FARO TECHNOLOGIES INC
Form 10-Q
November 02, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2007

OR

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

For the transition period from ______ to ______

Commission File Number: 0-23081

FARO TECHNOLOGIES, INC.

(Exact name of Registrant as specified in its charter)

Florida	**59-3157093**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
125 Technology Park, Lake Mary, Florida	**32746**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s Telephone Number, including area code: (407) 333-9911

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 16,581,893 shares of the registrant s common stock as of October 25, 2007.

FARO TECHNOLOGIES, INC.

Quarterly Report on Form 10-Q

Quarter Ended September 29, 2007

INDEX

Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(in thousands, except share data)	**September 29, 2007**	**December 31, 2006**
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 25,409	$ 15,689
Short-term investments	72,780	15,790
Accounts receivable, net	44,554	42,706
Inventories	26,440	23,429
Deferred income taxes, net	2,695	1,845
Prepaid expenses and other current assets	7,115	3,222
Total current assets	178,993	102,681
Property and Equipment:		
Machinery and equipment	12,008	9,131
Furniture and fixtures	4,625	3,988
Leasehold improvements	3,066	2,615
Property and equipment at cost	19,699	15,734
Less: accumulated depreciation and amortization	(12,651)	(8,889)
Property and equipment, net	7,048	6,845
Goodwill	18,510	17,266
Intangible assets, net	5,967	6,221
Service Inventory	10,448	7,278
Deferred income taxes, net	3,648	3,985
Total Assets	$ 224,614	$ 144,276
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 9,811	$ 11,182
Accrued liabilities	13,729	10,379
Income taxes payable	1,209	2,151
Current portion of unearned service revenues	6,945	4,569
Customer deposits	252	618
Current portion of long-term debt and obligations under capital leases	54	90
Total current liabilities	32,000	28,989
Unearned service revenues less current portion	5,123	2,917
Deferred tax liability, net	1,044	1,200
Long-term debt and obligations under capital leases less current portion	166	115

Total Liabilities	38,333	33,221
Commitments and contingencies See Note N		
Shareholders Equity:		
Common stock par value $.001, 50,000,000 shares authorized; 16,689,853 and 14,586,402 issued; 16,621,893 and 14,464,715 outstanding, respectively	17	14
Additional paid-in-capital	147,946	85,160
Retained earnings	35,142	25,452
Accumulated other comprehensive income	3,327	580
Common stock in treasury, at cost 40,000 shares	(151)	(151)
Total Shareholders Equity	186,281	111,055
Total Liabilities and Shareholders Equity	$ 224,614	$ 144,276

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

	Three Months Ended		Nine Months Ended	
(in thousands, except per share data)	**Sep 29, 2007**	**Sep 30, 2006**	**Sep 29, 2007**	**Sep 30, 2006**
SALES	$ 44,521	$ 38,365	$ 132,389	$ 108,463
COST OF SALES (exclusive of depreciation and amortization, shown separately below)	18,065	16,121	52,873	44,822
GROSS PROFIT	26,456	22,244	79,516	63,641
OPERATING EXPENSES:				
Selling	13,625	10,597	39,951	32,458
General and administrative	7,978	5,519	18,496	18,296
Depreciation and amortization	971	1,023	3,013	3,096
Research and development	2,881	1,741	7,129	5,390
Total operating expenses	25,455	18,880	68,589	59,240
INCOME FROM OPERATIONS	1,001	3,364	10,927	4,401
OTHER (INCOME) EXPENSE				
Interest (income)	(590)	(189)	(1,182)	(516)
Other (income) expense, net	(720)	(153)	(1,427)	(440)
Interest expense	3	3	7	9
INCOME BEFORE INCOME TAX	2,308	3,703	13,529	5,348
INCOME TAX EXPENSE	1,603	514	3,840	810
NET INCOME	$ 705	$ 3,189	$ 9,689	$ 4,538
NET INCOME PER SHARE BASIC	$ 0.04	$ 0.22	$ 0.64	$ 0.32
NET INCOME PER SHARE DILUTED	$ 0.04	$ 0.22	$ 0.63	$ 0.31

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(in thousands)	**Nine Months Ended Sep 29, 2007**	**Sep 30, 2006**
CASH FLOWS FROM:		
OPERATING ACTIVITIES:		
Net income	$ 9,689	$ 4,538
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,013	3,096
Amortization of stock options and restricted stock units	956	151
Provision for bad debts	223	
Deferred income tax benefit	(542)	(402)
Change in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable	(218)	(7,146)
Inventories	(4,798)	1,601
Prepaid expenses and other current assets	(695)	(2,117)
Income tax benefit from exercise of stock options	(2,993)	
Increase (decrease) in:		
Accounts payable and accrued liabilities	2,499	(537)
Income taxes payable	(785)	666
Customer deposits	(314)	345
Unearned service revenues	5,064	2,527
Net cash provided by operating activities	11,099	2,722
INVESTING ACTIVITIES:		
Purchases of property and equipment	(1,807)	(2,680)
Payments for intangible assets	(264)	(714)
(Purchases of) proceeds from short-term investments	(56,990)	700
Net cash used in investing activities	(59,061)	(2,694)
FINANCING ACTIVITIES:		
Payments of capital leases	(60)	(146)
Income tax benefit from exercise of stock options	2,993	
Proceeds from issuance of stock, net	58,409	
Net cash provided by (used in) financing activities	61,342	(146)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(3,660)	(212)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,720	(330)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	15,689	9,278
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 25,409	$ 8,948

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

FARO TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended September 29, 2007 and September 30, 2006

(Unaudited)

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

NOTE A DESCRIPTION OF BUSINESS

FARO Technologies, Inc. and subsidiaries (collectively the Company or FARO) design, develop, manufacture, market and support software-based three-dimensional measurement devices for manufacturing, industrial, building construction and forensic applications. The Company s principal products include the Faro Arm, Faro Scan Arm and Faro Gage, all articulated electromechanical measuring devices, and the Faro Laser Tracker and the Faro Laser Scanner LS, both laser-based measuring devices. Markets for the Company s products include automobile, aerospace, heavy equipment, and law enforcement agencies. The Company sells the vast majority of its products though a direct sales force located in many of the world s largest industrialized countries.

NOTE B PRINCIPLES OF CONSOLIDATION

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

NOTE C BASIS OF PRESENTATION

The consolidated financial statements of the Company include all adjustments considered necessary by management for their fair presentation in conformity with accounting principles generally accepted in the United States of America. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The consolidated results of operations for the three and nine months ended September 29, 2007 are not necessarily indicative of results that may be expected for the year ending December 31, 2007 or any future period.

The information included in this Form 10-Q, including the interim consolidated financial statements and notes that accompany these financial statements, should be read in conjunction with the audited consolidated financial statements and related notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

NOTE D IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure certain financial instruments and other eligible items at fair value when the items are not otherwise currently required to be measured at fair value. Under SFAS 159, the decision to measure items at fair value is made at specified election dates on an irrevocable instrument-by-instrument basis. Entities electing the fair value option would be required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. Entities electing the fair value option are required to distinguish, on the face of the statement of financial position, the fair value of assets and liabilities for which the fair value option has been elected and similar assets and liabilities measured using another measurement attribute. If elected, SFAS 159 will be effective as of the beginning of the first fiscal year that begins after November 15, 2007, with earlier adoption permitted if all of the requirements of SFAS 159 are adopted. The impact of the adoption of SFAS 159 will be dependent on the extent to which the Company chooses to elect to measure eligible items at fair value.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not require any new fair value measurements; rather, it applies to other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007. The Company has not determined the effect, if any, that the adoption of this statement will have on its financial condition or results of operations.

In June 2006, the FASB ratified the Emerging Issues Task Force (EITF) position EITF 06-3, *How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)* (EITF 06-3), that addresses disclosure requirements for taxes assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, and may include, but is not limited to, sales, use, value-added, and some excise taxes. EITF 06-3 requires disclosure of the method of accounting for the applicable assessed taxes and the amount of assessed taxes that are included in revenues if they are accounted for under the gross method. The provisions of EITF 06-3 are effective for interim and annual reporting periods beginning after December 15, 2006, with earlier application permitted. The Company presents sales and other taxes collected from customers on a net basis, accordingly such taxes are not included in revenues and cost of sales.

