

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

FORM 10-K

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

For the fiscal year ended **December 31, 2020**

or

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

For the transition period from _____ to _____

Commission File Number **0-23081**

FARO TECHNOLOGIES, INC.

(Exact name of Registrant as Specified in Its Charter)

Florida
(State or Other Jurisdiction
of Incorporation or Organization)

59-3157093
(I.R.S. Employer
Identification Number)

250 Technology Park,
(Address of Principal Executive Offices)

Lake Mary, Florida

32746
(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	Trading Symbols(s)	Name of each exchange on which registered
Common Stock, par value \$.001	FARO	Nasdaq Global Select Market LLC

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant has filed a report on and attestation to its management’s assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report.

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

The aggregate market value of the Registrant’s common stock held by non-affiliates of the Registrant on June 30, 2020 (the last business day of the Registrant’s most recently completed second fiscal quarter) was \$944,801,358 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 15, 2021, there were outstanding 18,018,797 shares of the Registrant’s common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s proxy statement for the 2021 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 Annual 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,” “intend,” “estimate,” “goal,” “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:

- an economic downturn in the manufacturing industry or the domestic and international economies in the regions of the world where we operate;
- the effect of the COVID-19 pandemic, including on our business operations, as well as its impact on general economic and financial market conditions;
- our inability to further penetrate our customer base and target markets;
- our ability to realize the intended benefits of our undertaking to transition to a company that is reorganized around functions to improve the efficiency of our sales organization and to improve operational effectiveness;
- our inability to successfully execute our new strategic plan and restructuring plan, including but not limited to additional impairment charges and/or higher than expected severance costs and exit costs, and our inability to realize the expected benefits of such plans;
- development by others of new or improved products, processes or technologies that make our products less competitive or obsolete;
- our inability to maintain what we believe to be our technological advantage by developing new products and enhancing our existing products;
- the outcome of the U.S. Government’s review of, or investigation into, our potential overcharging of the U.S. Government under our General Services Administration Federal Supply Schedule contracts, any resulting penalties, damages or sanctions imposed on us and the outcome of any resulting litigation to which we may become a party, loss of future government sales and potential impacts on customer and supplier relationships and our reputation;
- risks associated with our international operations, such as difficulties in staffing and managing foreign operations, increased political and economic instability, compliance with potentially evolving 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;
- changes in trade regulation, which result in rising prices of imported steel, steel byproducts, aluminum, and aluminum byproducts used as raw materials in the production of measurement devices, and our ability to pass those costs on to our customers or require our suppliers to absorb such costs;
- changes in foreign regulation, which may result in rising prices of our measurement devices sold as exports to our international customers, our customers’ willingness to absorb incremental import tariffs, and the corresponding impact on our profitability;
- 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 (“CAM2”) 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;
- our inability to adequately establish and maintain effective internal controls over financial reporting;
- 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) manufacturing inefficiencies associated with new product introductions, (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 inability of our sales and marketing programs to achieve their sales targets, (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) inefficiencies in the management of our inventories and fixed assets, and (xvii) compliance with government regulations including health, safety, and environmental matters;
- changes in gross margin due to a changing mix of products sold and the different gross margins on different products and sales channels;
- changes in applicable laws, rules or regulations, or their interpretation or enforcement, or the enactment of new laws, rules or regulations that apply to our business operations or require us to incur significant expenses for compliance;
- our inability to successfully comply with the requirements of the Restriction of Hazardous Substances (“ROHS2”) Directive and the Waste Electrical and Electronic Equipment (“WEEE”) Directive in the European Union;
- 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;
- our ability to successfully retain our executive officers and other key personnel;
- delays and disruption in delivery of materials and services from suppliers;
- difficulties in recruiting research and development engineers and application engineers;
- the failure to effectively manage the effects of any future growth;
- the impact of reductions or projected reductions in government spending, or uncertainty regarding future levels of government expenditures, particularly in the defense sector;
- variations in our effective income tax rate, which make it difficult to predict our effective income 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 fluctuations in exchange rates;
- the effect of estimates and assumptions with respect to critical accounting policies and the impact of the adoption of recently issued accounting pronouncements;
- the effect of changes in political conditions in the U.S. and other countries in which we operate, including the effect of changes in U.S. trade policies or the United Kingdom’s withdrawal from the European Union, on general market conditions, global trade policies and currency exchange rates;
- the magnitude of increased warranty costs from new product introductions and enhancements to existing products;
- the sufficiency of our plants to meet manufacturing requirements;
- 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;
- the impact of geographic changes in the manufacturing or sales of our products on our effective income tax rate; and
- our ability to comply with the requirements for favorable income tax rates in foreign jurisdictions.

A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included throughout this filing and particularly 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

FARO 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 are a global technology company that designs, develops, manufactures, markets and supports software driven, three-dimensional (“3D”) measurement, imaging, and realization solutions for the 3D metrology, architecture, engineering and construction (“AEC”) and public safety analytics markets. We enable our customers to capture, measure, manipulate, interact with and share data from the physical world in a virtual environment and then translate this information back into the physical domain. Our technology enables highly accurate 3D measurement, imaging, comparison and projection of parts and complex structures within production, assembly and quality assurance processes. Our FARO suite of 3D products and software solutions are used for inspection of components and assemblies, rapid prototyping, reverse engineering, documenting large volume or structures in 3D, surveying and construction, assembly layout, machine guidance as well as in investigation and reconstructions of crash and crime scenes. We sell the majority of our solutions through a direct sales force across a range of industries including automotive, aerospace, metal and machine fabrication, surveying, architecture, engineering and construction, public safety forensics and other industries.

COVID-19

Our business is significantly vulnerable to the economic effects of pandemics and other public health crises, including the ongoing novel coronavirus (“COVID-19”) pandemic that has surfaced in virtually every country of our global operating footprint. During 2020, we experienced a significant decline in the demand for our products and services across all of our served markets as a result of the impact of the spread of COVID-19. While COVID-19 has negatively impacted demand for our products and services overall, it has provided us with the opportunity to adapt to operating in a virtual environment. We significantly increased the utilization of our existing virtual sales demonstration infrastructure which has enabled ongoing customer product education. We launched an updated web-based learning system with Faro Academy that has resulted in an increase in the attendance of our virtual training and product information seminars as our customers take advantage of the opportunity to remotely participate and to better understand the capabilities of our products and software offerings.

We continue to assess the ongoing impact of COVID-19 on our business results and remain committed to taking actions to address the health and safety of our employees and customers, as well as the negative effects from demand disruption and production impacts, including, but not limited to, the following:

- Operating our business with a focus on our employee health and safety, which includes minimizing travel, implementing remote work policies, maintaining employee distancing and enhancing the sanitation of all of our facilities;
- Monitoring of our liquidity, reduction of supply flows into our manufacturing facilities, disciplined inventory management, and limiting capital expenditures; and
- Continuously reviewing our financial strategy to enhance financial flexibility in these volatile financial markets.

We continue to maintain a strong capital structure with a cash balance of \$185.6 million and no debt as of December 31, 2020. We believe that our liquidity position is adequate to meet our projected needs in the reasonably foreseeable future.

Strategy

Historically, we operated in five verticals—3D Manufacturing, Construction Building Information Modeling (“Construction BIM”), Public Safety Forensics, 3D Design and Photonics—and had three reporting segments—3D Manufacturing, Construction BIM and Emerging Verticals. During the second half of 2019, our Chief Executive Officer (“CEO”) and FARO’s management team formulated and began to implement a new comprehensive strategic plan for our business. Our strategic planning process included extensive conversations with employees, customers, investors and suppliers to identify both where the Company can provide sustained and differentiated customer value and where opportunities existed to improve operating efficiencies. We identified areas of our business that needed enhanced focus or change in order to improve our efficiency and cost structure. As part of our strategic plan, we reassessed and redefined our go-to-market strategy, refocused our marketing engagement with our customers, re-evaluated our hardware and software product portfolio and examined how key decisions are made throughout our global organization. Additionally, we focused on other organizational optimization efforts, including the simplification of our overly complex management structure.

As part of our new strategic plan, and based on the recommendation of our CEO, who is also our Chief Operating Decision Maker (“CODM”), in the fourth quarter of 2019, we eliminated our vertical structure in favor of a functional structure. Our new executive leadership team is comprised of functional leaders in areas such as sales, marketing, operations, research and development and general and administrative, and resources are allocated to each function at a consolidated unit level. We no longer have separate business units, segment managers or vertical leaders who report to the CODM with respect to operations, operating results or planning for levels or components below the total Company level. Instead, our CODM now allocates resources and evaluates performance on a Company-wide basis. Based on these changes, commencing with the fourth quarter of 2019, we report as one reporting segment that develops, manufactures, markets, supports and sells a suite of 3D imaging and software solutions.

In addition to the reorganization of the Company’s structure, we evaluated our hardware and software product portfolio and the operations of certain of our recent acquisitions. As a result of this evaluation, we simplified our hardware and software product portfolio and divested our Photonics business and 3D Design related assets obtained from our acquisition of Opto-Tech SRL and its subsidiary Open Technologies SRL (collectively, “Open Technologies”) in the second quarter of 2020.

On February 14, 2020, our Board of Directors approved a global restructuring plan (the “Restructuring Plan”), which supports our strategic plan in an effort to improve operating performance and ensure that we are appropriately structured and resourced to deliver sustainable value to our shareholders and customers. Key activities under the Restructuring Plan, which targeted \$40 million in annualized savings to be realized by the fourth quarter of 2020, include decreasing total headcount by approximately 500 employees upon the completion of the Restructuring Plan. The elimination of our vertical structure allowed us to successfully complete our redefined go-to-market strategy which placed increased focus on our customers and enabled our sales employees, supported by our talented pool of field application engineers, to sell all product lines globally.

Our new marketing leadership team has focused its efforts on gaining an increased understanding of customer applications and workflows which enables value-based product positioning while optimizing our customer's total cost of ownership. By strengthening our understanding of customer applications and workflows, we will continue to develop high-value solutions across our product and software platforms. Also, our marketing leadership team has transformed our lead generation process and implemented technology to provide our sales organization with higher quality leads which optimizes the time and effort spent by our newly organized sales team.

We continue to focus on organizational optimization and improved decision making throughout the Company. Prior to the execution of the Restructuring Plan, the Company had strong geographic organizations with decentralized decision making. Additionally, the previous vertical structure layered on top of the geographic organization led to an overly complex and costly management structure. The newly formed global functional organization has enabled centralized management and clear process ownership, eliminating redundant resources and increasing the Company's agility and ability to execute the new strategic plan during the COVID-19 global pandemic.

We made significant progress executing the Restructuring Plan during 2020. We recorded a pre-tax charge of approximately \$15.8 million during the year ended December 31, 2020 primarily consisting of severance and related benefits, professional fees and other related charges and costs including a non-cash expense of \$0.4 million related to the disposal of our Photonics business and 3D Design related assets. The reduction of our global workforce and new cost structure allowed the Company to maintain a strong capital structure despite depressed sales levels primarily as a result of the COVID-19 pandemic.

At this time, we are continuing to evaluate the future key activities by which these additional charges will originate. We estimate additional pre-tax charges of \$5 million to \$15 million for fiscal year 2021. These activities are expected to be substantially completed by the end of 2021.

Acquisition

On August 21, 2020, FARO Technologies, Inc. issued a press release announcing that it has acquired Advanced Technical Solutions in Scandinavia AB (“ATS”), a Swedish company focused on 3D digital twin solution technology. ATS software and proprietary traceable 3D system enables highly accurate and repeatable 3D scans. High accuracy 3D digital twin simulations allow capital intensive industries such as automotive and aerospace to reduce their time to market and cost.

Industry Background

We have a wide variety of customers that support a large number of industries, including automotive, aerospace, metal and machine fabrication, surveying, architecture, engineering and construction, as well as, public safety forensics. The pressures in improving overall manufacturing costs, improving profitability in AEC and the need for more complete information in public safety all are driving the need for more accurate 3D data faster, more automated and available remotely, world-wide. In each of the industries we serve, there is a growing need for accurate 3D information for high accuracy inspection, machine alignment and calibration, as-built modeling and design, quality control, digital twin and crash and crime scene investigations as well as pre-incident planning. Each of these industries are undergoing some form of a digital transformation that drives the need for our solutions to help improve our customers' yields, reduce costs and drive additional profitability.

In the manufacturing industry, the continued focus on higher yields, cost reductions and decreased time to market drive the need for more accurate information to support overall manufacturing processes including part quality, machine down time and overall manufacturing yield. The dimensional metrology market will be challenged to continue to provide higher accuracy results to meet the continuing demand of ever tightening tolerances in both the automotive and aerospace industries. The higher accuracy requirements will also result in trends away from hand measurement tools towards more automated and integrated equipment. With increasing pressure on costs, the need for tighter quality control and increased automation will drive the adoption of applications and processes with the need for real-time 3D information to make quick, accurate decisions to optimize the manufacturing process. Industry 4.0 will also continue to drive the need to have 3D information available on-demand across the entire manufacturing ecosystem.

The emergence of building information modeling ("BIM") in the AEC market has required improvements in 3D documentation, coordination and simulation across the entire building lifecycle. BIM, in part, is the compilation of a 3D model representation of a project that can be updated real time and compare actual to design. BIM is believed to become more prevalent as it aides in reducing cost associated with scrap and overruns. The ability to obtain accurate, real-time 3D measurements and information will help to replace existing methodologies such as tape measures and chalk lines. In addition, an increase in modular and pre-fab construction is being driven by growing urbanization, government initiatives and a need for affordable housing. Modular and pre-fab construction allow for building all, or large portions, of a building and then assembling these on-site. The processes of creating such structures resembles more traditional manufacturing flows where real-time 3D measurements and information can vastly improve the costs associated with re-work of materials and poor quality.

The increased focus in public safety around cost, technology adoption and public scrutiny will increase the acceptance of 3D solutions to accurately capture and analyze crime and crash scenes. Body cams, drones, and advanced analytical software are all examples of increased technology adoption in the public safety sector. Laser scanning technology is used today to capture crime scenes quickly and accurately before leaving the scene. The 3D point cloud that is generated from this data allows for further detailed analysis around bullet trajectory, blood spatter and cast off with full confidence and without the need to revisit the crime scene. This information can be easily shared between police investigators, district attorneys and defense attorneys across multiple jurisdictions. In addition, crash scenes can also be reconstructed by using the 3D information collected while on-site. This information can also be easily shared among different departments, insurance companies and investigators. 3D data capture and analysis allows pre-incident planning activities to prepare in the event of an emergency such as fires or for tactical planning of safety-relevant events like political summits or schools. The time savings and confidence in data collection and analysis will continue to result in 3D technology becoming an integral set of tools in public safety analytics.

FARO Products

FaroArm® Portfolio. The FaroArm® portfolio consists of a combination of a portable, articulated measurement arm available in various sizes, a computer, and CAM2® software programs, which are described below under "FARO Software", and optional laser line probes ("LLP") for scanning larger objects. They are primarily sold to customers in the automotive, aerospace, metal and machine fabrication industries.

- **Quantum Arm** – The Quantum series of articulated arms comes in various sizes ranging from 1.5 meters up to 4.0 meters in probing diameter to allow for measuring a large array of part sizes. The 1.5 meter FaroArm® and FARO Gage, offer the highest accuracy for measuring small parts, molds and assemblies replacing the need for small handheld tools such as micrometers, calipers and height gauges. The Quantum V2 Arms are ergonomically designed 6-axis articulated ARMs that have the ability to measure across a wide range of sizes and accuracies in various applications and industries. FaroArm® 8-axis allows additional degrees of freedom to capture the most complex parts.

- **LLP** - FAROBlu™ and Prizm™ line of laser line probes offer the ability to upgrade a Quantum Arm into a ScanArm providing high accuracy, 3D point-cloud data in full color. As with the Quantum, the ScanArm is available from 2.5 meters to 4.0 meters measuring diameter to allow for a wide range of applications at a wide range of part sizes. The LLP provides the user the ability to achieve high-speed point cloud capture with different density through basic, standard and high-definition models. The ScanArm offers the same portability and ease of use as the Quantum series.

FARO Laser Tracker. The FARO Vantage® Laser Tracker combines a portable, large-volume laser measurement tool, a computer, and CAM2® software programs, representing a product offering primarily sold to customers in the aerospace, automotive, metal and machine fabrication industries.

- **Laser Tracker Vantage®** – The FARO Laser Tracker Vantage® utilizes a laser beam for ultra-precise measurement of objects of up to 80 meters. It enables manufacturing, engineering, and quality control professionals to build, measure and inspect large parts, machine tools and other large objects on-site and in-process.
- **6DoF FARO Vantage® Laser Tracker** – Together with the hand-held 6Probe, a fully-integrated hand-held probe, the 6DoF FARO Vantage® Laser Tracker expands the capabilities of large volume measurement by allowing users to access hidden, hard-to-reach locations by probing and scanning.

FARO Laser Projector. The FARO Tracer^M and Tracer^{SI} accurately project a laser outline onto a 3D surface or object, providing a virtual template that operators and assemblers can use to quickly and accurately position components. The laser template is created using a 3D Computer-Aided Design (“CAD”) model that enables the system to visually project a laser outline of parts, reference points, or areas of interest. The result is a virtual and collaborative 3D template to eliminate scrap and streamline a wide range of assembly and production applications. This product is primarily sold to customers in the aerospace, metal working and AEC industries.

FARO Laser Scanning Portfolio. The laser scanning portfolio utilizes laser technology to measure and collect a cloud of data points, allowing for the detailed and precise 3D rendering of an object or area. This technology is used for factory planning, facility life-cycle management, quality control, forensic analysis and capturing large volumes of 3D data.

- **Focus** - The FARO Focus laser scanner utilizes laser technology to measure and collect a cloud of data points, allowing for the detailed and precise 3D rendering of an object or an area as large as an industrial facility. The Focus is available in several models which allow the customer to choose the best capability for their applications. Faro Focus M70 is ultra-portable and captures high accuracy point cloud data for short range measurements. Faro Focus S150 and S350 are designed to capture high accurate and dense point cloud data at mid to long range distances, respectively. The large distant range of measurement capability ensures there is a model to capture 3D information of almost any device, structure or facility. This product is primarily sold to customers in the AEC and public safety industries.
- **Freestyle 2** - The FARO Freestyle 2 is a high-quality, portable 3D scanner designed for photorealistic 3D reality capture. It is a lightweight, handheld device with a high degree of flexibility, allowing operators to scan anywhere in most conditions. This product is primarily sold to customers in the AEC and public safety industries.
- **ScanPlan** - The FARO ScanPlan is a handheld mapper that captures two-dimensional (“2D”) floor plans. The FARO ScanPlan performs real-time capturing and diagramming of as-built floor plans of buildings for threat assessment, pre-incident planning, fire protection engineering and facility management. This product is primarily sold to customers in the AEC and public safety industries.
- **Swift** - The FARO Swift is designed to accurately and quickly capture large areas. The Faro Swift combines the laser scanning capability of the Focus along with the ScanPlan handheld mapper to allow for quickly capturing manufacturing areas or documenting existing buildings. FARO Webshare software allows for an easy to use web based platform to easily view the 3D point cloud data captured by Swift. This solution is primarily sold to customers in the AEC and public safety industries.

FARO Software. We provide a complete portfolio of software solutions that integrate with FARO hardware products to merge data and provide collaborative workflows and applications.

- **CAM2®** allows users in the 3D metrology market to efficiently fulfill quality assurance and inspection tasks.
- **BuildIT Construction** is a construction quality control software solution that leverages reality data to uncover design deviations compared to construction industry standards.
- **BuildIT Metrology** is a 3D metrology software platform for alignment, inspection and build applications.

- **BuildIT Projector** allows manufacturers to plan and operate imaging laser projection and verification workflows to improve the quality and speed of assembly processes.
- **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 Zone** allows public safety professionals to diagram, analyze and share any scene, available in both 2D and 3D. The software combines data to accelerate forensic crime investigations, crashes and pre-incident planning.
- **FARO As-Built™** enables AEC professionals to integrate reality data into any CAD and virtual design environment for buildings.
- **Webshare** is a native cloud platform that allows users to collaborate, view, share and explore 3D reality data security and directly from any common web browser.

Warranties, Software Maintenance and Services. We generally warrant our products against defects in design, materials and workmanship for one year. To support our product lines, we also separately sell hardware service contracts that typically range from one year to three years, software maintenance contracts which enable our customers to receive the latest software updates and typically range from one year to three years, and comprehensive support, training and technology consulting services to our customers.

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, public safety and other applications. Our metrology, reverse engineering and factory automation applications are purchased primarily by customers in the automotive and aerospace markets and a diverse array of manufacturing customers from small machine shops to large industrial manufacturers. Applications are used by these customers for alignment, part inspection, dimensional analysis, first article inspection, incoming and in-process inspection, machine calibration, non-contact inspection, robot calibration, tool building and setup, and assembly guidance. Our building information modeling applications are purchased primarily by customers in the AEC markets. Applications are used by these customers for as-built documentation, construction monitoring, surveying, asset and facility management, and heritage preservation. Our public safety applications are purchased primarily by law enforcement agencies, private investigators, and forensic experts and are used for capturing environmental or situational scenes, crash and fire scene investigations and environmental safety evaluations. Our ten largest customers by revenue represented an aggregate of approximately 3.8% of our total sales in 2020. No customer represented more than 1.0% of our sales in 2020.

Sales and Marketing

We sell our products worldwide through direct sales and service offices, as well as third-party distributors and resellers. We have direct sales personnel in Australia, Brazil, Canada, China, France, Germany, India, Italy, Japan, Malaysia, Mexico, the Netherlands, Poland, Portugal, Singapore, South Korea, Spain, Sweden, Switzerland, Thailand, Turkey, the United Kingdom, and the United States. 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. Each team has the ability to sell multiple product lines. We employ a variety of marketing techniques to promote brand awareness and customer identification. As of December 31, 2020, we employed 511 sales and marketing specialists globally.

Research and Development

We believe that our future success depends, in part, on our ability to maintain what we believe to be our technological leadership, which will require ongoing enhancements of both our hardware and software products and the development of new applications and products that provide 3D measurement and imaging solutions. The field of 3D measurement and imaging 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 imaging solutions. 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, 2020, we employed 258 scientists and technicians in our research and development efforts. Research and development expenses were approximately \$42.9 million in 2020, compared to \$44.2 million in 2019 and \$46.1 million in 2018.

Intellectual Property

We own approximately 702 patents and pending patent applications worldwide, which generally expire on a rolling basis between 2021 and 2045. We also own approximately 90 trademark registrations worldwide, with 46 pending trademark applications.

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 uses 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 valid, 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. 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 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

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 have entered, and may continue to enter, into longer agreements to purchase sufficient inventory to satisfy warranty commitments or to ensure adequate component availability. To date, we have not experienced any significant difficulty in locating and obtaining the materials necessary to fulfill our production schedules.

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[®], and FAROBlu[™] and Prizm[™] laser line probe 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 ISO 9001:2015 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.

We manufacture our FARO Quantum Arm products in our manufacturing facility located in Switzerland for customer orders from Europe, the Middle East and Africa (“EMEA”), in our manufacturing facility located in Singapore for customer orders from the Asia-Pacific region, and in our manufacturing facility located in Florida for customer orders from the Americas. We manufacture our FARO Focus laser scanner in our manufacturing facilities located in Germany and Switzerland for customer orders from EMEA and the Asia-Pacific region, and in our manufacturing facility located in Pennsylvania for customer orders from the Americas. We manufacture our FARO Laser Tracker and our FARO Laser Projector products in our facility located in Pennsylvania. We expect all of our existing manufacturing facilities to have the production capacity necessary to support our volume requirements during 2021.

