with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or the Exchange Act, except to the extent that we specifically incorporate it by reference into such filing.

The following line graph compares the cumulative five-year returns of our common stock with (1) the cumulative returns of the NASDAQ Composite-Total Returns and (2) the Morningstar Scientific & Technical Instruments Index.

For purposes of preparing the graph, we assumed that an investment of $100 was made at market close on December 31, 2010, the last trading day before the beginning of our fifth preceding fiscal year, with reinvestment of any dividends at the time they were paid. We did not pay any dividends during the period indicated.

The comparison in the graph below is based on historical data. The stock price performance shown on the graph is not necessarily indicative of future price performance. Information used in the graph and table was obtained from Zacks Investment Research, a source believed to be reliable, but we are not responsible for any errors or omissions in such information.

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Company/Market/Peer Group	2010	2011	2012	2013	2014	2015
FARO Technologies, Inc.	$ 100.00	$ 140.07	$ 108.65	$ 177.53	$ 190.86	$ 89.89
NASDAQ Composite-Total Returns	$ 100.00	$ 99.17	$ 116.48	$ 163.21	$ 187.27	$ 200.31
Morningstar Scientific & Technical Instruments	$ 100.00	$ 100.10	$ 117.05	$ 148.13	$ 155.39	$ 135.36

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ITEM 6. SELECTED FINANCIAL DATA.

	Year ended December 31,				
in thousands, except share and per-share data	2015	2014	2013	2012	2011
Consolidated Statement of Operations Data:					
Sales	$ 317,548	$ 341,826	$ 291,784	$ 273,395	$ 254,164
Gross profit	167,677	188,914	161,893	149,619	143,689
Income from operations	13,122	37,340	30,154	31,554	32,858
Income before income tax (benefit) expense	12,806	37,522	28,862	30,942	31,705
Net income	12,813	33,649	21,509	22,998	23,377
Net income per common share:					
Basic	$ 0.74	$ 1.95	$ 1.26	$ 1.36	$ 1.42
Diluted	$ 0.74	$ 1.93	$ 1.25	$ 1.34	$ 1.39
Weighted average shares outstanding:					
Basic	17,288,665	17,247,727	17,087,104	16,910,830	16,503,773
Diluted	17,389,473	17,416,453	17,241,115	17,129,128	16,868,471

	As at December 31,				
	2015	2014	2013	2012	2011
Consolidated Balance Sheet Data:					
Working capital(1)	$ 229,127	$ 256,170	$ 263,166	$ 232,396	$ 197,539
Total assets	409,186	425,463	391,496	350,807	312,791
Total debt-capital leases	28	8	16	64	341
Total shareholders equity	327,644	343,854	315,950	282,736	247,898

(1) In 2015 management reassessed certain inventory policies based on recent sales and customer trends. As a result, we now expect our sales demonstration inventory to be held by our sales representatives for more than one year. To reflect this change in policy, we reclassified $18.5 million as of December 31, 2015 and December 31, 2014 from current assets to long-term assets, impacting the working capital calculation. Working capital as of December 31, 2013, December 31, 2012 and December 31, 2011 have not be adjusted to reflect this change in policy as it is not practical to do so.

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

The following information should be read in conjunction with our Consolidated Financial Statements, including the notes thereto, included in Part II, Item 8 of this Annual Report on Form 10-K.

Overview

We design, develop, manufacture, market and support software driven, three-dimensional (3D) measurement, imaging and realization systems. We sell the majority of our products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building information modeling, construction, public safety, cultural heritage and other applications. Our FaroArm®, FARO Laser ScanArm®, FARO Gage, FARO Laser Tracker , FARO Cobalt Array 3D Imager, and their companion CAM2® software, provide for Computer-Aided Design, or CAD, based inspection and/or factory-level statistical process control and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. Our FARO Focus^{3D} and FARO Freestyle^{3D} laser scanners, and their companion SCENE, FARO public safety software and FARO 3D software, are utilized for a wide variety of 3D modeling, documentation and high-density surveying applications, including in two of our key vertical markets Building Information Modeling (BIM)/Construction Information Management (CIM) and public safety.

We derive our revenues primarily from the sale of our measurement equipment and their related multi-faceted CAM2 software programs. Revenue related to these products is generally recognized upon shipment. In addition, we sell extended warranties and training and technology consulting services relating to our products. We recognize revenue from extended warranties on a straight-line basis over the term of the warranty and revenue from training and technology consulting services when the services are provided. We also receive royalties from licensing agreements for our historical medical technology and recognize revenue from these royalties as licensees use the technology.

We operate in international markets throughout the world and maintain sales offices in Brazil, Canada, China, France, Germany, India, Italy, Japan, Malaysia, Mexico, the Netherlands, Poland, Singapore, South Korea, Spain, Switzerland, Thailand, Turkey, the United Kingdom, the United States, and Vietnam. We manage and report our global sales in three regions: the Americas, Europe/Africa and Asia-Pacific.

We manufacture our FaroArm, FARO Laser ScanArm, FARO Gage, FARO Laser Tracker and FARO Cobalt Array 3D Imager products in our manufacturing facility located in Switzerland for customer orders from the Europe/Africa region, in our manufacturing facility located in Singapore for customer orders from the Asia-Pacific region, and in our manufacturing facilities located in Florida and Pennsylvania for customer orders from the Americas. We manufacture our FARO Focus^{3D} and FARO Freestyle^{3D} products in our facilities located in Stuttgart, Germany and Schaffhausen, Switzerland. We expect all of our existing plants to have the production capacity necessary to support our volume requirements through 2016.

We account for wholly owned foreign subsidiaries in the currency of the respective foreign jurisdiction. Therefore, fluctuations in exchange rates may have an impact on the value

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of the intercompany account balances denominated in different currencies. We are 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. However, none were utilized in 2015, 2014 or 2013.

Executive Summary

Over the past decade, we have continued to achieve profitability, with the exception of a loss in 2009 that resulted primarily from the decline of the global economy in that year. Historically, our sales and earnings have grown as a result of continuing market demand for and acceptance of our products, increased sales activity in part through additional sales staff worldwide, new product launches or enhancements, and acquisitions. Our historical financial performance is not indicative of our future financial performance.

Our fiscal 2015 results reflected the effect of the significant strengthening of the U.S. dollar throughout 2015 and other macroeconomic conditions that negatively impacted the capital budgets of many of our customers. Although our financial results did not meet our internal targets, there were a number of highlights in 2015:

Product innovation In the first quarter of 2015, we launched the FARO Freestyle3D laser scanner. This handheld laser scanner can quickly document rooms, structures and objects in 3D and create high-definition point clouds. We also launched the FARO Freestyle3DX in the third quarter of 2015, which delivers enhanced scanning accuracy of 1 millimeter at a 1 meter range.

Strategic acquisitions In the first quarter of 2015, we completed the acquisition of kubit GmbH and ARAS 360 Technologies Inc. These software businesses provide us with the opportunity to offer our customers a complementary suite of integrated 3D documentation products within the public safety and Building Information Modeling (BIM)/ Construction Information Management (CIM) markets.

Infrastructure investment To support future growth and to enhance our business information and transactions systems and financial reporting, we implemented SAP, an enterprise resource planning (ERP) system. SAP was implemented in phases, beginning with the Americas region, where implementation commenced at the start of the fourth quarter of 2014. The implementation continued in 2015 in the Europe/Africa region and was completed in the Asia-Pacific region in the fourth quarter of 2015.

Share repurchases In October 2015, our Board of Directors authorized an increase to our existing share repurchase program from $30 million to $50 million. In the fourth quarter of 2015, we repurchased 809,241 shares under the program for a total cash payment of $22.8 million. As of December 31, 2015, we had authorization to repurchase $18.3 million remaining under the repurchase program.

Our fiscal 2015 results were also impacted by the write-down of inventory, mainly in the third quarter of 2015. Based upon the planned timing of new product introductions and a sudden and significant decline in demand for our products during the three months ended September 26, 2015, our on-hand inventory levels exceeded our estimated requirements, resulting in excess inventory. We use several contract manufacturers and suppliers to provide manufacturing services for our products. In the normal course of business, to reduce manufacturing lead times and ensure adequate component availability, we enter into agreements with these manufacturers and suppliers to purchase sufficient inventory based on our forecast demand. At September 26, 2015, we had purchase commitments with

suppliers for inventory that we no longer expected to utilize through the product lifecycle and for warranty commitments. Consequently, we recorded a $5.9 million write-down of excess inventory and a $2.0 million loss on purchase commitments in the third quarter of 2015, resulting in an aggregate write-down of $7.9 million.

We are undertaking several important initiatives in 2016 to drive long-term growth and profitability, including reorganizing our business around specific vertical markets, modernizing our sales process to improve the efficiency of our sales organization, accelerating and maintaining a consistent schedule of new product introductions, and harmonizing our global functions to improve effectiveness. The timing of the implementation of the reorganization of our sales and marketing organizations around vertical markets in 2016 is dependent upon a number of factors, including making the necessary adjustments to our new ERP system.

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Results of Operations

The following table sets forth, for the periods presented, the percentage of sales represented by certain items in our consolidated statements of operations:

	Years ended December 31,		
	2015	2014	2013
Statement of Operations Data:			
Sales	100.0%	100.0%	100.0%
Cost of sales	47.2%	44.7%	44.5%
Gross margin	52.8%	55.3%	55.5%
Operating expenses:			
Selling and marketing	25.0%	23.4%	24.6%
General and administrative	11.8%	10.7%	10.5%
Depreciation and amortization	3.5%	2.2%	2.4%
Research and development	8.4%	8.0%	7.7%
Total operating expenses	48.7%	44.3%	45.2%
Income from operations	4.1%	11.0%	10.3%
Interest income	0.0%	0.0%	0.0%
Other expense	0.1%	0.0%	0.4%
Interest expense	0.0%	0.0%	0.0%
Income before income tax (benefit) expense	4.0%	11.0%	9.9%
Income tax (benefit) expense	0.0%	1.1%	2.5%
Net Income	4.0%	9.9%	7.4%

2015 Compared to 2014

Sales. Sales totaled $317.5 million for the year ended December 31, 2015 compared with $341.8 million for the year ended December 31, 2014, a decrease of $24.3 million or 7.1%. The lower sales reflected a $24.3 million unfavorable impact of foreign exchange rates primarily due to a weakening of the Euro, Japanese Yen and Brazilian Real relative to the U.S. dollar. Excluding the foreign exchange rate impact, sales for the year ended December 31, 2015 would have been about even compared with the year ended December 31, 2014. Our sales were favorably impacted by the introduction of our FARO Freestyle^{3D} product launched in the first quarter of 2015 and a higher average selling price for our products, offset by a decline in unit sales across all regions. Arm (comprising the FaroArm, FARO Laser ScanArm, and FARO Gage) sales were lower by 5%, reflecting an 11% decrease in units sold partially offset by a higher average selling price mostly due to increased sales of our Arm accessories such as the Laser Line Probe HD. Laser Tracker (comprising the FARO Laser Tracker Vantage and ION products) sales were lower by 22%, reflecting a 18% decrease in units sold. Laser Scanner (comprising the FARO Focus^{3D} and FARO Freestyle^{3D}) sales were lower by 6%, primarily reflecting an 8% decline in units sold of the FARO Focus^{3D} Laser Scanner, partially offset by sales of the new FARO Freestyle^{3D} launched in 2015. Total product sales were $259.8 million for the year ended December 31, 2015 compared with $284.1 million in 2014. Service revenue totaled $57.7 million for both the years ended December 31, 2015 and 2014, reflecting an increase in warranty revenue offset by the unfavorable impact

from foreign exchange rates.