NOTE E STOCK-BASED COMPENSATION

In December 2004, the FASB issued SFAS No. 123R, *Share-Based Payment. (* SFAS 123R) SFAS No. 123R requires employee stock options and rights to purchase shares under stock participation plans to be accounted for under the fair value method, and eliminates the ability to account for these instruments under the intrinsic value method prescribed by APB Opinion No. 25 *Accounting for Stock Issued to Employers* , as allowed under the original provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* . Under the intrinsic value based method, compensation cost is measured by the excess, if any, of the quoted market price of the stock at the grant date over the amount an employee must pay to acquire the stock. Under the fair value based method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the service period, which is usually the vesting period, which is generally three years. The Company adopted the provisions of SFAS No. 123R on January 1, 2006 using the modified prospective application transition method. The Company uses the Black-Scholes option pricing model to determine the fair value of stock option grants. In order to determine the fair value of restricted stock awards the Company uses the closing market price of its common stock on the date of grant.

In accordance with the provisions of SFAS No. 123R, the Company recorded total share-based compensation expense of $956 and $196 for the nine months ended September 29, 2007 and September 30, 2006, respectively, and $383 and $84 for the three months ended September 29, 2007 and September 30, 2006, respectively.

The following table summarizes the stock option activity for the nine months ended September 29, 2007:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Terms (Yrs)	Aggregate Intrinsic Value as of September 29, 2007
Outstanding at beginning of year	1,058,440	$ 16.04		
Granted	199,445	24.87		
Forfeited	(16,910)	19.84		
Exercised	(440,011)	12.20		
Outstanding at September 29, 2007	800,964	$ 20.24	7.34	$ 16,951

The weighted-average grant-date fair value of the stock options granted during the nine months ended September 29, 2007 was $24.87 per option. There were no stock options granted during the nine months ended September 30, 2006. The total intrinsic value of stock options exercised during the nine months ended September 29, 2007 and September 30, 2006 was $8.0 million and $0.5 million, respectively. The total intrinsic value of stock options exercised during the three months ended September 29, 2007 and September 30, 2006 was $2.0 million and $0.3 million, respectively. The fair value of stock options vested during the three months ended September 29, 2007 and September 30, 2006 was $0.05 million and $0.0 million, respectively. The fair value of stock options vested during the nine months ended September 29, 2007 and September 30, 2006 was $0.20 million and $0.03 million, respectively.

The following table summarizes information about stock options outstanding at September 29, 2007:

	Options Outstanding at September 29, 2007			Options Exercisable at September 29, 2007	
Option Exercise Price Range	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Terms (Yrs)	Number of Shares	Weighted Average Exercise Price
Up to $1.50	3,835	$ 1.50	4.09	3,835	$ 1.50
$1.51 - $3.00	71,102	2.29	4.37	71,102	2.29
$3.01 - $10.00	15,000	4.25	4.19	15,000	4.25
$10.01 - $20.00	248,204	18.86	7.10	231,871	19.17
Over $20.00	462,823	24.41	8.06	272,178	24.10
	800,964	$ 20.24	7.34	593,986	18.91

The following table summarizes the restricted stock activity and weighted average grant-date fair values for the nine months ended September 29, 2007:

	Shares	Weighted-Average Grant-Date Fair Value
Non-vested at beginning of year	40,524	$ 19.95
Granted	27,496	26.93
Forfeited		
Vested	(7,000)	22.55

Non-vested at September 29, 2007	61,020	$	23.06

The Company used the Black-Scholes option-pricing model to determine the fair value of options granted during the nine months ended September 29, 2007 and September 30, 2006, using the following assumptions:

	Nine months ended September 29, 2007	Nine months ended September 30, 2006
Risk-free interest rate	4.50%	5.00%
Expected dividend yield		
Expected option life	4.0 years	4.0 years
Stock price volatility	60.1% and 62.8%	63.2%

As of September 29, 2007, there was $3.1 million of total unrecognized stock-based compensation expense related to non-vested stock-based compensation arrangements. The expense is expected to be recognized over a weighted average period of 2.3 years.

NOTE F SUPPLEMENTAL CASH FLOW INFORMATION

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

	Nine Months Ended	
	Sep 29, 2007	Sep 30, 2006
Cash paid for interest	$ 8	$ 8
Cash paid for income taxes	2,519	1,251
Non-Cash Activity:		
Value of shares issued for milestones related to the acquisition of iQvolution	430	349
Purchase price adjustment for tax effects of acquisition of iQvolution		1,506
Capital lease obligations	174	81

NOTE G ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	As of Sep 29, 2007	As of Dec 31, 2006
Accounts receivable	$ 45,182	$ 43,164
Allowance for doubtful accounts	(628)	(458)
Total	$ 44,554	$ 42,706

NOTE H INVENTORIES

Inventories consist of the following:

	As of Sep 29, 2007	As of Dec 31, 2006
Raw materials	$ 10,503	$ 9,754
Finished goods	3,964	2,160
Sales demonstration inventory	13,475	11,919
Reserve for excess and obsolete	(1,502)	(404)
Inventory	26,440	23,429
Service inventory	10,448	7,278
Total	$ 36,888	$ 30,707

NOTE I EARNINGS PER SHARE

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

	Three Months Ended				Nine Months Ended			
	September 29, 2007		September 30, 2006		September 29, 2007		September 30, 2006	
	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic EPS	15,726,009	$ 0.04	14,326,357	$ 0.22	15,037,745	$ 0.64	14,333,775	$ 0.32
Effect of dilutive securities	262,779		176,953		278,251	(0.01)	180,372	
Diluted EPS	15,988,788	$ 0.04	14,503,310	$ 0.22	15,315,996	$ 0.63	14,514,147	$ 0.31

NOTE J ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	As of Sep 29, 2007	As of Dec 31, 2006
Accrued compensation and benefits	$ 7,515	$ 7,195
Accrued warranties	1,867	1,369
Professional and legal fees	845	972
Other accrued liabilities	3,502	843
	$ 13,729	$ 10,379

Activity related to accrued warranties was as follows:

Nine Months Ended

	Sep 29, 2007	Sep 30, 2006
Beginning Balance	$ 1,369	$ 861
Provision for warranty expense	837	606
Warranty expired	(339)	(452)
Ending Balance	$ 1,867	$ 1,015

NOTE K INCOME TAXES

On July 13, 2006, the FASB issued Interpretation No. 48. *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes* and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006.

FARO adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company did not record an adjustment to its liability through retained earnings. FARO has a $0.5 million liability recorded for unrecognized tax benefits as of January 1, 2007 and September 29, 2007, which includes interest and penalties of $0.05 million.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in tax expense. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is $0.5 million. FARO does not currently anticipate that the total amount of unrecognized tax benefits will significantly increase or decrease by the end of 2007. The Company is subject to income taxes at the federal, state and foreign country level. The Company s tax returns are subject to examination at the U.S. federal level from 2003 forward and at the state level subject to a three to five year statute of limitations. The Company s tax returns are currently under examination by taxing authorities in Germany for the years 2001 through 2003.

The tax provision for the nine months ended September 29, 2007 increased from the tax provision for the nine months ended September 30, 2006, principally due to an increase in earnings. Total deferred tax assets for the Company s foreign subsidiaries relating to net operating loss carryforwards were $7.7 million and $6.3 million at September 29, 2007 and December 31, 2006, respectively. The related valuation allowance was $5.8 million and $4.4 million at September 29, 2007 and December 31, 2006, respectively. The Company s effective tax rate increased to 28.4% for the nine months ended September 29, 2007 from 15.1% in the prior year period as a result of an increase in expenses that are non-deductible for U.S. income tax purposes of $2.65 million related to an accrual for penalties in connection with the resolution of the FCPA matter. The Company s effective income tax rate, excluding this effect, would have been 19.9% for the nine months ended September 29, 2007. The Company s tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company s tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction.

The effective income tax rate for 2006 and 2007 includes a reduction in the statutory corporate tax rates for the Company s operations in Switzerland. The favorable tax rate ruling requires the Company to maintain a certain level of manufacturing operations in Switzerland. The aggregate dollar effect of this favorable tax rate was approximately $1.7 million, or $0.11 per share, in the nine month period ended September 29, 2007, and $1.1 million, or $0.08 per share, in the nine month period ended September 30, 2006.

The Company received confirmation of a tax holiday during the third quarter of 2006 for its operations in Singapore for a period of four years commencing January 1, 2006 and an additional six year extension at a favorable tax rate subject to certain terms and conditions including employment, spending, and capital investment. The aggregate dollar effect of this favorable tax rate was approximately $1.3 million, or $0.09 per share, during the nine month period ended September 29, 2007, and $0.43 million, or $0.03 per share, in the nine months ended September 30, 2006.