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 trackers, 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 FaroArm® portfolio, FARO Laser Tracker, and FARO Focus solution lines, we compete primarily with Hexagon Manufacturing Intelligence, a division of Hexagon AB; Automated Precision, Inc.; Artec Europe, S.a.r.l.; Leica Geosystems AG, a division of Hexagon AB; and Trimble Inc. In the FARO Laser Projector product line, we compete primarily with Virtek Vision International, a division of Gerber Technology LLC. 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 value 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, collection, recycling, treatment and disposal of covered electronic products and components, import and export of products, currency conversions and repatriation, taxation of foreign earnings, and the 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. We currently hold RoHS2 and WEEE registration, and we believe we are in compliance with such directives of the European Union.

In addition, a number of data protection laws impact, or may impact, the manner in which we collect, process and transfer personal data. Most notably, the European Union’s General Data Protection Regulation (“GDPR”), which went into effect in May 2018, expands data protection compliance obligations and authorizes significantly increased fines for noncompliance, requiring additional compliance resources and efforts on our part. Further, a number of other regions where we do business, including the United States, the Asia-Pacific region and Latin America, have enacted or are considering new data protection regulations that may impact our business activities that involve the processing of personal data. In addition, U.S. and international laws that have been applied to protect user privacy (including laws regarding unfair and deceptive practices in the U.S. and GDPR in the EU) may be subject to evolving interpretations or applications in light of privacy developments. For example, evolution of laws governing the cross-border transfer of data, such as the invalidation of the EU–U.S. Privacy Shield, creates additional uncertainty around the legality and logistics of such transfers. Compliance with enhanced data protection laws requires additional resources and efforts, and noncompliance with personal data protection regulations could result in increased regulatory enforcement and significant monetary fines and costs.

We currently sell our products and related services to the U.S. Government (the “Government”) under two General Services Administration (“GSA”) Federal Supply Schedule contracts (the “GSA Contracts”). The Government, as well as state and local governments, can typically terminate or modify their contracts with us either at their discretion or if we default by failing to perform under the terms of the applicable contract, which could expose us to liability and impede our ability to compete in the future for contracts and orders. Our sales to the Government under the GSA Contracts represented approximately 2.8% of our total sales for 2020.

Backlog and Seasonality

At December 31, 2020, we had orders representing approximately \$19.7 million in sales outstanding, of which \$7.9 million related to services that we expect to deliver within one year. The product-related outstanding orders as of December 31, 2020 were \$11.8 million, of which \$4.2 million were shipped by February 15, 2021. As of February 15, 2021, we had orders representing approximately \$16.4 million in sales outstanding, inclusive of 2020 open and undelivered orders, of which \$8.1 million related to service orders and \$8.3 million were product-related orders. We believe that a significant portion of the outstanding product-related orders as of February 15, 2021 will be shipped during 2021. At December 31, 2019 and 2018, we had orders representing approximately \$28.0 million and \$17.5 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.

Human Capital

At December 31, 2020, we had 1,364 full-time employees worldwide, consisting of 511 sales and marketing professionals, 265 customer service/training/application engineering specialists, 192 production and supply chain staff, 258 research and development staff, and 138 administrative staff. We are not a party to any collective bargaining agreements and believe our employee relations are satisfactory.

The Company believes that our future growth and success will depend in part on our ability to attract and retain highly-skilled personnel. The executive management team is responsible for developing and executing the Company's human capital strategy. The human capital strategy includes the attraction, acquisition, engagement and development of the Company's employees necessary to execute on our strategy and design of employee compensation and benefits programs to fit the needs of our worldwide employees. The CEO and Chief People Officer regularly update the Company's board of directors on key areas of our human capital strategy, including the following:

Diversity and Inclusion: FARO believes in the benefits workforce diversity can provide. Innovation is critical for any technology company – and we believe that it benefits by the creative thinking that happens when people with different perspectives and backgrounds come together. We believe diverse teams can better relate to the many and varied needs of our customers. We promote a culture where individual differences are valued which also allows us to attract the very best talent further encouraging our people to reach their full potential. As part of this cultural commitment, we also invest in formal programs designed to foster diversity through networking, talent management and targeted career development.

We conduct regular workforce engagement surveys to take the “pulse” of our people and gather their insights. We are committed to making all benefit and employment-related decisions in compliance with established equal employment opportunity statutes and without regard to religion, national origin, age, gender, race, color, ancestry, sexual orientation, disability, marital status, citizenship, pregnancy, medical condition or any other protected class status, as defined by local, state or federal laws.

We believe strongly in building a global workforce that is diverse and that can build strong working relationships with our customers in the countries we operate. We support an inclusive culture and motivate our workforce to be themselves while at work. We are committed to providing our employees with a positive and safe work environment that is free of discrimination, harassment and workplace violence. We encourage our employees to embrace different ideas, strengths, interests and cultural backgrounds. People development, and inclusion are important to us. We understand the importance of giving back to the communities in which we live and work.

Health and Safety: Health, safety, and the well-being of our employees is one of our top priorities. We strive to achieve world-class safety levels on an annual basis. Our safety culture focuses on reducing workplace injuries and is supported by effective communication and reporting of workplace injuries. Due to the COVID-19 pandemic, most of our non-manufacturing and technical service personnel continue to work remote from our offices. Our global manufacturing operations, including facilities located in Exton, Pennsylvania, Lake Mary, Florida, Germany, Switzerland and Singapore continue to be designated as essential business and therefore continue to operate. To protect our employees in facilities in which our teams operate, we have employed significant preventative measures to ensure the health and safety of our employees, including temperature screenings prior to entering our plants, enforcement of safe distancing between employees within our plants, encouragement that employees wash hands often, and stay-at-home measures if symptoms of COVID-19 arise during work hours or prior to entering our plants.

Available Information

We make available, free of charge on our Internet website at 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.” We have included our website address throughout this filing as textual references only. The information on, or accessible through, our website is not a part of, or incorporated into, this Annual Report on Form 10-K. 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 to be material to our business.

Risks Related to Our Business and Industry

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

The 3D measurement and imaging solutions 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 growth depends on the ability of our products to attain broad market acceptance.

The market for traditional fixed-base coordinate measurement machines, or 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.

We market closely interdependent hardware products 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 imaging solutions 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 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. Our recent acquisitions are, and any future acquisitions 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 of the acquired business to meet our performance expectations;
- 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.

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 2020, approximately 81% 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 future sales may 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.

On March 11, 2020, the World Health Organization declared the outbreak of a novel coronavirus ("COVID-19") as a global pandemic, which continues to spread throughout the United States and around the world. Our operations are significantly vulnerable to the effects of pandemics, such as COVID-19, which have, and could continue to materially impact our business.

We are significantly vulnerable to the economic effects of pandemics and other public health crises, including the ongoing COVID-19 outbreak that has surfaced in every country of our global operating footprint. The impact of COVID-19 including the severity of a "second wave" or other additional periods of increases or spikes in the number of COVID-19 cases in areas in which we operate, disruptions to our business, changes in consumer behaviors, restrictions on individual and business activities, and financial liquidity concerns, has created significant volatility in the macro-economic environment and led to reduced economic activity. There have been and continues to be material actions taken by global government authorities to contain and slow the spread of COVID-19, including travel bans, quarantines, and stay-at-home orders to restrict activities for individuals and businesses.

Most of our non-manufacturing and technical service personnel continue to work from home, which began in March 2020. Our global manufacturing operations, including facilities located in Exton, Pennsylvania, Lake Mary, Florida, Germany, Switzerland and Singapore continue to be designated as essential business and therefore continue to operate. To protect our employees in facilities in which our teams operate, we have and continue to employ significant preventative measures to ensure the health and safety of our employees, including temperature screenings prior to entering our plants, enforcement of safe distancing between employees within our plants, encouragement that employees wash hands often, and stay-at-home measures if symptoms of COVID-19 arise during work hours or prior to entering our plants.

The full impact of the COVID-19 pandemic on our financial condition and results of operations will depend on future events and developments, such as the duration and magnitude of the outbreak and future possible subsequent outbreaks. The impacts of the pandemic include, but are not limited to, the following:

- Potential production slowdowns of our factories in impacted countries or potential supply and distribution chain disruption, which could in the future result in increased costs and decreased efficiency, and which have and could impact our ability to respond to rapid changes in demand;
- The demand for our products and services, and whether the pandemic leads to recessionary conditions in any of our key markets, including potential trade customer financial restructuring or insolvency and increases in accounts receivable balances with our trade customer base; Potential future impairment in value of our tangible or intangible assets could be recorded as a result of weaker economic conditions;
- Potential significant disruption of global financial markets, which could have a negative impact on our ability to access capital in the future, and which has, together with operational impacts noted above, necessitated certain recent liquidity creation and preservation actions as a precautionary measure;
- Fluctuations in forecasted earnings before tax and corresponding volatility in our effective tax rate;
- Potential operational disruption if key employees terminate their employment or become ill, as well as diversion of our management team's attention from non-COVID-19 related matters; and
- Potential investigations, legal claims or litigation against us for actions we have taken or may take, or decisions we have made or may make, as a consequence of the pandemic;

As such, the ultimate impact on our financial condition and results of operations cannot be determined at this time. In 2020, we have been adversely affected and continue to expect our business, financial condition and results of operations to be adversely affected.

In addition, we cannot predict the impact that COVID-19 will have on our trade customers, suppliers, consumers, and each of their financial conditions; however, any material effect on these parties could adversely impact us. The impact of COVID-19 may also exacerbate other risks discussed for the year ended December 31, 2020, any of which could have a material adverse effect on our business, financial condition and results of operations.

We have experienced a significant transition in our executive management team in the last two years. Any delay in the integration of our executive management team or our failure to successfully attract and retain qualified personnel could have an adverse effect on our business and results of operations.

Our executive management team has gone through a significant transition in the last two years, including the hiring of a new President and Chief Executive Officer and the hiring of a new Chief Financial Officer. Any delay in the integration of our executive management team could affect our ability to develop, implement and execute our business strategies and plans, which could have an adverse effect on our business and results of operations.

In addition, if we fail to successfully attract qualified personnel or to retain our executive management team and other key personnel, our sales, profitability and growth and our ability to execute our business strategies and plans could be adversely impacted. Turnover of management could also adversely impact our stock price and our client relationships and could make recruiting for future management positions more difficult. We face competition for qualified personnel, which could result in increased salaries and other compensation expenses and could negatively affect our profitability.

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, including tariffs, 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.

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, 2020, we had approximately 17.9 million shares outstanding held by non-affiliates. Our daily trading volume for the year ended December 31, 2020 averaged approximately 103,881 shares.

In addition, stock markets have experienced in the past and may in the future experience a high level of price and volume volatility, and the market prices of equity securities of many companies have experienced in the past and may in the future experience 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 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.

We are subject to risks of natural disasters and other catastrophic events.

The occurrence of one or more natural disasters, such as fires, explosions, tornadoes, hurricanes, earthquakes, floods and other forms of severe weather, or the occurrence of acts of war, political unrest, terrorist activities or labor issues, including due to public health crises such as pandemics and epidemics, 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, severe weather and such other events 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.

Developments relating to the United Kingdom's ("UK") exit from European Union membership could adversely impact our business.

On June 23, 2016, the UK held a referendum in which voters approved an exit from the European Union, commonly referred to as "Brexit." Following a protracted period of negotiation, the UK ceased to be a member of the European Union on January 31, 2020, after the ratification and approval of a withdrawal agreement by the European Union and the UK. The withdrawal agreement provided for a transition period until December 31, 2020 (the "Transition Period"), during which the terms of the future trading relationship between the European Union and the UK were negotiated. Throughout the Transition Period, the legal and regulatory framework between the UK and the European Union had remained the same.

Brexit and the perceptions as to its potential impact have and may continue to adversely affect business activity and economic conditions in Europe and globally and could contribute to instability in global financial and foreign exchange markets after the Transition Period. Brexit could also have the effect of imposing greater restrictions on, and costs associated with, imports and exports between the UK and European Union member states, including, without limitation, the imposition of tariffs and increased regulatory complexities. The hiring and retention of skilled labor may also become more challenging if the free movement of workers between the European Union and the UK ends. We may also be impacted by potential exchange rate volatility. Any of these factors could adversely affect our business and operating results by adversely affecting customer demand and our relationships with customers in the UK and the European Union. In addition, as a result of Brexit, other European countries may seek to conduct referenda with respect to their continuing membership with the European Union.

Given these possibilities and others we may not anticipate, as well as the lack of comparable precedent, the full extent to which we will be affected by Brexit is uncertain. Any of the potential negative effects of Brexit could adversely affect our business, results of operations and financial condition.

We may face difficulties managing the effects of any future 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 any future growth, our business, financial condition and operating results may be harmed.

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, or uncertainty regarding future levels of government expenditures, could have an adverse effect on our results of operations. Additionally, if Congress is unable to pass appropriations bills in a timely manner, a government shutdown could result, which may have impacts in addition to those resulting from budget cuts, sequestration impacts or program-level appropriations, including payment delays, impairment of our ability to perform work on existing contracts and reductions in future orders.

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.

Risks Related to Our Financial Position and Need for Additional Capital

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 have caused, and may in the future 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. Additionally, currency fluctuations could require us to increase prices to foreign customers, which could result in lower net sales by us to those customers. If we do not adjust the prices for our products in response to unfavorable currency fluctuations, we could be forced to sell our products at a lower margin or at a net loss. 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 Restructuring Plan and our new strategic plan.

On February 14, 2020, our Board of Directors approved a global Restructuring Plan, which is intended to support our new strategic plan in an effort to improve operating performance and ensure that we are appropriately structured and resourced to deliver sustainable value to our shareholders and customers. Key activities under the Restructuring Plan include a continued focus on efficiency and cost-saving efforts, which includes decreasing total headcount by approximately 500 employees upon completion of the Restructuring Plan. These activities are expected to be substantially complete by the end of 2021. Actual results, including the costs of the Restructuring Plan, may differ materially from our expectations, resulting in our inability to realize the expected benefits of the Restructuring Plan and our new strategic plan and negatively impacting our ability to execute our future plans and strategies, which could have a material adverse effect on our business, financial condition and results of operations.

Changes in tariffs and other export regulations could increase the cost of our products sold to our international customers, which could negatively impact our sales and profitability.

Our international sales operations are subject to extensive laws, governmental regulations and policies, including but not limited to tariffs and other export regulations. Changes in export regulations could increase the cost of our products sold as exports to our international customers. If our international customers are not willing to absorb the incremental costs resulting from those tariffs or other export regulations, it could negatively impact our sales to such customers, as well as our profitability.

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.

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;
- manufacturing inefficiencies related to new product introductions;
- excess or obsolete inventory, shrinkage or other inventory losses due to product obsolescence, change in demand for our products, scrap or material price changes;
- impairment charges of goodwill or intangible assets;
- expansion of our manufacturing capability;
- the size and timing of customer orders, many of which are received towards the end of a 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 our effective income tax rate and difficulty in predicting our effective 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.

Future impairments of our goodwill, intangible and long-lived assets could adversely affect our financial condition and results of operations.

Because the historical and projected future performance of certain of our recently acquired operations were lower than our expectations, the technologies, intellectual property, know-how and related intangibles were no longer aligned with our go-forward strategies, and due to other initiatives in connection with our new strategic plan, in the fourth quarter of 2019, we recorded an impairment of \$35.2 million on our non-current assets, which charge was included in operating expenses. Further, we disposed of certain of our operations in the second quarter of 2020. See Note 7, “Goodwill” and Note 8, “Intangible Assets” to the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for further information regarding the impairment. We currently hold a total of \$13.3 million in intangible assets, net of accumulated amortization, and \$57.5 million in goodwill at December 31, 2020. Events may occur or circumstances may change such that the carrying value is not recoverable or it becomes more likely than not that the fair value of long-lived assets is reduced below the carrying value of the assets, which could result in a further write-down of our assets.

In addition, certain of our long-lived assets such as leasehold improvements, machinery, equipment, and sales demonstration assets may experience impairment as a result of events such as the closure of sites, introduction of new products, decisions to exit certain products or markets, and changes in technology. We depreciate long-lived assets and amortize intangible assets at levels we believe are adequate; however, an impairment of these assets could have a material adverse impact on our business, financial condition and results of operations.

If we fail to establish and maintain effective internal controls 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 controls over financial reporting. As part of this process, we are required to document and test our internal controls over financial reporting, management is required to assess and issue a report concerning our internal controls over financial reporting, and our independent registered public accounting firm is required to attest to the effectiveness of our internal controls over financial reporting. Our internal controls over financial reporting may not prevent or detect misstatements because of their 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 controls over financial reporting can provide only reasonable assurance with respect to the preparation and fair presentation of financial statements. If we fail to adequately establish and maintain effective internal controls over financial reporting, 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.

Our financial results may be adversely affected by exposure to additional tax liabilities.

As a multinational corporation, we are subject to income tax in the United States and numerous foreign jurisdictions. Our effective tax rate is directly impacted by the application of complex tax laws and regulations and is highly dependent upon the geographic mix of our worldwide earnings or losses, the tax regulations in each country or geographic region in which we operate, and the availability of tax credits and loss carry-forwards. Our provision for income taxes and tax liability in the future could be adversely affected by many factors including, but not limited to, income before taxes being lower than anticipated in countries with lower statutory tax rates and higher than anticipated in countries with higher statutory tax rates, changes in the valuation of deferred tax assets and liabilities, and changes in tax laws, regulations, accounting principles or interpretation of accounting principles. Application of tax laws and regulations is also subject to legal and factual interpretation, judgment, and uncertainty. Further, tax laws are subject to change as a result of changes in fiscal policy and legislation and the evolution of regulations and court rulings.

The income and non-income tax regimes we are subject to or operate under may be subject to significant change. Changes in tax laws or tax rulings, or changes in interpretations of existing laws, could materially affect our financial position and results of operations. Certain countries in Europe, as well as a number of other countries and organizations, have recently proposed or recommended changes to existing tax laws that could significantly increase our tax obligations in many countries where we do business or require us to change the manner in which we operate our business. The Organization for Economic Cooperation and Development (“OECD”) has continued to issue guidelines and proposals related to its Base Erosion and Profit Sharing initiative, which could potentially result in legislative changes to the tax treatment of our foreign operations, as well as impact our effective tax rate and the value of our deferred tax assets.

A valuation allowance may be required for our U.S. deferred tax assets, which may reduce our earnings and have a material adverse effect on our business, results of operations and financial condition.

Our balance sheet includes \$47.5 million in deferred tax assets. Approximately half of that amount relates to U.S. deferred tax assets. On a quarterly basis, we assess our ability to realize our deferred tax assets to ensure no valuation allowance is required. The ultimate realization of our U.S. deferred tax assets is dependent upon our ability to generate future U.S. taxable income during the periods in which those deferred tax assets would be deductible. Our inability to realize our U.S. deferred tax assets may reduce our earnings and have a material adverse effect on our business, results of operations and financial condition. Based on an evaluation we conducted, we determined that it was not necessary to establish a valuation allowance against any of our U.S. deferred tax assets as of December 31, 2020. However, we will continue to monitor whether a valuation allowance is necessary, and if we are required to establish a valuation allowance against our deferred tax assets, it could have a material adverse effect on our results of operations and financial condition

Risks Related To Product Development And Regulatory Process

Product failures or product availability and performance issues could result in increased warranty costs and 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. The impact of new product introductions, including the costs associated with new product introductions, such as product development, marketing, assembly line start-up costs and low introductory period production volumes, and manufacturing inefficiencies associated with new product introductions could have an adverse effect on our business and financial condition. Failures in, or performance issues impacting, our new or existing products could result in increased warranty costs, product recall costs, delays in new product introductions or existing product enhancements, and a loss of sales and customers, which would have an adverse effect on our business and financial condition. The supply of raw materials for a new or existing product could be delayed or constrained, or a key vendor could delay shipments, which may decrease product availability, causing a loss of sales and customers.

Increases in the cost of raw materials or components used in our products could negatively impact our business and profitability.

Our products contain various raw materials, including steel, steel byproducts, aluminum and aluminum byproducts. We use raw materials directly in manufacturing and in components that we purchase from our suppliers. These raw materials are subject to extensive laws, governmental regulations and policies, including tariffs and other import restrictions. Changes to the laws, governmental regulations and policies governing these raw materials, including tariffs and other import restrictions, have increased and could continue to increase the cost of such raw materials and, correspondingly, the cost of manufacturing our products. If the costs of our raw materials further increase, whether due to changes in laws, governmental regulations or policies or for other reasons, we may not be able to pass on these costs to our customers, which could have a material adverse effect on our business, results of operations and financial condition. Even in the event that increased costs can be passed through to our customers, our gross margin percentages would decline. Additionally, our suppliers are also subject to fluctuations in the prices of raw materials and may attempt to pass all or a portion of such increases on to us. In the event they are successful in doing so, our margins would decline.

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.

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 trackers, 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 FaroArm[®], FARO ScanArm, FARO Laser Tracker[™], and FARO Focus product lines, we compete primarily with Hexagon Manufacturing Intelligence, a division of Hexagon AB; Automated Precision, Inc.; Artec Europe, S.a.r.l.; Leica Geosystems AG, a division of Hexagon AB; and Trimble Inc. In the FARO Laser Projector product line, we compete primarily with Virtek Vision International, a division of Gerber Technology LLC. 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. If 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 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, collection, recycling, treatment and disposal of covered electronic products and components, import and export of products, currency conversions and repatriation, taxation of foreign earnings 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.

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. While we currently hold WEEE registration and believe we are in compliance with the directives of the European Union, including the RoHS2 directive, parallel initiatives are being proposed in other jurisdictions, including several states in the United States and China. If we do not comply with any such initiatives, our sales and results of operations could be materially impacted.

In addition, a number of data protection laws impact, or may impact, the manner in which we collect, process and transfer personal data. Most notably, the GDPR, which went into effect in May 2018, expands data protection compliance obligations and authorizes significantly increased fines for noncompliance, requiring additional compliance resources and efforts on our part. Further, a number of other regions where we do business, including the United States, the Asia-Pacific region and Latin America, have enacted or are considering new data protection regulations that may impact our business activities that involve the processing of personal data. Compliance with enhanced data protection laws requires additional resources and efforts, and noncompliance with personal data protection regulations could result in increased regulatory enforcement and significant monetary fines and costs, which could have an adverse effect on our business, results of operations and financial condition.

Our sales to the U.S. government are subject to compliance with regulatory and contractual requirements, and noncompliance could expose us to liability or impede current or future business.

The Government, as well as state and local governments, can typically terminate or modify their contracts with us either at their discretion or if we default by failing to perform under the terms of the applicable contract, which could expose us to liability and impede our ability to compete in the future for contracts and orders. The failure to comply with regulatory and contractual requirements could subject us to investigations, price reductions, up to treble damages, fines or other sanctions and penalties. Additionally, violations of certain regulatory and contractual requirements could also result in us being suspended or debarred from future government contracting.

We have sold our products and related services to the Government under General Services Administration Federal Supply Schedule contracts since 2002 and are currently selling our products and related services to the Government under two such GSA Contracts. Our sales to the Government under the GSA Contracts were approximately \$8.5 million, or approximately 2.8% of our total sales, for the year ended December 31, 2020. Each GSA Contract is subject to extensive legal and regulatory requirements and includes, among other provisions, a price reduction clause (the "Price Reduction Clause"), which generally requires us to reduce the prices billed to the Government under the GSA Contracts to correspond to the lowest prices billed to certain benchmark customers.