Sales in the Americas region increased $4.4 million, or 3.2%, to $143.4 million for the year ended December 31, 2015 compared with $139.0 million for the year ended December 31, 2014. Foreign exchange rates had an unfavorable impact on sales of $3.4 million. Excluding the impact of foreign exchange rates, sales in the Americas region increased $7.8 million or 5.6%. Product sales in the Americas region increased by $1.0 million, or 0.9%, to $115.8 million for the year ended December 31, 2015 compared with $114.8 million in the prior year, reflecting primarily a higher average Arm selling price partially offset by lower unit sales due to the weaker macro-economic conditions in Brazil. Service revenue in the Americas region increased by $3.4 million, or 14.0%, to $27.6 million for the year ended December 31, 2015 compared with $24.2 million for the prior year, primarily reflecting an increase in warranty revenue due to specific promotions targeting warranty renewals this year.

Sales in the Europe/Africa region totaled $103.1 million for the year ended December 31, 2015 compared with $120.1 million for the year ended December 31, 2014, a year-over-year decrease of $17.0 million, or 14.1%. Excluding the unfavorable impact from foreign exchange rates of $16.4 million, sales in the Europe/Africa region were about even for the year ended December 31, 2015 compared with the prior year. Product sales in the Europe/Africa region totaled $82.9 million for the year ended December 31, 2015 compared with $96.4 million for the year ended December 31, 2014, a decrease of $13.5 million, or 14.0%, reflecting the unfavorable impact of foreign exchange rates. Service revenue in the Europe/Africa region totaled $20.2 million for the year ended December 31, 2015 compared with $23.7 million for 2014, a decline of $3.5 million, or 14.7%, reflecting the unfavorable impact of foreign exchange rates.

Sales in the Asia-Pacific region totaled $71.0 million for the year ended December 31, 2015 compared with $82.7 million for the year ended December 31, 2014. Excluding the unfavorable foreign exchange rate impact of $4.6 million, sales in the region were lower by 8.6%. Total product sales in the Asia-Pacific region were $61.1 million for the year ended December 31, 2015 compared with $72.9 million in the prior year. This decrease reflected lower FARO Focus^{3D} Laser Scanner sales, delayed and canceled customer spending, and aggressive price competition. Service revenue in the Asia-Pacific region increased by $0.1 million, or 1.4%, to $9.9 million for the year ended December 31, 2015 from $9.8 million in the prior year, primarily due to higher warranty revenue.

Gross profit. Gross profit was $167.7 million for the year ended December 31, 2015 compared with $188.9 million for the year ended December 31, 2014. The decrease of $21.2 million, or 11.2%, reflected primarily unfavorable foreign exchange rates, lower Asia-Pacific product sales and an increase in our inventory reserve recorded in the third quarter 2015, partially offset by sales growth in the Americas region. Gross margin was 52.8% for the year ended December 31, 2015 compared with 55.3% in the prior year. Gross margin from product sales was 56.1% for the year ended December 31, 2015 compared with 59.5% in the prior year. This decrease reflected primarily the increase in inventory reserve and higher manufacturing costs as a percent of sales consistent with lower sales volume, partially offset by a higher average Arm selling price. Gross margin from service revenue increased by 3.5 percentage points to 37.8% for the year ended December 31, 2015 from 34.3% for the year ended December 31, 2014, reflecting primarily higher warranty revenue and lower service costs.

Selling and Marketing Expenses. Selling and marketing expenses were $79.3 million for the year ended December 31, 2015 compared with $80.2 million for the year ended December 31, 2014. The lower selling and marketing expenses of $0.9 million, or 1.1%, primarily reflected lower sales commissions, partially offset by an increase in marketing headcount driven by the two completed acquisitions in 2015.

Worldwide sales and marketing headcount increased by 22, or 4.5%, to 512 at December 31, 2015 from 490 at December 31, 2014. Regionally, our sales and marketing headcount increased by 4, or 2.4%, to 171 at December 31, 2015 from 167 at December 31, 2014 for the Americas; increased by 15, or 9.6%, to 172 at December 31, 2015 from 157 at December 31, 2014 in Europe/Africa; and increased by 3, or 1.8%, in Asia-Pacific to 169 at December 31, 2015 from 166 at December 31, 2014.

In 2015, selling and marketing expenses as a percentage of sales were 25.0% for the year ended December 31, 2015 compared with 23.4% for the year ended December 31, 2014. Regionally, selling and marketing expenses were 22.6% of sales in the Americas for the year ended December 31, 2015 compared with 20.8% of sales in the year ended December 31, 2014; 29.1% of sales for Europe/Africa for the year ended December 31, 2015 compared with 27.3% of sales in the prior year; and 23.7% of sales for Asia-Pacific for the year ended December 31, 2015 compared with 22.3% of sales in the prior year.

General and administrative expenses. General and administrative expenses were $37.5 million for the year ended December 31, 2015 compared with $36.5 million for the year ended December 31, 2014. The increase in general and administrative expenses reflected primarily severance costs relating to cost reduction initiatives, as well as higher advisory and consulting fees to support our ERP implementation, acquisition expenses and other professional fees. General and administrative expenses as a percentage of sales increased to 11.8% for the year ended December 31, 2015 from 10.7% for the year ended December 31, 2014.

Depreciation and amortization expenses. Depreciation and amortization expenses were $11.2 million for the year ended December 31, 2015 compared with $7.4 million for the year ended December 31, 2014. This increase of $3.8 million reflected primarily the new Exton facility, implementation of the new ERP system, and amortization expense related to our recent acquisitions.

Research and development expenses. Research and development expenses were $26.6 million for the year ended December 31, 2015 compared with $27.5 million for the year ended December 31, 2014. The lower expenses reflected primarily a reduction in high-cost contractor expenses, timing of product development activities, and the impact of favorable foreign exchange rates, partially offset by an impairment charge related to the discontinuation of a licensing agreement. Research and development expenses as a percentage of sales increased to 8.4% for the year ended December 31, 2015 from 8.0% for the year ended December 31, 2014.

Other (income) expense. Other (income) expense changed by $0.5 million to $0.3 million of expense for the year ended December 31, 2015 compared with $0.2 million of income for the year ended December 31, 2014. The change was primarily driven by foreign exchange transaction losses resulting from changes in foreign exchange rates on the value of current intercompany account balances of our subsidiaries denominated in other currencies.

Income tax (benefit) expense. Income tax benefit for the year ended December 31, 2015 was $7,000 compared with income tax expense of $3.9 million for the year ended December 31, 2014. This change reflected primarily lower pre-tax income offset partially by a discrete tax benefit of $4.5 million related to the reversal of a valuation allowance in 2014. Our effective tax rate was (0.1%) for the year ended December 31, 2015 compared with 10.3% in the prior year. Our effective tax rate continues to be lower than the statutory tax rate in the United States reflecting primarily our global footprint in foreign jurisdictions with lower tax rates. In particular, the low tax rate recognized in 2015 primarily reflected higher operating income in jurisdictions like Switzerland where we have a favorable tax ruling and operating losses in our jurisdictions that have a higher statutory tax rate, such as the United States and Germany. Our effective tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of our products and a change in statutory tax rates in a jurisdiction, as well as the resulting effect on taxable income in each jurisdiction.

Net income. Net income was $12.8 million for the year ended December 31, 2015 compared with $33.6 million for the year ended December 31, 2014 reflecting the impact of the factors described above.

2014 Compared to 2013

Sales. Total sales increased $50.0 million, or 17.2%, to $341.8 million in the year ended December 31, 2014 from $291.8 million for the year ended December 31, 2013. Our sales growth reflected primarily favorable sales growth across all product lines, including Arm (comprising the FaroArm, FARO Laser ScanArm, and FARO Gage), Laser Tracker (comprising the FARO Laser Tracker Vantage and ION products) and Laser Scanner (FARO Focus^{3D} product line) and across all geographic regions. Arm sales growth of 18% reflected primarily an 11% increase in units sold and a higher average selling price from the release of our new Laser Line Probe HD for our FARO Laser ScanArm. Laser Tracker units sold increased 16% and Laser Tracker sales grew 1% despite pricing pressures and the unfavorable impact of foreign exchange rates. Sales of Laser Scanner increased by 38% reflecting primarily the continued adoption of the technology in the BIM/CIM and public safety markets. Foreign exchange rates had an unfavorable impact on sales of $6.5 million for the year ended December 31, 2014, reflecting primarily a weaker Euro and Yen relative to the U.S. Dollar. Product sales increased by $45.3 million, or 19.0%, to $284.1 million for the year ended December 31, 2014 from $238.8 million in the year ended December 31, 2013, primarily reflecting the higher Laser Scanner and Arm sales discussed above. Service revenue increased by $4.7 million, or 8.9%, to $57.7 million for the year ended December 31, 2014 from $53.0 million in the year ended December 31, 2013, primarily reflecting an increase in warranty revenue of $3.0 million and an increase in customer service revenue of $1.5 million due to higher unit sales.

Sales in the Americas region increased $18.6 million, or 15.4%, to $139.0 million for the year ended December 31, 2014 from $120.4 million in the prior year. Foreign exchange rates had an unfavorable impact on sales of $1.1 million. Product sales in the Americas region increased by $17.2 million, or 17.6%, to $114.8 million for the year ended December 31, 2014 from $97.6 million in the prior year, reflecting primarily a 50% increase in Laser Scanner sales and a 14% increase in Arm sales. Service revenue in the Americas region increased by $1.4 million, or 6.0%, to $24.2 million for the year ended December 31, 2014 from $22.8 million for the prior year, reflecting primarily an increase in customer service revenue of $0.9 million and warranty revenue of $0.8 million.

Sales in the Europe/Africa region increased $16.7 million, or 16.2%, to $120.1 million for the year ended December 31, 2014 from $103.4 million in the year ended December 31, 2013. Foreign exchange rates had an unfavorable impact on sales of $1.8 million, or 1.7 percentage points. Product sales in the Europe/Africa region increased by $13.7 million, or 16.6%, to $96.4 million for the year ended December 31, 2014 from $82.7 million in the prior year, reflecting primarily a 29% increase in Laser Scanner sales and a 20% increase in Arm sales. Service revenue in the Europe/Africa region increased by $3.0 million, or 14.8%, to $23.7 million for the year ended December 31, 2014 from $20.7 million in the prior year, reflecting primarily an increase in warranty revenue of $2.0 million and customer service revenue of $0.6 million.

Sales in the Asia-Pacific region increased $14.7 million, or 21.7%, to $82.7 million for the year ended December 31, 2014 from $68.0 million in the year ended December 31, 2013. Foreign exchange rates had an unfavorable impact on sales of $3.6 million, or 5.4 percentage points. Product sales in the Asia-Pacific region increased by $14.4 million, or 24.7%, to $72.9 million for the year ended December 31, 2014 from $58.5 million in the prior year, reflecting primarily a 38% increase in Laser Scanner sales, a 25% increase in Laser Tracker sales, and a 20% increase in Arm sales. Service revenue in the Asia-Pacific region increased by $0.3 million, or 3.3%, to $9.8 million for the year ended December 31, 2014 from $9.5 million in the prior year, reflecting primarily a modest increase in warranty and training revenue.

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Gross profit. Gross profit increased by $27.0 million, or 16.7%, to $188.9 million for the year ended December 31, 2014 from $161.9 million for the year ended December 31, 2013, reflecting an increase in sales revenue. Foreign exchange rates had an unfavorable impact on gross profit of $2.2 million for the year ended December 31, 2014. Gross margin at 55.3% for the year ended December 31, 2014 was slightly lower than 55.5% for the year ended December 31, 2013. Gross margin from product revenue increased by 0.4 percentage points to 59.5% for the year ended December 31, 2014 from 59.1% for the year ended December 31, 2013, reflecting primarily lower manufacturing costs related to achieved efficiencies for our Arm and Laser Tracker products and improved average selling prices for Arm products that included our new Laser Line Probe HD, partially offset by a less favorable overall sales mix with the year-over-year increase in units of Laser Scanners sold. The results included a $3.3 million write-off of sales demonstration and service loaner inventory that became obsolete through the release of new products. Gross margin from service revenue decreased by 4.8 percentage points to 34.3% for the year ended December 31, 2014 from 39.1% for the year ended December 31, 2013, reflecting primarily an increase in customer service employees to support the growth in our product sales.