NOTE L SEGMENT REPORTING

The Company has three reportable segments based upon geographic regions: Americas, Europe/Africa and Asia Pacific. The company develops, manufactures, markets, supports and sells CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software in each of these regions. These activities represent approximately 99% of consolidated sales. The Company evaluates performance and allocates resources based upon profitable growth and assets deployed.

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

	Three Months Ended		Nine Months Ended	
	Sep 29, 2007	Sep 30, 2006	Sep 29, 2007	Sep 30, 2006
Americas Region				
Net sales to external customers	$ 19,053	$ 15,694	$ 58,092	$ 45,105
Operating income	(4,466)	(264)	(2,280)	(5,882)
Long-lived assets	12,302	12,382	12,302	12,382
Capital expenditures	424	373	1,234	1,363
Total assets	$ 136,114	$ 66,020	$ 136,114	$ 66,020
Europe/Africa Region				
Net sales to external customers	$ 16,949	$ 14,908	$ 51,044	$ 42,536
Operating income	3,001	1,962	6,928	5,797
Long-lived assets	17,633	15,829	17,633	15,829
Capital expenditures	254	293	673	1,031
Total assets	$ 64,981	$ 50,140	$ 64,981	$ 50,140
Asia Pacific Region				
Net sales to external customers	$ 8,519	$ 7,763	$ 23,253	$ 20,822
Operating income	2,466	1,666	6,279	4,486
Long-lived assets	1,590	1,657	1,590	1,657
Capital expenditures	138	54	302	457
Total assets	$ 23,519	$ 17,898	$ 23,519	$ 17,898
Totals				
Net sales to external customers	$ 44,521	$ 38,365	$ 132,389	$ 108,463
Operating income	1001	3364	10927	4401
Long-lived assets	31525	29868	31525	29868
Capital expenditures	816	720	2209	2851
Total assets	$ 224,614	$ 134,058	$ 224,614	$ 134,058

NOTE M OTHER COMPREHENSIVE INCOME

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

	Three Months Ended		Nine Months Ended	
	Sep 29, 2007	**Sep 30, 2006**	**Sep 29, 2007**	**Seps 30, 2006**
NET INCOME	$ 705	$ 3,189	$ 9,689	$ 4,538
OTHER COMPREHENSIVE INCOME (LOSS):				
Currency translation adjustments	2430	(599)	2,747	1,632
COMPREHENSIVE INCOME	3135	2,590	12,436	6,170

NOTE N COMMITMENTS AND CONTINGENCIES

Leases The Company is a party to leases arising in the normal course of business which expire on or before 2013. Total obligations under these leases are approximately $3.2 million for 2007.

Purchase Commitments The Company enters into purchase commitments for products and services in the ordinary course of business. These purchases generally cover production requirements for 60 to 90 days. As of September 29, 2007, the Company does not have any long-term commitments for purchases.

Securities Litigation On December 6, 2005, the first of four essentially identical class action securities fraud lawsuits were filed against the Company and certain officers of the Company (the Securities Litigation). On April 19, 2006, the four lawsuits were consolidated, and Kornitzer Capital Management, Inc. (Kornitzer) was appointed as the lead plaintiff. On May 16, 2006, Kornitzer filed its Consolidated Amended Class Action Complaint against the Company and the individual defendants (the Amended Complaint). The Amended Complaint also named Grant Thornton LLP, the Company s independent registered public accounting firm, as an additional defendant.

On July 31, 2006, the Company filed a Motion to Dismiss the Amended Complaint. On February 3, 2007, the Court dismissed the Amended Complaint, without prejudice. As to the Company and the individual defendants, the Court s decision primarily was based on its findings that the Amended Complaint failed to adequately allege: (i) scienter (i.e., intentionally fraudulent or severely reckless conduct) with respect to certain claims; and (ii) that certain supposed misrepresentations or omissions actually caused economic loss. The Court granted Kornitzer leave to file a Second Amended Complaint by February 22, 2007.

On February 22, 2007, Kornitzer filed its Consolidated Second Amended Class Action Complaint (the Second Amended Complaint) against the Company, the individual defendants and Grant Thornton LLP. In the Second Amended Complaint, as in the Amended Complaint, Kornitzer seeks to represent a class consisting of all persons who purchased or otherwise acquired the Company s publicly traded securities between April 15, 2004 and March 15, 2006. On behalf of the alleged class, Kornitzer seeks an unspecified amount of damages, premised on allegations that each defendant made misrepresentations and omissions of material fact during the class period in violation of the Securities Exchange Act of 1934. Among other things, Kornitzer alleges that the Company s reported inventory, gross margins and profits were false and misleading during a portion of the class period because the Company consciously overstated the value of its inventory; that the Company misstated during 2005 certain of the selling expenses it had accrued and had expected to incur; that certain Asian sales that the Company had reported during the class period had been the product of unlawful payments made in violation of the Foreign Corrupt Practices Act, and that the Company failed to disclose that it was utilizing unlawful means to achieve such sales; and that certain of the Company s statements regarding the Company s systems of internal controls had been false and misleading, in light of the above and other circumstances. On May 11, 2007, the Company filed a motion to dismiss the Second Amended Complaint. On September 19, 2007, the Court entered an order denying the Company s and the individual defendant s motion to dismiss the Second Amended Complaint, as filed against the Company and those individuals. The Court entered an order granting Grant Thornton LLP s separately filed a motion to dismiss the Second Amended Complaint with prejudice.

The Company has timely notified the issuer of its Executive Liability and Entity Securities Liability insurance policy of the Securities Litigation, and has reserved the full amount of its $250,000 retention under the policy. The Company believes that the material allegations made in the Second Amended Complaint are without merit and intends to vigorously defend the Securities Litigation.

Voluntary Disclosure of Foreign Corrupt Practices Act Matter to the Securities and Exchange Commissions and Department of Justice As previously reported by the Company, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company s Audit Committee instituted an internal investigation into this matter in February 2006, and the Company voluntarily notified the SEC and the DOJ of this matter in March 2006. The Company s internal investigation into this matter has been completed. The Company s internal investigation identified certain improper payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA.

Results of the investigation revealed that referral fee payments in possible violation of the FCPA were $165,000 and $265,000 in 2004 and 2005, respectively, which were recorded in selling expenses in the Company s statements of income. The related sales to customers to which payment of these referral fees had been made totaled approximately $1.3 million and $3.24 million in 2004 and 2005, respectively. Additional improper referral fee payments of $122,000 were made in January and February 2006 related to sales contracts in 2005. The Company had sales in China of $9.0 million in 2005 and $4.2 million in 2004, approximately 7% and 4% of total sales, respectively.

The Company has provided to the SEC and the DOJ information obtained during the course of this investigation and is cooperating with both agencies. The SEC and the DOJ have a broad range of civil and criminal remedies that they may seek to impose against corporations and individuals in appropriate circumstances, including without limitation disgorgement, fines, penalties, and other injunctive and equitable relief, as well as additional changes to the Company s business practices and compliance programs.

The Company has engaged in settlement discussions with both the SEC and the DOJ concerning the FCPA matter. Although there is no assurance that such discussions will result in a resolution of the FCPA matter, the Company has determined that the settlement discussions are likely to result in a resolution that will include a fine and disgorgement of associated profits. The Company has recorded in the third quarter of 2007 a reserve of $2.65 million in anticipation of the amount that could be necessary to satisfy its financial obligations to the SEC and the DOJ in resolving this matter. Predicting at this time when the FCPA matter will be finally resolved with the SEC and the DOJ is not possible. The monetary sanctions ultimately paid by the Company to the SEC and the DOJ in resolving this matter, whether imposed on the Company or agreed to by settlement, may exceed the amount that has been reserved by the Company.

The Company anticipates that resolution of the matter will not result in formal criminal charges being filed against it by the DOJ. The Company expects that as part of the final resolution of the FCPA matter with the SEC and the DOJ, in addition to monetary sanctions, the Company will have continuing obligations with the SEC and the DOJ with respect to monitoring, compliance with the FCPA and other laws, full cooperation with the government, and the adoption of a compliance code containing specific provisions intended to prevent violations of the FCPA. The Company expects that the failure to comply with any such continuing obligations could result in the SEC and the DOJ seeking to impose penalties against the Company in the future.