Late in the fourth quarter of 2018, during an internal review we preliminarily determined that certain of our pricing practices may have resulted in the Government being overcharged under the Price Reduction Clauses of the GSA Contracts (the "GSA Matter"). As a result, we performed remediation efforts, including but not limited to, the identification of additional controls and procedures to ensure future compliance with the pricing and other requirements of the GSA Contracts. We also retained outside legal counsel and forensic accountants to assist with these efforts and to conduct a comprehensive review of our pricing and other practices under the GSA Contracts (the "Review"). On February 14, 2019, we reported the GSA Matter to the GSA and its Office of Inspector General.

As a result of the GSA Matter, for the fourth quarter 2018, we reduced our total sales by a \$4.8 million estimated cumulative sales adjustment, representative of the last six years of estimated overcharges to the Government under the GSA Contracts. In addition, for the fourth quarter of 2018, we recorded \$0.5 million of imputed interest related to the estimated cumulative sales adjustment, which increased Interest expense, net and resulted in an estimated total liability of \$5.3 million for the GSA Matter. This adjustment was based on our preliminary review as of February 20, 2019, the date of our Annual Report on Form 10-K for the year ended December 31, 2018. In addition, in first quarter 2019, we recorded an additional \$0.1 million of imputed interest related to the estimated cumulative sales adjustment.

On July 15, 2019, we submitted a report to the GSA and its Office of Inspector General setting forth the findings of the Review conducted by our outside legal counsel and forensic accountants. Based on the results of the Review, we reduced our total sales for second quarter 2019 by an incremental \$5.8 million sales adjustment, reflecting an estimated aggregate overcharge of \$10.6 million under the GSA Contracts for the period from July 2011 to March 2019. In addition, we recorded an incremental \$0.7 million of imputed interest related to the estimated cumulative sales adjustment for the remainder of 2019, which increased Interest expense, net and resulted in a \$6.5 million total incremental increase in the estimated total liability for the GSA Matter.

In January 2020, we received requests for additional information from the GSA and its Office of Inspector General to which we corresponded through June 2020. As a result of this continuing investigation, we reduced our total sales for the second quarter 2020 by an incremental \$0.6 million sales adjustment, reflecting an estimated aggregate overcharge of \$11.2 million under the GSA Contracts for the period from July 2011 to September 2020. We are working with the GSA in responding to any additional inquiries arising from the investigation. We recorded an incremental \$0.2 million of imputed interest related to the estimated cumulative sales adjustment for the third quarter of 2020 and determined in the fourth quarter of 2020 that an adjustment to reduce imputed interest by \$0.7 million was required. As of the date of the filing of this Annual Report on Form 10-K, we have recorded an aggregate estimated total liability for the GSA Matter of \$12.3 million.

We intend to cooperate fully with this and any other Government inquiries. The Government's review of, or investigation into, this matter could result in civil and criminal penalties, administrative sanctions, and contract remedies being imposed on us, including but not limited to, termination of the GSA Contracts, repayments of amounts already received under the GSA Contracts, forfeiture of profits, damages, suspension of payments, fines, and suspension or debarment from doing business with the Government and possibly U.S. state and local governments. We may also be subject to litigation and recovery under the federal False Claims Act and possibly similar state laws, which could include claims for treble damages, penalties, fees and costs. As a result, we cannot reasonably predict the outcome of the Government's review of, or investigation into, this matter at this time or the resulting future financial impact on us. Any of these outcomes could have a material adverse effect on our reputation, our sales, results of operations, cash flows and financial condition, and the trading price of our common stock. In addition, we have incurred, and will continue to incur, legal and related costs in connection with the Review and the Government's response to this matter.

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 United States Department of Justice, or DOJ, concerning certain payments made by our subsidiary in China that may have violated 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.

Risks Related to Intellectual Property

Any failure 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 rights 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.

In addition, despite our efforts to protect our patents and other proprietary rights, unauthorized parties may attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. 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 uses 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.

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.

Risks Related To Reliance On Third Parties

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

Outside vendors provide key components, such as electronic components and semiconductors, 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 products, we may experience delays or interruptions in our operations, which would adversely affect our business, results of operations and financial condition.

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, security breaches, natural disasters and errors by employees. Though losses arising from some of these issues may 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. Cyber incidents have been increasing in sophistication and frequency and can include third parties gaining access to employee or customer data using stolen or inferred credentials, computer malware, viruses, spamming, phishing attacks, ransomware, card skimming code, and other deliberate attacks and attempts to gain unauthorized access. 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. While we are not currently aware of any impact that the SolarWinds supply chain attack had on our business, this is a recent event, and the scope of the attack is yet unknown. Therefore, there is residual risk that we may experience a security breach arising from the SolarWinds supply chain attack.

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 involving us or involving 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 have in the past experienced security incidents, and we may in the future experience other data security incidents or breaches affecting personally identifiable information or other confidential business information. If new customers or existing customers believe that our systems do not provide adequate security for the storage of personally identifiable information or other confidential or sensitive information, they may choose not to engage in business with us. Additionally, actual, potential or anticipated attacks may cause us to incur increasing costs, including costs to deploy additional personnel and protection technologies, train employees, and engage third-party experts and consultants. Although we maintain cyber liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Americas

Our headquarters is located in a leased building in Lake Mary, Florida containing approximately 46,500 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, as well as a 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™, FARO Focus, and FARO Laser Projector product lines. We also lease a facility in Nuevo Leon, Mexico containing service and sales operations, which consists of approximately 36,000 square feet.

Europe/Middle East/Africa

In EMEA, our primary operations are located in a leased building in Stuttgart, Germany containing approximately 105,300 square feet. This facility houses the manufacturing, research and development, administration, sales, marketing and service management personnel for our EMEA 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 EMEA. We also have a leased service and sales facility located in Warwickshire, Great Britain consisting of approximately 12,700 square feet.

Asia-Pacific

In APAC, our primary operations are located in a leased building in Singapore containing approximately 22,000 square feet. This facility houses the administration, sales, marketing, service management personnel and manufacturing for our Asia-Pacific operations. Our Japan operations are located in a leased building in Nagoya, Japan containing approximately 15,900 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 24,700 square feet for sales, marketing and service operations.

We believe our current facilities will be adequate for our needs in 2021 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".

As of February 15, 2021, we had 37 holders of record of our 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 years ended December 31, 2020, 2019 and 2018, 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 \$30.0 million share repurchase program. Subsequently, in October 2015, our Board of Directors authorized an increase to the existing share repurchase program from \$30.0 million to \$50.0 million. In December 2018, our Board of Directors authorized management to utilize the share repurchase program, beginning January 1, 2019, to maintain the number of our issued and outstanding shares to address the dilutive impact of stock options exercises and the settlement of restricted stock units. 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 under this program. 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. We made no stock repurchases during the years ended December 31, 2020, 2019 and 2018 under this program. As of December 31, 2020, we had authorization to repurchase \$18.3 million of the \$50.0 million authorized by our Board of Directors under the existing share repurchase program.

Performance Graph

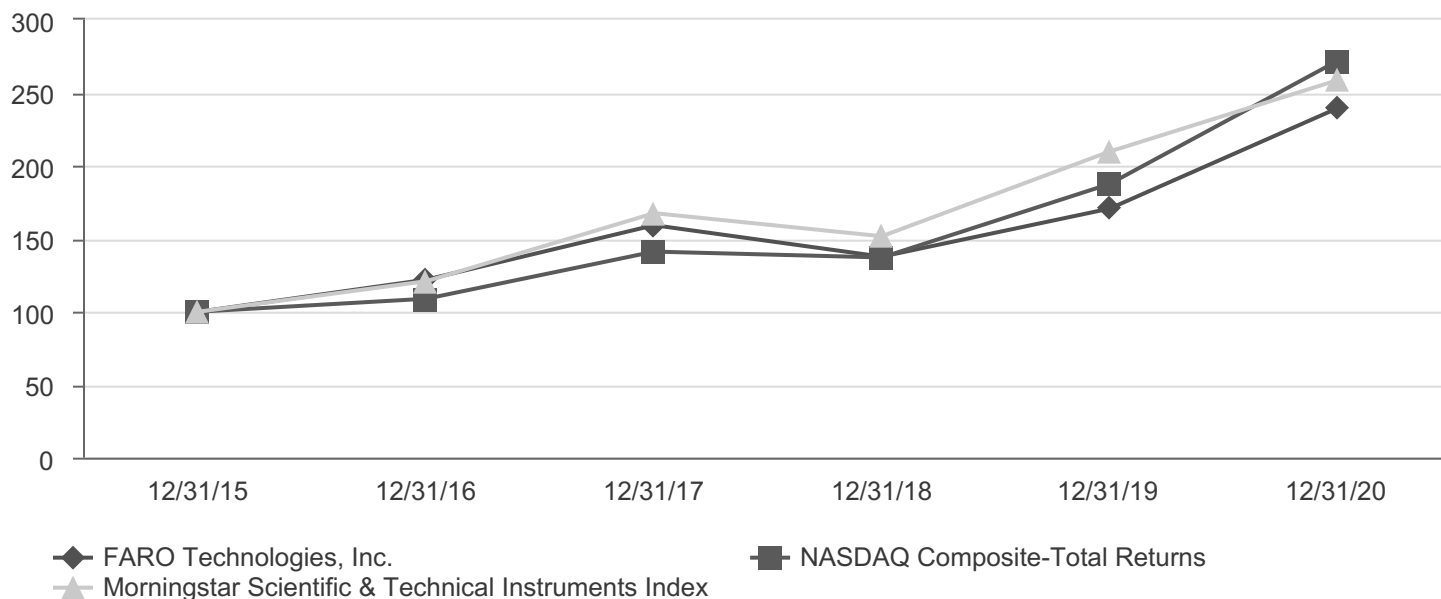
The following performance graph and related information shall not be deemed to be "soliciting material" or to be "filed" with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or the Exchange Act, except to the extent that we specifically 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, 2015, 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.

Comparison of 5 Year Cumulative Total Return
Assumes Initial Investment of \$100
December 2020



Company/Market/Peer Group	2015	2016	2017	2018	2019	2020
FARO Technologies, Inc.	\$ 100.00	\$ 121.95	\$ 159.22	\$ 137.68	\$ 170.57	\$ 239.27
Nasdaq Composite-Total Returns	\$ 100.00	\$ 108.87	\$ 141.14	\$ 137.13	\$ 185.45	\$ 271.64
Morningstar Scientific & Technical Instruments Index	\$ 100.00	\$ 120.91	\$ 167.48	\$ 151.66	\$ 209.65	\$ 258.49

ITEM 6. SELECTED FINANCIAL DATA

in thousands, except share and per-share data	Year ended December 31,				
	2020	2019 ⁽²⁾	2018	2017	2016
Consolidated Statement of Operations Data:					
Sales	\$ 303,768	\$ 381,765	\$ 403,627	\$ 360,917	\$ 325,584
(Loss) Income from operations	(30,682)	(58,634)	5,754	5,322	13,284
(Loss) Income before income tax (benefit) expense	(30,773)	(61,014)	4,558	5,827	12,626
Net income (loss)	629	(62,147)	4,930	(14,516)	11,107
Net income (loss) per common share:					
Basic	\$ 0.04	\$ (3.58)	\$ 0.29	\$ (0.87)	\$ 0.67
Diluted	\$ 0.04	\$ (3.58)	\$ 0.29	\$ (0.87)	\$ 0.67
Weighted average shares outstanding:					
Basic	17,769,958	17,383,415	17,043,167	16,711,534	16,654,786
Diluted	17,926,324	17,383,415	17,348,456	16,711,534	16,681,710

	As of December 31,				
	2020	2019	2018	2017	2016 ⁽¹⁾
Consolidated Balance Sheet Data:					
Working capital	\$ 215,988	\$ 216,251	\$ 219,219	\$ 218,274	\$ 212,055
Total assets	525,592	486,842	506,244	458,578	423,714
Total debt-capital leases	424	751	360	475	21
Total shareholders' equity	360,303	331,992	376,609	352,066	339,657

⁽¹⁾ In 2017, we adopted Accounting Standards Update 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes* ("ASU 2015-17"), as issued by the Financial Accounting Standards Board, which requires that deferred tax liabilities and assets be classified as non-current in a classified balance sheet. We adopted ASU 2015-17 on a retrospective basis. As a result, the working capital amounts as of December 31, 2016 have been reduced by \$7.6 million to conform with the current year presentation of deferred tax assets as non-current assets.

⁽²⁾ As part of our new strategic plan, in the fourth quarter of 2019, we began reorganizing the Company into a functional structure and evaluated our hardware product portfolio and the operations of certain of our recent acquisitions. As a result of our annual goodwill and intangible asset impairment test in December 2019 performed in connection with the preparation of our financial statements for the fourth quarter and year ended December 31, 2019, we recorded an impairment charge of \$35.2 million in the fourth quarter of 2019, which included \$21.2 million in goodwill, \$10.5 million in intangible assets associated with recent acquisitions, \$1.4 million in intangible assets related to capitalized patents and \$2.1 million in other asset write-downs. We also recorded a charge of \$12.8 million in the fourth quarter of 2019, increasing our reserve for excess and obsolete inventory, based on our analysis of our inventory reserves in connection with our strategy to simplify our hardware product portfolio and cease selling certain products.

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 are a global technology company that designs, develops, manufactures, markets and supports software driven, three-dimensional (“3D”) measurement, imaging, and realization solutions for the 3D metrology, architecture, engineering and construction (“AEC”) and public safety analytics markets. We enable our customers to capture, measure, manipulate, interact with and share data from the physical world in a virtual environment and then translate this information back into the physical domain. Our technology enables highly accurate 3D measurement, imaging, comparison and projection of parts and complex structures within production, assembly and quality assurance processes. Our FARO suite of 3D products and software solutions are used for inspection of components and assemblies, rapid prototyping, reverse engineering, documenting large volume or structures in 3D, surveying and construction, assembly layout, machine guidance as well as in investigation and reconstructions of crash and crime scenes. We sell the majority of our solutions through a direct sales force across a range of industries including automotive, aerospace, metal and machine fabrication, surveying, architecture, engineering and construction, public safety forensics and other industries.

We derive our revenues primarily from the sale of our measurement equipment and related multi-faceted 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 the revenue from hardware service contracts and software maintenance contracts on a straight-line basis over the contractual term, and revenue from training and technology consulting services when the services are provided.

We operate in international markets throughout the world and maintain sales offices in Australia, Brazil, Canada, China, France, Germany, India, Italy, Japan, Malaysia, Mexico, the Netherlands, Poland, Portugal, Singapore, South Korea, Spain, Switzerland, Thailand, Turkey, the United Kingdom, and the United States.

We manufacture our FARO Quantum Arm products in our manufacturing facility located in Switzerland for customer orders from Europe, the Middle East and Africa (“EMEA”), in our manufacturing facility located in Singapore for customer orders from the Asia-Pacific region, and in our manufacturing facility located in Florida for customer orders from the Americas. We manufacture our FARO Focus laser scanner in our manufacturing facilities located in Germany and Switzerland for customer orders from EMEA and the Asia-Pacific region, and in our manufacturing facility located in Pennsylvania for customer orders from the Americas. We manufacture our FARO Laser Tracker and our FARO Laser Projector products in our facility located in Pennsylvania. We expect all of our existing manufacturing facilities to have the production capacity necessary to support our volume requirements during 2021.

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 of the intercompany account balances denominated in different currencies and reflected in our consolidated financial statements. 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 2020, 2019 or 2018.

Executive Summary

COVID-19 and Impact On Our Business

Our business is significantly vulnerable to the economic effects of pandemics and other public health crises, including the ongoing COVID-19 pandemic that has surfaced in virtually every country of our global operating footprint. During the second and third quarter of 2020, we experienced a significant decline in the demand for our products and services across all of our served markets as a result of the impact of the spread of COVID-19. Although COVID-19 has negatively impacted demand for our products and services overall, the global pandemic also has provided us with the opportunity to adapt to a virtual environment and to capitalize on our existing virtual sales demonstration infrastructure which we have had in place for several years. We launched an updated web-based learning system with Faro Academy that has resulted in an increase in the attendance of our virtual training and product information seminars as our customers take advantage of the opportunity to remotely participate and to better understand the capabilities of our products and software offerings.

We continue to assess the ongoing impact of COVID-19 on our business results and remain committed to taking actions to address the health and safety of our employees and customers, as well as the negative effects from demand disruption and production impacts, including, but not limited to, the following:

- Operating our business with a focus on our employee health and safety, which includes minimizing travel, remote work policies, maintaining employee distancing and enhanced sanitation of all of our facilities;
- Monitoring of our liquidity, reduction of supply flows into our manufacturing facilities, disciplined inventory management, and scrutinization of our capital expenditures; and
- Continuously reviewing our financial strategy to strengthen financial flexibility in these volatile financial markets.

We continue to maintain a strong capital structure with a cash balance of \$185.6 million and no debt as of December 31, 2020. We believe that our liquidity position is adequate to meet our projected needs in the reasonably foreseeable future.

Future developments, such as the potential resurgence of COVID-19 in countries that have begun to recover from the early impact of the pandemic and actions taken by governments in response to future resurgence, that are highly uncertain and not able to be predicted will determine the extent to which the COVID-19 outbreak continues to impact the Company's results of operations and financial conditions. See Item 1A, Risk Factors, included in Part I of this Annual Report on Form 10-K for an additional discussion of risks related to COVID-19.

Our total sales decreased \$78.0 million, or 20.4%, to \$303.8 million for the year ended December 31, 2020 from \$381.8 million for the year ended December 31, 2019. Our product sales decreased \$71.1 million, or 24.5%, primarily due to the unfavorable impact of end market demand softness related to the COVID-19 pandemic and other fluctuations in market conditions. Our service revenue decreased \$6.9 million, or 7.5%, primarily due to the unfavorable impact of end market demand softness related to the COVID-19 pandemic. Also, foreign exchange rates had a positive impact on total sales of \$0.7 million, decreasing the percent that our overall sales declined by approximately 0.2 percentage points, primarily due to the strengthening of the Euro relative to the U.S. dollar.

Change in Organizational Structure and Segment Reporting

Historically, we operated in five verticals—3D Manufacturing, Construction Building Information Modeling (“Construction BIM”), Public Safety Forensics, 3D Design and Photonics—and had three reporting segments—3D Manufacturing, Construction BIM and Emerging Verticals. During the second half of 2019, our Chief Executive Officer (“CEO”) and FARO's management team formulated and began to implement a new comprehensive strategic plan for our business. Our strategic planning process included extensive conversations with employees, customers, investors and suppliers to identify both where the Company can provide sustained and differentiated customer value and where opportunities existed to improve operating efficiencies. We identified areas of our business that needed enhanced focus or change in order to improve our efficiency and cost structure. As part of our strategic plan, we reassessed and redefined our go-to-market strategy, refocused our marketing engagement with our customers, re-evaluated our hardware and software product portfolio and examined how key decisions are made throughout our global organization. Additionally, we focused on other organizational optimization efforts, including the simplification of our overly complex management structure.

As part of our new strategic plan, and based on the recommendation of our CEO, who is also our Chief Operating Decision Maker (“CODM”), in the fourth quarter of 2019, we eliminated our vertical structure in favor of a functional structure. Our new executive leadership team is comprised of functional leaders in areas such as sales, marketing, operations, research and development and general and administrative, and resources are allocated to each function at a consolidated unit level. We no longer have separate business units, segment managers or vertical leaders who report to the CODM with respect to operations, operating results or planning for levels or components below the total Company level. Instead, our CODM now allocates resources and evaluates performance on a Company-wide basis. Based on these changes, commencing with the fourth quarter of 2019, we report as one reporting segment that develops, manufactures, markets, supports and sells a suite of 3D imaging and software solutions.

In addition to the reorganization of the Company’s structure, we evaluated our hardware and software product portfolio and the operations of certain of our recent acquisitions. As a result of this evaluation, we simplified our hardware and software product portfolio and divested our Photonics business and 3D Design related assets obtained from our acquisition of Opto-Tech SRL and its subsidiary Open Technologies SRL (collectively, “Open Technologies”) in the second quarter of 2020.

On February 14, 2020, our Board of Directors approved a global restructuring plan (the “Restructuring Plan”), which supports our strategic plan in an effort to improve operating performance and ensure that we are appropriately structured and resourced to deliver sustainable value to our shareholders and customers. Key activities under the Restructuring Plan, which targeted \$40 million in annualized savings to be realized by the fourth quarter of 2020, include decreasing total headcount by approximately 500 employees upon the completion of the Restructuring Plan. The elimination of our vertical structure allowed us to successfully complete our redefined go-to-market strategy which placed increased focus on our customers and enabled our sales employees, supported by our talented pool of field application engineers, to sell all product lines globally.

Our new marketing leadership team has focused its efforts on gaining an increased understanding of customer applications and workflows which enables value-based product positioning while optimizing our customer's total cost of ownership. By strengthening our understanding of customer applications and workflows, we will continue to develop high-value solutions across our product and software platforms. Also, our marketing leadership team has transformed our lead generation process and implemented technology to provide our sales organization with higher quality leads which optimizes the time and effort spent by our newly organized sales team.

We continue to focus on organizational optimization and improved decision making throughout the Company. Prior to the execution of the Restructuring Plan, the Company had strong geographic organizations with decentralized decision making. Additionally, the previous vertical structure layered on top of the geographic organization led to an overly complex and costly management structure. The newly formed global functional organization has enabled centralized management and clear process ownership, eliminating redundant resources and increasing the Company's agility and ability to execute the new strategic plan during the COVID-19 global pandemic.

We made significant progress executing the Restructuring Plan during 2020. We recorded a pre-tax charge of approximately \$15.8 million during the year ended December 31, 2020 primarily consisting of severance and related benefits, professional fees and other related charges and costs including a non-cash expense of \$0.4 million related to the disposal of our Photonics business and 3D Design related assets. The reduction of our global workforce and new cost structure allowed the Company to maintain a strong capital structure despite depressed sales levels primarily as a result of the COVID-19 pandemic.

At this time, we are continuing to evaluate the future key activities by which these additional charges will originate. We estimate additional pre-tax charges of \$5 million to \$15 million for fiscal year 2021. These activities are expected to be substantially completed by the end of 2021.

Acquisition of ATS

On August 21, 2020, we acquired all of the outstanding shares of Advanced Technical Solutions in Scandinavia AB (“ATS”), a Swedish company focused on 3D digital twin solution technology for a purchase price of €5.1 million (\$6.0 million) paid, net of cash acquired, subject to certain additional post-closing adjustments, and up to €1.0 million (\$1.2 million) in contingent consideration that may be earned by the former owners if certain product development milestones are met in a three-year period. The U.S. Dollar amounts have been converted from Euros based on the foreign exchange rate in effect on the closing date of the acquisition. We believe this acquisition enables the Company to provide high accuracy 3D digital twin simulations for industries such as automotive and aerospace. The results of ATS’s operations as of and after the date of acquisition have been included in our consolidated financial statements as of December 31, 2020.

Presentation of Information and Reclassifications

Amounts reported in millions within this Annual Report on Form 10-K are computed based on the amounts in thousands. As a result, the sum of the components reported in millions may not equal the total amount reported in millions due to rounding. Certain columns and rows within the tables that follow may not add due to the use of rounded numbers. Percentages presented are calculated based on the respective amounts in thousands.

Depreciation and amortization expenses are being reported in our statements of operations to reflect departmental costs. Previously, those expenses were reported as a separate line item under operating expenses. Amounts related to depreciation and amortization expenses for the year ended December 31, 2018 have been restated throughout this Annual Report on Form 10-K to reflect this reclassification of depreciation and amortization expenses and to conform to the current period presentation.