Selling and Marketing Expenses. Selling and marketing expenses increased by $8.5 million, or 11.8%, to $80.2 million for the year ended December 31, 2014 from $71.7 million for the year ended December 31, 2013. The increase in selling and marketing expenses reflected primarily higher compensation costs of $6.8 million including additional headcount and higher commissions, advertising and trade show costs of $0.7 million, travel costs of $0.6 million, and facility costs of $0.4 million.

Worldwide sales and marketing headcount increased by 57, or 13.2%, to 490 at December 31, 2014 from 433 at December 31, 2013. Regionally, our sales and marketing headcount increased by 31, or 22.8%, to 167 at December 31, 2014 from 136 at December 31, 2013 for the Americas; increased by 16, or 11.3%, to 157 at December 31, 2014 from 141 at December 31, 2013 in Europe/Africa; and increased by 10, or 6.4%, in Asia-Pacific to 166 at December 31, 2014 from 156 at December 31, 2013.

In 2014, our selling and marketing expenses decreased to 23.4% of sales in the year ended December 31, 2014 from 24.6% of sales in the year ended December 31, 2013. Regionally, selling and marketing expenses were 20.8% of sales in the Americas for the year ended December 31, 2014 compared to 21.4% of sales in the year ended December 31, 2013; 27.3% of sales for Europe/Africa for the year ended December 31, 2014 compared to 28.8% of sales in the prior year; and 22.3% of sales for Asia-Pacific for the year ended December 31, 2014 compared to 23.6% of sales in the prior year.

General and administrative expenses. General and administrative expenses increased by $5.9 million, or 19.2%, to $36.5 million, for the year ended December 31, 2014 from $30.6 million in the year ended December 31, 2013, reflecting primarily higher compensation costs of $4.0 million for higher headcount and an increase in our consulting and advisory services of $1.9 million relating primarily to our ERP system implementation and strategic planning initiatives. General and administrative expenses as a percentage of sales increased to 10.7% for the year ended December 31, 2014 from 10.5% for the year ended December 31, 2013.

Depreciation and amortization expenses. Depreciation and amortization expenses increased by $0.4 million, or 5.5%, to $7.4 million for the year ended December 31, 2014 from $7.0 million in the year ended December 31, 2013, reflecting primarily the depreciation of our ERP system.

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Research and development expenses. In 2014, we increased our investment in research and development to accelerate new product development by increasing engineering headcount by 17. As a result, research and development expenses increased $5.1 million, or 22.7%, to $27.5 million for the year ended December 31, 2014 from $22.4 million for the year ended December 31, 2013. Research and development expenses as a percentage of sales increased to 8.0% for the year ended December 31, 2014 from 7.7% for the year ended December 31, 2013.

Other (income) expense. Other (income) expense decreased by $1.5 million to $0.2 million of income for the year ended December 31, 2014, from expense of $1.3 million for the year ended December 31, 2013, primarily as a result of foreign exchange transaction gains resulting from changes in foreign exchange rates on the value of current intercompany account balances of our subsidiaries denominated in different currencies.

Income tax expense. Income tax expense decreased by $3.5 million to $3.9 million for the year ended December 31, 2014 from $7.4 million for the year ended December 31, 2013, primarily due to a discrete tax benefit of $4.5 million recorded in the third quarter of 2014 reflecting a reduction in the valuation allowance, partially offset by higher pre-tax income. The valuation allowance was originally established against net operating losses in certain foreign subsidiaries. During 2014, these foreign subsidiaries demonstrated a pattern of profitability that resulted in our concluding that the valuation allowance should be reversed. The effective tax rate decreased to 10.3% for the year ended December 31, 2014 compared with 25.5% for the year ended December 31, 2013, primarily due to the discrete tax benefit. Our effective 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, our effective tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of our products and the resulting effect on taxable income in each jurisdiction.

Net income. Net income increased by $12.1 million to $33.6 million for the year ended December 31, 2014 from $21.5 million for the year ended December 31, 2013 as a result of the factors discussed above. Foreign exchange rates had an unfavorable impact on net income of $0.9 million for the year ended December 31, 2014.

Liquidity and Capital Resources

Cash and cash equivalents decreased by $1.9 million to $107.4 million at December 31, 2015 from $109.3 million at December 31, 2014. The decrease in cash and cash equivalents was primarily due to the $22.8 million in common stock repurchases in 2015, the $12.1 million in cash payments made for two acquisitions completed in 2015, and $14.2 million in capital expenditures related to our ERP implementation and production equipment to support new products. This was partially offset by proceeds from the sale of $22.0 million in Treasury Bills and $28.0 million in higher cash flow from operations reflecting lower receivables and inventory balances compared with the prior year.

Of our cash and cash equivalents, $71.2 million was held by foreign subsidiaries. Our intent is to indefinitely reinvest these funds in our foreign operations, as the cash is needed to fund on-going operations. In the event circumstances change, leading to the conclusion that these funds will not be indefinitely reinvested, we would need to accrue at the time of such determination for the income taxes that would be triggered upon their repatriation.

On July 11, 2006, we entered into a loan agreement providing for an available line of credit of $30.0 million, which was most recently amended effective March 15, 2012. Loans under the Amended and Restated Loan Agreement, as amended, bear interest at the rate of LIBOR plus a fixed percentage between 1.50% and 2.00%. The Amended and Restated Loan Agreement required us to maintain a minimum cash balance of $25 million and tangible net worth measured at the end of each of our fiscal quarters. The term of the Amended and Restated Loan Agreement, as amended, expired on March 31, 2015. We did not draw on this line of credit and we did not extend the term of the loan agreement.

On November 24, 2008, our Board of Directors approved a $30 million share repurchase program. Acquisitions for the share repurchase program may 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 expiration date or other restriction governing the period over which we can repurchase shares under the program. In October 2015, our Board of Directors authorized an increase to the existing share repurchase program from $30 million to $50 million. In 2015, we purchased a total of 809,241 shares for a total cash payment of $22.8 million. As of December 31, 2015, we had authorization to repurchase $18.3 million remaining under the repurchase program.

We believe that our working capital and anticipated cash flow from operations will be sufficient to fund our long-term liquidity requirements for the foreseeable future.

We have no off balance sheet arrangements.

Contractual Obligations and Commercial Commitments

We are party to capital leases on equipment with an initial term of 36 to 60 months and other non-cancelable operating leases. These obligations are presented below as of December 31, 2015 (dollars in thousands):

		Payments Due by Period			
Contractual Obligations	**Total**	**< 1 Year**	**1-3 Years**	**3-5 Years**	**> 5 Years**
Operating lease obligations	$ 28,602	$ 6,737	$ 10,130	$ 6,013	$ 5,722
Capital lease obligations	28	8	15	5	$
Purchase obligations	15,161	10,678	4,483		
Other obligations	2,695	363	2,332		
Total	$ 46,486	$ 17,786	$ 16,960	$ 6,018	$ 5,722

We enter into purchase commitments for products and services in the ordinary course of business. These purchases generally cover production requirements for 60 to 120 days as well as materials necessary to service customer units through the product lifecycle and for warranty commitments. To ensure adequate component availability in preparation for new product introductions, we also have $4.5 million in long-term commitments for purchases to be delivered through 2017. Other obligations included in the table primarily represent estimated payments due for acquisition related earn-outs. We had a $0.3 million liability for unrecognized tax benefits that is excluded from the contractual obligations table due to the uncertainty of the period of settlement, if any, with the respective taxing authorities.

Inflation

Inflation did not have a material impact on our results of operations in recent years, and we do not expect inflation to have a material impact on our operations in 2016.

Critical Accounting Policies

The preparation of our consolidated financial statements requires our 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. We base our 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 our management there may be other estimates or assumptions that are reasonable, we believe that, given the current facts and circumstances, it is unlikely that applying any such other reasonable estimate or assumption would materially impact the financial statements.

In response to the SEC s financial reporting release, FR-60, Cautionary Advice Regarding Disclosure About Critical Accounting Policies, we have selected our critical accounting policies for purposes of explaining the methodology used in our calculation, in addition to any inherent uncertainties pertaining to the possible effects on our financial condition. The critical policies discussed below are our processes of recognizing revenue, the reserve for excess and obsolete inventory, income taxes, the reserve for warranties, goodwill impairment, business combinations and stock-based compensation. These policies affect current assets and operating results and are therefore critical in assessing our financial and operating status. These policies involve certain assumptions that, if incorrect, could have an adverse impact on our operations and financial position.

Revenue Recognition

Revenue is recognized when the price is fixed, collectability is reasonably assured, the title and risks and rewards of ownership have passed to the customer and the earnings process is complete. Revenue related to our measurement, imaging, and realization equipment and related software is generally recognized upon shipment, as we consider the earnings process complete as of the shipping date. Fees billed to customers associated with the distribution of products are classified as revenue. We warrant our 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. We separately sell extended warranties. Extended warranty revenues are recognized on a straight-line basis over the term of the warranty. Costs relating to extended warranties are recognized as incurred. Revenue from sales of software only is recognized when no further significant production, modification or customization of the software is required and when the following criteria are met: persuasive evidence of a sales agreement exists, delivery has occurred, and the sales price is fixed or determinable and deemed collectible. Revenues resulting from sales of comprehensive support, training and technology consulting services are recognized as such services are performed and are deferred when billed in advance of the performance of services. Revenue from the licensing agreements for the use of our technology for medical applications is generally recognized as licensees use the technology. Amounts representing royalties for the current year and not received as of year-end are estimated as due based on historical data and recognized in the current year. Revenues are presented net of sales-related taxes.

Reserve for Excess and Obsolete Inventory

Because the value of inventory that will ultimately be realized cannot be known with exact certainty, we rely upon both past sales history and future sales forecasts to provide a basis for the determination of the reserve. Inventory is considered potentially obsolete if we have withdrawn those products from the market or had no sales of the product for the past 12 months, and have no sales forecasted for the next 12 months. Inventory is considered potentially excess if the quantity on hand exceeds 12 months of expected remaining usage. The resulting obsolete and excess parts are then reviewed to determine if a substitute usage or

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a future need exists. Items without an identified current or future usage are reserved in an amount equal to 100% of the FIFO cost of such inventory. Our products are subject to changes in technologies that may make certain of our products or their components obsolete or less competitive, which may increase our historical provisions to the reserve.

Income Taxes

We review our 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 we might employ to utilize such assets, including net operating loss carryforwards. Based on the positive and negative evidence of recoverability, we establish a valuation allowance against the net deferred assets of a taxing jurisdiction in which we operate, unless it is more likely than not that we will recover such assets through the above means. In the future, our evaluation of the need for the valuation allowance will be significantly influenced by our ability to maintain profitability and our ability to predict and achieve future projections of taxable income over at least a two-year period.

Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of operating a global business, there are many transactions for which the ultimate tax outcome is uncertain. We establish provisions for income taxes when, despite the belief that tax positions are fully supportable, there remain certain positions that do not meet the minimum probability threshold as described by Accounting Standards Codification Topic 740, Income Taxes, which is a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority. In the ordinary course of business, we are examined by various federal, state, and foreign tax authorities. We regularly assess the potential outcome of these examinations and any future examinations for the current or prior years in determining the adequacy of our provision for income taxes. We assess the likelihood and amount of potential adjustments and adjust the income tax provision, the current tax liability and deferred taxes in the period in which the facts that gave rise to a revision become known.