The Company terminated, in March 2006, certain personnel in the Asia-Pacific Region and re-assigned the duties of other personnel in both the Asia-Pacific Region and the U.S. as a result of the internal investigation. The Company instituted the following remedial measures:

- Contracted with a third party forensics accounting team to conduct an in-depth audit of the operations in China and in other countries in the Asia-Pacific region and to make recommendations for improvement to the internal control systems.

- Reviewed third party distributor arrangements in an effort to assure that all contracts include adherence to the FCPA.

Performed due diligence on all third party distributors and implemented a process to assess potential new distributors.

Established an in-house internal audit function including hiring a Director of Internal Audit.

Consolidated the human resources, financial accounting and reporting functions for the Asia region into the Singapore operations.

Implemented an internal certification process to ascertain whether similar issues may exist elsewhere in the Company.

Implemented a quarterly internal certification process to confirm adherence to Company policy and all applicable laws and regulations that will include all regional leadership, country management and other sales management.

Implemented additional training on FCPA and other matters for employees and a confidential compliance reporting system.

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

NOTE O LINE OF CREDIT

On July 11, 2006, the Company entered into a loan agreement providing for an available line of credit of $30.0 million. Loans under the loan agreement bear interest at the rate of LIBOR plus 1.75% and require the Company to maintain certain ratios with respect to a debt covenant agreement, including current ratio, consolidated EBITDA, and senior funded debt to EBITDA. As of September 29, 2007, the Company is in compliance with all of the covenants under the Amended Loan Agreement. The term of the Amended Loan Agreement extends to April 30, 2009. The Company has not drawn on this line of credit.

NOTE P SHAREHOLDERS EQUITY

On August 14, 2007, the Company sold 1,650,000 shares of common stock in a registered direct offering to certain institutional investors at $34.00 per share. The net proceeds after deducting placement fees and other offering expenses were $53.0 million.

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

The following information should be read in conjunction with the Consolidated Financial Statements, including the notes thereto, included elsewhere in this Form 10-Q, and the Management s Discussion and Analysis of Financial Condition and Results of Operations included in the Company s 2006 Annual Report, Form 10-K, for the year ended December 31, 2006.

FARO Technologies, Inc. (FARO , the Company , us , we , or our) has made forward-looking statements in this report (within the meaning Private Securities Litigation Reform Act of 1995). Statements that are not historical facts or that describe our plans, beliefs, goals, intentions, objectives, projections, expectations, assumptions, strategies, or future events are forward-looking statements. In addition, words such as may, will, believe, plan, should, could, seek, expect, anticipate, intend, estimate, goal, objective, project, forecast, targ discussions of our strategy or other intentions identify forward-looking statements. Other written or oral statements that constitute forward-looking statements also may be made by the Company from time to time.

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

our inability to further penetrate our customer base;

development by others of new or improved products, processes or technologies that make our products obsolete or less competitive;

our inability to maintain our technological advantage by developing new products and enhancing our existing products;

our inability to successfully identify and acquire target companies or achieve expected benefits from acquisitions that are consummated;

the cyclical nature of the industries of our customers and the financial condition of our customers;

the fact that the market potential for the CAM2 market and the potential adoption rate for our products are difficult to quantify and predict;

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

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, (iv) raw material price fluctuations, (v) expansion of our manufacturing capability and other inflationary pressures, (vi) the size and timing of customer orders, (vii) the amount of time that it takes to fulfill orders and ship our products, (viii) the length of our sales cycle to new customers and the time and expense incurred in further penetrating our existing customer base, (ix) increases in operating expenses required for product development and new product, marketing, (x) costs associated with new product introductions, such as product development, marketing, assembly line start-up costs and low introductory period production volumes, (xi) the timing and market acceptance of new products and product enhancements, (xii) customer order deferrals in anticipation of new products and product enhancements, (xiii) our success in expanding our sales and marketing programs, (xiv) start-up costs associated with opening new sales offices outside of the United States, (xv) fluctuations in revenue without proportionate adjustments in fixed costs, (xvi) the efficiencies achieved in managing inventories and fixed assets, (xvii) investments in potential acquisitions or strategic sales, product or other initiatives, (xviii) shrinkage or other inventory losses due to product obsolescence, scrap or material price changes, (xix) adverse changes in the manufacturing industry and general economic conditions, (xx) compliance with government regulations including health, safety, and environmental matters, and (xxi) other factors noted herein;

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

our inability to successfully implement the requirements of Restriction of use of Hazardous Substances (RoHS) and Waste Electrical and Electronic Equipment (WEEE) compliance into our products;

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

the impact of competitive products and pricing in the CAM2 market and the broader market for measurement and inspection devices;

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

risks associated with expanding international operations, such as fluctuations in currency exchange rates, difficulties in staffing and managing foreign operations, political and economic instability, compliance with import and export regulations, and the burdens and potential exposure of complying with a wide variety of U.S. and foreign laws and labor practices;

unforeseen developments in our Foreign Corrupt Practices Act (FCPA) matter or in complying with the FCPA in the future;

there is no assurance that the Company s discussions with the SEC and the DOJ will result in a resolution of the FCPA matter with either the DOJ or the SEC or that any such resolution, if reached, may differ from the resolution currently anticipated by the Company;

predicting when the FCPA matter will be finally resolved with the SEC and the DOJ is not possible;

the amount of monetary sanctions ultimately paid by the Company to the SEC and the DOJ in resolving the FCPA matter, whether imposed on the Company or agreed to by settlement, may exceed the amount that has been reserved by the Company;

the ultimate costs of the Company s continuing monitoring obligations in respect of the FCPA matter are uncertain and may vary from the Company s preliminary estimates of such amount as a result of a number of factors, including without limitation the fact that neither the scope of the monitoring obligation nor the identity of outside monitoring firm have been determined;

the outcome of the class action securities litigation against us, including any amounts that are not covered by the Company s D&O insurance;

higher than expected increases in expenses relating to our Asia Pacific expansion of our Singapore manufacturing facility;

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

difficulties in recruiting research and development engineers, and application engineers;

the failure to effectively manage our growth;

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

the loss of key suppliers and the inability to find sufficient alternative suppliers in a reasonable period or on commercially reasonable terms.

Overview

The Company designs, develops, manufactures, markets and supports portable, software driven, 3-D measurement systems that are used in a broad range of manufacturing, industrial, building construction and forensic applications. The Company s Faro Arm, Faro Scan Arm and Faro Gage articulated measuring devices, the Faro Laser Scanner LS, the Faro Laser Tracker, and their companion CAM2 software, provide for Computer-Aided Design (CAD)-based inspection and/or factory-level statistical process control and high-density surveying. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD software to improve productivity, enhance product quality and decrease rework and scrap in the manufacturing process. The Company uses the acronym CAM2 for this process, which stands for computer-aided measurement. As of October 2007, our products have been purchased by approximately 7,000 customers worldwide, ranging from small machine shops to such large manufacturing and industrial companies as Audi, Bell Helicopter, Boeing, British Aerospace, Caterpillar, Daimler Chrysler, General Electric, General Motors, Honda, Johnson Controls, Komatsu Dresser, Lockheed Martin, Nissan, Siemens and Volkswagen, among many others.

The Company operates in international markets throughout the world. It maintains sales offices in France, Germany, Great Britain, Japan, Spain, Italy, China, India, Poland, Netherlands, Malaysia and Vietnam. The Company added a new regional headquarters in Singapore in the third quarter of 2005 along with a new manufacturing and service facility there in the fourth quarter of 2005. In 2006 the Company closed its South Korean office and established a third party distributor relationship for serving that market, and in December 2006, the Company established a sales office in Thailand. The Company manages and reports its global sales in three regions: the Americas, Europe/Africa and Asia/Pacific. In the first nine months of 2007, 43.9% of the Company s sales were in the Americas compared to 41.6% in the first nine months of 2006, 38.5% were in the Europe/Africa region compared to 39.2% in the first nine months of 2006 and 17.6% were in the Asia/Pacific region, compared to 19.2% in the same prior year period (see also Note L- Segment Reporting, to the financial statements above).

The Company derives its revenues primarily from the sale of its Faro Arm, Faro Scan Arm, Faro Gage, Faro Laser Tracker and Faro Laser Scanner LS 3-D measurement equipment, and their related multi-faceted software. Revenue related to these products is generally recognized upon shipment. In addition, the Company sells one and three-year extended warranties and training and technology consulting services relating to the Company s products. The Company recognizes the revenue from extended warranties on a straight-line basis. The Company also receives royalties from licensing agreements for its historical medical technology and recognizes the revenue from these royalties as licensees use the technology.