Selling and marketing expenses and general and administrative expenses are now being reported in the accompanying statements of operations together in one line as Selling, general and administrative. Previously, those expenses were reported as two separate line items under operating expenses. Amounts related to selling, general and administrative expenses for the year ended December 31, 2018 have been restated throughout this Annual Report on Form 10-K to reflect this reclassification of selling, general and administrative expenses and to conform to the current period presentation.

Software maintenance revenue is now being reported in the accompanying statements of operations as a component of product sales. Previously, these revenues were reported in service sales. Amounts related to software maintenance revenue for the year ended December 31, 2018 have been restated throughout this Annual Report on Form 10-K to reflect this reclassification of software maintenance revenue and to conform to the current period presentation.

Software maintenance cost of sales is now being reported in the accompanying statements of operations as a component of product cost of sales. Previously, these cost of sales was reported in service cost of sales. Amounts related to software maintenance cost of sales for the year ended December 31, 2018 have been restated throughout this Annual Report on Form 10-K to reflect this reclassification of software maintenance cost of sales and to conform to the current period presentation.

Results of Operations

2020 Compared to 2019

(dollars in millions)	Years ended December 31,				Change (\$) 2020 vs 2019
	2020		2019		
		% of Sales		% of Sales	
Product	\$ 218.6	72.0 %	\$ 289.7	75.9 %	\$ (71.1)
Service	85.2	28.0 %	92.1	24.1 %	(6.9)
Total sales	303.8	100.0 %	381.8	100.0 %	(78.0)
Product	98.9	32.5 %	133.2	34.9 %	(34.4)
Service	45.1	14.8 %	50.4	13.2 %	(5.3)
Total cost of sales	143.9	47.4 %	183.6	48.1 %	(39.7)
Gross profit	159.8	52.6 %	198.1	51.9 %	(38.3)
Operating expenses					
Selling, general and administrative	131.8	43.4 %	177.4	46.5 %	(45.6)
Research and development	42.9	14.1 %	44.2	11.6 %	(1.3)
Restructuring costs	15.8	5.2 %	—	— %	15.8
Impairment loss	—	— %	35.2	9.2 %	(35.2)
Total operating expenses	190.5	62.7 %	256.8	67.3 %	(66.3)
Other expense	0.1	— %	2.4	0.6 %	(2.3)
Income tax (benefit) expense	(31.4)	(10.3)%	1.1	0.3 %	(32.5)
Net income (loss)	\$ 0.6	0.2 %	\$ (62.1)	(16.3)%	\$ 62.7

Consolidated Results

Sales. Total sales decreased by \$78.0 million, or 20.4%, to \$303.8 million for the year ended December 31, 2020 from \$381.8 million for the year ended December 31, 2019. Total product sales decreased by \$71.1 million, or 24.5%, to \$218.6 million for the year ended December 31, 2020 from \$289.7 million for the year ended December 31, 2019. Our product sales decreased due to the unfavorable impact of end market demand softness related to the COVID-19 pandemic and other fluctuations in market conditions. Service sales decreased by \$6.9 million, or 7.5%, to \$85.2 million for the year ended December 31, 2020 from \$92.1 million for the year ended December 31, 2019, primarily due to the unfavorable impact of end market demand softness related to the COVID-19 pandemic and other fluctuations in market conditions. Foreign exchange rates had a positive impact on sales of \$0.7 million, reducing our overall sales decline by approximately 0.2 percentage points, primarily due to the strengthening of the Euro relative to the U.S. dollar.

Gross profit. Gross profit decreased by \$38.3 million, or 19.3%, to \$159.8 million for the year ended December 31, 2020 from \$198.1 million for the year ended December 31, 2019. Gross margin increased to 52.6% for the year ended December 31, 2020 from 51.9% in the prior year period. Gross margin from product revenue increased by 0.8 percentage points to 54.8% for the year ended December 31, 2020 from 54.0% in the prior year period. This increase in gross margin from product revenue was primarily due to 2019 being burdened by a \$12.8 million increase in our reserve for excess and obsolete inventory recorded in connection with our strategic decisions to simplify our hardware and software product portfolio and cease selling certain products. Gross margin from service revenue increased by 1.8 percentage points to 47.1% for the year ended December 31, 2020 from 45.3% for the prior year period, primarily due to a reduction in departmental costs as a result of the Restructuring Plan.

Selling, general and administrative expenses. Selling, general and administrative (“SG&A”) expenses decreased by \$45.6 million, or 25.7%, to \$131.8 million, for the year ended December 31, 2020 from \$177.4 million for the year ended December 31, 2019. This decrease was driven primarily by decreased salaries and wages and other cost savings initiatives to reduce non-personnel costs that resulted from the Restructuring Plan. Additionally, a decrease in selling commission expense and travel expense was driven by reduced global sales and pandemic stay-at-home orders, respectively. SG&A expenses as a percentage of sales decreased to 43.4% for the year ended December 31, 2020 from 46.5% for the year ended December 31, 2019.

Research and development expenses. Research and development expenses decreased \$1.3 million, or 2.9%, to \$42.9 million for the year ended December 31, 2020 from \$44.2 million for the year ended December 31, 2019. This decrease was mainly driven by a decrease in purchased technology intangible amortization expense as a result of the impairment of certain intangible assets in connection with the Restructuring Plan. Research and development expenses as a percentage of sales increased to 14.1% for the year ended December 31, 2020 from 11.6% for the year ended December 31, 2019.

Restructuring costs. In February 2020, we initiated the Restructuring Plan to improve business effectiveness, streamline operations and achieve a stated target cost level for the Company as a whole. Restructuring costs included in operating expenses for the year ended December 31, 2020 were \$15.8 million primarily consisting of severance and related benefits charges.

Impairment loss. As a result of our annual goodwill and intangible asset impairment test performed in the prior year, we recorded an impairment loss of \$35.2 million in the fourth quarter of 2019, which included \$21.2 million in goodwill, \$10.5 million in intangible assets associated with recent acquisitions, \$1.4 million in intangible assets related to capitalized patents, and \$2.1 million in other asset write-downs. There were no similar impairments in 2020.

Other expense. Other expense was \$0.1 million for the year ended December 31, 2020 compared to \$2.4 million for the year ended December 31, 2019. This decrease was primarily driven by the impairment charge related to our equity investment in present4D GmbH (“present4D”) recorded in the second quarter of 2019 and the impairment charge related to our note receivable due from present4D recorded in the fourth quarter of 2019.

Income tax (benefit) expense. Income tax benefit for the year ended December 31, 2020 was \$31.4 million compared with an income tax expense of \$1.1 million for the year ended December 31, 2019. Our effective tax rate was 102.0% for the year ended December 31, 2020 compared to 1.9% for the year ended December 31, 2019. The change in income tax (benefit) expense was primarily due to the Company completing an intra-entity transfer of certain intellectual property rights (“IP Rights”) which resulted in the Company establishing a deferred tax asset benefit of \$19.2 million, based on the fair value of the IP rights transferred in December 2020.

Net income (loss). Net income was \$0.6 million for the year ended December 31, 2020 compared with net loss of \$62.1 million for the year ended December 31, 2019, reflecting the impact of the factors described above.

2019 Compared to 2018

(dollars in millions)	Years ended December 31,				Change (\$) 2019 vs 2018
	2019		2018		
		% of Sales		% of Sales	
Product	\$ 289.7	75.9 %	\$ 320.6	79.4 %	\$ (30.9)
Service	92.1	24.1 %	83.0	20.6 %	9.0
Total sales	381.8	100.0 %	403.6	100.0 %	(21.9)
Product	133.2	34.9 %	130.9	32.4 %	2.4
Service	50.4	13.2 %	51.2	12.7 %	(0.8)
Total cost of sales	183.6	48.1 %	182.1	45.1 %	1.6
Gross profit	198.1	51.9 %	221.6	54.9 %	(23.4)
Operating expenses					
Selling, general and administrative	177.4	46.5 %	169.7	42.0 %	7.7
Research and development	44.2	11.6 %	46.1	11.4 %	(1.9)
Impairment loss	35.2	9.2 %	—	— %	35.2
Total operating expenses	256.8	67.3 %	215.8	53.5 %	41.0
Other expense	2.4	0.6 %	1.2	0.3 %	1.2
Income tax expense (benefit)	1.1	0.3 %	(0.4)	(0.1)%	1.5
Net (loss) income	<u>\$ (62.1)</u>	(16.3)%	<u>\$ 4.9</u>	1.2 %	<u>\$ (67.0)</u>

Consolidated Results

Sales. Total sales decreased by \$21.9 million, or 5.4%, to \$381.8 million for the year ended December 31, 2019 from \$403.6 million for the year ended December 31, 2018. Total product sales decreased by \$30.9 million, or 9.6%, to \$289.7 million for the year ended December 31, 2019 from \$320.6 million for the year ended December 31, 2018. Our product sales decrease reflected lower unit sales primarily driven by continuing softness in many of our served markets, with particular softness in the automotive and broader Asian markets. Service sales increased by \$9.0 million, or 10.9%, to \$92.1 million for the year ended December 31, 2019 from \$83.0 million for the year ended December 31, 2018, primarily due to an increase in warranty and customer service revenue driven by the growth of our global installed, serviceable base and focused sales initiatives to maintain customer relationships after the purchase of our measurement devices. Foreign exchange rates had a negative impact on sales of \$13.0 million, decreasing our overall sales by approximately 3.2%, primarily due to the weakening of the Euro and Chinese Yuan relative to the U.S. dollar.

Gross profit. Gross profit decreased by \$23.4 million, or 10.6%, to \$198.1 million for the year ended December 31, 2019 from \$221.6 million for the year ended December 31, 2018. Gross margin decreased to 51.9% for the year ended December 31, 2019 from 54.9% in the prior year period. Gross margin from product revenue decreased by 5.2 percentage points to 54.0% for the year ended December 31, 2019 from 59.2% in the prior year period. This decrease in gross margin from product revenue was primarily due to the \$12.8 million increase in our reserve for excess and obsolete inventory recorded in the fourth quarter of 2019 in connection with our strategic decisions to simplify our hardware and software product portfolio and cease selling certain products, compared to a \$4.7 million increase in our reserve for excess and obsolete inventory recorded in 2018. Gross margin from service revenue increased by 7.0 percentage points to 45.3% for the year ended December 31, 2019 from 38.3% for the prior year period, primarily due to the leveraging effect of higher warranty and customer service revenue as well as improved efficiencies in our customer service repair process.

Selling, general and administrative expenses. Selling, general and administrative (“SG&A”) expenses increased by \$7.7 million, or 4.5%, to \$177.4 million, for the year ended December 31, 2019 from \$169.7 million for the year ended December 31, 2018. This increase was driven primarily by executive team transition costs, including the acceleration of stock-based compensation expense related to the accelerated vesting of stock options and restricted stock units granted to our prior executive officers and severance costs, professional fees incurred related to the GSA Matter, and an increase in compensation expenses related to our increased selling headcount, partially offset by lower commission expense due to the decrease in product sales. SG&A expenses as a percentage of sales increased to 46.5% for the year ended December 31, 2019 from 42.0% for the year ended December 31, 2018.

Research and development expenses. Research and development expenses decreased \$1.9 million, or 4.1%, to \$44.2 million for the year ended December 31, 2019 from \$46.1 million for the year ended December 31, 2018. This decrease in research and development expenses was mainly due to a decrease in materials and consulting costs, as well as favorable changes in foreign currencies as the U.S. dollar strengthened against the Euro, which decreased the compensation cost of foreign research and development employees. Research and development expenses as a percentage of sales increased to 11.6% for the year ended December 31, 2019 from 11.4% for the year ended December 31, 2018.

Impairment loss. As a result of our annual goodwill and intangible asset impairment test performed in December 2019, we recorded an impairment loss of \$35.2 million in the fourth quarter of 2019, which included \$21.2 million in goodwill, \$10.5 million in intangible assets associated with recent acquisitions, \$1.4 million in intangible assets related to capitalized patents, and \$2.1 million in other asset write-downs. There were no similar impairments in 2018.

Other expense. Other expense was \$2.4 million for the year ended December 31, 2019 compared to \$1.2 million for the year ended December 31, 2018. This increase was primarily driven by the impairment charge related to our equity investment in present4D GmbH (“present4D”) recorded in the second quarter of 2019 and the impairment charge related to our note receivable due from present4D recorded in the fourth quarter of 2019, partially offset by a favorable adjustment to the contingent consideration liability from a prior year acquisition.

Income tax expense (benefit). Income tax expense for the year ended December 31, 2019 was \$1.1 million compared with an income tax benefit of \$0.4 million for the year ended December 31, 2018. Our effective tax rate was 1.9% for the year ended December 31, 2019 compared to (8.2%) for the year ended December 31, 2018. The change in income tax expense (benefit) was primarily due to \$8.5 million of income tax expense recorded in the year ended December 31, 2019 resulting from our determination that it is more likely than not that certain foreign deferred tax assets will not be fully realized and the establishment of a valuation due to a history of cumulative losses in related jurisdictions. Additionally, the year-over-year change in our income tax expense (benefit) and our effective tax rate was partially due to a pretax book loss during the year ended December 31, 2019 as compared with pretax book income in the year ended December 31, 2018, as well as provision-to-return adjustments recorded in 2019 and 2018.

Net (loss) income. Net loss was \$62.1 million for the year ended December 31, 2019 compared with net income of \$4.9 million for the year ended December 31, 2018, reflecting the impact of the factors described above.

Liquidity and Capital Resources

Cash and cash equivalents increased by \$52.0 million to \$185.6 million at December 31, 2020 from \$133.6 million at December 31, 2019. Cash flows from operating activities provide our primary source of liquidity. We generated positive cash flows from operations of \$21.4 million during the year ended December 31, 2020 compared to \$32.5 million during the year ended December 31, 2019. The change was mainly due to a decrease in non-cash adjustments to reconcile net income more than offsetting an increase due to certain working capital reductions.

Cash flows provided by investing activities during the year ended December 31, 2020 were \$13.9 million compared with cash flows used in investing activities of \$9.3 million during the year ended December 31, 2019. The change was primarily due to proceeds from sales of investments of \$25.0 million during the year ended December 31, 2020, compared to no such activity in the year ended December 31, 2019.

Cash flows provided by financing activities during the years ended December 31, 2020 and December 31, 2019 were \$11.1 million and \$2.2 million, respectively. The increase was primarily driven by higher proceeds from the issuance of stock relating to the exercise of stock options during the year ended December 31, 2020 compared to the prior year and decreased contingent consideration paid in connection with our recent acquisitions in the year ended December 31, 2020.

Of our cash and cash equivalents, \$119.2 million was held by foreign subsidiaries as of December 31, 2020. On December 22, 2017, the United States enacted the U.S. Tax Cuts and Jobs Act, resulting in significant modifications to existing law, which included a transition tax on the mandatory deemed repatriation of foreign earnings. As a result of the U.S. Tax Cuts and Jobs Act, the Company can repatriate foreign earnings and profits to the U.S. with minimal U.S. income tax consequences, other than the transition tax and global intangible low-taxed income (“GILTI”) tax. The Company reinvested a large portion of its undistributed foreign earnings and profits in acquisitions and other investments and intends to bring back a portion of foreign cash in certain jurisdictions where the Company will not be subject to local withholding taxes and which were subject already to transition tax and GILTI tax.

On November 24, 2008, our Board of Directors approved a \$30.0 million share repurchase program. Subsequently, in October 2015, our Board of Directors authorized an increase to the existing share repurchase program from \$30.0 million to \$50.0 million. In December 2018, our Board of Directors authorized management to utilize the share repurchase program, beginning January 1, 2019, to maintain the number of our issued and outstanding shares to address the dilutive impact of stock options exercises and the settlement of restricted stock units. 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 under this program. 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. We made no stock repurchases during the years ended December 31, 2020, 2019 and 2018 under this program. As of December 31, 2020, we had authorization to repurchase \$18.3 million of the \$50.0 million authorized by our Board of Directors under the existing share repurchase program.

We believe that our working capital and anticipated cash flow from operations will be sufficient to fund our long-term liquidity operating requirements for at least the next 12 months.

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-cancellable operating leases. These obligations are presented below as of December 31, 2020 (dollars in thousands):

Contractual Obligations	Payments Due by Period				
	Total	< 1 Year	1-3 Years	3-5 Years	> 5 Years
Operating lease obligations	\$ 33,322	\$ 6,914	\$ 10,193	\$ 7,611	\$ 8,604
Capital lease obligations	445	292	134	19	\$ —
Purchase obligations	45,138	44,196	942	—	—
Transition tax liability	11,080	1,166	3,353	6,561	—
Other obligations	1,056	—	1,056	—	—
Total	<u>\$ 91,041</u>	<u>\$ 52,568</u>	<u>\$ 15,678</u>	<u>\$ 14,191</u>	<u>\$ 8,604</u>

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. As of December 31, 2020, we had approximately \$44.2 million in purchase commitments that are expected to be delivered within the next 12 months. To ensure adequate component availability in preparation for new product introductions, we also had \$0.9 million in long-term commitments for purchases to be delivered after 12 months. During the fourth quarter of 2017, we recorded a provisional amount of \$17.4 million related to the increase to our taxes payable pursuant to the U.S. Tax Cuts and Jobs Act associated with the mandatory deemed repatriation of the earnings of our foreign subsidiaries, or transition tax. During the fourth quarter of 2018, we decreased the provisional estimate of the one-time transition tax by \$2.8 million upon completing our analysis of earnings and profits of our foreign subsidiaries and utilization of foreign tax credits. \$1.8 million of the decrease related to a change in our deferred tax assets, and \$1.0 million was an income tax benefit recorded in the fourth quarter of 2018. We made our first three transition tax payments in 2018, 2019, and 2020 and will pay the remaining liability over the next five years. Other obligations included in the table primarily represent estimated payments due for acquisition related earn-outs of \$1.1 million.

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 2021.

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, current liabilities 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 operating results and financial position.

Revenue Recognition

For arrangements with multiple performance obligations, which represent promises within an arrangement that are capable of being distinct, we allocate revenue to all distinct performance obligations based on their relative standalone selling prices ("SSP"). When available, we use observable prices to determine the SSP. When observable prices are not available, SSPs are established that reflect our best estimates of what the selling prices of the performance obligations would be if they were sold regularly on a standalone basis.

Revenue related to our measurement and imaging equipment and related software is generally recognized upon shipment from our facilities or when delivered to the customer's location, as determined by the agreed upon shipping terms, at which time we are entitled to payment and title and control has passed to the customer. Fees billed to customers associated with the distribution of products are classified as revenue. We generally 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. To support our product lines, we also sell hardware service contracts that typically range from one year to three years. Hardware service contract revenues are recognized on a straight-line basis over the term of the contract. Costs relating to hardware service contracts 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 risks and rewards of ownership have passed to the customer. These software arrangements generally include short-term maintenance that is considered post-contract support ("PCS"), which is considered to be a separate performance obligation. We generally establish a standalone sales price for this PCS component based on our software maintenance contract renewals. Software maintenance contracts, when sold, are recognized on a straight-line basis over the term of the contract. 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. Payment for products and services is collected within a short period of time following transfer of control or commencement of delivery of services, as applicable. 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 a future need exists. Items without an identified current or future usage are reserved in an amount equal to 100% of the first-in first-out 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, 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. Our evaluation of the need for the valuation allowance is significantly influenced by our ability to achieve profitability and our ability to predict and achieve future projections of taxable income.

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 FASB ASC Topic 740, 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 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.

Goodwill Impairment

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 each year, or more frequently if indicators of potential impairment exist (i.e., that it is more likely than not that the fair value of the reporting unit is less than the carrying value), to determine if the carrying value of the recorded goodwill or indefinite lived intangible assets is impaired.

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 quantitative goodwill impairment test is 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 quantitative goodwill impairment test. We perform the 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 impair goodwill for the excess amount of the reporting unit compared to its fair value, not to be reduced below zero. Management concluded there was no goodwill impairment for the years ended December 31, 2020 and 2018. However, during 2019 as a result of this test and under our historical reporting unit structure, the estimated fair value of each of the Photonics reporting unit, which included goodwill recognized with the Instrument Associates, LLC d/b/a Nutfield Technology (“Nutfield”), Laser Control Systems Limited (“Laser Control Systems”) and Lanmark Controls, Inc. (“Lanmark”) acquisitions, and the 3D Design reporting unit, which included goodwill recognized with the acquisition of Opto-Tech SRL and its subsidiary Open Technologies SRL (collectively, “Open Technologies”), were determined to be significantly less than the carrying value of such reporting unit, indicating a full impairment. This impairment was driven primarily by historical and projected financial performance lower than our expectations and changes in our go-forward strategy in connection with our new strategic plan.

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. Critical estimates are also made in valuing earn-outs, which represent arrangements to pay former owners based on the satisfaction of performance criteria. 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, restricted stock units 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 valuation model. The fair value of restricted stock units and stock options with a market condition is estimated, at the date of grant, using the Monte Carlo Simulation valuation 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. We elect to account for forfeitures related to the service condition-based awards as they occur.

We expense stock-based compensation for stock options, restricted stock awards, restricted stock units and performance awards over the requisite service period. For awards with only a service condition, we expense stock-based compensation 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 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.

Also, beginning in October 2018, our non-employee directors may elect to have their annual cash retainers and annual equity retainers paid in the form of deferred stock units pursuant to the 2014 Equity Incentive Plan and the 2018 Non-Employee Director Deferred Compensation Plan. Each deferred stock unit represents the right to receive one share of our common stock upon the non-employee director's separation of service from the Company. We record compensation cost associated with our deferred stock units over the period of service.

Impact of Recently Adopted Accounting Standards

In February 2016, the FASB issued Accounting Standards Update (“ASU”) No. 2016-02, Leases (Topic 842) (“ASU 2016-02”), which is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements to enable users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. ASU No. 2018-11, Leases (Topic 842): Targeted Improvements, was issued by the FASB in July 2018 and allows for a cumulative-effect adjustment transition method of adoption. We adopted ASU 2016-02 effective as of January 1, 2019 utilizing the cumulative-effect adjustment transition method of adoption, which resulted in the recognition on our consolidated balance sheet as of December 31, 2019 of \$18.4 million of right-of-use assets for operating leases, \$19.6 million of lease liability for operating leases, \$0.8 million of property and equipment, net for finance leases and \$0.8 million of lease liability for finance leases under which we function as a lessee. We elected certain practical expedients available under the transition provisions to (i) allow aggregation of non-lease components with the related lease components when evaluating accounting treatment, (ii) apply the modified retrospective adoption method, utilizing the simplified transition option, which allows us to continue to apply the legacy guidance in FASB ASC Topic 840, including its disclosure requirements, in the comparative periods presented in the year of adoption, and (iii) use hindsight in determining the lease term (that is, when considering our options to extend or terminate the lease and to purchase the underlying asset) and in assessing impairment of our right-of-use assets. The adoption of ASU 2016-02 also required us to include any initial direct costs, which are incremental costs that would not have been incurred had the lease not been obtained, in the right-of-use assets. The recognition of these costs in connection with our adoption of this guidance did not have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangible - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment (“ASU 2017-04”), which is intended to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under the new guidance, we perform our goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge is recognized for the amount by which the carrying amount exceeds the reporting unit’s fair value up to the amount of the goodwill allocated to the reporting unit. The new guidance also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform Step 2 of the goodwill impairment test if it fails the qualitative assessment. We adopted this guidance in connection with our annual impairment test for the fiscal year ended December 31, 2019. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”), which requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. ASU 2016-13, and subsequent related amendments to ASU 2016-13, replace the existing incurred loss impairment model with an expected loss model that requires the use of forward-looking information to calculate credit loss estimates. It also eliminates the concept of other-than-temporary impairment and requires credit losses related to available-for-sale debt securities to be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. These changes will result in earlier recognition of credit losses. We adopted ASU 2016-13 effective as of January 1, 2020, and the adoption of the new guidance did not have a material impact on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Exposure

We conduct a significant portion of our business outside the United States. In 2020, 61% of our revenue was invoiced, and a significant portion of our operating expenses were paid, in foreign currencies. At December 31, 2020, 42% of our assets were 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 2020, 2019 or 2018.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
FARO Technologies, Inc.