Reserve for Warranties

We establish at the time of sale a liability for the one year warranty included with the initial purchase price of 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 included 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. We evaluate our 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. We have a history of new product introductions and enhancements to existing products, which may result in unforeseen issues that increase our warranty costs. While such expenses have historically been within expectations, we cannot guarantee this will continue in the future.

Goodwill Impairment

Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. Goodwill is not amortized but is tested for impairment at least annually. We perform our annual review in the fourth quarter of each year, or more frequently if

indicators of potential impairment exist, to determine if the carrying value of the recorded goodwill is impaired. If an asset is impaired, the difference between the value of the asset reflected in the financial statements and its current fair value is recognized as an expense in the period in which the impairment occurs.

Each period, and for any of our reporting units, we can elect to initially perform a qualitative assessment to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If we believe, as a result of our qualitative assessment, that it is more likely than not that the fair value of a reporting unit containing goodwill is not less than our carrying amount, then the first and second steps of the quantitative goodwill impairment test are unnecessary. If we elect to bypass the qualitative assessment option, or if the qualitative assessment was performed and resulted in being unable to conclude that it is not more likely than not that the fair value of a reporting unit containing goodwill is less than its carrying amount, we will perform the two-step quantitative goodwill impairment test. We perform the first step of the two-step quantitative goodwill impairment test by calculating the fair value of the reporting unit using a discounted cash flow method, and then comparing the fair value with the carrying amount of the reporting unit. If the carrying amount of the reporting unit exceeds its fair value, we perform the second step of the quantitative goodwill impairment test to measure the amount of the impairment loss, if any. Management has concluded there was no goodwill impairment for the years ended December 31, 2015, 2014 and 2013.

Business Combinations

We allocate the fair value of purchase consideration to the assets acquired and liabilities assumed based on their fair values at the acquisition date. The excess of the fair value of purchase consideration over the fair value of the assets acquired and liabilities assumed is recorded as goodwill. When determining the fair values of assets acquired and liabilities assumed, management makes significant estimates and assumptions, especially with respect to intangible assets. Critical estimates in valuing intangible assets include, but are not limited to, expected future cash flows, which include consideration of future growth rates and margins, customer attrition rates, future changes in technology and brand awareness, loyalty and position, and discount rates. Fair value estimates are based on the assumptions management believes a market participant would use in pricing the asset or liability. Amounts recorded in a business combination may change during the measurement period, which is a period not to exceed one year from the date of acquisition, as additional information about conditions existing at the acquisition date becomes available.

Stock-Based Compensation

We measure and record compensation expense using the applicable accounting guidance for share-based payments related to stock options, restricted stock, and performance-based awards granted to our directors and employees. The fair value of stock options, including performance awards, without a market condition is determined by using the Black-Scholes option-pricing model. The fair value of restricted stock awards and stock options with a market condition is estimated, at the date of grant, using the Monte Carlo Simulation model. The Black-Scholes and Monte Carlo Simulation valuation models incorporate assumptions as to stock price volatility, the expected life of options or awards, a risk-free interest rate and dividend yield. In valuing our stock options, significant judgment is required in determining the expected volatility of our common stock and the expected life that individuals will hold their stock options prior to exercising. Expected volatility for stock options is based on the historical and implied volatility of our own common stock while the volatility for our restricted stock units with a market condition is based on the historical volatility of our own stock and the stock of companies within our defined peer group. The expected life of stock options is derived from the historical actual term of option grants and an estimate of future

exercises during the remaining contractual period of the option. While volatility and estimated life are assumptions that do not bear the risk of change subsequent to the grant date of stock options, these assumptions may be difficult to measure as they represent future expectations based on historical experience. Further, our expected volatility and expected life may change in the future, which could substantially change the grant-date fair value of future awards of stock options and, ultimately, the expense we record. The fair value of restricted stock, including performance awards, without a market condition is estimated using the current market price of our common stock on the date of grant. Additionally, in calculating compensation expense for these awards, we are also required to estimate the extent to which awards will be forfeited prior to vesting. Many factors are considered when estimating expected forfeitures, including types of awards, employee class and historical experience. To the extent actual results or updated estimates of forfeiture differ from current estimates, such amounts are recorded as a cumulative adjustment to the previously recorded amounts.

We expense stock-based compensation for stock options, restricted stock awards, and performance awards over the requisite service period. For awards with only a service condition, we expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the requisite service period for the entire award. For awards with both performance and service conditions, we expense the stock-based compensation, adjusted for estimated forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the award, taking into account the probability that we will satisfy the performance condition. Furthermore, we expense awards with a market condition over the three-year vesting period regardless of the value that the award recipients ultimately receive. Excess tax benefits are credited to common stock when the deduction reduces cash taxes payable. When we have tax deductions in excess of the compensation cost, they are classified as financing cash inflows in the Consolidated Statements of Cash Flows.

Impact of Recently Issued Accounting Standards

In September 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments, which eliminates the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. Instead, the acquirers must recognize measurement-period adjustments during the period in which the amounts are determined. The new guidance is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted. We do not believe the implementation of this standard will have a material impact on our consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which changes the measurement principle for inventory from the lower of cost or market to the lower of cost and net realizable value. ASU 2015-11 defines net realizable value as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new guidance must be applied on a prospective basis and is effective for fiscal years beginning after December 15, 2015, and interim periods within those years, with early adoption permitted. We do not believe the implementation of this standard will have a material impact on our consolidated financial statements.

In May 2014, the FASB issued an amendment to its accounting guidance related to revenue recognition. The amendment was the result of a joint project between the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue and to develop common revenue standards for U.S. GAAP and International Financial Reporting Standards. To meet those objectives, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09). ASU

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2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In August 2015, the FASB issued ASU 2015-14, Revenue from contracts with customers (Topic 606): Deferral of the Effective Date, deferring the effective date of ASU 2014-09 by one year. With this deferral, the new standard is effective for us on January 1, 2018. The standard permits the use of either the retrospective or cumulative effective transition method. We are evaluating the impact of adopting this standard on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk.

Foreign Exchange Exposure

We conduct a significant portion of our business outside the United States. At present, 58% of our revenue is invoiced, and a significant portion of our operating expense paid, in foreign currencies, as well as 56% of our assets is denominated in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on our 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 our operations cannot be accurately predicted due to the constantly changing exposure to various currencies, the fact that all foreign currencies do not react in the same manner in relation to the U.S. dollar and the number of currencies involved, although our most significant exposures are to the Euro, Swiss franc, Japanese yen, and Brazilian real. To the extent that the percentage of our non-U.S. dollar revenues derived from international sales increases in the future, our exposure to risks associated with fluctuations in foreign exchange rates may increase. We are 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. However, we have not used such instruments in the past, and none were utilized in 2015, 2014 or 2013.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

FARO Technologies Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of FARO Technologies Inc. (a Florida corporation) and subsidiaries (the Company) as of December 31, 2015 and 2014, and the related consolidated statements of operations, comprehensive income, shareholders equity, and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FARO Technologies Inc. and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2015, based on criteria established in the 2013 *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 29, 2016 expressed an adverse opinion.

/s/ GRANT THORNTON LLP

Orlando, Florida

February 29, 2016

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	December 31, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 107,356	$ 109,289
Short-term investments	42,994	64,995
Accounts receivable, net	69,918	83,959
Inventories, net	45,571	43,094
Deferred income taxes, net	7,792	5,936
Prepaid expenses and other current assets	18,527	16,079
Total current assets	292,158	323,352
Property and equipment:		
Machinery and equipment	54,124	45,254
Furniture and fixtures	5,945	6,156
Leasehold improvements	18,471	19,676
Property and equipment at cost	78,540	71,086
Less: accumulated depreciation and amortization	(42,594)	(41,741)
Property and equipment, net	35,946	29,345
Goodwill	26,371	19,205
Intangible assets, net	15,985	9,109
Service and sales demonstration inventory, net	33,709	36,886
Deferred income taxes, net	4,050	6,624
Other long-term assets	967	942
Total assets	$ 409,186	$ 425,463
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 11,345	$ 15,437
Accrued liabilities	22,574	26,127
Current portion of unearned service revenues	26,114	23,572
Customer deposits	2,998	2,046
Total current liabilities	63,031	67,182
Unearned service revenues - less current portion	15,025	13,799
Deferred income tax liability	686	
Other long-term liabilities	2,800	628

Total liabilities		81,542		81,609
Commitments and contingencies - See Note 13				
Shareholders equity:				
Preferred stock - par value $0.01, 10,000,000 shares authorized; none issued				
Common stock - par value $.001, 50,000,000 shares authorized; 18,077,594 and 17,997,665 issued; 16,588,118 and 17,317,430 outstanding, respectively		18		18
Additional paid-in capital		206,996		200,090
Retained earnings		172,329		159,516
Accumulated other comprehensive loss		(19,861)		(6,695)
Common stock in treasury, at cost - 1,489,476 and 680,235 shares, respectively		(31,838)		(9,075)
Total shareholders equity		327,644		343,854
Total liabilities and shareholders equity	$	409,186	$	425,463

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

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)	Years ended December 31, 2015	2014	2013
SALES			
Product	$ 259,842	$ 284,147	$ 238,841
Service	57,706	57,679	52,943
Total sales	317,548	341,826	291,784
COST OF SALES			
Product	113,983	114,994	97,630
Service	35,888	37,918	32,261
Total cost of sales (exclusive of depreciation and amortization, shown separately below)	149,871	152,912	129,891
GROSS PROFIT	167,677	188,914	161,893
OPERATING EXPENSES			
Selling and marketing	79,306	80,157	71,689
General and administrative	37,474	36,479	30,600
Depreciation and amortization	11,217	7,428	7,038
Research and development	26,558	27,510	22,412
Total operating expenses	154,555	151,574	131,739
INCOME FROM OPERATIONS	13,122	37,340	30,154
OTHER (INCOME) EXPENSE			
Interest income	(111)	(96)	(74)
Other (income) expense, net	371	(94)	1,357
Interest expense	56	8	9
INCOME BEFORE INCOME TAX (BENEFIT) EXPENSE	12,806	37,522	28,862
INCOME TAX (BENEFIT) EXPENSE	(7)	3,873	7,353
NET INCOME	$ 12,813	$ 33,649	$ 21,509
NET INCOME PER SHARE - BASIC	$ 0.74	$ 1.95	$ 1.26
NET INCOME PER SHARE - DILUTED	$ 0.74	$ 1.93	$ 1.25
Weighted average shares - Basic	17,288,665	17,247,727	17,087,104

Weighted average shares - Diluted	17,389,473	17,416,453	17,241,115

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

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

	Years ended December 31,		
(in thousands)	2015	2014	2013
Net income	$ 12,813	$ 33,649	$ 21,509
Currency translation adjustments, net of tax	(13,166)	(13,961)	925
Comprehensive (loss) income	$ (353)	$ 19,688	$ 22,434

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

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2015, 2014, AND 2013

(in thousands except share data)	Common Stock Shares	Common Stock Amounts	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Common Stock in Treasury	Total
BALANCE JANUARY 1, 2013	16,973,644	$ 18	$ 181,094	$ 104,358	$ 6,341	$ (9,075)	$ 282,736
Net income				21,509			21,509
Currency translation adjustment, net of tax					925		925
Restricted stock issued and stock based compensation under incentive plans	17,441		4,367				4,367
Stock options exercised	197,052		5,444				5,444
Income tax benefit from exercise of stock options			969				969
BALANCE DECEMBER 31, 2013	17,188,137	$ 18	$ 191,874	$ 125,867	$ 7,266	$ (9,075)	$ 315,950
Net income				33,649			33,649
Currency translation adjustment, net of tax					(13,961)		(13,961)
Restricted stock issued and stock based compensation under incentive plans	24,588		4,678				4,678
Stock options exercised	104,705		3,369				3,369
Income tax benefit from exercise of stock options			169				169
BALANCE DECEMBER 31, 2014	17,317,430	$ 18	$ 200,090	$ 159,516	$ (6,695)	$ (9,075)	$ 343,854
Net income				12,813			12,813
Currency translation adjustment, net of tax					(13,166)		(13,166)
Restricted stock issued and stock based compensation under incentive plans	13,143		4,306				4,306
Stock options exercised	66,786		2,287				2,287