The Company manufactures its Faro Arm, FARO Gage, and FARO Laser Tracker products in its manufacturing facility located in Switzerland for customer orders from the Europe/Africa region and in its manufacturing facility located in Singapore for customer orders from the Asia/Pacific region. The Company manufactures its Faro Arm, FARO Gage, and FARO Laser Tracker products in the Company s manufacturing facilities located in Florida and Pennsylvania for customer orders from the Americas. The Company manufactures its Faro Laser Scanner LS product in its facility located in Stuttgart, Germany. The Company expects all its existing plants to have the production capacity necessary to support its growth through 2008.

The Company has had twenty-one consecutive profitable quarters through September 29, 2007. Its sales and earnings growth have been the result of a number of factors, including: continuing market demand for and acceptance of the Company s products; increased sales activity in part through additional sales staff worldwide, new products and product enhancements such as the FARO Gage and Laser Scanner; and the effect of acquisitions.

In the third quarter ended September 29, 2007 new order bookings increased $5.1 million, or 13.2%, to $43.8 million from $38.7 million in the prior year period. New orders increased $4.7 million, or 30.3%, in the Americas to $20.2 million, from $15.5 million in the prior year period. New orders increased $1.4 million, or 9.5% to $16.1 million in Europe/Africa from $14.7 million in the prior year. In Asia/Pacific new orders decreased $1.0 million, or 11.8% to $7.5 million, from $8.5 million in the prior year period.

Accounting for wholly owned foreign subsidiaries is maintained in the currency of the respective foreign jurisdiction and, therefore, fluctuations in exchange rates may have an impact on inter-company accounts reflected in the Company s consolidated financial statements. The Company is aware of the availability of off-balance sheet financial instruments to hedge exposure to foreign currency exchange rates, including cross-currency swaps, forward contracts and foreign currency options (see Foreign Exchange Exposure below). However, it does not regularly use such instruments, and none were utilized in 2006 or the nine months ended September 29, 2007.

The Company s effective tax rate increased to 28.4% for the nine months ended September 29, 2007 from 15.1% in the prior year period as a result of an increase in expenses that are non-deductible for U.S. income tax purposes of $2.65 million related to an accrual for penalties in connection with the resolution of the FCPA matter. The Company s effective income tax rate, excluding this effect, would have been 19.9% for the nine months ended September 29, 2007. The Company currently estimates the effective tax rate, excluding the effects of the FCPA matter, will approximate 18%-22% for the remainder of 2007. The Company believes that calculating its effective tax rate without the impact of the FCPA charge is useful to management and investors to provide greater clarity and to facilitate internal and external comparisons to the Company s historical tax rate. The Company s third quarter effective tax rate without the impact of the FCPA charge would have been calculated in accordance with FIN No. 18. The Company s tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company s tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products. The Company has received a favorable income tax rate commitment from the Swiss government as an incentive to establish a manufacturing plant in Switzerland. In 2006, the Company received approval from the Singapore Economic Development Board for a favorable multi-year income tax holiday for its Singapore headquarters and manufacturing operations subject to certain terms and conditions including employment, spending and capital investment.

As previously reported by the Company, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company s Audit Committee instituted an internal investigation into this matter in February 2006, and the

Company voluntarily notified the SEC and the DOJ of this matter in March 2006. The Company s internal investigation into this matter has been completed. The Company s internal investigation identified certain improper payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA.

Results of the investigation revealed that referral fee payments in possible violation of the FCPA were $165,000 and $265,000 in 2004 and 2005, respectively, which were recorded in selling expenses in its statements of income. The related sales to customers to which payment of these referral fees had been made totaled approximately $1.3 million and $3.24 million in 2004 and 2005, respectively. Additional improper referral fee payments of $122,000 were made in January and February 2006 related to sales contracts in 2005. The Company had sales in China of $9.0 million in 2005 and $4.2 million in 2004, approximately 7% and 4% of total sales, respectively. The Company incurred expenses of $3.8 million in 2006 and $3.0 million in the nine months ended September 29, 2007, relating to the FCPA matter, including $2.65 million for estimated fines and penalties to the DOJ and SEC.

The Company has provided to the SEC and the DOJ information obtained during the course of this investigation and is cooperating with both agencies. The SEC and the DOJ have a broad range of civil and criminal remedies that they may seek to impose against corporations and individuals in appropriate circumstances, including without limitation disgorgement, fines, penalties, and other injunctive and equitable relief, as well as additional changes to the Company s business practices and compliance programs.

The Company has engaged in settlement discussions with both the SEC and the DOJ concerning the FCPA matter. Although there is no assurance that such discussions will result in a resolution of the FCPA matter, the Company has determined that the settlement discussions are likely to result in a resolution that will include a fine and disgorgement of associated profits. The Company has recorded in the third quarter of 2007 a reserve of $2.65 million in anticipation of the amount that could be necessary to satisfy its financial obligations to the SEC and the DOJ in resolving this matter. Predicting at this time when the FCPA matter will be finally resolved with the SEC and the DOJ is not possible. The monetary sanctions ultimately paid by the Company to the SEC and the DOJ in resolving this matter, whether imposed on the Company or agreed to by settlement, may exceed the amount that has been reserved by the Company.

The Company anticipates that resolution of the matter will not result in formal criminal charges being filed against it by the DOJ. The Company expects that as part of the final resolution of the FCPA matter with the SEC and the DOJ, in addition to monetary sanctions, the Company will have continuing obligations with the SEC and the DOJ with respect to monitoring, compliance with the FCPA and other laws, full cooperation with the government, and the adoption of a compliance code containing specific provisions intended to prevent violations of the FCPA. The Company expects that the failure to comply with any such continuing obligations could result in the SEC and the DOJ seeking to impose penalties against the Company in the future.

The Company terminated, in March 2006, certain personnel in the Asia-Pacific Region and re-assigned the duties of other personnel in both the Asia-Pacific Region and the U.S. as a result of the internal investigation. Additionally, the Company instituted the following remedial measures:

- Contracted with a third party forensics accounting team to conduct an in-depth audit of the operations in China and in other countries in the Asia-Pacific region and to make recommendations for improvement to the internal control systems.

- Reviewed third party distributor arrangements in an effort to assure that all contracts include adherence to the FCPA.

- Performed due diligence on all third party distributors and implemented a process to assess potential new distributors.

- Established an in-house internal audit function including hiring a Director of Internal Audit.

- Consolidated the human resources, financial accounting and reporting functions for the Asia region into the Singapore operations.

Implemented an internal certification process to ascertain whether similar issues may exist elsewhere in the Company.

Implemented a quarterly internal certification process to confirm adherence to company policy and all applicable laws and regulations that will include all regional leadership, country management and other sales management.

Implemented additional training on FCPA and other matters for employees and a confidential compliance reporting system.

The Company is currently involved in a class action securities fraud lawsuit. (See Part II. OTHER INFORMATION: Item 1. Legal Proceedings). Neither the ultimate outcome of any of these actions, nor the potential impact on the Company s business, financial condition, or reported results of operations in any future period can be predicted.

Results of Operations

Three Months Ended September 29, 2007 Compared to the Three Months Ended September 30, 2006

Sales increased by $6.1 million or 16.0% to $44.5 million in the three months ended September 29, 2007 from $38.4 million for the three months ended September 30, 2006. This increase resulted primarily from an increase in unit sales. Sales in the Americas region increased $3.4 million or 21.4% to $19.1 million for the three months ended September 29, 2007 from $15.7 million in the three months ended September 30, 2006. Sales in the Europe/Africa region increased $2.0 million or 13.7%, to $16.9 million for the three months ended September 29, 2007 from $14.9 million in the three months ended September 30, 2006. Sales in the Asia/Pacific region increased $0.8 million or 9.7% to $8.5 million for the three months ended September 29, 2007 from $7.8 million in the three months ended September 30, 2006.

Gross profit increased by $4.3 million or 18.9% to $26.5 million for the three months ended September 29, 2007 from $22.2 million for the three months ended September 30, 2006. Gross margin increased to 59.4% for the three months ended September 29, 2007 from 58.0% for the three months ended September 30, 2006. The increase in gross margin is primarily due to an increase in unit sales in product lines with lower unit costs than in the prior period and as a result of continuing productivity improvements.