Opinion on the financial statements

We have audited the accompanying consolidated balance sheets of FARO Technologies, Inc. (a Florida corporation) and subsidiaries (the “Company”) as of December 31, 2020 and 2019, the related consolidated statements of operations, comprehensive income (loss), changes in shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2020, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2020 and 2019, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2020, 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) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2020, 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 17, 2021 expressed an unqualified opinion.

Basis for opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical audit matters

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Reserve for excess and obsolete inventory

As described further in Note 1 to the financial statements, the reserve for excess and obsolete inventory is established utilizing the Company’s past sales history and future sales forecasts. Inventory is considered to be potentially obsolete if the product has been withdrawn from the market or the product had no sales for the past 12 months and the product has 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 items are then reviewed to determine if a substitute usage exists, and items without an identified current or future usage are reserved in an amount equal to 100% of the first-in first-out cost of the inventory. We identified the reserve for excess and obsolete inventory as a critical audit matter.

The principal consideration for our determination that the reserve for excess and obsolete inventory was a critical audit matter was the high risk of estimation uncertainty due to significant judgments in management’s analysis, which included management’s assessment of current and future usage of identified potentially excess and obsolete inventory. Management’s assessment was based on qualitative and quantitative factors, such as the impact from competitors, impact of competing products, product market acceptance, introduction of newer product offerings, product failures, dependence on suppliers for materials, and other considerations evaluated by management in making its assessment of excess and obsolete inventories.

Our audit procedures related to the reserve for excess and obsolete inventory included the following, among others:

- We evaluated the design and tested the operating effectiveness of the key controls relating to the excess and obsolete reserve.
- We tested the calculation of current inventories within the excess and obsolete reserve by recalculating the analysis of the previous 12 months' usage and evaluating the reasonableness of forecasted sales.
- We tested the significant assumptions made by management for not reserving potentially excess and obsolete inventory. As part of our procedures, we obtained and inspected corroborating information to support the expectation of future usage, which included evidence such as forecasts of future sales, evaluation of product repair rates, outstanding products in the field, as well as need for replacement parts. We also inquired if any outstanding purchase orders from customers, or any other relevant evidence was available to corroborate management's assertions, as applicable.

Income taxes

As described further in Note 12 to the financial statements, the Company is a multinational corporation that is subject to income taxes in the United States and numerous foreign jurisdictions. The Company's effective tax rate is directly impacted by the application of complex tax laws and regulations, which are highly dependent upon the geographic mix of worldwide earnings or losses, the tax regulations in each country or geographic region in which they operate, and the availability of tax credit and loss carryforwards. In addition, the recoverability of deferred tax assets in both domestic and foreign jurisdictions is based on the weight of positive and negative evidence of recoverability, which includes future reversals of deferred tax liabilities, projections of future taxable income, and tax planning strategies. We identified income tax (benefit) expense and the deferred tax assets and liabilities as a critical audit matter.

The principal consideration for our determination that the income tax (benefit) expense and valuation and recoverability of deferred tax assets and liabilities was a critical audit matter were due to the multinational presence of the Company in numerous foreign jurisdictions, with varying complex tax laws and regulations. These rules may be subject to interpretation depending on the jurisdiction and may involve significant management judgment. In addition, there is a high risk of estimation uncertainty due to significant management judgment related to establishing or reversing a valuation allowance against a deferred tax asset in a jurisdiction, which may be based on various forms of positive and negative evidence regarding the recoverability of a deferred tax asset. The audit effort involved the use of professionals with specialized skills and knowledge to assist in evaluating the audit evidence obtained.

Our audit procedures related to the income tax (benefit) expense and deferred tax asset and liability amounts included the following, among others:

- We evaluated the design and tested the operating effectiveness of the key controls relating to the income tax provision and deferred tax asset and liability amounts, including the development of future earnings and assumptions around the timing of reversals of existing taxable temporary differences. We also tested management's controls around the review of the completeness and accuracy of the qualitative and quantitative valuation allowance analysis.
- We involved foreign tax professionals from member firms to assess significant income tax positions and calculations for completeness and accuracy. In addition, we reconciled the tax provision calculations to the underlying accounting records, tax returns, and other supporting documentation.
- We involved international tax professionals from the firm to test the Company's assumptions regarding its geographic mix of worldwide earnings or losses. As part of those procedures, we noted the Company's geographic mix of earnings or losses was calculated pursuant to third party transfer pricing studies performed by qualified parties. In addition, we involved specialists to review the Company's transfer pricing assertions.
- We tested the Company's analysis of recoverability of its deferred tax assets in each of its jurisdictions based on evidence received from management to support the balances.

/s/ GRANT THORNTON LLP

We have served as the Company's auditor since 2004.

Orlando, Florida
February 17, 2021

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	December 31, 2020	December 31, 2019
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 185,633	\$ 133,634
Short-term investments	—	24,870
Accounts receivable, net	64,616	76,162
Inventories, net	47,391	58,554
Prepaid expenses and other current assets	26,295	28,996
Total current assets	<u>323,935</u>	<u>322,216</u>
Non-current assets:		
Property, plant and equipment, net	23,091	26,954
Operating lease right-of-use asset	26,107	18,418
Goodwill	57,541	49,704
Intangible assets, net	13,301	14,471
Service and sales demonstration inventory, net	31,831	33,349
Deferred income tax assets, net	47,450	18,766
Other long-term assets	2,336	2,964
Total assets	<u>\$ 525,592</u>	<u>\$ 486,842</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 14,121	\$ 13,718
Accrued liabilities	42,593	38,072
Income taxes payable	3,442	5,182
Current portion of unearned service revenues	39,149	39,211
Customer deposits	2,807	3,108
Lease liability	5,835	6,674
Total current liabilities	<u>107,947</u>	<u>105,965</u>
Unearned service revenues - less current portion	21,757	20,578
Lease liability - less current portion	22,131	13,698
Deferred income tax liabilities	787	357
Income taxes payable - less current portion	11,583	13,177
Other long-term liabilities	1,084	1,075
Total liabilities	<u>165,289</u>	<u>154,850</u>
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 \$0.001, 50,000,000 shares authorized; 19,384,350, 18,988,379 issued; 17,990,707 and 17,576,618 outstanding, respectively	19	19
Additional paid-in capital	287,979	267,868
Retained earnings	113,508	112,879
Accumulated other comprehensive loss	(10,160)	(17,399)
Common stock in treasury, at cost - 1,393,643 shares and 1,411,761, respectively	(31,043)	(31,375)
Total shareholders' equity	<u>360,303</u>	<u>331,992</u>
Total liabilities and shareholders' equity	<u>\$ 525,592</u>	<u>\$ 486,842</u>

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)	Years ended December 31,		
	2020	2019	2018
SALES			
Product	\$ 218,587	\$ 289,679	\$ 320,584
Service	85,181	92,086	83,043
Total sales	303,768	381,765	403,627
COST OF SALES			
Product	98,864	133,246	130,876
Service	45,057	50,387	51,198
Total cost of sales	143,921	183,633	182,074
GROSS PROFIT	159,847	198,132	221,553
OPERATING EXPENSES			
Selling, general and administrative	131,827	177,378	169,717
Research and development	42,896	44,175	46,082
Restructuring costs	15,806	—	—
Impairment loss	—	35,213	—
Total operating expenses	190,529	256,766	215,799
(LOSS) INCOME FROM OPERATIONS	(30,682)	(58,634)	5,754
OTHER EXPENSE (INCOME)			
Interest income	(340)	(714)	(429)
Other expense, net	431	2,313	1,139
Interest expense	—	781	486
(LOSS) INCOME BEFORE INCOME TAX (BENEFIT) EXPENSE	(30,773)	(61,014)	4,558
INCOME TAX (BENEFIT) EXPENSE	(31,402)	1,133	(372)
NET INCOME (LOSS)	<u>\$ 629</u>	<u>\$ (62,147)</u>	<u>\$ 4,930</u>
NET INCOME (LOSS) PER SHARE - BASIC	<u>\$ 0.04</u>	<u>\$ (3.58)</u>	<u>\$ 0.29</u>
NET INCOME (LOSS) PER SHARE - DILUTED	<u>\$ 0.04</u>	<u>\$ (3.58)</u>	<u>\$ 0.29</u>
Weighted average shares - Basic	<u>17,769,958</u>	<u>17,383,415</u>	<u>17,043,167</u>
Weighted average shares - Diluted	<u>17,926,324</u>	<u>17,383,415</u>	<u>17,348,456</u>

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)	Years ended December 31,		
	2020	2019	2018
Net income (loss)	\$ 629	\$ (62,147)	\$ 4,930
Currency translation adjustments, net of income tax	7,239	1,084	(10,661)
Comprehensive income (loss)	\$ 7,868	\$ (61,063)	\$ (5,731)

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2020, 2019, AND 2018

(in thousands, except share data)	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Common Stock in Treasury	Total
	Shares	Amounts					
BALANCE JANUARY 1, 2018	<u>16,796,884</u>	<u>\$ 18</u>	<u>\$ 223,055</u>	<u>\$ 168,624</u>	<u>\$ (7,822)</u>	<u>\$ (31,809)</u>	<u>\$ 352,066</u>
Net income				4,930			4,930
Currency translation adjustment, net of income tax					(10,661)		(10,661)
Stock-based compensation	—		7,620				7,620
Common stock issued, net of shares withheld for employee taxes	456,127	1	20,654			200	20,855
Cumulative effect of the adoption of ASU 2014-09				1,799			1,799
BALANCE DECEMBER 31, 2018	<u>17,253,011</u>	<u>\$ 19</u>	<u>\$ 251,329</u>	<u>\$ 175,353</u>	<u>\$ (18,483)</u>	<u>\$ (31,609)</u>	<u>\$ 376,609</u>
Net loss				(62,147)			(62,147)
Currency translation adjustment, net of income tax					1,084		1,084
Stock-based compensation			11,071				11,071
Common stock issued, net of shares withheld for employee taxes	323,607		5,468			234	5,702
Cumulative effect of the adoption of ASU 2016-02				(327)			(327)
BALANCE DECEMBER 31, 2019	<u>17,576,618</u>	<u>\$ 19</u>	<u>\$ 267,868</u>	<u>\$ 112,879</u>	<u>\$ (17,399)</u>	<u>\$ (31,375)</u>	<u>\$ 331,992</u>
Net income				629			629
Currency translation adjustment, net of income tax					7,239		7,239
Stock-based compensation	—		8,314				8,314
Common stock issued, net of shares withheld for employee taxes	414,089		11,797			332	12,129
BALANCE DECEMBER 31, 2020	<u>17,990,707</u>	<u>\$ 19</u>	<u>\$ 287,979</u>	<u>\$ 113,508</u>	<u>\$ (10,160)</u>	<u>\$ (31,043)</u>	<u>\$ 360,303</u>

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

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

(in thousands)	Years Ended December 31,		
	2020	2019	2018
CASH FLOWS FROM:			
OPERATING ACTIVITIES:			
Net income (loss)	\$ 629	\$ (62,147)	\$ 4,930
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	14,239	18,516	18,313
Compensation for stock options and restricted stock units	8,314	11,071	7,620
Provision for bad debts (net of recoveries)	440	2,090	907
Loss on disposal of assets	383	2,639	192
Provision for excess and obsolete inventory	1,349	16,886	5,757
Impairment of goodwill	—	21,233	—
Impairment of acquired intangibles	—	10,548	—
Impairment of loan to affiliate	—	549	—
Deferred income tax (benefit) expense	(28,444)	(6,304)	689
Change in operating assets and liabilities:			
(Increase) decrease in:			
Accounts receivable, net	12,346	10,406	(15,995)
Inventories	10,343	(4,136)	(20,532)
Prepaid expenses and other assets	3,862	1,188	(11,310)
Increase (decrease) in:			
Accounts payable and accrued liabilities	2,390	(2,518)	11,195
Income taxes payable	(3,357)	1,041	(3,286)
Customer deposits	(374)	(30)	513
Unearned service revenues	(726)	11,436	7,330
Net cash provided by operating activities	21,394	32,468	6,323
INVESTING ACTIVITIES:			
Purchases of investments	—	(50,000)	(47,000)
Proceeds from sale of investments	25,000	50,000	33,000
Purchases of property and equipment	(4,774)	(6,675)	(11,021)
Payments for internally capitalized patents	(1,298)	(2,118)	(1,900)
Acquisition of business, net of cash received	(6,036)	—	(27,067)
Other	1,015	(549)	(1,786)
Net cash provided (used in) by investing activities	13,907	(9,342)	(55,774)
FINANCING ACTIVITIES:			
Payments on capital leases	(338)	(358)	(157)
Payments of contingent consideration for acquisitions	(733)	(3,101)	(888)
Payments for taxes related to net share settlement of equity awards	(2,602)	(2,199)	—
Proceeds from issuance of stock related to stock option exercises	14,731	7,901	20,855
Net cash provided by financing activities	11,058	2,243	19,810
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	5,640	(518)	(2,536)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	51,999	24,851	(32,177)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	133,634	108,783	140,960
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 185,633	\$ 133,634	\$ 108,783

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2020, 2019 and 2018
(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” or “our”) design, develop, manufacture, market and support software driven, three-dimensional (“3D”) measurement, imaging, and realization solutions for the 3D metrology, architecture, engineering and construction (“AEC”) and public safety analytics markets. We enable our customers to capture, measure, manipulate, interact with and share data from the physical world in a virtual environment and then translate this information back into the physical domain. Our technology enables highly accurate 3D measurement, imaging, comparison and projection of parts and complex structures within production, assembly and quality assurance processes. Our FARO suite of 3D products and software solutions are used for inspection of components and assemblies, rapid prototyping, reverse engineering, documenting large volume or structures in 3D, surveying and construction, assembly layout, machine guidance as well as in investigation and reconstructions of crash and crime scenes. We sell the majority of our solutions through a direct sales force across a range of industries including automotive, aerospace, metal and machine fabrication, surveying, architecture, engineering and construction, public safety forensics and other industries.

Historically, we operated in five verticals—3D Manufacturing, Construction Building Information Modeling (“Construction BIM”), Public Safety Forensics, 3D Design and Photonics—and had three reporting segments—3D Manufacturing, Construction BIM and Emerging Verticals. During the second half of 2019, our Chief Executive Officer (“CEO”) and FARO’s management team formulated and began to implement a new comprehensive strategic plan for our business. Our strategic planning process included extensive conversations with employees, customers, investors and suppliers to identify both where the Company can provide sustained and differentiated customer value and where opportunities existed to improve operating efficiencies. We identified areas of our business that needed enhanced focus or change in order to improve our efficiency and cost structure. As part of our strategic plan, we reassessed and redefined our go-to-market strategy, refocused our marketing engagement with our customers, re-evaluated our hardware and software product portfolio and examined how key decisions are made throughout our global organization. Additionally, we focused on other organizational optimization efforts, including the simplification of our overly complex management structure.

As part of our new strategic plan, and based on the recommendation of our CEO, who is also our Chief Operating Decision Maker (“CODM”), in the fourth quarter of 2019, we eliminated our vertical structure and began reorganizing the Company into a functional structure. Our executive leadership team is now comprised of functional leaders in areas such as sales, marketing, operations, research and development and general and administrative, and resources are allocated to each function at a consolidated unit level. We no longer have separate business units, or segment managers or vertical leaders who report to the CODM with respect to operations, operating results or planning for levels or components below the total Company level. Instead, our CODM now allocates resources and evaluates performance on a Company-wide basis. Based on these changes, commencing with the fourth quarter of 2019, we are now reporting as one reporting segment that develops, manufactures, markets, supports and sells CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software and 3D documentation systems. Our reporting segment sells into a variety of end markets, including automotive, aerospace, metal and machine fabrication, architecture, engineering, construction 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 loss. Foreign currency transaction gains and losses are included in net income (loss).

Revenue Recognition, Product Warranty and Extended Warranty Contracts—Revenue is recognized as performance obligations within a contract are satisfied in an amount that reflects the consideration we expect to receive in exchange for satisfaction of those performance obligations, or standalone selling price. Our contracts with customers may include multiple performance obligations. For such arrangements, we allocate revenues to each performance obligation based on its relative standalone selling price. We make this allocation estimate utilizing data from the sale of our applicable products and services to customers separately in similar circumstances. Revenue related to our measurement and imaging equipment and related software is generally recognized upon shipment from our facilities or when delivered to the customer's location, as determined by the agreed upon shipping terms, at which time we are entitled to payment and title and control has passed to the customer. Fees billed to customers associated with the distribution of products are classified as revenue. We generally 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. To support our product lines, we also sell hardware service contracts which revenues are recognized on a straight-line basis over the term of the contract. Hardware service contracts generally extend between one month and three years. Costs relating to hardware service contracts 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 risks and rewards of ownership have passed to the customer. These software arrangements generally include short-term maintenance that is considered post-contract support (“PCS”), which is considered to be a separate performance obligation. We generally establish a standalone sales price for this PCS component based on our software maintenance contract renewals. Software maintenance contracts, when sold, are recognized on a straight-line basis over the term of the contract. 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. Payment for products and services is collected within a short period of time following transfer of control or commencement of delivery of services, as applicable. 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 had deposits with foreign banks totaling \$119.2 million and \$89.3 million as of December 31, 2020 and 2019, respectively.

Accounts Receivable and Related Allowance for Credit Losses—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 credit losses. 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 credit losses, which adjusts gross trade accounts receivable to their net realizable value. The allowance for credit losses 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 credit losses. 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 and imaging devices utilized by sales representatives to present our products to customers. Management expects sales demonstration inventory to be held by our sales representatives for up to three years, at which time it is 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. 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. See Note 6, “Inventories” for further information regarding inventories.

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 potentially 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 one 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 \$10.8 million, \$13.0 million and \$12.9 million in 2020, 2019 and 2018, 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. Balances of major classes of depreciable assets and total accumulated depreciation as of December 31, 2020 and 2019 are as follows:

	December 31, 2020	December 31, 2019
Property, plant and equipment:		
Machinery and equipment	\$ 91,984	\$ 83,900
Furniture and fixtures	6,620	6,377
Leasehold improvements	21,414	21,397
Property, plant and equipment at cost	120,018	111,674
Less: accumulated depreciation and amortization	(96,927)	(84,720)
Property, plant and equipment, net	\$ 23,091	\$ 26,954

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 include consideration of future growth rates and margins, customer attrition rates, future changes in technology and brand awareness, loyalty and position, and discount rates. Critical estimates are also made in valuing earn-outs, which represent arrangements to pay former owners based on the satisfaction of performance criteria. 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 Intangible Assets—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 each year, or more frequently if indicators of potential impairment exist (i.e., that it is more likely than not that the fair value of the reporting unit is less than the carrying value), to determine if the carrying value of the recorded goodwill or indefinite lived intangible assets is impaired.

Each period, and for our single reporting unit, we can elect to perform a qualitative assessment to determine whether it is necessary to perform a 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 our reporting unit containing goodwill is less than its carrying amount, then the quantitative goodwill impairment test is 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 quantitative goodwill impairment test. We calculate 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 record the amount of the impairment loss, if any.

Management concluded there was no goodwill impairment for the year ended December 31, 2020, \$21.2 million impairment loss for the year ended December 31, 2019 and no goodwill impairment for the year ended December 31, 2018. We test goodwill for impairment annually on December 31 of each reporting year or more frequently if an event occurs or circumstances would indicate that it is more likely than not the fair value of the reporting unit is less than the carrying value. We performed our annual quantitative test of goodwill during 2020 and 2018 as of December 31. We changed the timing of our annual test of goodwill during 2019 to align with our updated strategic plan and annual budgetary process. Accordingly, we performed our annual quantitative test for impairment of our recorded goodwill as of December 10, 2019. As a result of this test, the estimated fair value of each of the Photonics reporting unit, which included goodwill recognized with the Instrument Associates, LLC d/b/a Nutfield Technology (“Nutfield”), Laser Control Systems Limited (“Laser Control Systems”) and Lanmark Controls, Inc. (“Lanmark”) acquisitions, and the 3D Design reporting unit, which included goodwill recognized with the acquisition of Opto-Tech SRL and its subsidiary Open Technologies SRL (collectively, “Open Technologies”), were determined to be significantly less than the carrying value of such reporting unit, indicating a full impairment. This \$21.2 million impairment loss was driven primarily by historical and projected financial performance lower than our expectations and changes in our go-forward strategy in connection with our new strategic plan. See Note 7, “Goodwill” for further information regarding goodwill.

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, 2020 and 2019, there were no indefinite-lived intangible assets.

Product technology and patents are recorded at cost. Amortization expense 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 5 years.

As a result of historical and projected financial performance being lower than our expectations and changes in our go-forward strategy in connection with our new strategic plan, the estimated fair value of acquired intangibles recognized with the Nutfield, Laser Control Systems, Lanmark and Open Technologies acquisitions were determined to be less than the net carrying value for such assets. We recognized an impairment charge related to such acquired intangibles of \$10.5 million in 2019. We recognized no impairment charges related to intangibles in 2020 or 2018. See Note 8, “Intangible Assets” for further information regarding intangible assets.

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. To date, the time incurred between the attainment of the related products’ technological feasibility and general release to customers has been short.

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. Our evaluation of the need for the valuation allowance is significantly influenced by our ability to maintain profitability and our ability to predict and achieve future projections of taxable income.

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. See Note 12, “Income Taxes” for further information regarding income taxes.

Earnings (Loss) Per Share (“EPS”)—Basic (loss) earnings per share is computed by dividing net (income) 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 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. When we report a loss for the period presented, the diluted loss per share calculation does not include our potential common stock, as the inclusion of these shares in the calculation would have an anti-dilutive effect. A reconciliation of the number of common shares used in the calculation of basic and diluted EPS is presented in Note 15, “(Loss) Earnings Per Share.”

Accounting for Stock-Based Compensation—We have two 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, restricted stock units 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-valuation model. The fair value of restricted stock unit awards and stock options with a market condition is estimated, at the date of grant, using the Monte Carlo Simulation valuation 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 and restricted stock units, including performance awards, without a market condition is estimated using the current market price of our common stock on the date of grant.

We expense stock-based compensation for stock options, restricted stock awards, restricted stock units and performance awards over the requisite service period. For awards with only a service condition, we expense stock-based compensation 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 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. All income tax-related cash flows resulting from share-based payments are reported as operating activities in the statement of cash flows in the deferred income tax benefit line item. We elect to account for forfeitures related to the service condition-based awards as they occur.