Income tax benefit from exercise of stock options			313				313
Repurchase of common stock	(809,241)					(22,763)	(22,763)
BALANCE DECEMBER 31, 2015	16,588,118	$ 18	$ 206,996	$ 172,329	$ (19,861)	$ (31,838)	$ 327,644

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

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	Years Ended December 31, 2015	2014	2013
CASH FLOWS FROM:			
OPERATING ACTIVITIES:			
Net income	$ 12,813	$ 33,649	$ 21,509
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	11,217	7,428	7,038
Compensation for stock options and restricted stock units	4,306	4,678	4,367
Provision for bad debts (net recovery of)	346	(306)	1,001
Loss on disposal of assets	947		
Write-down of inventories	10,878	3,272	1,167
Deferred income tax (benefit) expense	(655)	(4,707)	645
Income tax benefit from exercise of stock options	(313)	(169)	(969)
Change in operating assets and liabilities:			
Decrease (increase) in:			
Accounts receivable	9,584	(24,587)	(4,053)
Inventories	(18,021)	(21,995)	(1,286)
Prepaid expenses and other assets	(2,834)	(3,501)	(3,346)
(Decrease) increase in:			
Accounts payable and accrued liabilities	(6,401)	8,867	6,108
Income taxes payable		(1,560)	(2,028)
Customer deposits	1,114	(724)	353
Unearned service revenues	5,051	5,313	3,772
Net cash provided by operating activities	28,032	5,658	34,278
INVESTING ACTIVITIES:			
Proceeds from sale of investments	22,001		
Purchases of property and equipment	(14,169)	(18,722)	(4,350)
Payments for intangible assets	(2,140)	(1,221)	(2,204)
Purchase of business acquired, net of cash	(12,066)	(1,150)	
Net cash used in investing activities	(6,374)	(21,093)	(6,554)
FINANCING ACTIVITIES:			
Payments on capital leases	(8)	(8)	(93)
Repurchase of common stock	(22,763)		
Income tax benefit from exercise of stock options	313	169	969
Proceeds from issuance of stock, net	2,287	3,369	5,444
Net cash (used in) provided by financing activities	(20,171)	3,530	6,320

EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(3,420)	(3,436)	(2,647)
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,933)	(15,341)	31,397
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	109,289	124,630	93,233
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 107,356	$ 109,289	$ 124,630

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

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FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2015, 2014 and 2013

(in thousands, except share and per share data or as otherwise noted)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business FARO Technologies, Inc. and its subsidiaries (collectively FARO, the Company, us, we our) designs, develops, manufactures, markets and supports software driven, three-dimensional (3D) measurement, imaging and realization systems. We sell the majority of our products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building information modeling, construction, public safety, cultural heritage and other applications. Our FaroArm®, FARO Laser ScanArm®, FARO Gage, FARO Laser Tracker , FARO Cobalt Array 3D Imager, and their companion CAM2® software provide for Computer-Aided Design, or CAD, based inspection and/or factory-level statistical process control and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. Our FARO Focus3D and FARO Freestyle3D laser scanners, and their companion SCENE, FARO public safety software, and FARO 3D software are utilized for a wide variety of 3D modeling, documentation and high-density surveying applications, including in two of our key vertical markets Building Information Modeling (BIM)/Construction Information Management (CIM) and public safety.

Principles of Consolidation Our consolidated financial statements include the accounts of FARO Technologies, Inc. and its subsidiaries, all of which are wholly owned. All intercompany transactions and balances have been eliminated. The financial statements of our 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. Foreign currency transaction gains and losses are included in income.

Revenue Recognition, Product Warranty and Extended Warranty Contracts Revenue is recognized when the price is fixed, collectability is reasonably assured, the title and risks and rewards of ownership have passed to the customer and the earnings process is complete. Revenue related to our measurement, imaging, and realization equipment and related software is generally recognized upon shipment, as we consider the earnings process complete as of the shipping date. The related software sold with our equipment function together and deliver the tangible product s essential functionality. Fees billed to customers associated with the distribution of products are classified as revenue. We warrant our 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. We separately sell extended warranties. Extended warranty revenues are recognized on a straight-line basis over the term of the warranty. Costs relating to extended warranties are recognized as incurred. Revenue from sales of software only is recognized when no further significant production, modification or customization of the software is required and when the following criteria are met: persuasive evidence of a sales agreement exists, delivery has occurred, and the sales price is fixed or determinable and deemed collectible. These software arrangements generally include short-term maintenance that is considered post-contract support (PCS). We generally establish vendor-specific objective evidence (VSOE) of fair value for this PCS component

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based on our maintenance renewal rate. Maintenance renewals, when sold, are recognized on a straight-line basis over the term of the maintenance agreement. Revenues resulting from sales of comprehensive support, training and technology consulting services are recognized as such services are performed and are deferred when billed in advance of the performance of services. Revenue from the licensing agreements for the use of our technology for medical applications is generally recognized as licensees use the technology. Amounts representing royalties for the current year and not received as of year-end are estimated as due based on historical data and recognized in the current year. Revenues are presented net of sales-related taxes.

Cash and Cash Equivalents We consider cash on hand and amounts on deposit with financial institutions with maturities of three months or less when purchased to be cash and cash equivalents. We have deposits with foreign banks totaling $71.2 million and $58.9 million as of December 31, 2015 and 2014, respectively. We do not intend to repatriate those funds. (See Note 12, *Income Taxes*).

Accounts Receivable and Related Allowance for Doubtful Accounts Credit is extended to customers based on an evaluation of a customer s financial condition and, generally, collateral is not required. Accounts receivable are generally due within 30 to 90 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due. We make judgments as to the collectability of accounts receivable based on historical trends and future expectations. Management estimates an allowance for doubtful accounts, which adjusts gross trade accounts receivable to its net realizable value. The allowance for doubtful accounts is based on an analysis of all receivables for possible impairment issues and historical write-off percentages. We write off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. We do not generally charge interest on past due receivables.

Inventories Inventories are stated at the lower of cost or net realizable value using the first-in first-out (FIFO) method. Shipping and handling costs are classified as a component of cost of sales in the consolidated statements of operations. Sales demonstration inventory is comprised of measuring, imaging and realization devices utilized by sales representatives to present our products to customers. In the third quarter of 2015, management reassessed certain inventory policies based on recent sales and customer trends and in light of new product introductions, impacting our entire product portfolio. As a result of these recent policy amendments management now expects sales demonstration inventory to be held by our sales representatives for up to three years, at which time it would be refurbished and transferred to finished goods as used equipment, stated at the lower of cost or net realizable value. Management expects these refurbished units to remain in finished goods inventory and be sold within 12 months at prices that produce reduced gross margins. To reflect our revised expectation, $18.5 million in sales demonstration inventory was reclassified from Inventories, net , a current asset, to Service and sales demonstration inventory, net , a long-term asset, as of December 31, 2015 on the consolidated balance sheet. In addition, we reclassified $16.2 million in sales demonstration inventory from Inventories, net to Service and sales demonstration inventory, net , on the consolidated balance sheet as of December 31, 2014 and reclassified $3.0 million from sales demonstration inventory to finished goods as of December 31, 2014, to conform with this current policy. Sales demonstration inventory remains classified as inventory, as it is available for sale and any required refurbishment prior to sale is minimal.

Service inventory is typically used to provide a temporary replacement product to a customer covered by a premium warranty when the customer s unit requires service or repair and as training equipment. Service inventory is available for sale; however, management does

not expect service inventory to be sold within 12 months and, as such, classifies this inventory as a long-term asset. Service inventory that we utilize for training or repairs which we deem as no longer available for sale is transferred to fixed assets at the lower of cost or net realizable value and depreciated over its remaining useful life, typically three years. We transferred $3.0 million of service inventory to Property and Equipment in 2015.

Reserve for Excess and Obsolete Inventory Since the value of inventory that will ultimately be realized cannot be known with exact certainty, we rely upon both past sales history and future sales forecasts to provide a basis for the determination of the reserve. Inventory is considered potentially obsolete if we have withdrawn those products from the market or had no sales of the product for the past 12 months and have no sales forecasted for the next 12 months. Inventory is considered potentially excess if the quantity on hand exceeds 12 months of expected 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 are reserved in an amount equal to 100% of the FIFO cost of such inventory. Our products are subject to changes in technologies that may make certain of our products or their components obsolete or less competitive, which may increase our historical provisions to the reserve.

Property and Equipment Property and equipment purchases exceeding a thousand dollars are capitalized and recorded at cost. Depreciation is computed beginning on the date that the asset is placed into service using the straight-line method over the estimated useful lives of the various classes of assets as follows:

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

Leasehold improvements are amortized on a straight-line basis over the lesser of the life of the asset or the remaining term of the lease.

Depreciation expense was $9,238, $6,171 and $5,825 in 2015, 2014 and 2013, respectively. Accelerated methods of depreciation are used for income tax purposes in contrast to book purposes, and as a result, appropriate provisions are made for the related deferred income taxes.

Business Combinations We allocate the fair value of purchase consideration to the assets acquired and liabilities assumed based on their fair values at the acquisition date. The excess of the fair value of purchase consideration over the fair value of these assets acquired and liabilities assumed is recorded as goodwill. When determining the fair values of assets acquired and liabilities assumed, management makes significant estimates and assumptions, especially with respect to intangible assets. Critical estimates in valuing intangible assets include, but are not limited to, expected future cash flows, which includes consideration of future growth rates and margins, customer attrition rates, future changes in technology and brand awareness, loyalty and position, and discount rates. Fair value estimates are based on the assumptions management believes a market participant would use in pricing the asset or liability. Amounts recorded in a business combination may change during the measurement period, which is a period not to exceed one year from the date of acquisition, as additional information about conditions existing at the acquisition date becomes available.

Goodwill and Intangibles Goodwill represents the excess cost of a business acquisition over the fair value of the net assets acquired. We do not amortize goodwill; however, we perform an annual review in the fourth quarter of each year, or more frequently if indicators of potential impairment exist, to determine if the carrying value of the recorded goodwill or indefinite lived intangible assets is impaired. If an asset is impaired, the difference between the value of the asset reflected in the financial statements and its current fair value is recognized as an expense in the period in which the impairment occurs.

Each period, and for any of our reporting units, we can elect to perform a qualitative assessment to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If we believe, as a result of our qualitative assessment, that it is not more likely than not that the fair value of a reporting unit containing goodwill is less than its carrying amount, then the first and second steps of the quantitative goodwill impairment test are unnecessary. If we elect to bypass the qualitative assessment option, or if the qualitative assessment was performed and resulted in the Company being unable to conclude that it is not more likely than not that the fair value of a reporting unit containing goodwill is greater than its carrying amount, we will perform the two-step quantitative goodwill impairment test. We perform the first step of the two-step quantitative goodwill impairment test by calculating the fair value of the reporting unit using a discounted cash flow method and market approach method, and then comparing the respective fair value with the carrying amount of the reporting unit. If the carrying amount of the reporting unit exceeds its fair value, we perform the second step of the quantitative goodwill impairment test to measure the amount of the impairment loss, if any. Management has concluded there was no goodwill impairment for the years ended December 31, 2015, 2014 and 2013.

Other intangible assets principally include patents, existing product technology and customer relationships that arose in connection with our acquisitions. Other intangible assets are recorded at fair value at the date of acquisition and are amortized over their estimated useful lives of 3 to 20 years. As of December 31, 2015, there were no indefinite-lived intangible assets.