Selling expenses increased by $3.0 million or 28.6% to $13.6 million for the three months ended September 29, 2007 from $10.6 million for three months ended September 30, 2006. This increase was primarily due to an increase in commission and compensation expense of $1.8 million, an increase in marketing and advertising costs of $0.6 million and an increase in travel related expenses of $0.6 million. Worldwide sales and marketing headcount increased by 61, to 312 from 251 between September 30, 2006 and September 29, 2007. Regionally, the Company s sales and marketing headcount increased by 35 or 46.1% in the Americas, to 111 from 76; increased by 9 or 8.0% in Europe/Africa, to 121 from 112 and increased by 17 or 27.0% in Asia/Pacific, to 80 from 63 between September 30, 2006 and September 29, 2007. The Company intends to continue to selectively increase its sales and marketing headcount to meet selected market opportunities. As a percentage of sales, selling expenses increased to 30.6% of sales in the three months ended September 29, 2007 from 27.6% in the three months ended September 30, 2006. Regionally, selling expenses were 28.7% of sales in the Americas for the quarter, compared to 25.0% of sales in the year-ago quarter, 34.0% of sales for Europe/Africa compared to 32.2% of sales in the year-ago quarter and 28.2% of sales for Asia/Pacific compared to 24.0% of sales in the year-ago quarter.

General and administrative expenses increased by $2.5 million or 44.6%, to $8.0 million for the three months ended September 29, 2007 from $5.5 million for the three months ended September 30, 2006 due to an the accrual of $2.65 million for estimated fines and penalties related to the settlement of the FCPA matter. The third quarter of 2006 included a $0.4 million expense that was related to the Company s investigation of possible violations of the Foreign Corrupt Practices Act by its Chinese subsidiary and $0.6 million related to patent litigation. Excluding the effects of these items, general and administrative expenses increased by $0.8 million primarily as a result of increases in compensation costs, including equity based compensation, of $.7 million. General and administrative expenses as a percentage of sales increased to 17.9% for the three months ended September 29, 2007 from 14.4% for the three months ended September 30, 2006.

Depreciation and amortization expenses remained at $1.0 million for the three months ended September 29, 2007 and $1.0 million for the three months ended September 30, 2006.

Research and development expenses increased to $2.9 million for the three months ended September 29, 2007 from $1.7 million for the three months ended September 30, 2006 primarily as a result of an increase in compensation and third party R&D expense related to new product releases. Research and development expenses as a percentage of sales increased to 6.5% for the three months ended September 29, 2007 from 4.5% for the three months ended September 30, 2006.

Interest income, net increased by $0.40 million to $0.59 million for the three months ended September 29, 2007 from $0.19 million for the three months ended September 30, 2006, due to an increase in short term investments.

Other (income) expense, net increased by $0.57 million to $0.72 million of income for the three months ended September 29, 2007, from $0.15 million for the three months ended September 30, 2006, primarily as a result of an increase in foreign exchange transaction gains.

Income tax expense increased by $1.1 million to $1.6 million for the three months ended September 29, 2007 from $0.5 million for the three months ended September 30, 2006. . The Company s effective tax rate increased to 69.5% for the three months ended September 29, 2007 from 13.9% in the prior year period primarily as a result of an increase in non-deductible expenses related to the $2.65 million accrual for penalties in connection with the resolution of the FCPA matter. The Company s effective income tax rate, excluding this effect, would have been 19.9% for the three months ended September 29, 2007. The Company currently estimates the effective tax rate, excluding the effects of the FCPA matter, will approximate 18%-22% for the remainder of 2007. The Company believes that calculating its effective tax rate without the impact of the FCPA charge is useful to management and investors to provide greater clarity and to facilitate internal and external comparisons to the Company s historical tax rate. The Company s third quarter effective tax rate without the impact of the FCPA charge would have been calculated in accordance with FIN No. 18. The Company s tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company s tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction. Total deferred taxes for the Company s foreign subsidiaries relating to net operating loss carryforwards were $7.7 million and $6.3 million at September 29, 2007 and December 31, 2006, respectively. The related valuation allowance was $5.8 million and $4.4 million at September 29, 2007 and December 31, 2006, respectively.

Net income decreased by $2.5 million to $0.7 million for the three months ended September 29, 2007 from $3.2 million for the three months ended September 30, 2006 as a result of the factors described above.

Nine Months Ended September 29, 2007 Compared to the Nine Months Ended September 30, 2006

Sales increased by $23.9 million or 22.1% to $132.4 million in the nine months ended September 29, 2007 from $108.5 million for the nine months ended September 30, 2006. This increase resulted primarily from an increase in unit sales. Sales in the Americas region increased $13.0 million or 28.8% to $58.1 million for the nine months ended September 29, 2007 from $45.1 million in the nine months ended September 30, 2006. Sales in the Europe/Africa region increased $8.5 million or 20.0%, to $51.0 million for the nine months ended September 29, 2007 from $42.5 million in the nine months ended September 30, 2006. Sales in the

Asia/Pacific region increased $2.5 million or 11.7% to $23.3 million for the nine months ended September 29, 2007 from $20.8 million in the nine months ended September 30, 2006.

Gross profit increased by $15.9 million or 24.9% to $79.5 million for the nine months ended September 29, 2007 from $63.6 million for the nine months ended September 30, 2006. Gross margin increased to 60.1% for the nine months ended September 29, 2007 from 58.7% for the nine months ended September 30, 2006. The increase in gross margin is primarily due to an increase in unit sales in product lines with lower unit costs than the prior year period and as a result of continuing productivity improvements.

Selling expenses increased by $7.5 million or 23.1% to $40.0 million for the nine months ended September 29, 2007 from $32.5 million for nine months ended September 30, 2006. This increase was primarily due to an increase in commission and compensation expense of $4.2 million, an increase in marketing and advertising costs of $1.5 million, an increase in travel related expenses of $0.9 million and an increase in recruiting and hiring expense of $0.4 million. Worldwide sales and marketing headcount increased by 61, to 312 from 251 between September 30, 2006 and September 29, 2007. Regionally, the Company s sales and marketing headcount increased by 35 or 46.1% in the Americas, to 111 from 76; increased by 9 or 8.0% in Europe/Africa, to 121 from 112 and increased by 17 or 27.0% in Asia/Pacific, to 80 from 63 between September 30, 2006 and September 29, 2007. The Company intends to continue to selectively increase its sales and marketing headcount as the market demands. As a percentage of sales, selling expenses increased to 30.2% of sales in the nine months ended September 29, 2007 from 29.9% in the nine months ended September 30, 2006. Regionally, selling expenses were 26.4% of sales in the Americas for the nine months ended September 29, 2007, compared to 27.3% of sales in the year-ago period, 34.7% of sales for Europe/Africa compared to 32.1% of sales and 29.6% of sales compared to 31.2% of sales in the same prior year period for Asia/Pacific.

General and administrative expenses increased by $0.2 million or 1.1%, to $18.5 million for the nine months ended September 29, 2007 from $18.3 million for the nine months ended September 30, 2006 and included the accrual of penalties of $2.65 million related to the settlement of the FCPA matter. The nine month period ended September 29, 2007 included $0.4 million related to the Company s investigation of possible violations of the Foreign Corrupt Practices Act by its Chinese subsidiary compared to $3.6 million in the prior year period. The nine month period ended September 29, 2007 included $0.6 million related to patent litigation compared to $1.6 million in the prior year period. Excluding the effects of the penalty accrual and the professional fees related to the FCPA matter and patent litigation, general and administrative expenses decreased by $0.6 million primarily as a result of increases in compensation costs of $1.6 million, including equity based compensation, offset against the decrease in patent litigation fees. General and administrative expenses as a percentage of sales decreased to 14.0% for the nine months ended September 29, 2007 from 16.9% for the nine months ended September 30, 2006.

Depreciation and amortization expenses decreased by $0.1 million to $3.0 million for the nine months ended September 29, 2007 from $3.1 million for the nine months ended September 30, 2006.

Research and development expenses increased to $7.1 million for the nine months ended September 29, 2007 from $5.4 million for the nine months ended September 30, 2006 primarily as a result of an increase in compensation and third party R&D expense. Research and development expenses as a percentage of sales increased to 5.4% for the nine months ended September 29, 2007 from 5.0% for the nine months ended September 30, 2006.

Interest income, net increased by $0.67 million to $1.18 million for the nine months ended September 29, 2007 from $0.51 million for the nine months ended September 30, 2006, due to an increase in short term investments.

Other (income) expense, net increased by $0.99 million to $1.43 million of income for the nine months ended September 29, 2007, from income of $0.44 million for the nine months ended September 30, 2006, primarily as a result of an increase in foreign exchange transaction gains.