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 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 Adopted Accounting Standards—In February 2016, the FASB issued Accounting Standards Update (“ASU”) No. 2016-02, Leases (Topic 842) (“ASU 2016-02”), which is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements to enable users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. ASU No. 2018-11, Leases (Topic 842): Targeted Improvements, was issued by the FASB in July 2018 and allows for a cumulative-effect adjustment transition method of adoption. We adopted ASU 2016-02 effective as of January 1, 2019 utilizing the cumulative-effect adjustment transition method of adoption, which resulted in the recognition on our consolidated balance sheet as of December 31, 2019 of \$18.4 million of right-of-use assets for operating leases, \$19.6 million of lease liability for operating leases, \$0.8 million of property and equipment, net for finance leases and \$0.8 million of lease liability for finance leases under which we function as a lessee. We elected certain practical expedients available under the transition provisions to (i) allow aggregation of non-lease components with the related lease components when evaluating accounting treatment, (ii) apply the modified retrospective adoption method, utilizing the simplified transition option, which allows us to continue to apply the legacy guidance in FASB ASC Topic 840, including its disclosure requirements, in the comparative periods presented in the year of adoption, and (iii) use hindsight in determining the lease term (that is, when considering our options to extend or terminate the lease and to purchase the underlying asset) and in assessing impairment of our right-of-use assets. The adoption of ASU 2016-02 also required us to include any initial direct costs, which are incremental costs that would not have been incurred had the lease not been obtained, in the right-of-use assets. The recognition of these costs in connection with our adoption of this guidance did not have a material impact on our consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangible - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment (“ASU 2017-04”), which is intended to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under the new guidance, we perform our goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge is recognized for the amount by which the carrying amount exceeds the reporting unit’s fair value up to the amount of the goodwill allocated to the reporting unit. The new guidance also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform Step 2 of the goodwill impairment test if it fails the qualitative assessment. We adopted this guidance in connection with our annual impairment test for the fiscal year ended December 31, 2019. The adoption of this guidance did not have a material impact on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”), which requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. ASU 2016-13, and subsequent related amendments to ASU 2016-13, replace the existing incurred loss impairment model with an expected loss model that requires the use of forward-looking information to calculate credit loss estimates. It also eliminates the concept of other-than-temporary impairment and requires credit losses related to available-for-sale debt securities to be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. These changes will result in earlier recognition of credit losses. We adopted ASU 2016-13 effective as of January 1, 2020, and the adoption of the new guidance did not have a material impact on our consolidated financial statements.

Reclassifications—Certain prior year amounts have been reclassified in the accompanying consolidated financial statements to conform to the current period presentation:

- Depreciation and amortization expenses are being reported in the accompanying statements of operations to reflect departmental costs. Previously, those expenses were reported as a separate line item under operating expenses. Amounts related to depreciation and amortization expenses for the year ended December 31, 2018 has been restated throughout this Annual Report on Form 10-K to reflect this reclassification of depreciation and amortization expenses and to conform to the current period presentation, as set forth in the following tables;
- Selling and marketing expenses and general and administrative expenses are now being reported in the accompanying statements of operations together in one line as Selling, general and administrative. Previously, those expenses were reported as two separate line items under operating expenses. Amounts related to selling, general and administrative expenses for the year ended December 31, 2018 have been reclassified throughout this Annual Report on Form 10-K to reflect this reclassification of selling, general and administrative expenses and to conform to the current period presentation, as set forth in the following tables;
- Software maintenance revenue is now being reported in the accompanying statements of operations as a component of product sales. Previously, these revenues were reported in service sales. Amounts related to software maintenance sales for the year ended December 31, 2018 have been reclassified throughout this Annual Report on Form 10-K to reflect this reclassification of software maintenance sales and to conform to the current period presentation, as set forth in the following tables; and
- Software maintenance cost of sales is now being reported in the accompanying statements of operations as a component of product cost of sales. Previously, these cost of sales was reported in service cost of sales. Amounts related to software maintenance cost of sales for the year ended December 31, 2018 have been reclassified throughout this Annual Report on Form 10-K to reflect this reclassification of software maintenance cost of sales and to conform to the current period presentation, as set forth in the following tables.

For the twelve months ended December 31, 2018:

	As Reported	Depreciation and Amortization Adjustment	Selling, General and Administrative Adjustment	Software Maintenance Adjustment	As Adjusted
Sales					
Product	\$ 311,102	\$ —	\$ —	\$ 9,482	\$ 320,584
Service	92,525	—	—	(9,482)	83,043
Total sales	\$ 403,627	\$ —	\$ —	\$ —	\$ 403,627
Cost of Sales					
Product	\$ 124,802	\$ 3,406	\$ —	\$ 2,668	\$ 130,876
Service	50,480	3,386	—	(2,668)	51,198
Total cost of sales	\$ 175,282	\$ 6,792	\$ —	\$ —	\$ 182,074
Operating Expenses					
Selling, general and administrative	\$ —	\$ 5,145	\$ 164,572	\$ —	\$ 169,717
Selling and marketing	116,920	—	(116,920)	—	—
General and administrative	47,652	—	(47,652)	—	—
Depreciation and amortization	18,313	(18,313)	—	—	—
Research and development	39,706	6,376	—	—	46,082
Total operating expenses	\$ 222,591	\$ (6,792)	\$ —	\$ —	\$ 215,799

2. SUPPLEMENTAL CASH FLOW INFORMATION

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

	Years ended December 31,		
	2020	2019	2018
Supplemental cash flow information:			
Cash paid for interest	\$ 21	\$ 6	\$ 4
Cash paid for income taxes	\$ 3,409	\$ 5,498	\$ 5,813
Supplemental noncash investing and financing activities:			
Transfer of service and sales demonstration inventory to fixed assets	\$ 1,688	\$ 3,044	\$ 964
Assumption of contingent consideration from acquisition	\$ 980	\$ —	\$ 6,751

3. REVENUES

The following tables present our revenues by sales type as presented in our consolidated statements of operations disaggregated by the timing of transfer of goods or services (in thousands):

	Years ended December 31,		
	2020	2019	2018
Product Sales			
Products transferred to a customer at a point in time	\$ 205,849	\$ 277,841	\$ 311,102
Products transferred to a customer over time	12,738	11,838	9,482
	<u>\$ 218,587</u>	<u>\$ 289,679</u>	<u>\$ 320,584</u>
Service Sales			
Service transferred to a customer at a point in time	\$ 36,732	\$ 48,593	\$ 42,932
Service transferred to a customer over time	48,449	43,493	40,111
	<u>\$ 85,181</u>	<u>\$ 92,086</u>	<u>\$ 83,043</u>

The following table presents our revenues disaggregated by geography, based on the billing addresses of our customers (in thousands):

	Years ended December 31,		
	2020	2019	2018
Total Sales to External Customers			
United States and Canada	\$ 119,769	\$ 151,646	\$ 156,242
EMEA ⁽¹⁾	91,390	122,279	127,261
Other APAC ⁽¹⁾	51,804	60,796	68,908
China	31,748	32,934	36,130
Other Americas ⁽¹⁾	9,057	14,110	15,086
	<u>\$ 303,768</u>	<u>\$ 381,765</u>	<u>\$ 403,627</u>

⁽¹⁾ Regions represent Europe, the Middle East, and Africa (EMEA); Asia-Pacific, excluding China (Other APAC); and Mexico and Brazil (Other Americas).

We capitalize commission expenses related to deliverables transferred to a customer over time and amortize such costs ratably over the term of the contract. As of December 31, 2020, the deferred cost asset related to deferred commissions was approximately \$4.1 million. For classification purposes, \$2.6 million and \$1.5 million are comprised within the Prepaid expenses and other current assets and Other long-term assets, respectively, on our consolidated balance sheet as of December 31, 2020. As of December 31, 2019, the deferred cost asset related to deferred commissions was approximately \$3.1 million. For classification purposes, \$2.1 million and \$1.0 million are comprised within the Prepaid expenses and other current assets and Other long-term assets, respectively, on our consolidated balance sheet as of December 31, 2019.

The unearned service revenue liabilities reported on our consolidated balance sheets reflect the contract liabilities to satisfy the remaining performance obligations for extended warranties and software maintenance. The current portion of unearned service revenues on our consolidated balance sheets is what we expect to recognize to revenue within twelve months after the applicable balance sheet date relating to extended warranty and software maintenance contract liabilities. The Unearned service revenues - less current portion on our consolidated balance sheets is what we expect to recognize to revenue extending beyond twelve months after the applicable balance sheet date relating to extended warranty and software maintenance contract liabilities. Customer deposits on our consolidated balance sheets represent customer prepayments on contracts for performance obligations that we must satisfy in the future to recognize the related contract revenue. These amounts are generally related to performance obligations which are delivered in less than 12 months. During the year ended December 31, 2020, we recognized \$35.2 million of revenue that was deferred on our consolidated balance sheet as of December 31, 2019. During the year ended December 31, 2019, we recognized \$30.2 million of revenue that was deferred on our consolidated balance sheet as of December 31, 2018.

The nature of certain of our contracts gives rise to variable consideration, primarily related to an allowance for sales returns. We are required to estimate the contract asset related to sales returns and record a corresponding adjustment to Cost of Sales. Our allowance for sales returns for December 31, 2020 and December 31, 2019 was approximately \$0.3 million and \$0.1 million, respectively.

Shipping and handling fees billed to customers in a sales transaction are recorded in Product Sales and shipping and handling costs incurred are recorded in Cost of Sales. We exclude from Sales any value-added, sales and other taxes that we collect concurrently with revenue-producing activities.

4. ALLOWANCE FOR CREDIT LOSSES

Activity in the allowance for credit losses was as follows:

	Years ended December 31,		
	2020	2019	2018
Balance, beginning of year	\$ 3,449	\$ 1,748	\$ 1,957
Provision (net of recovery)	440	2,090	907
Amounts written off, net of recoveries	(1)	(389)	(1,116)
Balance, end of year	<u>\$ 3,888</u>	<u>\$ 3,449</u>	<u>\$ 1,748</u>

5. SHORT-TERM INVESTMENTS

We had no short-term investments at December 31, 2020. Short-term investments at December 31, 2019 were comprised of U.S. Treasury Bills totaling \$24.8 million, consisting of \$8.9 million that matured on March 12, 2020 and \$15.9 million that matured on June 11, 2020. The interest rates on the U.S. Treasury Bills held on December 31, 2019 that matured on March 12, 2020 and June 11, 2020 were 1.8% and 1.4%, respectively. The investments are classified as held-to-maturity and recorded at cost plus accrued interest, which approximates fair value.

6. INVENTORIES

Inventories are stated at the lower of cost or net realizable value using the first-in first-out method. We have three principal categories of inventory: 1) manufactured product to be sold; 2) sales demonstration inventory - completed product used to support our sales force, for demonstrations and held for sale; and 3) service inventory - completed product and parts used to support our service department and held for sale. Shipping and handling costs are classified as a component of cost of sales in our consolidated statements of operations. Sales demonstration inventory is held by our sales representatives for up to three years, at which time it is refurbished and transferred to finished goods as used equipment, stated at the lower of cost or net realizable value. We expect these refurbished units to remain in finished goods inventory and to be sold within 12 months at prices that produce reduced gross margins. Service inventory is 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 and 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 the remaining life, typically three years.

Inventories consist of the following:

	December 31, 2020	December 31, 2019
Raw materials	\$ 29,955	\$ 36,956
Finished goods	17,436	21,598
Inventories, net	<u>\$ 47,391</u>	<u>\$ 58,554</u>
Service and sales demonstration inventory, net	<u>\$ 31,831</u>	<u>\$ 33,349</u>

7. GOODWILL

We had approximately \$57.5 million and \$49.7 million of goodwill as of December 31, 2020 and 2019, respectively. Changes in these balances are shown below:

(in thousands)	December 31, 2020	December 31, 2019
Goodwill, beginning	\$ 49,704	\$ 67,274
Recognized goodwill	5,467	4,443
Impairment of goodwill	—	(21,233)
Foreign currency translation	2,370	(780)
Goodwill, ending	<u>\$ 57,541</u>	<u>\$ 49,704</u>

We test goodwill for impairment annually on December 31 of each reporting year or more frequently if an event occurs or circumstances would indicate that it is more likely than not the fair value of the reporting unit is less than the carrying value. We performed our annual quantitative test of goodwill during 2020 as of December 31, 2020, and recorded no impairment expense for the year ended December 31, 2020. During 2019, we changed the timing of our annual test of goodwill to align with our updated strategic plan and annual budgetary process. Accordingly, in connection with the preparation of our financial statements for the year ended December 31, 2019, we performed our annual quantitative test for impairment of our recorded goodwill as of December 10, 2019. As a result of this test, the estimated fair value of each of the Photonics reporting unit, which included goodwill recognized with the Nutfield, Laser Control Systems and Lanmark acquisitions, and the 3D Design reporting unit, which included goodwill recognized with the Open Technologies acquisition, were determined to be less than the carrying value of such reporting unit, indicating a full impairment. This impairment was driven primarily by historical and projected financial performance lower than our expectations and changes in our go-forward strategy in connection with our new strategic plan.

As part of our new strategic plan, and based on the recommendation of our CEO, who is also our CODM, in the fourth quarter of 2019, we eliminated our vertical structure and began reorganizing the Company into a functional structure. Our executive leadership team is now comprised of functional leaders in areas such as sales, marketing, operations, research and development and general and administrative, and resources are allocated to each function at a consolidated unit level. We no longer have separate business units, or segment managers or vertical leaders who report to the CODM with respect to operations, operating results or planning for levels or components below the total Company level. Instead, our CODM now allocates resources and evaluates performance on a Company-wide basis. Based on these changes, commencing with the fourth quarter of 2019, we are now reporting as one reporting segment that develops, manufactures, markets, supports and sells CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software and 3D documentation systems. Our reporting segment sells into a variety of end markets, including automotive, aerospace, metal and machine fabrication, architecture, engineering, construction and public safety. Accordingly, there are no reporting segment goodwill balances at December 31, 2020 and 2019, respectively.

8. INTANGIBLE ASSETS

Intangible assets consist of the following:

	As of December 31, 2020		
	Carrying Value	Accumulated Amortization	Net Intangible
Amortizable intangible assets:			
Product technology	\$ 14,625	\$ 10,785	\$ 3,840
Patents and trademarks	14,325	7,495	6,830
Customer relationships	6,541	4,002	2,539
Other	5,265	5,173	92
Total	\$ 40,756	\$ 27,455	\$ 13,301

	As of December 31, 2019		
	Carrying Value	Accumulated Amortization	Net Intangible
Amortizable intangible assets:			
Product technology	\$ 24,135	\$ 19,798	\$ 4,337
Patents and trademarks	13,726	6,894	6,832
Customer relationships	5,150	2,509	2,641
Other	8,875	8,214	661
Total	\$ 51,886	\$ 37,415	\$ 14,471

For the year ended, December 31, 2019, as a result of historical and projected financial performance lower than our expectations and changes in our go-forward strategy in connection with our new strategic plan, the estimated fair value of acquired intangibles recognized with the Nutfield, Laser Control Systems, Lanmark and Open Technologies acquisitions were determined to be less than the carrying value of the net carrying value for such assets. We recognized an impairment charge related to such acquired intangibles of \$10.5 million in the fourth quarter of 2019. This impairment charge was primarily related to customer relationship and technology intangible assets.

Amortization expense was \$3.4 million, \$5.6 million and \$5.4 million in 2020, 2019 and 2018, respectively. The estimated amortization expense for each of the years 2021 through 2025 and thereafter is as follows:

Years ending December 31,	Amount
2021	\$ 3,760
2022	2,536
2023	1,903
2024	1,569
2025	1,394
Thereafter	2,139
	\$ 13,301

9. ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	As of December 31,	
	2020	2019
Accrued compensation and benefits	\$ 17,457	\$ 15,366
Accrued restructuring costs	2,347	—
Accrued warranties	1,683	2,090
Professional and legal fees	1,810	1,793
Taxes other than income	5,013	4,077
General services administration contract contingent liability (see Note 13)	12,325	11,886
Other accrued liabilities	1,958	2,860
	<u>\$ 42,593</u>	<u>\$ 38,072</u>

Activity related to accrued warranties was as follows:

	Years ended December 31,		
	2020	2019	2018
Balance, beginning of year	\$ 2,090	\$ 2,571	\$ 2,628
Provision for warranty expense	2,727	3,600	4,096
Fulfillment of warranty obligations	(3,134)	(4,081)	(4,153)
Balance, end of year	<u>\$ 1,683</u>	<u>\$ 2,090</u>	<u>\$ 2,571</u>

10. FAIR VALUE MEASUREMENTS

The guidance on fair value measurements and disclosures defines fair value, establishes a framework for measuring fair value, and requires enhanced disclosures about assets and liabilities measured at fair value. Fair value is defined as the price at which an asset could be exchanged in a current transaction between knowledgeable, willing parties. A liability's fair value is defined as the amount that would be paid to transfer the liability to a new obligor, not the amount that would be paid to settle the liability with the creditor. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models are used to determine fair value. These models employ valuation techniques that involve some level of management estimation and judgment, the degree of which is dependent on the price transparency for the instruments or market and the instruments' complexity.

Assets and liabilities recorded at fair value on a recurring basis in our consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by the guidance on fair value measurements, are directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities and are as follows:

Level 1 - Valuation is based upon quoted market prices for identical instruments traded in active markets.

Level 2 - Valuation is based on quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 - Valuation is generated from model-based techniques that use significant assumptions not observable in the market. Valuation techniques include use of discounted cash flow models and similar techniques.

Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are categorized in the tables below based upon the lowest level of significant input to the valuations. Historically, we have presented short-term investments in the fair value table presented below. As our short-term investments in the accompanying consolidated balance sheets are comprised of U.S. Treasury Bills, these investments are classified as held-to-maturity investments and are not recorded at fair value on a recurring basis in our consolidated balance sheets. As such, we have removed short-term investments from the table below.

	December 31, 2020		
	Level 1	Level 2	Level 3
Liabilities:			
Contingent consideration ⁽¹⁾	\$ —	\$ —	\$ 1,056
Total	\$ —	\$ —	\$ 1,056

	December 31, 2019		
	Level 1	Level 2	Level 3
Liabilities:			
Contingent consideration ⁽¹⁾	\$ —	\$ —	\$ 733
Total	\$ —	\$ —	\$ 733

⁽¹⁾ Contingent consideration liability represents arrangements to pay the former owners of certain companies we acquired based on the former owners attaining future product release milestones. We use a probability-weighted discounted cash flow model to estimate the fair value of contingent consideration liabilities. These probability-weightings are developed internally and assessed on a quarterly basis. The change in the fair value of the contingent consideration from December 31, 2019 to December 31, 2020 were primarily related to the execution of our new strategic plan where we disposed of the acquired company that was related to the arrangement to pay former owners, as well as the consummation of a new arrangement to pay the former owners of our recent acquisition. The undiscounted maximum payment as of December 31, 2020 under the arrangements was \$1.2 million, based on certain milestones.

11. OTHER EXPENSE (INCOME), NET

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

	Years ended December 31,		
	2020	2019	2018
Foreign exchange transaction losses	\$ 1,680	\$ 1,211	\$ 1,386
Present4D impairment	—	2,152	—
Contingent consideration fair value adjustment	—	(1,562)	—
Other	(1,249)	512	(247)
Total other expense, net	\$ 431	\$ 2,313	\$ 1,139

12. INCOME TAXES

Income (loss) before income tax (benefit) expense consists of the following:

	Years ended December 31,		
	2020	2019	2018
Domestic	\$ (33,991)	\$ (40,963)	\$ (1,723)
Foreign	3,218	(20,051)	6,281
(Loss) Income before income taxes	\$ (30,773)	\$ (61,014)	\$ 4,558

The components of the income tax expense (benefit) for income taxes are as follows:

	Years ended December 31,		
	2020	2019	2018
Current:			
Federal	\$ (3,557)	\$ 3,215	\$ (1,694)
State	169	400	120
Foreign	(2,032)	3,809	1,394
Current income tax (benefit) expense	(5,420)	7,424	(180)
Deferred:			
Federal	(2,886)	(7,630)	(486)
State	(2,937)	(1,667)	(153)
Foreign	(20,159)	3,006	447
Deferred income tax benefit	(25,982)	(6,291)	(192)
Income tax (benefit) expense	<u>\$ (31,402)</u>	<u>\$ 1,133</u>	<u>\$ (372)</u>

During fiscal 2020, we completed intra-entity transfers of certain intellectual property rights (“IP Rights”) which resulted in the Company establishing deferred tax assets and related tax benefits of \$19.2 million, based on fair value of the IP rights transferred in December 2020. The determination of the fair value involves significant judgment on future revenue growth, operating profit and discount rates. Unforeseen events and circumstances may occur that could affect either the accuracy or validity or such assumptions, estimates or actual results. The sustainability of our future tax benefits may be dependent upon the acceptance of the valuation estimates and assumptions by the taxing authorities in those jurisdictions impacted by the intra-entity transfers of IP rights.

Reconciliations of the income tax expense at the U.S. federal statutory income tax rate compared to our actual income tax (benefit) expense are summarized below:

	Years ended December 31,		
	2020	2019	2018
Tax expense at statutory rate	\$ (6,462)	\$ (12,812)	\$ 956
State income taxes, net of federal benefit	(1,400)	(1,564)	(13)
Foreign tax rate difference	1,999	(1,954)	(1,003)
Research and development credit	(662)	(753)	(919)
Change in valuation allowance	(3,736)	8,485	464
Equity based compensation	(42)	(25)	(390)
Impact of permanent differences of non-deductible cost	(602)	1,550	727
Provision to return adjustments & deferred adjustments	(572)	356	(654)
Change in enacted tax rates	(1,138)	359	58
Global intangible low-taxed income ("GILTI")	—	1,795	402
Intangible & goodwill impairment	—	4,999	—
Other	440	697	—
Impact of intra-entity IP transfers	(19,227)	—	—
Income tax (benefit) expense	<u>\$ (31,402)</u>	<u>\$ 1,133</u>	<u>\$ (372)</u>

The components of our net deferred income tax assets and liabilities are as follows:

	As of December 31,	
	2020	2019
Net deferred income tax asset - Non-current		
Warranty cost	\$ 310	\$ 616
Inventory reserve	5,234	4,820
Unearned service revenue	11,607	11,616
Employee stock options	3,271	4,157
Tax credits	2,828	1,207
Loss carryforwards	8,530	7,481
Depreciation	1,419	345
Other, net	735	1,760
Intangibles & goodwill	19,295	—
Lease liability	6,986	4,591
Total deferred tax assets	<u>60,215</u>	<u>36,593</u>
Valuation allowance	<u>(6,916)</u>	<u>(10,419)</u>
Total deferred tax assets net of valuation allowance	<u>53,299</u>	<u>26,174</u>
Net deferred income tax liability - Non-current		
Intangibles & goodwill	—	(3,174)
Right of use asset	(6,636)	(4,591)
Total deferred tax liabilities	<u>(6,636)</u>	<u>(7,765)</u>
Net deferred tax assets	<u>\$ 46,663</u>	<u>\$ 18,409</u>

Our domestic entities had deferred income tax assets in the amount of \$21.4 million and \$15.3 million as of December 31, 2020 and December 31, 2019, respectively. At December 31, 2020 we had U.S. federal and state net operating loss carryforwards of \$1.3 million and \$28.4 million, respectively. Federal and state net operating loss carryforwards will begin to expire in 2035 and 2029, respectively. We also had federal and state R&D credits of \$2.3 million and \$0.4 million, respectively. The federal credits will begin to expire in 2039 and our state credits carryforward indefinitely. At December 31, 2020, our foreign subsidiaries had deferred tax assets primarily relating to Intangibles of \$19.4 million and net operating losses of \$7.1 million, the majority of which can be carried forward indefinitely. At December 31, 2019, our foreign subsidiaries had deferred tax assets primarily relating to net operating losses of \$7.2 million. The valuation allowance for deferred tax assets as of December 31, 2020 and 2019 was \$6.9 million and \$10.4 million, respectively. The net change in the total valuation allowance for each of the years ended December 31, 2020, 2019 and 2018 was a \$3.7 million decrease, an \$8.5 million increase and a \$0.5 million increase, respectively.