Product technology and patents are recorded at cost. Amortization is computed using the straight-line method over the lives of the product technology and patents of 7 to 20 years.

The remaining weighted-average amortization period for all our intangible assets is nine years.

Long-Lived Assets Long-lived assets, other than goodwill, are evaluated for impairment when events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Management has concluded that there were no indications of impairment of these assets during the years ended December 31, 2015, 2014 and 2013.

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

Reserve for Warranties We establish at the time of sale a liability for the one year warranty included with the initial purchase price of our products, 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 included 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. We evaluate our 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. We have a history of new product

introductions and enhancements to existing products, which may result in unforeseen issues that increase our warranty costs. While such expenses have historically been within expectations, we cannot guarantee this will continue in the future.

Income Taxes We review our deferred tax assets on a regular basis to evaluate their recoverability based upon expected future reversals of deferred tax assets and liabilities, projections of future taxable income, and tax planning strategies that we might employ to utilize such assets, including net operating loss carryforwards. Based on the positive and negative evidence for recoverability, we establish a valuation allowance against the net deferred tax assets of a taxing jurisdiction in which we operate unless it is more likely than not that we will recover such assets through the above means. In the future, our evaluation of the need for the valuation allowance will be significantly influenced by our ability to maintain profitability and our ability to predict and achieve future projections of taxable income over at least a two-year period.

We recognize tax benefits related to uncertain tax positions only if it is more likely than not that the tax position will be sustained upon examination by taxing authorities. For those positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. In the ordinary course of business, we are examined by various federal, state, and foreign tax authorities. We regularly assess the potential outcomes of these examinations and any future examinations for the current or prior years in determining the adequacy of our provision for income taxes.

Earnings Per Share (EPS) Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding. Diluted earnings per share is computed by also considering the impact of potential common stock on both net income and the weighted average number of shares outstanding. Our potential common stock consists of employee and director stock options, restricted stock, restricted stock units and performance-based awards. Our potential common stock is excluded from the basic earnings per share calculation and is included in the diluted earnings per share calculation when doing so would not be anti-dilutive. Performance-based awards are included in the computation of diluted earnings per share only to the extent that the underlying performance conditions (and any applicable market condition) (i) are satisfied as of the end of the reporting period or (ii) would be considered satisfied if the end of the reporting period were the end of the related contingency period and the result would be dilutive under the treasury stock method. A reconciliation of the number of common shares used in the calculation of basic and diluted EPS is presented in Note 15, *Earnings Per Share*.

Accounting for Stock-Based Compensation We have several stock-based employee and director compensation plans, which are described more fully in Note 14, *Stock Compensation Plans*.

We measure and record compensation expense using the applicable accounting guidance for share-based payments related to stock options, restricted stock, and performance-based awards granted to our directors and employees. The fair value of stock options, including performance awards, without a market condition is estimated, at the date of grant, using the Black-Scholes option-pricing model. The fair value of restricted stock awards and stock options with a market condition is estimated, at the date of grant, using the Monte Carlo Simulation model. The Black-Scholes and Monte Carlo Simulation valuation models incorporate assumptions as to stock price volatility, the expected life of options or awards, a risk-free interest rate and dividend yield. In valuing our stock options, significant judgment is required in determining the expected volatility of our common stock and the expected life that individuals will hold their stock options prior to exercising. Expected volatility for stock options is based on the historical and implied volatility of our own common stock while the volatility for our restricted stock units with a market condition is based on the historical volatility of our own stock and the stock of companies within our defined peer group. The

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expected life of stock options is derived from the historical actual term of option grants and an estimate of future exercises during the remaining contractual period of the option. While volatility and estimated life are assumptions that do not bear the risk of change subsequent to the grant date of stock options, these assumptions may be difficult to measure as they represent future expectations based on historical experience. Further, our expected volatility and expected life may change in the future, which could substantially change the grant-date fair value of future awards of stock options and, ultimately, the expense we record. The fair value of restricted stock, including performance awards, without a market condition is estimated using the current market price of our common stock on the date of grant. Additionally, in calculating compensation expense for these awards, we are also required to estimate the extent to which awards will be forfeited prior to vesting. Many factors are considered when estimating expected forfeitures, including types of awards, employee class and historical experience. To the extent actual results or updated estimates of forfeiture differ from current estimates, such amounts are recorded as a cumulative adjustment to the previously recorded amounts.

We expense stock-based compensation for stock options, restricted stock awards, and performance awards over the requisite service period. For awards with only a service condition, we expense stock-based compensation, adjusted for estimated forfeitures, using the straight-line method over the requisite service period for the entire award. For awards with both performance and service conditions, we expense the stock-based compensation, adjusted for estimated forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the award, taking into account the probability that we will satisfy the performance conditions. Furthermore, we expense awards with a market condition over the three-year vesting period regardless of the value that the award recipients ultimately receive. Excess tax benefits are credited to common stock when the deduction reduces cash taxes payable. When we have tax deductions in excess of the compensation cost, they are classified as financing cash inflows in the Consolidated Statements of Cash Flows.

Concentration of Credit Risk Financial instruments that expose us to concentrations of credit risk consist principally of short-term investments and operating demand deposit accounts. Our policy is to place our operating demand deposit accounts with high credit quality financial institutions, the balances of which at times may exceed federally insured limits. We continually monitor our banking relationships and believe we are not exposed to any significant credit risk on our operating demand deposit accounts.

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

Impact of Recently Issued Accounting Standards In September 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments, which eliminates the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. Instead, the acquirers must recognize measurement-period adjustments during the period in which the amounts are determined. The new guidance is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted. We do not believe the implementation of this standard will have a material impact on our consolidated financial statements.

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In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory, which changes the measurement principle for inventory from the lower of cost or market to the lower of cost and net realizable value. ASU 2015-11 defines net realizable value as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new guidance must be applied on a prospective basis and is effective for fiscal years beginning after December 15, 2015, and interim periods within those years, with early adoption permitted. We do not believe the implementation of this standard will have a material impact on our consolidated financial statements.

In May 2014, the FASB issued an amendment to its accounting guidance related to revenue recognition. The amendment was the result of a joint project between the FASB and the International Accounting Standards Board (IASB) to clarify the principles for recognizing revenue and to develop common revenue standards for U.S. GAAP and International Financial Reporting Standards. To meet those objectives, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU 2014-09). ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In August 2015, the FASB issued ASU 2015-14, Revenue from contracts with customers (Topic 606): Deferral of the Effective Date, deferring the effective date of ASU 2014-09 by one year. With this deferral, the new standard is effective for us on January 1, 2018. The standard permits the use of either the retrospective or cumulative effective transition method. We are evaluating the impact of adopting this standard on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

Reclassifications Certain prior year amounts have been reclassified in the accompanying consolidated financial statements to conform to the current period presentation. For example, certain prior year inventory balances were reclassified in the accompanying consolidated financial statements to reflect changes in management s expectations. See Note 5, *Inventories*, for additional information.

2. SUPPLEMENTAL CASH FLOW INFORMATION

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

	Years ended December 31,		
	2015	2014	2013
Supplemental cash flow information:			
Cash paid for interest	$ 55	$ 7	$ 8
Cash paid for income taxes	4,682	10,844	10,286
Supplemental noncash investing and financing activities:			
Transfer of service and sales demonstration inventory to fixed assets	2,979	41	383

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3. ALLOWANCE FOR DOUBTFUL ACCOUNTS

Activity in the allowance for doubtful accounts was as follows:

	Years ended December 31,		
	2015	2014	2013
Balance, beginning of year	$ 1,844	$ 3,686	$ 3,780
Provision (net of recovery)	346	(306)	1,001
Amounts written off, net of recoveries	(773)	(1,536)	(1,095)
Balance, end of year	$ 1,417	$ 1,844	$ 3,686

4. SHORT-TERM INVESTMENTS

Short-term investments of $43.0 million and $65.0 million at December 31, 2015 and 2014, respectively, were comprised of six-month U.S. Treasury Bills that mature through April 14, 2016. 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 plus accrued interest, which approximates fair value. The fair value of the U.S. Treasury Bills at December 31, 2015 and 2014 were classed as Level 1 as they are traded with sufficient frequency and volume to enable us to obtain pricing information on an ongoing basis. For further discussion of fair value, refer to Note 10, *Fair Value Measurements*.

5. INVENTORIES

Inventories consist of the following:

	As of December 31, 2015	As of December 31, 2014
Raw materials	$ 28,190	$ 27,266
Finished goods	17,381	15,828
Inventories, net	$ 45,571	$ 43,094
Service and sales demonstration inventory, net	$ 33,709	$ 36,886

Based upon the planned timing of new product introductions and a sudden and significant decline in demand for our products during the three months ended September 26, 2015, our on-hand inventory levels exceeded our estimated requirements, resulting in excess inventory. We use several contract manufacturers and suppliers to provide manufacturing services for our products. In the normal course of business, to reduce manufacturing lead times and ensure adequate component availability, we enter into agreements with these manufacturers and suppliers to purchase sufficient inventory based on our forecast demand. At September 26, 2105, we had purchase commitments with suppliers for inventory that we no longer expected to utilize through the product lifecycle and for warranty commitments. Consequently, we recorded a $5.9 million write-down of excess inventory and a $2.0 million loss on

purchase commitments in the third quarter of 2015. The aggregate of $7.9 million is included within the consolidated statement of cash flows for the year ended December 31, 2015 under the caption Write-down of inventories .

6. GOODWILL

Our goodwill at December 31, 2015 and 2014 is related to our previous acquisitions. We evaluate each reporting unit s fair value as compared to its carrying value on December 31 of each year or more frequently if events or changes in circumstances indicate that the carrying value may exceed the fair value. We first performed a qualitative assessment to determine

whether it was necessary to perform the two-step goodwill impairment test. We concluded a quantitative goodwill impairment test, or step 1, was necessary. The fair value of the reporting units was measured using a discounted cash flow model incorporating discount rates commensurate with the risks involved for each reporting unit and a market approach. The key assumptions used in the discounted cash flow model include discount rates, growth rates, cash flow projections and terminal value rates. These rates are susceptible to change and require significant management judgment. The market approach relies on an analysis of publicly-traded companies similar to us and derives a range of revenue and profit multiples. The publicly-traded companies used in the market approach were selected based on our defined peer group. The resulting multiples were then applied to each reporting unit to determine fair value. Impairments to goodwill are charged against earnings in the period the impairment is identified. We have two reporting units for which goodwill was tested on December 31, 2015: the Americas Region, and the Europe/Africa Region, as shown in the table below. As of December 31, 2015 and 2014, we did not have any goodwill that was identified as impaired. The increase in goodwill in 2015 reflected the acquisitions completed in 2015, partially offset by changes in foreign exchange rates. The decrease in goodwill in 2014 related to changes in foreign exchange rates, partially offset by goodwill resulting from an acquisition completed in 2014.

December 31, 2015	Beginning Balance	Additions	Foreign Currency Translation	Ending Balance
Americas Region	$ 8,366	$ 4,964	$ (389)	$ 12,941
Europe/Africa region	10,839	3,805	(1,214)	13,430
Asia Pacific Region				
Total	$ 19,205	$ 8,769	$ (1,603)	$ 26,371

December 31, 2014	Beginning Balance	Additions	Foreign Currency Translation		Ending Balance	
Americas Region	$ 6,994	$ 1,372	$	$		8,366
Europe/Africa region	12,364		(1,525)			10,839
Asia Pacific Region						
Total	$ 19,358	$ 1,372	$ (1,525)	$		19,205

immediately after giving effect to such transaction (and treating any indebtedness that becomes an obligation of the Successor Company or any subsidiary of the Company as a result of such transaction as having been incurred by the Successor Company or such subsidiary at the time of such transaction), no default or Event of Default would occur or be continuing; and

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the Company has delivered to the Trustee an officers certificate and an opinion of counsel, each stating that such consolidation, merger, or transfer complies with the Indenture.