Income tax expense increased by $3.0 million to $3.8 million for the nine months ended September 29, 2007 from $0.8 million for the nine months ended September 30, 2006. This increase was primarily due to an increase in pretax income. The Company s effective tax rate increased to 28.4% for the nine months ended September 29, 2007 from 15.1% as a result of an increase in expenses that are non-deductible for U.S. income tax purposes of $2.65 million related to an accrual for penalties in connection with the resolution of the FCPA matter. The Company s effective income tax rate, excluding this effect, would have been 19.9% for the nine months ended September 29, 2007. The Company currently estimates the effective tax rate, excluding the effects of the FCPA matter, will approximate 18%-22% for the remainder of 2007. The Company believes that calculating its effective tax rate without the impact of the FCPA charge is useful to management and investors to provide clarity and to facilitate internal and external comparisons to the Company s historical tax rate. The Company s third quarter effective tax rate without the impact of the FCPA charge would have been calculated in accordance with FIN No. 18. The Company s tax rate continues to be lower than the statutory tax rate in the United States primarily as a result of favorable tax rates in foreign jurisdictions. However, the Company s tax rate could be impacted positively or negatively by geographic changes in the manufacturing or sales of its products and the resulting effect on taxable income in each jurisdiction. Total deferred taxes for the Company s foreign subsidiaries relating to net operating loss carryforwards were $7.7 million and $6.3 million at September 29, 2007 and December 31, 2006, respectively. The related valuation allowance was $5.8 million and $4.4 million at September 29, 2007 and December 31, 2006, respectively.

Net income increased by $5.2 million to $9.7 million for the nine months ended September 29, 2007 from $4.5 million for the nine months ended September 30, 2006 as a result of the factors described above.

Liquidity and Capital Resources

The Company has financed its operations primarily from cash provided by operating activities, proceeds of its 1997 initial public offering of common stock of approximately $31.5 million and, its 2003 private placement of its common stock with various institutional investors totaling approximately $24.9 million.

On January 10, 2005, the Company filed a Registration Statement on Form S-3 with the Securities and Exchange Commission allowing it to raise proceeds of up to $125 million. The proceeds from any offerings with respect to this registration statement, if any, would be used for either repayment or refinancing of debt, acquisition of additional businesses or technologies or for working capital and general corporate purposes.

On August 14, 2007, the Company sold 1,650,000 shares of common stock in a registered direct offering pursuant to its Form S-3 Registration Statement to certain institutional investors at $34.00 per share. The net proceeds after deducting placement fees and other offering expenses were $53.0 million.

Cash and cash equivalents increased by $9.7 million to $25.4 million at September 29, 2007 from $15.7 million at December 31, 2006. In addition, the Company increased its short term investments by $57.0 million to $72.8 million at September 29, 2007 from $15.8 million at December 31, 2006. The increase was primarily attributable to cash provided by the proceeds from the registered direct offering of $53.0 million.

The increase in cash and cash equivalents resulted from cash provided by operating activities of $11.1 million, proceeds of $5.4 million from the issuance of common stock related to the exercise of stock options and $3.0 million of related income tax benefit, partially offset by purchases of equipment and intangible assets of $2.2 million, and $3.7 million related to the effects of foreign exchange rate changes on cash.

On July 11, 2006, the Company entered into a loan agreement providing for an available line of credit of $30.0 million. Loans under the agreement bear interest at the rate of LIBOR plus 1.75% and require the Company to maintain certain ratios with respect to a debt covenant agreement, including current ratio, consolidated EBITDA, and senior funded debt to EBITDA. As of September 29, 2007, the Company was in compliance with all of the covenants under the Amended Loan Agreement. The term of the Amended Loan Agreement extends to April 30, 2009. The Company has not drawn on this line of credit.

The Company believes that its working capital, together with anticipated cash flow from its operations and its credit facility will be sufficient to fund its long-term liquidity requirements for the foreseeable future.

Critical Accounting Policies

In response to the SEC s financial reporting release, FR-60,

Cautionary Advice Regarding Disclosure About Critical Accounting Policies, the Company has selected its critical accounting policies for purposes of explaining the methodology used in the calculation in addition to any inherent uncertainties pertaining to the possible effects on its financial condition. The critical policies discussed below are the Company s processes of recognizing revenue, the reserve for excess and obsolete inventory, income taxes, and the reserve for warranties. These policies affect current assets and operating results and are therefore critical in assessing the Company s financial and operating status. These policies involve certain assumptions that, if incorrect, could create an adverse impact on the Company s operations and financial position.

The preparation of these consolidated financial statements requires the Company s management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, as well as disclosure of contingent assets and liabilities. The Company bases its estimates on historical experience along with various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Some of these judgments can be subjective and complex and, consequently, actual results may differ from these estimates under different assumptions or conditions. While for any given estimate or assumption made by the Company s management there may be other estimates or assumptions that are reasonable, the Company believes that, given the current facts and circumstances, it is unlikely that applying any such other reasonable estimate or assumption would materially impact the financial statements.

Revenue Recognition - Revenue related to the Company s measurement equipment and related software is generally recognized upon shipment as the Company considers the earnings process substantially complete as of the shipping date. Revenue from sales of software only is recognized when no further significant production, modification or customization of the software is required and where the following criteria are met: persuasive evidence of a sales agreement exists, delivery has occurred, and the sales price is fixed or determinable and deemed collectible. Revenues resulting from sales of comprehensive support, training and technology consulting services are recognized as such services are performed. Extended maintenance plan revenues are recognized on a straight-line basis over the life of the plan. The Company warrants its products against defects in design, materials and workmanship for one year. A provision for estimated future costs relating to warranty expense is recorded when products are shipped. Costs relating to extended maintenance plans are recognized as incurred. Revenue from the licensing agreements for the use of the Company s technology for medical applications is recognized on an accrual basis based on historical data.

The Reserve for Excess and Obsolete Inventory Since the value of inventory that will ultimately be realized cannot be known with exact certainty, the Company relies upon both past sales history and future sales forecasts to provide a basis for the determination of the reserve. Inventory is considered obsolete if the Company has withdrawn those products from the market or had no sales of the product for the past 12 months, and have no sales forecasted for the next 12 months. Inventory is considered excess if the quantity on hand exceeds 12 months of remaining usage. The resulting obsolete and excess parts are then reviewed to determine if a substitute usage or a future need exists. Items without an identified current or future usage will be reserved in an amount equal to 100% of the FIFO cost of such inventory. The Company s products are subject to changes in technologies that may make certain of its products or their components obsolete or less competitive, which may increase its historical provisions to the reserve.

Income Taxes The Company reviews its deferred tax assets on a regular basis to evaluate their recoverability based upon expected future reversals of deferred tax liabilities, projections of future taxable income over a two year period, and tax planning strategies that its might employ to utilize such assets, including net operating loss carryforwards. Based on the positive and negative evidence described in Financial Accounting Standards Board Statement No. 109, Accounting for Income Taxes , the Company establishes a valuation allowance against the net deferred assets of a taxing jurisdiction in which it operates unless it is more likely than not that it will recover such assets through the above means. In the future, the Company s evaluation of the need for the valuation allowance will be significantly influenced by its ability to achieve profitability and its ability to predict and achieve future projections of taxable income.

The Company operates in a number of different countries around the world and considers the statutory rates within each jurisdiction to determine the overall effective tax rate. In 2003, the Company began to manufacture its products in Switzerland, where it has received a favorable income tax rate commitment from the Swiss government as an incentive to establish a manufacturing plant there. The aggregate dollar effect of this favorable tax rate was approximately $1.7 million, or $0.11 per share for the nine months ended September 29, 2007, and $1.1 million, or $0.08 per share for the nine months ended September 30, 2006.

In 2005, the Company opened a regional headquarters and began to manufacture its products in Singapore, where it received approval for a four year tax holiday from the Singapore Economic Development Board as an incentive to establish a manufacturing plant and regional headquarters. The aggregate dollar effect of this favorable tax rate was approximately $1.3 million, or $0.09 per share for the nine months ended September 29, 2007, and $0.43 million, or $0.03 per share for the nine months ended September 30, 2006.

The Company is subject to certain terms and conditions including employment, spending, and capital investment in each of these countries in order to receive these favorable tax rates or be subject to the statutory rates. Significant judgment is required in determining the Company s worldwide provision for income taxes. In the ordinary course of global business, there are many transactions for which the ultimate tax outcome is uncertain. The Company has appropriately reserved for its tax uncertainties based on the criteria established by Interpretation No. 48. Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 .