The valuation allowance as of December 31, 2020 and 2019 was primarily related to foreign net operating loss carryforwards that, in the judgment of management, were not more likely than not to be realized. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences are deductible. Management considers the scheduled reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), projected taxable income, and tax-planning strategies in making this assessment.

On December 22, 2017, the United States enacted the U.S. Tax Cuts and Jobs Act, resulting in significant modifications to existing law, which included a transition tax on the mandatory deemed repatriation of foreign earnings. As a result of the U.S. Tax Cuts and Jobs Act, the Company can repatriate foreign earnings and profits to the U.S. with minimal U.S. income tax consequences, other than the transition tax and GILTI tax. The Company reinvested a large portion of its undistributed foreign earnings and profits in acquisitions and other investments and intends to bring back a portion of foreign cash in certain jurisdictions where the Company will not be subject to local withholding taxes and which were subject already to transition tax and GILTI tax. At December 31, 2020, we have not provided for approximately \$0.4 million of withholding tax on foreign earnings and profits in certain jurisdictions that we intend to invest these earnings indefinitely.

Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of a global business, there are many transactions for which the ultimate tax outcome is uncertain. We review our tax contingencies on a regular basis and make appropriate accruals as necessary.

As of December 31, 2020, 2019 and 2018, our unrecognized tax benefits totaled \$1.9 million, \$1.9 million and \$0.3 million, respectively, which are included in Income taxes payable - less current portion in our consolidated balance sheet.

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

	Years ended December 31,		
	2020	2019	2018
Balance at January 1	\$ 1,924	\$ 324	\$ 324
Additions based on tax positions related to the current year	273	314	—
Additions for tax positions of prior years	—	1,675	—
Lapse of statute of limitations	(324)	(389)	—
Balance at December 31	<u>\$ 1,873</u>	<u>\$ 1,924</u>	<u>\$ 324</u>

We file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. The table below summarizes the open tax years and ongoing tax examinations in major jurisdictions as of December 31, 2020

Jurisdiction	Open Years	Examination in Process
United States - Federal Income Tax	2016-2020	2016
United States - various states	2016-2020	N/A
Germany	2013-2020	2013-2014
Switzerland	2018-2020	N/A
Singapore	2016-2020	N/A

We recognize accrued interest and penalties related to unrecognized tax benefits in income tax expense. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$1.9 million. We do not currently anticipate that the total amount of unrecognized tax benefits will result in material changes to our financial position. We are subject to income taxes at the federal, state and foreign country level. Our tax returns are subject to examination at the U.S. state level are subject to a three to four year statute of limitations, depending on the state.

13. COMMITMENTS AND CONTINGENCIES

Purchase Commitments — 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. As of December 31, 2020, we had approximately \$44.2 million in purchase commitments that are expected to be delivered within the next 12 months. To ensure adequate component availability in preparation for new product introductions, as of December 31, 2020, we also had \$0.9 million in long-term commitments for purchases to be delivered after 12 months.

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.

U.S. Government Contracting Matter — We have sold our products and related services to the U.S. Government (the “Government”) under General Services Administration (“GSA”) Federal Supply Schedule contracts (the “GSA Contracts”) since 2002 and are currently selling our products and related services to the Government under two such GSA Contracts. Each GSA Contract is subject to extensive legal and regulatory requirements and includes, among other provisions, a price reduction clause (the “Price Reduction Clause”), which generally requires us to reduce the prices billed to the Government under the GSA Contracts to correspond to the lowest prices billed to certain benchmark customers.

Late in the fourth quarter of 2018, during an internal review we preliminarily determined that certain of our pricing practices may have resulted in the Government being overcharged under the Price Reduction Clauses of the GSA Contracts (the “GSA Matter”). As a result, we performed remediation efforts, including but not limited to, the identification of additional controls and procedures to ensure future compliance with the pricing and other requirements of the GSA Contracts. We also retained outside legal counsel and forensic accountants to assist with these efforts and to conduct a comprehensive review of our pricing and other practices under the GSA Contracts (the “Review”). On February 14, 2019, we reported the GSA Matter to the GSA and its Office of Inspector General.

As a result of the GSA Matter, for the fourth quarter of 2018, we reduced our total sales by a \$4.8 million estimated cumulative sales adjustment, representative of the last six years of estimated overcharges to the Government under the GSA Contracts. In addition, for the fourth quarter of 2018, we recorded \$0.5 million of imputed interest related to the estimated cumulative sales adjustment, which increased Interest expense, net and resulted in an estimated total liability of \$5.3 million for the GSA Matter. This estimate was based on our preliminary review as of February 20, 2019, the date of our Annual Report on Form 10-K for the year ended December 31, 2018.

On July 15, 2019, we submitted a report to the GSA and its Office of Inspector General setting forth the findings of the Review conducted by our outside legal counsel and forensic accountants. Based on the results of the Review, we reduced our total sales for second quarter 2019 by an incremental \$5.8 million sales adjustment, reflecting an estimated aggregate overcharge of \$10.6 million under the GSA Contracts for the period from July 2011 to March 2019. In addition, we recorded an incremental \$0.7 million of imputed interest related to the estimated cumulative sales adjustment during 2019, which increased Interest expense, net and resulted in a \$6.5 million total incremental increase in the estimated total liability for the GSA Matter.

In January 2020, we received requests for additional information from the GSA and its Office of Inspector General to which we corresponded through June 2020. As a result of this continuing investigation, we reduced our total sales for the second quarter 2020 by an incremental \$0.6 million sales adjustment, reflecting an estimated aggregate overcharge of \$11.2 million under the GSA Contracts for the period from July 2011 to December 2020. We are working with the GSA in responding to any additional inquiries arising from the investigation. We recorded an incremental \$0.2 million of imputed interest related to the estimated cumulative sales adjustment for the third quarter of 2020 and determined in the fourth quarter of 2020 that an adjustment to reduce imputed interest by \$0.7 million was required. As of the date of the filing of this Annual Report on Form 10-K, we have recorded an aggregate estimated total liability for the GSA Matter of \$12.3 million. This estimate is based on the information we have as of the date of this Annual Report on Form 10-K and is subject to change based on discussions with our outside legal counsel and the Government.

We intend to cooperate fully with this and any other Government inquiries. The Government's review of, or investigation into, this matter could result in civil and criminal penalties, administrative sanctions, and contract remedies being imposed on us, including but not limited to, termination of the GSA Contracts, repayments of amounts already received under the GSA Contracts, forfeiture of profits, damages, suspension of payments, fines, and suspension or debarment from doing business with the Government and possibly U.S. state and local governments. We may also be subject to litigation and recovery under the federal False Claims Act and possibly similar state laws, which could include claims for treble damages, penalties, fees and costs. As a result, we cannot reasonably predict the outcome of the Government's review of, or investigation into, this matter at this time or the resulting future financial impact on us. Any of these outcomes could have a material adverse effect on our reputation, our sales, results of operations, cash flows and financial condition, and the trading price of our common stock. In addition, we have incurred, and will continue to incur, legal and related costs in connection with the Review and the Government's response to this matter.

14. STOCK COMPENSATION PLANS

We have two compensation plans that provide for the granting of stock options and other share-based awards to key employees and non-employee members of the Board of Directors. The 2009 Equity Incentive Plan ("2009 Plan"), and the 2014 Equity Incentive Plan ("2014 Plan") provide for granting options, restricted stock, restricted stock units or stock appreciation rights to employees and non-employee directors.

We were authorized to grant awards for up to 1,781,546 shares of common stock under the 2009 Plan, as well as any shares underlying awards outstanding under our 2004 Equity Incentive Plan (the "2004 Plan") as of the effective date of the 2009 Plan that thereafter terminated or expired unexercised or were canceled, forfeited or lapsed for any reason. There were 17,150 options outstanding at December 31, 2020 under the 2009 Plan at an exercise price of \$57.54. The options outstanding under the 2009 Plan have a 7-year term.

In May 2014, our shareholders approved the 2014 Plan authorizing us to grant awards for up to 1,974,543 shares of common stock, as well as any shares underlying awards outstanding under the 2004 Plan and 2009 Plan as of the effective date of the 2014 Plan that thereafter terminate or expire unexercised or are canceled, forfeited or lapse for any reason. In May 2018, our shareholders approved an amendment to the 2014 Plan, which increased the number of shares available for issuance under the 2014 Plan by 1,000,000 shares. A maximum of 2,974,543 shares are available for issuance under the 2014 Plan, as amended, plus the number of shares (not to exceed 891,960) underlying awards outstanding under the 2004 Plan and the 2009 Plan as of May 29, 2014 that thereafter terminate or expire unexercised or are canceled, forfeited or lapse for any reason. There were 137,898 options outstanding at December 31, 2020 under the 2014 Plan at exercise prices between \$33.05 and \$61.30. The options outstanding under the 2014 Plan have a 7-year term and generally vest over a 3-year period.

Upon election to the Board, each non-employee director receives an initial equity grant of shares of restricted common stock with a value equal to \$100,000, calculated using the closing share price on the date of the non-employee director's election to the Board. The initial restricted stock grant vests on the third anniversary of the grant date, subject to the non-employee director's continued membership on the Board. Annually, the non-employee directors are granted restricted shares equal to \$100,000 on the first business day following the annual meeting of shareholders, calculated using the closing price of our common stock on that day. In addition, the independent Chairman of the Board is annually granted restricted shares with a value equal to \$50,000, and the Lead Director, if one has been appointed, would be annually granted restricted shares with a value equal to \$40,000 on the first business day following the annual meeting of shareholders, calculated using the closing price of our common stock on that day. The shares of restricted stock granted annually to our non-employee directors, our independent Chairman of the Board and, if applicable, our Lead Director vest on the day prior to the following year's annual meeting date, subject to a non-employee director's continued membership on the Board. We record compensation cost associated with our restricted stock grants on a straight-line basis over the vesting term. Our non-employee directors also may elect to have their annual cash retainers and annual equity retainers paid in the form of deferred stock units pursuant to the 2014 Plan and the 2018 Non-Employee Director Deferred Compensation Plan. Each deferred stock unit represents the right to receive one share of our common stock upon the non-employee director's separation of service from the Company. We record compensation cost associated with our deferred stock units over the period of service.

Annually, upon approval by our Compensation Committee, we grant stock-based awards, which historically have been in the form of stock options and/or restricted stock units, to certain employees. We also grant stock-based awards, which historically have been in the form of stock options and/or restricted stock units, to certain new employees throughout the year. The fair value of these stock-based awards is determined by using (a) the current market price of our common stock on the grant date in the case of restricted stock units without a market condition, (b) the Monte Carlo Simulation valuation model in the case of performance-based restricted stock units with a market condition, or (c) the Black-Scholes option valuation model in the case of stock options.

For the stock-based awards granted in 2019 and 2020, the time-based restricted stock units vest in three equal annual installments beginning one year after the grant date. The performance-based restricted stock unit awards vest at the end of the 3-year performance period if the applicable performance measure is achieved. The related stock-based compensation expense will be recognized over the requisite service period, taking into account the probability that we will satisfy the performance measure. The performance-based restricted stock units granted in 2020 will be earned and will vest based upon our total shareholder return (“TSR”) relative to the TSR attained by companies within our defined benchmark group, the Russell 2000 Growth Index. Due to the TSR presence in these performance-based restricted stock units, the fair value of these awards was determined using the Monte Carlo Simulation valuation model. We expense these market condition awards over the three-year vesting period regardless of the value the award recipients ultimately receive.

The Monte Carlo Simulation valuation model incorporates assumptions as to stock price volatility, the expected life of options or awards, a risk-free interest rate and dividend yield. The weighted-average grant-date fair value of the performance-based restricted stock units that were granted during 2020 and 2019 valued using the Monte Carlo Simulation valuation model was \$80.38 and \$66.16, respectively. For performance-based restricted stock units granted during 2020 and 2019 valued using the Monte Carlo Simulation valuation model, we used the following assumptions:

	Year ended December 31	
	2020	2019
Risk-free interest rate	1.2 %	1.8% - 2.48%
Expected dividend yield	— %	— %
Term	3 years	3 years
Expected volatility	40.0 %	45.0 %
Weighted-average expected volatility	40.0 %	45.0 %

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

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

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value as of December 31, 2020
Outstanding at January 1, 2020	486,682	\$ 52.37		
Granted	—	—		
Forfeited	(34,605)	57.51		
Exercised	(297,029)	49.60		
Outstanding at December 31, 2020	155,048	\$ 56.53	2.3	\$ 2,187
Options exercisable at December 31, 2020	148,469	\$ 56.31	0.8	\$ 2,125

The aggregate intrinsic value of stock options exercised during the years ended December 31, 2020, 2019, and 2018 was \$4.2 million, \$3.4 million and \$7.5 million, respectively. The total fair value of stock options vested during the years ended December 31, 2020, 2019, and 2018 was \$0.8 million, \$5.1 million and \$3.7 million, respectively.

The following table summarizes the restricted stock and restricted stock unit activity and weighted-average grant date fair values for the year ended December 31, 2020:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at January 1, 2020	398,318	\$ 49.53
Granted	208,405	65.36
Forfeited	(56,850)	56.56
Vested	(172,426)	41.46
Non-vested at December 31, 2020	<u>377,447</u>	<u>\$ 60.92</u>

We recorded total stock-based compensation expense associated with our stock incentive plans of \$8.3 million, \$11.1 million and \$7.6 million in 2020, 2019 and 2018, respectively.

As of December 31, 2020, there was \$13.6 million in total unrecognized stock-based compensation expense related to non-vested stock-based compensation arrangements. The expense is expected to be recognized over a weighted-average period of 1.9 years.

The following table summarizes total stock-based compensation expense for each of the line items on our consolidated statement of operations:

	Years ended December 31,		
	2020	2019	2018
Cost of Sales			
Product	\$ 356	\$ 628	\$ 477
Service	346	373	351
Total cost of sales	<u>\$ 702</u>	<u>\$ 1,001</u>	<u>\$ 828</u>
Operating Expenses			
Selling, general and administrative	\$ 6,327	\$ 8,786	\$ 5,210
Research and development	1,285	1,282	1,583
Total operating expenses	<u>\$ 7,612</u>	<u>\$ 10,068</u>	<u>\$ 6,793</u>

15. EARNINGS PER SHARE

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 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. When we report a net loss for the period presented, the diluted loss per share calculation does not include our potential common stock, as the inclusion of these shares in the calculation would have an anti-dilutive effect. A reconciliation of the number of common shares used in the calculation of basic and diluted earnings per share is presented below:

	Years Ended December 31,					
	2020		2019		2018	
	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic earnings per share	17,769,958	\$ 0.04	17,383,415	\$ (3.58)	17,043,167	\$ 0.29
Effect of dilutive securities	156,366	—	—	—	305,289	—
Diluted earnings per share	<u>17,926,324</u>	<u>\$ 0.04</u>	<u>17,383,415</u>	<u>\$ (3.58)</u>	<u>17,348,456</u>	<u>\$ 0.29</u>
Securities excluded from the determination of weighted average shares for the calculation of diluted earnings per share, as they were potentially antidilutive	<u>—</u>		<u>886,274</u>		<u>393,970</u>	

16. EMPLOYEE RETIREMENT BENEFIT PLAN

We maintain a 401(k) defined contribution retirement plan for our eligible U.S. employees. Costs charged to operations in connection with the 401(k) plan during 2020, 2019 and 2018 aggregated to \$1.8 million, \$2.2 million, and \$2.1 million, respectively.

17. VARIABLE INTEREST ENTITY

A variable interest entity (“VIE”) is an entity that has one of three characteristics: (1) it is controlled by someone other than its shareowners or partners, (2) its shareowners or partners are not economically exposed to the entity's earnings (for example, they are protected against losses), or (3) it lacks sufficient equity to permit the entity to finance its activities without additional subordinated financial support from other parties.

On April 27, 2018, we invested \$1.8 million in present4D GmbH (“present4D”), a software solutions provider for professional virtual reality presentations and training environments, in the form of an equity capital contribution. This contribution represented a minority investment in present4D. This investment's business purpose is to coordinate the design and development of modules supporting compatibility with virtual reality for our existing software offerings.

As of our investment date, present4D was thinly capitalized and lacked the sufficient equity to finance its activities without additional subordinated financial support and is classified as a VIE. We do not have power over decisions that significantly affect present4D's economic performance and do not represent its primary beneficiary. After April 27, 2020, present4D may request additional equity financing of up to \$1.8 million from us in exchange for additional share capital, which additional equity financing would be at our discretion. In July 2019, we originated a \$0.5 million note with present4D, which we may convert into additional equity in present4D at our discretion in the event of a default. Further, the note is collateralized by the perpetual and royalty-free, non-exclusive, transferable and sublicensable license granted to us to use present4D's software.

We do not intend to provide future support to present4D or to obtain the aforementioned additional share capital in the future. We do not intend to use the perpetual and royalty-free, non-exclusive, transferable and sublicensable license granted to us to use present4D's software. During the year ended December 31, 2019, we wrote off our investment in, and our note receivable with, present4D and recognized a total loss of \$2.2 million. Our portion of present4D's net loss for the year ended December 31, 2019 was approximately \$0.2 million. We had no remaining asset related to present4D at December 31, 2020 and December 31, 2019. We have no remaining exposure to loss for our involvement with present4D.

18. GEOGRAPHIC INFORMATION

Historically, we operated in five verticals—3D Manufacturing, Construction Building Information Modeling (“Construction BIM”), Public Safety Forensics, 3D Design and Photonics—and had three reporting segments—3D Manufacturing, Construction BIM and Emerging Verticals. During the second half of 2019, our Chief Executive Officer (“CEO”) and FARO's management team formulated and began to implement a new comprehensive strategic plan for our business. Our strategic planning process included extensive conversations with employees, customers, investors and suppliers to identify both where the Company can provide sustained and differentiated customer value and where opportunities existed to improve operating efficiencies. We identified areas of our business that needed enhanced focus or change in order to improve our efficiency and cost structure. As part of our strategic plan, we reassessed and redefined our go-to-market strategy, refocused our marketing engagement with our customers, re-evaluated our hardware and software product portfolio and examined how key decisions are made throughout our global organization. Additionally, we focused on other organizational optimization efforts, including the simplification of our overly complex management structure.

As part of our new strategic plan, and based on the recommendation of our CEO, who is also our Chief Operating Decision Maker (“CODM”), in the fourth quarter of 2019, we eliminated our vertical structure and began reorganizing the Company into a functional structure. Our executive leadership team is now comprised of functional leaders in areas such as sales, marketing, operations, research and development and general and administrative, and resources are allocated to each function at a consolidated unit level. We no longer have separate business units, or segment managers or vertical leaders who report to the CODM with respect to operations, operating results or planning for levels or components below the total Company level. Instead, our CODM now allocates resources and evaluates performance on a Company-wide basis. Based on these changes, commencing with the fourth quarter of 2019, we are now reporting as one reporting segment that develops, manufactures, markets, supports and sells CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software and 3D documentation systems. Our reporting segment sells into a variety of end markets, including automotive, aerospace, metal and machine fabrication, architecture, engineering, construction and public safety. These activities represent more than 99% of consolidated sales.

Total sales to external customers is based upon the geographic location of the customer.

	For the Years Ended December 31,		
	2020	2019	2018
Total sales to external customers			
United States and Canada	\$ 119,769	\$ 151,646	\$ 156,242
Americas-Other	9,057	14,110	15,086
Germany	46,166	52,083	53,251
Europe-Other	45,224	70,196	74,010
Japan	4,998	33,361	37,607
China	31,748	32,934	36,130
Asia-Other	46,806	27,435	31,301
	<u>\$ 303,768</u>	<u>\$ 381,765</u>	<u>\$ 403,627</u>

Long-lived assets consist primarily of property, plant, and equipment, goodwill, and intangible assets, and are attributed to the geographic area in which they are located or originated, as applicable.

	As of December 31,		
	2020	2019	2018
Long-Lived Assets			
United States	\$ 42,729	\$ 45,225	\$ 61,557
Americas-Other	10,415	10,889	10,702
Germany	26,671	26,295	30,154
Europe-Other	10,966	4,984	24,935
Japan	1,192	1,423	1,039
Asia-Other	1,960	2,313	2,358
	<u>\$ 93,933</u>	<u>\$ 91,129</u>	<u>\$ 130,745</u>

19. LEASES

We have operating and finance leases for manufacturing facilities, corporate offices, research and development facilities, sales and training facilities, vehicles, and certain equipment under which we assume the role of lessee. We do not lease assets as a lessor. Our leases have remaining lease terms of less than one year to approximately ten years, some of which include options to extend the leases for up to eight years, and some of which include options to terminate the leases within three months. We currently do not sublease any of our leased assets.

We determine if an arrangement is a lease at inception. Operating leases are included in Operating lease right-of-use (“ROU”) asset, Lease liability, and Lease liability - less current portion in our consolidated balance sheets. Finance leases are included in Property and equipment, net, Lease liability, and Lease liability - less current portion in our condensed consolidated balance sheets.

ROU assets represent our right to use an underlying asset for the lease term, and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and lease liabilities are recognized on the commencement date of the lease based on the present value of lease payments over the lease term. Variable lease payments that depend on an index or rate include the variable portion when calculating ROU assets and lease liabilities. Variable lease payments that do not depend on an index or rate are expensed as incurred. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available on the commencement date of the lease to determine the present value of lease payments. We use the implicit rate when readily determinable. The operating lease ROU assets also include any lease payments made and lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option at the time the lease is commenced. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

While we have lease agreements with lease and non-lease components, we account for the lease and non-lease components as a single lease component.

The components of lease expense were as follows:

	Year Ended December 31, 2020	Year Ended December 31, 2019
Operating lease cost	\$ 8,506	\$ 8,114
Finance lease cost:		
Amortization of ROU assets	\$ 307	\$ 363
Interest on lease liabilities	\$ 29	\$ 45
Total finance lease cost	<u>\$ 336</u>	<u>\$ 408</u>

We recognize lease payments made for short-term leases where terms are 12 months or less as the payments are incurred. Our short-term lease cost for the year ended December 31, 2020 and December 31, 2019 was \$0.1 million and \$0.2 million respectively.

Supplemental balance sheet information related to leases was as follows:

	As of December 31, 2020	As of December 31, 2019
Operating leases:		
Operating lease right-of-use asset	\$ 26,107	\$ 18,418
Current operating lease liability	\$ 5,557	\$ 6,349
Operating lease liability - less current portion	21,985	13,272
Total operating lease liability	\$ 27,542	\$ 19,621
Finance leases:		
Property and equipment, at cost	\$ 1,813	\$ 1,870
Accumulated depreciation	(1,415)	(1,150)
Property and equipment, net	\$ 398	\$ 720
Current finance lease liability	\$ 278	\$ 325
Finance lease liability - less current portion	146	426
Total finance lease liability	\$ 424	\$ 751
Weighted Average Remaining Lease Term (in years):		
Operating leases	6.55	4.48
Finance leases	1.93	2.48
Weighted Average Discount Rate:		
Operating leases	5.66 %	5.10 %
Finance leases	5.07 %	5.09 %

Supplemental cash flow information related to leases was as follows:

	Year Ended December 31, 2020	Year Ended December 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows from operating leases	\$ 8,272	\$ 8,037
Operating cash flows from finance leases	\$ 29	\$ 45
Financing cash flows from finance leases	\$ 309	\$ 358
ROU assets obtained in exchange for lease obligations:		
Operating leases	\$ 13,611	\$ 8,970

Maturities of lease liabilities are as follows:

Year Ending December 31,	Operating leases	Finance leases
2021	\$ 6,914	\$ 292
2022	5,472	89
2023	4,721	45
2024	4,341	17
2025	3,270	2
Thereafter	8,604	—
Total lease payments	\$ 33,322	\$ 445
Less imputed interest	(5,780)	(21)
Total	\$ 27,542	\$ 424

20. BUSINESS COMBINATIONS

On August 21, 2020, we acquired all of the outstanding shares of Advanced Technical Solutions in Scandinavia AB (“ATS”), a Swedish company focused on 3D digital twin solution technology for a purchase price of €5.1 million (\$6.0 million) paid, net of cash acquired, subject to certain additional post-closing adjustments, and up to €1.0 million (\$1.2 million) in contingent consideration that may be earned by the former owners if certain product development milestones are met in a three-year period. The U.S. Dollar amounts have been converted from Euros based on the foreign exchange rate in effect on the closing date of the acquisition. We believe this acquisition enables the Company to provide high accuracy 3D digital twin simulations for industries such as automotive and aerospace. The results of ATS’s operations as of and after the date of acquisition have been included in our consolidated financial statements as of December 31, 2020, and for the year ended December 31, 2020.