If the Successor Company expressly assumes all of the obligations of the Company under the Debt Securities and the Indenture, the Company will be released from such obligations.

Satisfaction and Discharge of the Indenture; Defeasance

The Indenture will generally cease to be of any further effect with respect to a series of Debt Securities if (1) the Company has delivered to the Trustee for cancellation all Debt Securities of such series (with certain limited exceptions) or (2) all Debt Securities of such series not theretofore delivered to the Trustee for cancellation have become due and payable, or are by their terms to become due and payable within one year or are to be called for redemption within one year, and the Company has deposited with the Trustee as trust funds the entire amount in the currency in which the Debt Securities are denominated sufficient to pay at maturity or upon redemption all such Debt Securities, including principal and premium, if any, and interest due or to become due on such date of maturity or redemption date, as the case may be, and if, in either case, the Company also pays or causes to be paid all other sums payable under the Indenture by the Company.

In addition, the Company has a legal defeasance option (pursuant to which it may terminate, with respect to the Debt Securities of a particular series, all of its obligations under such Debt Securities and the Indenture with respect to such Debt Securities) and a covenant defeasance option (pursuant to which it may terminate, with respect to the Debt Securities of a particular series, its obligations with respect to such Debt Securities under certain specified covenants contained in the Indenture or supplemental indenture). If the Company exercises its legal defeasance option with respect to a series of Debt Securities, payment of such Debt Securities may not be accelerated because of an Event of Default. If the Company exercises its covenant defeasance option with respect to a series of Debt Securities, payment of such Debt Securities may not be accelerated because of an Event of Default related to the specified covenants.

The Company may exercise its legal defeasance option or its covenant defeasance option with respect to the Debt Securities of a series only if:

- the Company irrevocably deposits in trust with the Trustee cash or U.S. Government Obligations for the payment of principal, premium and interest with respect to such Debt Securities to maturity or redemption, as the case may be;

- the Company delivers to the Trustee a certificate from a nationally recognized firm of independent accountants expressing their opinion that the payments of principal and interest when due and without reinvestment on the deposited U.S. Government Obligations plus any deposited money without investment will provide cash at such times and in such amounts as will be sufficient to pay the principal, premium and interest when due with respect to all the Debt Securities of such series to maturity or redemption, as the case may be;

- 123 days pass after the deposit is made and during the 123-day period no default described in the seventh or eighth bullet points under the heading Events of Default and Remedies above with respect to the Company occurs that is continuing at the end of such period;

- no default has occurred and is continuing on the date of such deposit and after giving effect thereto;

- the deposit does not constitute a default under any other agreement binding on the Company;

- the Company delivers to the Trustee an opinion of counsel to the effect that the trust resulting from the deposit does not constitute, or is qualified as, a regulated investment company under the Investment Company Act of 1940;

- the Company delivers to the Trustee an opinion of counsel addressing certain U.S. federal income tax

matters relating to the defeasance; and

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the Company delivers to the Trustee an officers certificate and an opinion of counsel, each stating that all conditions precedent to the defeasance and discharge of the Debt Securities of such series as contemplated by the Indenture have been complied with.

The Trustee will hold in trust money or U.S. Government Obligations deposited with it as described above and will apply the deposited money and the proceeds from deposited U.S. Government Obligations to the payment of principal, premium and interest with respect to the Debt Securities of the defeased series.

The Trustee

The Indenture does not prohibit the Trustee from serving as trustee under any other indenture to which the Company may be a party from time to time or from engaging in other transactions with the Company. The Company may maintain banking and other commercial relationships with the Trustee and its affiliates in the ordinary course of business and the Trustee may own Debt Securities.

Governing Law

The Indenture is, and the Debt Securities will be, governed by, and construed in accordance with, the laws of the State of New York.

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DESCRIPTION OF CAPITAL STOCK

The following summary describes the material features of our capital stock. This summary does not describe every aspect of our capital stock and is subject to, and qualified in its entirety by reference to, the provisions of our amended articles of incorporation and code of regulations, as currently in effect, each of which is incorporated by reference as an exhibit to the registration statement of which this prospectus is a part, and the applicable provisions of Ohio law.

Authorized Capital Stock

Our authorized capital stock consists of 150,000,000 common shares, without par value, 500,000 Class A Preferred Shares, without par value, and 500,000 Class B Preferred Shares, without par value. As of March 31, 2014, there were (1) 69,398,956 common shares issued and outstanding and (2) no Class A Preferred Shares or Class B Preferred Shares issued and outstanding.

Common Shares

Holders of our common shares are entitled to:

- one vote for each common share held;
- receive dividends when and as declared by our Board of Directors from funds legally available therefor, subject to the rights of holders of our preferred shares, if any; and
- share ratably in our net assets, legally available to our shareholders in the event of our dissolution, liquidation or winding up, after provision for distribution to the holders of any preferred shares and to the payment in full of all amounts required to be paid to creditors or provision for such payment.

Holders of our common shares have no preemptive, subscription, redemption, conversion or cumulative voting rights. Our outstanding common shares are, and any common shares that we issue pursuant to this prospectus and a prospectus supplement will be, when issued, fully

paid and nonassessable.

Preferred Shares

Under our amended articles of incorporation, our Board of Directors is authorized to issue, without any further vote or action by our shareholders, subject to certain limitations prescribed by Ohio law and the rules and regulations of the New York Stock Exchange, up to an aggregate of 500,000 Class A Preferred Shares and 500,000 Class B Preferred Shares, in one or more series. Our Board of Directors is also authorized to fix or change the rights, preferences, qualifications and limitations of each series, including the division of such shares into series, the designation and authorized number of shares included in each series, dividend and distribution rights, liquidation rights, preferences and price, redemption rights and price, sinking fund requirements, preemptive rights, conversion rights and restrictions on issuance of shares. Subject to the provisions of any applicable law, holders of Class A Preferred Shares and holders of Class B Preferred Shares are entitled to one vote per share and ten votes per share, respectively, on matters to be voted upon by the holders of common shares and preferred shares voting together as a single class. Ohio law also entitles the holders of preferred shares to exercise a class vote on certain matters.

Our Board of Directors may authorize the issuance of preferred shares with voting or conversion rights that could adversely affect the voting power or other rights of the holders of our common shares. The issuance of preferred shares could have the effect of decreasing the market price of our common shares. The issuance of preferred shares also could have the effect of delaying, deterring or preventing a change in control of the Company without further action by our shareholders.

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Anti-Takeover Effects of Amended Articles of Incorporation, Code of Regulations and Ohio Law

Certain provisions in our amended articles of incorporation and code of regulations and the Ohio Revised Code could discourage potential takeover attempts and make attempts by shareholders to change management more difficult. A description of these provisions is set forth below.

Classified Board of Directors

Our Board of Directors is divided into three classes, with three-year staggered terms. This classification system increases the difficulty of replacing a majority of the directors at any one time and may tend to discourage a third party from making a tender offer or otherwise attempting to gain control of us. It also may maintain the incumbency of our Board of Directors.

Removal of Directors

Under our amended articles of incorporation, any director, or the entire Board of Directors, may be removed from office, with or without cause, only by the affirmative vote of 75% of the voting power of the Company voting together as a single class. However, under current Ohio law, the directors of an issuing public corporation with a classified board may only be removed for cause. Because the Company is an issuing public corporation and has a classified Board of Directors, the directors of the Company may only be removed for cause. Directors may also be removed from office, but only for cause, by the affirmative vote of three-fourths of the directors then in office.

Advance Notice Requirements for Shareholder Proposals and Nominations for Election as Directors

Under our code of regulations, shareholders seeking to bring business before an annual meeting of shareholders or to nominate candidates for election as directors at an annual meeting must provide timely notice thereof in writing to the Company.

To be timely, a shareholder s notice with respect to business to be brought before an annual meeting must be delivered to, or mailed and received by, the Company not

less than 30 days prior to an annual meeting. However, if less than 40 days notice or prior public disclosure of the date of the meeting is given or made to shareholders, the shareholder s notice must be received no later than the close of business on the tenth day following the day on which such notice of the date of the meeting was mailed or such public disclosure was made.

In order to nominate an individual for election as a director at a meeting, a shareholder must give written notice of the shareholder s intention to make such nomination. The notice must be delivered to, or mailed and received by, the Company not less than 14 days or more than 50 days prior to any meeting called for the election of directors. However, if notice or public disclosure of the date of the meeting is given or made less than 21 days prior to the meeting, the shareholder notice must be received by the Company not later than the close of business on the seventh day following the day on which notice of the date of the meeting was mailed or publicly disclosed.

No Shareholder Action by Written Consent

Under our amended articles of incorporation, any action required or permitted to be taken by our shareholders must be effected at a duly called meeting of the shareholders and may not be effected by an action by written consent of the shareholders. This prevents our shareholders from initiating or effecting any action by written consent, thereby limiting the ability of shareholders to take actions opposed by our Board of Directors.

Special Meetings of Shareholders

Our code of regulations provides that special meetings of shareholders may be called only by the chairman of the board, the president, the secretary, the Board of Directors at a meeting, a majority of the directors acting without a meeting or the holders of at least 50% of all shares outstanding and entitled to vote at such meeting.

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Supermajority Voting Provisions

Under the Ohio General Corporation Law, in the case of most mergers, sales of all or substantially all the assets of a corporation and amendments to a corporation s articles of incorporation, the affirmative vote of two-thirds of the voting power of the corporation is required unless the corporation s articles of incorporation provide for a lower amount but not less than a majority. Our amended articles of incorporation change the default voting requirement provided by the Ohio General Corporation Law to a majority of the voting power, except that the affirmative vote of 75% of the voting power is required with respect to certain transactions between the Company and substantial shareholders as described below under the heading Transactions With Substantial Shareholders.

Transactions With Substantial Shareholders

Under our amended articles of incorporation, certain transactions between the Company and a substantial shareholder must be approved by the affirmative vote of the holders of 75% of the voting power of the Company (which vote must also include the affirmative vote of the holders of a majority of the voting power of the Company excluding the substantial shareholder in question). A substantial shareholder is defined as any person who beneficially owns more than 15% of our voting power or is an affiliate of the Company and at any time within the past three years beneficially owned more than 15% of our voting power, but does not include the Company, any of its subsidiaries, any employee benefit plan of the Company or any of its subsidiaries, the trustees of such a plan or any affiliate of the Company owning in excess of 10% of the outstanding common shares on August 3, 1998. Transactions requiring a supermajority shareholder vote include:

- any merger or consolidation of the Company or any subsidiary of the Company with or into any substantial shareholder or any other corporation which, after such merger or consolidation, would be an affiliate of a substantial shareholder;

- any sale, lease, exchange, mortgage, pledge, transfer or other disposition to or with any substantial shareholder of any substantial part of the assets of the Company or any subsidiary of the Company;

- the issuance or transfer by the Company or any subsidiary of the Company of equity securities to any substantial shareholder for consideration having an aggregate fair market value of $25 million or more;

- the adoption of any plan or proposal for the liquidation or dissolution of the Company if, as of the record date relating to such event, any person shall be a substantial shareholder; and

- any reclassification of securities or recapitalization of the Company, or any reorganization, merger or consolidation of the Company with any of its subsidiaries or any similar transaction which has the effect, directly or indirectly, of increasing the proportionate share of the outstanding equity securities of the Company or any subsidiary of the Company directly or beneficially owned by any substantial shareholder.

A supermajority shareholder vote is not required, however, with respect to any of the foregoing transactions which is approved by three-fourths of the Company s Board of Directors, provided that a majority of the directors in office and acting upon such matter are continuing directors (as defined in our amended articles of incorporation).

Control Share Acquisition Act

The Ohio General Corporation Law provides that certain notice and informational filings, and special shareholder meeting and voting procedures, must occur prior to any person s acquisition of an issuer s shares that would entitle the acquirer to exercise or direct the voting power of the issuer in the election of directors within any of the following ranges:

- one-fifth or more but less than one-third of such voting power;

one-third or more but less than a majority of such voting power; and

a majority or more of such voting power.

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This provision, which is known as the Control Share Acquisition Act, does not apply to a corporation if its articles of incorporation or code of regulations so provide. We have opted out of the application of the Control Share Acquisition Act in our code of regulations.

Merger Moratorium Statute

Chapter 1704 of the Ohio Revised Code, which is known as the Merger Moratorium Statute, generally addresses a wide range of business combinations and other transactions (including mergers, consolidations, asset sales, loans, disproportionate distributions of property and disproportionate issuances or transfers of shares or rights to acquire shares) between an Ohio corporation and an interested shareholder who, alone or with others, may exercise or direct the exercise of at least 10% of the voting power of the corporation in the election of directors. The Merger Moratorium Statute does not apply to a corporation if its articles of incorporation so provide. We have opted out of the application of the Merger Moratorium Statute in our amended articles of incorporation.

RATIO OF EARNINGS TO FIXED CHARGES

The following table sets forth our ratio of earnings (loss) to fixed charges for the nine months ended February 28, 2014 and for each of the previous five fiscal years. Our ratio of earnings (loss) to fixed charges for each of the periods set forth below has been computed on a consolidated basis and should be read in conjunction with our consolidated financial statements, including the notes to those financial statements, and other information set forth in our reports filed with the SEC.

	Nine Months Ended	Fiscal Year Ended May 31,				
	February 28, 2014	2013	2012	2011	2010	20
Ratio of earnings (loss) to fixed charges[(1)]	9.3	8.9	11.8	9.1	6.4	(

(1) The ratio of earnings (loss) to fixed charges is computed by dividing the fixed charges of the Company and our consolidated subsidiaries into earnings (loss). Earnings (loss) consists of earnings (loss) before income taxes and net earnings attributable to non-controlling interest (a) plus (i) distributions from unconsolidated affiliates, (ii) capitalized interest amortization and (iii) fixed charges and (b) less (i) equity in net income of unconsolidated affiliates and (ii) capitalized interest. Fixed charges include interest expense (which includes the amortization of debt offering costs), capitalized interest, fees related to our revolving trade accounts receivable securitization facility, and the portion of rent expense which is deemed to be representative of the interest factor.

(2) For the fiscal year ended May 31, 2009, our earnings were insufficient to cover our fixed charges by $113.9 million.

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USE OF PROCEEDS

Unless we state otherwise in the applicable prospectus supplement, we intend to use the net proceeds from the sale of the securities for general corporate purposes, which may include repayment or refinancing of indebtedness, working capital additions, capital expenditures, repurchases of our common shares, dividends, acquisitions and other strategic investments. Until we apply the proceeds from the sale of the securities, we may invest funds not required immediately for such purposes in short-term investment grade securities or as set forth in the applicable prospectus supplement.

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PLAN OF DISTRIBUTION

We may sell any of the securities being offered by this prospectus in any one or more of the following ways from time to time:

- to or through underwriters;
- to or through dealers;
- through agents;
- directly to purchasers;
- through any combination of these methods of sale; or
- through any other methods described in a prospectus supplement.

The prospectus supplement with respect to the securities being offered will describe the specific plan of distribution and the terms of the offering, including:

- the name or names of any underwriters, dealers or agents;
- the purchase price of the securities and the proceeds we will receive from the sale;
- any underwriting discounts, selling commissions, agency fees or other items constituting underwriters', dealers' or agents' compensation;
- any initial public offering price;

- any discounts or concessions allowed or reallowed or paid to dealers or agents; and
- any securities exchanges on which the securities may be listed.

Underwriters

Securities may be offered to the public either through underwriting syndicates represented by one or more managing underwriters or directly by one or more firms acting as underwriters. If we use underwriters, we will execute an underwriting agreement with those underwriters relating to the securities that we will offer. Unless we state otherwise in the applicable prospectus supplement, the obligations of the underwriters to purchase these securities will be subject to certain conditions and the underwriters will be obligated to purchase all of the offered securities if any are purchased.

The underwriters will acquire the securities for their own account and may resell the securities from time to time in one or more transactions at a fixed public offering price, at market prices prevailing at the time of sale, at prices related to such prevailing market prices or at negotiated prices. The underwriters may change from time to time any initial public offering price and any discounts or concessions allowed or reallowed or paid to dealers.

Dealers

If we use dealers in a sale, unless otherwise specified in the applicable prospectus supplement, we will sell the securities to the dealers as principals. The dealers may then resell such securities to the public at varying prices that they determine at the time of resale.

Agents

If we use agents in a sale, unless otherwise specified in the applicable prospectus supplement, the agents will act on a best efforts basis to solicit purchases for the period of their appointment.

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Compensation

In connection with the sale of our securities, underwriters or agents may receive compensation from us or from purchasers of securities for whom they may act as agents in the form of discounts, concessions or commissions. Underwriters may sell securities to or through dealers, and such dealers may receive compensation in the form of discounts, concessions or commissions from the underwriters or commissions from the purchasers for whom they may act as agents. Any underwriting compensation paid by us to underwriters or agents in connection with an offering of securities, and any discounts, concessions or commissions allowed or reallowed or paid to dealers, will be specified in the applicable prospectus supplement.

Underwriters, dealers and agents participating in the distribution of the securities may be deemed to be underwriters as defined in the Securities Act, and any discounts or commissions received by them from us and any profit realized by them on the resale of the securities may be treated as underwriting discounts and commissions under the Securities Act.

Direct Sales

We may directly solicit offers to purchase the securities and we may make sales of securities directly to institutional investors or others. These persons may be deemed to be underwriters within the meaning of the Securities Act with respect to resales of the securities. We will describe the terms of any direct sales in the applicable prospectus supplement.

Delayed Delivery Contracts

We may authorize underwriters, dealers or agents to solicit offers by institutions to purchase securities from us at the public offering price stated in the applicable prospectus supplement under delayed delivery contracts. These contracts provide for payment and delivery on a specified date in the future. If we use delayed delivery contracts, the applicable prospectus supplement will disclose such use and describe the conditions to which the delayed delivery contracts will be subject and the commissions payable for the solicitation of the delayed delivery contracts.

Indemnification

We may indemnify underwriters, dealers or agents who participate in the distribution of securities against certain liabilities, including liabilities under the Securities Act, and agree to contribute to payments which these underwriters, dealers or agents may be required to make.

General Information

Underwriters, agents or dealers and their affiliates may be customers of, engage in transactions with or perform services for us in the ordinary course of business.

The securities offered hereby may be a new issue of securities with no established trading market. Any underwriters that purchase securities from us may make a market in these securities. The underwriters will not be obligated, however, to make a market and may discontinue market-making at any time without notice to holders of the securities. We cannot assure you that there will be liquidity in the trading market for any other securities offered hereby.

In order to facilitate an offering of securities, persons participating in the offering may engage in transactions that stabilize, maintain or otherwise affect the price of the offered securities. Such transactions, if commenced, may be discontinued at any time. If any such activities will occur, they will be described in the applicable prospectus supplement.

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CERTAIN LEGAL MATTERS

Unless otherwise specified in the applicable prospectus supplement, the validity of the securities offered hereby will be passed upon for us by Vorys, Sater, Seymour and Pease LLP, Columbus, Ohio. As of the date of this prospectus, members of Vorys, Sater, Seymour and Pease LLP, and attorneys employed thereby, together with members of their immediate families, owned an aggregate of approximately 118,410 of our common shares. Certain legal matters with respect to the offered securities may be passed upon by counsel for any underwriters, dealers or agents, each of whom will be named in the applicable prospectus supplement.

EXPERTS

The consolidated financial statements and schedule of Worthington Industries, Inc. and subsidiaries as of May 31, 2013 and 2012, and for each of the years in the three-year period ended May 31, 2013, and management s assessment of the effectiveness of internal control over financial reporting as of May 31, 2013, have been incorporated by reference herein and in the registration statement in reliance upon the reports of KPMG LLP, independent registered public accounting firm, incorporated by reference herein, and upon the authority of said firm as experts in accounting and auditing.

The consolidated financial statements of Worthington Armstrong Venture and subsidiaries as of December 31, 2013 and 2012, and for each of the years in the three-year period ended December 31, 2013, and as of December 31, 2012 and 2011, and for each of the years in the three-year period ended December 31, 2012, have been incorporated by reference herein and in the registration statement in reliance upon the reports of KPMG LLP, independent auditors, incorporated by reference herein, and upon the authority of said firm as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the SEC. Our SEC filings are available to the public at the SEC s Internet website at www.sec.gov. You may also read and copy any of these SEC filings at the SEC s Public Reference Room

located at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. Our SEC filings are also available on our website at www.worthingtonindustries.com. The information on our website is not a part of this prospectus or any applicable prospectus supplement or other offering material.

We filed a registration statement on Form S-3 to register with the SEC the securities described in this prospectus. This prospectus is part of that registration statement. As permitted by SEC rules, this prospectus does not contain all the information contained in the registration statement or the exhibits to the registration statement. You may refer to the registration statement and accompanying exhibits for more information about us and our securities.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to incorporate by reference in this prospectus the information in documents that we file with the SEC. This means that we can disclose important information to you by referring you to those documents. The information we incorporate by reference is considered to be part of this prospectus, and information that we file later with the SEC will automatically update and supersede information included or previously incorporated by reference in this prospectus from the date we file the document containing such information.

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Except to the extent furnished and not filed with the SEC under Item 2.02 or Item 7.01 of Form 8-K or as otherwise permitted by SEC rules, we incorporate by reference in this prospectus the following documents that we have filed with the SEC and any future documents that we will file with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, on or after the date of this prospectus until we complete or terminate the offering of the securities offered by this prospectus and the applicable prospectus supplement(s):

our Annual Report on Form 10-K for the fiscal year ended May 31, 2013;

our Quarterly Reports on Form 10-Q for the quarterly periods ended August 31, 2013, November 30, 2013 and February 28, 2014;

our Current Reports on Form 8-K filed on June 24, 2013, June 27, 2013 (excluding Item 2.02 and Item 7.01), July 2, 2013 (excluding Item 2.02), July 31, 2013, September 26, 2013 (excluding Item 2.02 and Item 7.01), October 1, 2013 (two reports) (excluding Item 2.02), October 18, 2013, November 13, 2013, December 11, 2013, December 19, 2013 (excluding Item 2.02), December 20, 2013 (excluding Item 2.02), January 7, 2014, January 24, 2014, March 27, 2014 (excluding Item 2.02 and Item 7.01), March 28, 2014, April 1, 2014 (excluding Item 2.02) [as amended by our Current Report on Form 8-K/A filed on April 7, 2014 (excluding Item 2.02)], and April 7, 2014;

our definitive proxy statement on Schedule 14A with respect to our Annual Meeting of Shareholders held on September 26, 2013; and

the description of our common shares contained in our Registration Statement on Form 8-A (File No. 001-08399) filed on March 27, 2000, together with any subsequent registration statement or report

filed for the purpose of updating such description. We will provide without charge, upon written or oral request, a copy of any or all of the documents that are incorporated by reference in this prospectus (other than exhibits to those documents unless they are specifically incorporated by reference in those documents). Requests should be directed to:

Worthington Industries, Inc.

200 Old Wilson Bridge Road

Columbus, Ohio 43085

Attention: Investor Relations Department

(614) 438-3210

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