The acquisition of ATS constitutes a business combinations as defined by ASC Topic 805, *Business Combinations*. Accordingly, the assets acquired and liabilities assumed were recorded at their fair values on the date of acquisition. The purchase price allocations below represent our finalized determination of the fair value of the assets acquired and liabilities assumed for the acquisition.

Following is a summary of our allocations of the purchase price to the fair values of the assets acquired and liabilities assumed as of the date of the acquisition:

	<u>Fair Value</u> ⁽²⁾
Tangible assets acquired:	
Accounts receivable	\$ 185
Inventory	312
Other assets	389
Total tangible assets acquired	<u>886</u>
Liabilities assumed:	
Accounts payable and accrued liabilities	(355)
Total liabilities assumed	<u>(355)</u>
Intangible assets	1,295
Net assets acquired	<u>1,826</u>
Deferred income tax liability	(277)
Goodwill	5,467
Contingent consideration ⁽¹⁾	(980)
Purchase price paid, net of cash acquired	<u>\$ 6,036</u>
Contingent consideration ⁽¹⁾	980
Total purchase price	<u>\$ 7,016</u>

⁽¹⁾ This total consists primarily of the fair value of the projected contingent consideration.

⁽²⁾ Amounts converted from Euros to U.S. Dollars based on the foreign exchange rate on the closing date of the acquisition.

The goodwill arising from the acquisition consists largely of the expected synergies from combining operations as well as the value of the workforce. This goodwill is not tax deductible. Acquisition and integration costs are not included as components of consideration transferred, but are recorded as expense in the period in which such costs are incurred. To date, we have not incurred any material acquisition or integration costs for the ATS acquisition. Pro forma financial results for ATS has not been presented because the effect of this transaction was not material to our consolidated financial results.

Following are the details of the purchase price allocated to the intangible assets acquired for the ATS acquisition:

	Amount	Weighted Average Life (Years)
Brand	\$ 33	1
Technology	767	5
Customer relationships	495	10
Fair value of intangible assets acquired	<u>\$ 1,295</u>	7

21. RESTRUCTURING

In the first quarter of 2020, our Board of Directors approved a global restructuring plan (the “Restructuring Plan”), which is intended to support our strategic plan in an effort to improve operating performance and ensure that we are appropriately structured and resourced to deliver increased and sustainable value to our shareholders and customers. Key activities under the Restructuring Plan include a continued focus on efficiency and cost-saving efforts, which includes decreasing total headcount by approximately 500 employees upon the completion of the Restructuring Plan.

These activities are expected to be substantially completed by the end of 2021. Pre-tax charges of approximately \$49 million were recorded in the fourth quarter of 2019 in connection with the implementation of our new strategic plan and included the following:

- \$21.2 million impairment of goodwill;
- \$12.8 million charge, increasing our reserve for excess and obsolete inventory;
- \$10.5 million impairment of intangible assets associated with recent acquisitions;
- \$1.4 million impairment of intangible assets related to capitalized patents; and
- \$3.4 million impairment of other assets and other charges.

In connection with the Restructuring Plan, we recorded a pre-tax charge of approximately \$15.8 million during the year ended December 31, 2020 primarily consisting of severance and related benefits, professional fees and other related charges and costs including a non-cash expense of \$0.4 million related to the disposal of our Photonics business and 3D Design related assets. We received \$0.7 million in cash payments for the disposal of our Photonics business and 3D Design related assets in the second quarter. We estimate total additional pre-tax charges of \$5 million to \$15 million for fiscal year 2021.

At this time, we are continuing to evaluate the future key activities by which these additional charges will originate. Actual results, including the costs of the Restructuring Plan, may differ materially from our expectations, resulting in our inability to realize the expected benefits of the Restructuring Plan and our new strategic plan and negatively impacting our ability to execute our future plans and strategies, which could have a material adverse effect on our business, financial condition and results of operations.

In connection with the Restructuring Plan, we paid approximately \$13.1 million during the year ended December 31, 2020 primarily consisting of severance and related benefits. We expect an additional \$7 million to \$9 million of cash payments to be made for fiscal year 2021 related to the Restructuring Plan. Activity related to the accrued restructuring charge and cash payments during the year ended December 31, 2020 was as follows:

	Severance and other benefits	Professional fees and other related charges	Total
Balance at February 14, 2020	\$ —	\$ —	\$ —
Additions/Reductions charged to expense	12,107	3,349	15,456
Cash payments	(10,626)	(2,483)	(13,109)
Balance at December 31, 2020	1,481	866	2,347

22. QUARTERLY RESULT OF OPERATIONS (UNAUDITED)

Quarter ended	March 31, 2020	June 30, 2020	September 30, 2020	December 31, 2020
Sales ⁽¹⁾	\$ 79,515	\$ 60,564	\$ 70,736	\$ 92,953
Gross profit	43,873	28,896	36,298	50,780
Net (loss) income ⁽²⁾	(14,823)	(8,932)	(3,024)	27,408
Net (loss) income per share:				
Basic	\$ (0.84)	\$ (0.50)	\$ (0.17)	\$ 1.53
Diluted	\$ (0.84)	\$ (0.50)	\$ (0.17)	\$ 1.52

⁽¹⁾ For the second quarter of 2020, sales were reduced by an incremental \$0.6 million sales adjustment related to our GSA Contracts based on the results of the Review conducted by our outside legal counsel and forensic accountants.

⁽²⁾ During 2020, in connection with the Restructuring Plan, we recorded a pre-tax charge of approximately \$13.7 million during the first quarter 2020, \$0.6 million during the second quarter, \$0.3 million during the third quarter and \$1.2 million during the fourth quarter primarily consisting of severance and related benefits, professional fees and other related charges and costs including a non-cash expense of \$0.4 million related to the disposal of our Photonics business and 3D Design related assets.

Quarter ended	March 31, 2019	June 30, 2019	September 30, 2019	December 31, 2019
Sales ⁽¹⁾	\$ 93,617	\$ 93,491	\$ 90,516	\$ 104,141
Gross profit ⁽²⁾	53,018	50,741	50,772	43,601
Net income (loss) ⁽³⁾	152	(6,405)	(6,199)	(49,695)
Net income (loss) per share:				
Basic	\$ 0.01	\$ (0.37)	\$ (0.36)	\$ (2.85)
Diluted	\$ 0.01	\$ (0.37)	\$ (0.36)	\$ (2.85)

⁽¹⁾ For the second quarter of 2019, sales were reduced by an incremental \$5.8 million sales adjustment related to our GSA Contracts based on the results of the Review conducted by our outside legal counsel and forensic accountants.

⁽²⁾ For the fourth quarter of 2019, gross profit was reduced by a \$15.1 million inventory reserve charge primarily driven by the evaluation of our hardware and software product portfolio, which increased our reserve for excess and obsolete inventory.

⁽³⁾ For the fourth quarter of 2019, we incurred an impairment loss of \$35.2 million, which included \$21.2 million in goodwill, \$10.5 million in intangible assets associated with recent acquisitions, \$1.4 million in intangible assets related to capitalized patents, and \$2.1 million in other asset write-downs.

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2020. Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) are designed to provide reasonable assurance that information required to be disclosed in our reports filed under the Exchange Act, such as this Annual Report on Form 10-K, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures also include, without limitation, controls and procedures that are designed to provide reasonable assurance that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

The evaluation of our disclosure controls and procedures included a review of the control objectives and design, our implementation of the controls and the effect of the controls on the information generated for use in this Annual Report on Form 10-K. In conducting this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures, as defined by Rule 13a-15(e) under the Exchange Act, were effective as of December 31, 2020 to provide reasonable assurance that information required to be disclosed in this Annual Report on Form 10-K was recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and was accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended December 31, 2020 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management’s Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act). Internal control over financial reporting is the process designed under the Chief Executive Officer’s and the Chief Financial Officer’s supervision, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States.

There are inherent limitations in the effectiveness of internal control over financial reporting, including the possibility that misstatements may not be prevented or detected. Accordingly, an effective control system, no matter how well designed and operated, can provide only reasonable assurance of achieving the designed control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2020, as required by Exchange Act Rule 13a-15(c). In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 2013 *Internal Control - Integrated Framework*. Based on our assessment under the framework in the 2013 *Internal Control - Integrated Framework*, management concluded that our internal control over financial reporting was effective as of December 31, 2020.

Grant Thornton LLP, the independent registered public accounting firm that audited our consolidated financial statements and internal control over financial reporting, has issued an attestation report on our internal control over financial reporting as of December 31, 2020, which appears below.

FARO Technologies, Inc.

Lake Mary, Florida

February 17, 2021

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
FARO Technologies, Inc.

Opinion on internal control over financial reporting

We have audited the internal control over financial reporting of FARO Technologies, Inc. (a Florida corporation) and subsidiaries (the “Company”) as of December 31, 2020, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2020, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the consolidated financial statements of the Company as of and for the year ended December 31, 2020, and our report dated February 17, 2021 expressed an unqualified opinion on those financial statements.

Basis for opinion

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and limitations of internal control over financial reporting

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

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

/s/ GRANT THORNTON LLP

Orlando, Florida
February 17, 2021

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item with respect to directors and executive officers is incorporated herein by reference to the information under the headings “Election of Directors” and “Executive Officers” contained in our definitive proxy statement for our 2021 Annual Meeting of Shareholders, which we refer to as the Proxy Statement.

The information required by this Item regarding compliance with Section 16(a) of the Exchange Act appears under the heading “Delinquent Section 16(a) Reports” in the Proxy Statement and is incorporated herein by reference.

The information required by this Item with respect to corporate governance and our Code of Ethics is incorporated herein by reference to the information contained in the Proxy Statement under the heading “Corporate Governance and Board Matters.”

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item regarding executive compensation is incorporated herein by reference to the information contained in the Proxy Statement under the headings “Executive Compensation” and “2020 Director Compensation.”

The information required by this Item regarding Compensation Committee interlocks and insider participation is incorporated herein by reference to the information contained in the Proxy Statement under the heading “Corporate Governance and Board Matters.”

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

The information required by this Item regarding security ownership of certain beneficial owners and management and related stockholder matters is incorporated herein by reference to the information contained in the Proxy Statement under the headings “Security Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information.”

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

The information required by this Item about certain relationships and related transactions appears under the heading “Certain Relationships and Related Transactions” in the Proxy Statement and is incorporated herein by reference.

The information required by this Item regarding director independence is incorporated herein by reference to the information contained in the Proxy Statement under the heading “Corporate Governance and Board Matters.”

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item about principal accountant fees and services as well as related pre-approval policies appears under the heading “Independent Public Accountants” in the Proxy Statement and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements.

The following consolidated financial statements required by this item are included in Part II, Item 8 of this Annual Report on Form 10-K under the caption “Financial Statements and Supplementary Data”:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statements of Comprehensive Income (Loss)

Consolidated Statements of Shareholders’ Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

(2) Financial Statement Schedules.

All financial statement schedules have been omitted as they are either not required or not applicable, or the required information is otherwise included in our consolidated financial statements or the notes thereto.

(b) Exhibits. The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Annual Report on Form 10-K.

EXHIBIT INDEX

Exhibit No.	Description
2.1	Stock Purchase Agreement, dated as of August 26, 2016, by and among FARO Technologies, Inc., Laser Projection Technologies, Inc., each of the shareholders of Laser Projection Technologies, Inc. and Steven P. Kaufman in the capacity of the Seller Representative (Filed as Exhibit 2.1 to Registrant's Current Report on Form 8-K filed August 30, 2016, and incorporated herein by reference)**
2.2	Quota Purchase Agreement, dated as of July 13, 2018, by and among FARO Technologies, Inc., Opto-Tech SRL, each of the shareholders of Opto-Tech SRL, and Mr. Gianfranco Chiapparini, in the capacity as the Seller Representative (Filed as Exhibit 2.1 to Registrant's Current Report on Form 8-K, filed July 19, 2018, and incorporated herein by reference)**
3.1	Amended and Restated Articles of Incorporation, as amended (Filed as Exhibit 3.1 to Registrant's Registration Statement on Form S-1/A filed September 10, 1997, No. 333-32983, and incorporated herein by reference)
3.2	Amended and Restated Bylaws (Filed as Exhibit 3.1 to Registrant's Current Report on Form 8-K, filed March 31, 2020, and incorporated herein by reference)
4.1	Specimen Stock Certificate (Filed as Exhibit 4.1 to Registrant's Registration Statement on Form S-1/A, filed September 10, 1997, No. 333-32983, and incorporated herein by reference)
4.2	Description of the Registrant's Securities Registered under Section 12 of the Securities Exchange Act of 1934 (Filed as Exhibit 4.2 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2019, filed February 19, 2020, and incorporated herein by reference)
10.1	2009 Equity Incentive Plan (Filed as Appendix A to Registrant's Definitive Proxy Statement on Schedule 14A filed April 15, 2009, and incorporated herein by reference)*
10.2	First Amendment to the 2009 Equity Incentive Plan (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed April 15, 2011, and incorporated herein by reference)*
10.3	2014 Incentive Plan (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed June 3, 2014, and incorporated herein by reference)*
10.4	2014 Incentive Plan, as amended May 11, 2018 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed May 15, 2018, and incorporated herein by reference)*
10.5	Summary of Director Compensation Program (Filed as Exhibit 10.7 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2015, and incorporated herein by reference)*
10.6	Form of Intellectual Property and Confidentiality Agreement between FARO Technologies, Inc. and new employees (Filed as Exhibit 10.8 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2015, and incorporated herein by reference)
10.7	Form of Stock Option Award Agreement under the 2009 Equity Incentive Plan (Filed as Exhibit 10.10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2015, and incorporated herein by reference)*
10.8	Form of performance-based Stock Option Award Agreement under the 2014 Incentive Plan (Filed as Exhibit 10.12 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2015, and incorporated herein by reference)*
10.9	Form of performance-based Restricted Stock Unit Award Agreement under the 2014 Incentive Plan (Filed as Exhibit 10.13 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2015, and incorporated herein by reference)*
10.10	Form of Restricted Stock Unit Award Agreement under the 2014 Incentive Plan (Filed as Exhibit 10.4 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2016, and incorporated herein by reference)*
10.11	Form of time-based Stock Option Award Agreement under the 2014 Incentive Plan (Filed as Exhibit 10.15 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2016, and incorporated herein by reference)*

- 10.12 Form of Restricted Stock Award Agreement under the 2014 Incentive Plan (Filed as Exhibit 10.14 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2017, and incorporated herein by reference)*
- 10.13 Form of 2019 Restricted Stock Unit Award Agreement under the 2014 Incentive Plan (Filed as Exhibit 10.5 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2019, and incorporated herein by reference)*
- 10.14 Form of 2019 Restricted Stock Unit Award Agreement (Performance-Based) under the 2014 Incentive Plan (Filed as Exhibit 10.6 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2019, and incorporated herein by reference)*
- 10.15 Form of Amendment to 2019 Performance-Based Restricted Stock Unit Award Agreement (Filed as Exhibit 10.15 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2019, filed February 19, 2020, and incorporated herein by reference)*
- 10.16 Employment Agreement between FARO Technologies, Inc. and Joseph Arezone, dated as of April 27, 2016 (Filed as Exhibit 10.2 to Registrant's Current Report on Form 8-K, filed April 29, 2016, and incorporated herein by reference)*
- 10.17 Letter Agreement between FARO Technologies, Inc. and Joseph Arezone dated March 5, 2018 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed March 5, 2018, and incorporated herein by reference)*
- 10.18 Transition and Separation Agreement between FARO Technologies, Inc. and Joseph Arezone effective June 5, 2018 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed June 8, 2018, and incorporated herein by reference)*
- 10.19 Amended and Restated Employment Agreement between FARO Technologies, Inc. and Kathleen J. Hall, dated as of April 27, 2016 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed April 29, 2016, and incorporated herein by reference)*
- 10.20 Addendum to Amended and Restated Employment Agreement between FARO Technologies, Inc. and Kathleen J. Hall dated June 17, 2019 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed June 18, 2019, and incorporated herein by reference)*
- 10.21 Confidential Separation Agreement and General Release by and between FARO Technologies, Inc. and Kathleen J. Hall, dated August 26, 2019 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed August 27, 2019, and incorporated herein by reference)*
- 10.22 Amended and Restated Employment Agreement between FARO Technologies, Inc. and Jody S. Gale, dated as of April 27, 2016 (Filed as Exhibit 10.3 to Registrant's Current Report on Form 8-K filed April 29, 2016, and incorporated herein by reference)*
- 10.23 Employment Agreement between FARO Technologies, Inc. and Robert E. Seidel, dated December 21, 2016 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed December 21, 2016, and incorporated herein by reference)*
- 10.24 Transition and Separation Agreement by and between FARO Technologies, Inc. and Robert E. Seidel, dated July 31, 2019 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed August 2, 2019, and incorporated herein by reference)*
- 10.25 Letter Agreement between FARO Technologies, Inc. and Simon Raab dated January 9, 2019 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed January 11, 2019, and incorporated herein by reference)*
- 10.26 Employment Agreement between FARO Technologies, Inc. and Michael Burger dated April 5, 2019 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed April 9, 2019, and incorporated herein by reference)*
- 10.27 Offer Letter between FARO Technologies, Inc. and Allen Muhich, dated July 15, 2019 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed July 16, 2019, and incorporated herein by reference)*
- 10.28 FARO Technologies, Inc. Amended and Restated Change in Control Severance Policy, dated as of April 9, 2015 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed April 10, 2015, and incorporated herein by reference)*
- 10.29 2018 Non-Employee Director Deferred Compensation Plan (Filed as Exhibit 10.24 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2018, and incorporated herein by reference)*

- 10.30 Form of Deferred Stock Unit Award Agreement under the 2014 Incentive Plan and the 2018 Non-Employee Director Deferred Compensation Plan (Filed as Exhibit 10.25 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2018, and incorporated herein by reference)*
- 10.31 Form of Restricted Stock Unit Award Agreement under the 2014 Incentive Plan and the 2018 Non-Employee Director Deferred Compensation Plan (Filed as Exhibit 10.26 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2018, and incorporated herein by reference)*
- 10.32 FARO Technologies, Inc. Executive Severance Plan and Summary Plan Description, dated as of February 14, 2019 (Filed as Exhibit 10.27 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2018, and incorporated herein by reference)*
- 10.33 Office Flex Lease, dated September 26, 2007, by and between FARO Technologies, Inc. and Sun Life Assurance Company of Canada (Filed as Exhibit 10.15 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2007, and incorporated herein by reference)
- 10.34 First Amendment to Lease Agreement, dated October 1, 2009, by and between FARO Technologies, Inc. and Sun Life Assurance Company of Canada (Filed as Exhibit 10.27 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2009, and incorporated herein by reference)
- 10.35 Second Amendment to Office Flex Lease between RCS - Tech Park, LLC and FARO Technologies, Inc., dated as of February 27, 2019 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K, filed March 5, 2019, and incorporated herein by reference)*
- 10.36 Amended and Restated Lease Agreement, dated October 1, 2009, by and between FARO Technologies, Inc. and Emma Investments, LLC (Filed as Exhibit 10.26 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2009, and incorporated herein by reference)
- 10.37 First Amendment to Amended and Restated Lease Agreement between Emma Investments, LLC and FARO Technologies, Inc., dated as of May 14, 2014 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed May 16, 2014, and incorporated herein by reference)
- 10.38 Second Amendment to Amended and Restated Lease Agreement, dated as of January 29, 2019, by and between FARO Technologies, Inc. and Emma Investments, LLC (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed January 31, 2019, and incorporated herein by reference)
- 10.39 Agreement of Lease (Amendment and Restatement) between 290 National Road Limited Partnership and FARO Technologies, Inc., dated as of September 9, 2014 (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed September 12, 2014, and incorporated herein by reference)
- 10.40 Assignment and Assumption of Lease, dated April 21, 2017, by and between FARO Technologies, Inc., Instrument Associates, LLC and Century Park, L.L.C. (Filed as Exhibit 10.27 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2017, and incorporated herein by reference)
- 10.41 Non-residential Tenancy Agreement, dated July 1, 2017, by and between Eredi Martinelli Marmi E Graniti S.p.A. and Opto-tech S.R.L. (Filed as Exhibit 10.35 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2018, and incorporated herein by reference)
- 10.42 Form of Director Indemnification Agreement (Filed as Exhibit 10.1 to Registrant's Current Report on Form 8-K filed October 28, 2020).
- 10.43 Form of Officer Indemnification Agreement (Filed as Exhibit 10.2 to Registrant's Current Report on Form 8-K filed October 28, 2020).
- 21.1 List of Subsidiaries
- 23.1 Consent of Grant Thornton LLP
- 24.1 Power of Attorney relating to subsequent amendments (included on the signature page(s) of this report).
- 31-A Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31-B	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32-A	Certification of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32-B	Certification of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Properties
	The following information from our Annual Report on Form 10-K for the year ended December 31, 2020, formatted in Inline XBRL: (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Operations; (iii) Consolidated Statements of Comprehensive (Loss) Income; (iv) Consolidated Statements of Shareholders' Equity; (v) Consolidated Statements of Cash Flows; and (vi) Notes to Condensed Consolidated Financial Statements
101	
104	Cover Page Interactive Data File (Formatted in Inline XBRL and contained in Exhibit 101)

* Indicates management contracts or compensatory plans or arrangements

** Schedules and exhibits are omitted pursuant to Item 601(b)(2) of Regulation S-K. Registrant agrees to furnish supplementally a copy of any omitted schedules or exhibits to the Securities and Exchange Commission upon request.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FARO TECHNOLOGIES, INC.

Date: February 17, 2021

By: /s/ Allen Muhich
Allen Muhich, Chief Financial Officer
(Duly Authorized Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated. Each person whose signature appears below constitutes and appoints each of MICHAEL BURGER AND ALLEN MUHICH his or her true and lawful attorney-in-fact and agent, with full power of substitution and revocation, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this report and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, may lawfully do or cause to be done by virtue hereof.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Michael Burger</u> Michael Burger	Director, President and Chief Executive Officer (Principal Executive Officer)	February 17, 2021
<u>/s/ Allen Muhich</u> Allen Muhich	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	February 17, 2021
<u>/s/ John Donofrio</u> John Donofrio	Chairman of the Board and Director	February 17, 2021
<u>/s/ John Caldwell</u> John Caldwell	Director	February 17, 2021
<u>/s/ Lynn Brubaker</u> Lynn Brubaker	Director	February 17, 2021
<u>/s/ Stephen R. Cole</u> Stephen R. Cole	Director	February 17, 2021
<u>/s/ Jeffrey A. Graves</u> Jeffrey A. Graves	Director	February 17, 2021
<u>/s/ Yuval Wasserman</u> Yuval Wasserman	Director	February 17, 2021