The Reserve For Warranties The Company establishes at the time of sale a liability for the one year warranty included with the initial purchase price of the equipment based upon an estimate of the repair expenses likely to be incurred for the warranty period. The warranty period is measured in installation-months for each major product group. Warranty reserve is reflected in accrued liabilities in the accompanying consolidated balance sheets. The warranty expense is estimated by applying the actual total repair expenses for each product group in the prior period and determining a rate of repair expense per installation month. This repair rate is multiplied by the number of installation-months of warranty for each product group to determine the provision for warranty expenses for the period. The Company evaluates its exposure to warranty costs at the end of each period using the estimated expense per installation-month for each major product group, the number of units remaining under warranty and the remaining number of months each unit will be under warranty. The Company has a history of new product introductions and enhancements to existing products which may result in unforeseen issues that may increase its warranty costs. While such expenses have historically been within expectations, the Company cannot guarantee this will continue in the future.

Transactions with Related and Other Parties

The Company leased its headquarters in Lake Mary, Florida from Xenon Research, Inc., a company owned by Simon Raab, the Company s Chairman, and Diana Raab, his spouse. On May 22, 2007, Xenon Research sold the property and assigned the lease agreement to Emma Investments, LLC, an unrelated third party.

Foreign Exchange Exposure

The Company conducts a significant portion of its business outside the United States. At present, 56% of its revenues are invoiced, and a significant portion of its operating expenses paid, in foreign currencies. Fluctuations in exchange rates between the U.S. dollar and such foreign currencies may have a material adverse effect on the business, results of operations and financial condition, and could specifically result in foreign exchange gains and losses. The impact of future exchange rate fluctuations on the results of the Company s operations cannot be accurately predicted. To the extent that the percentage of its non-U.S. dollar revenues derived from international sales increases (or decreases) in the future, the Company s exposure to risks associated with fluctuations in foreign exchange rates may increase (or decrease).

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 29, 2007 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Securities Litigation On December 6, 2005, the first of four essentially identical class action securities fraud lawsuits were filed against the Company and certain officers of the Company (the Securities Litigation). On April 19, 2006, the four lawsuits were consolidated, and Kornitzer Capital Management, Inc. (Kornitzer) was appointed as the lead plaintiff. On May 16, 2006, Kornitzer filed its Consolidated Amended Class Action Complaint against the Company and the individual defendants (the Amended Complaint). The Amended Complaint also named Grant Thornton LLP, the Company s independent registered public accounting firm, as an additional defendant.

On July 31, 2006, the Company filed a Motion to Dismiss the Amended Complaint. On February 3, 2007, the Court dismissed the Amended Complaint, without prejudice. As to the Company and the individual defendants, the Court s decision primarily was based on its findings that the Amended Complaint failed to adequately allege: (i) scienter (i.e., intentionally fraudulent or severely reckless conduct) with respect to certain claims; and (ii) that certain supposed misrepresentations or omissions actually caused economic loss. The Court granted Kornitzer leave to file a Second Amended Complaint by February 22, 2007.

On February 22, 2007, Kornitzer filed its Consolidated Second Amended Class Action Complaint (the Second Amended Complaint) against the Company, the individual defendants and Grant Thornton LLP. In the Second Amended Complaint, as in the Amended Complaint, Kornitzer seeks to represent a class consisting of all persons who purchased or otherwise acquired the Company s publicly traded securities between April 15, 2004 and March 15, 2006. On behalf of the alleged class, Kornitzer seeks an unspecified amount of damages, premised on allegations that each defendant made misrepresentations and omissions of material fact during the class period in violation of the Securities Exchange Act of 1934. Among other things, Kornitzer alleges that the Company s reported inventory, gross margins and profits were false and misleading during a portion of the class period because the Company consciously overstated the value of its inventory; that the Company misstated during 2005 certain of the selling expenses it had accrued and had expected to incur; that certain Asian sales that the Company had reported during the class period had been the product of unlawful payments made in violation of the Foreign Corrupt Practices Act, and that the Company failed to disclose that it was utilizing unlawful means to achieve such sales; and that certain of the Company s statements regarding the Company s systems of internal controls had been false and misleading, in light of the above and other circumstances. On May 11, 2007, the Company filed a motion to dismiss the Second Amended Complaint. On September 19, 2007, the Court entered an order denying the Company s and the individual defendant s motion to dismiss the Second Amended Complaint, as filed against the Company and those individuals. The Court entered an order granting Grant Thornton LLP s separately filed motion to dismiss the Second Amended Complaint with prejudice.

The Company has timely notified the issuer of its Executive Liability and Entity Securities Liability insurance policy of the Securities Litigation, and has reserved the full amount of its $250,000 retention under the policy. The Company believes that the material allegations made in the Second Amended Complaint are without merit and intends to vigorously defend the Securities Litigation.

Voluntary Disclosure of Foreign Corrupt Practices Act Matter to the Securities and Exchange Commissions and Department of Justice As previously reported by the Company, the Company learned that its China subsidiary had made payments to certain customers in China that may have violated the FCPA and other applicable laws. The Company s Audit Committee instituted an internal investigation into this matter in February 2006, and the Company voluntarily notified the SEC and the DOJ of this matter in March 2006. The Company s internal investigation into this matter has been completed. The Company s internal investigation identified certain improper payments made in China and deficiencies in its controls with respect to its operations in China in possible violation of the FCPA.

Results of the investigation revealed that referral fee payments in possible violation of the FCPA were $165,000 and $265,000 in 2004 and 2005, respectively, which were recorded in selling expenses in the Company s statement of income. The related sales to customers to which payment of these referral fees had been made totaled approximately $1.3 million and $3.24 million in 2004 and 2005, respectively. Additional improper referral fee payments of $122,000 were made in January and February 2006 related to sales contracts in 2005. The Company had sales in China of $9.0 million in 2005 and $4.2 million in 2004, approximately 7% and 4% of total sales, respectively.

The Company has provided to the SEC and the DOJ information obtained during the course of this investigation and is cooperating with both agencies. The SEC and the DOJ have a broad range of civil and criminal remedies that they may seek to impose against corporations and individuals in appropriate circumstances, including without limitation disgorgement, fines, penalties, and other injunctive and equitable relief, as well as additional changes to the Company s business practices and compliance programs.

The Company has engaged in settlement discussions with both the SEC and the DOJ concerning the FCPA matter. Although there is no assurance that such discussions will result in a resolution of the FCPA matter, the Company has determined that the settlement discussions are likely to result in a resolution that will include a fine and disgorgement of associated profits. The Company has recorded in the third quarter of 2007 a reserve of $2.65 million in anticipation of the amount that could be necessary to satisfy its financial obligations to the SEC and the DOJ in resolving this matter. Predicting at this time when the FCPA matter will be finally resolved with the SEC and the DOJ is not possible. The monetary sanctions ultimately paid by the Company to the SEC and the DOJ in resolving this matter, whether imposed on the Company or agreed to by settlement, may exceed the amount that has been reserved by the Company.

The Company anticipates that resolution of the matter will not result in formal criminal charges being filed against it by the DOJ. The Company expects that as part of the final resolution of the FCPA matter with the SEC and the DOJ, in addition to monetary sanctions, the Company will have continuing obligations with the SEC and the DOJ with respect to monitoring, compliance with the FCPA and other laws, full cooperation with the government, and the adoption of a compliance code containing specific provisions intended to prevent violations of the FCPA. The Company expects that the failure to comply with any such continuing obligations could result in the SEC and the DOJ seeking to impose penalties against the Company in the future.

The Company terminated, in March 2006, certain personnel in the Asia-Pacific Region and re-assigned the duties of other personnel in both the Asia-Pacific Region and the U.S. as a result of the internal investigation. The Company instituted the following remedial measures:

- Contracted with a third party forensics accounting team to conduct an in-depth audit of the operations in China and in other countries in the Asia-Pacific region and to make recommendations for improvement to the internal control systems.

- Reviewed third party distributor arrangements in an effort to assure that all contracts include adherence to the FCPA.

- Performed due diligence on all third party distributors and implemented a process to assess potential new distributors.

- Established an in-house internal audit function including hiring a Director of Internal Audit.

- Consolidated the human resources, financial accounting and reporting functions for the Asia region into the Singapore operations.

- Implemented an internal certification process to ascertain whether similar issues may exist elsewhere in the Company.

- Implemented a quarterly internal certification process to confirm adherence to Company policy and all applicable laws and regulations that will include all regional leadership, country management and other sales management.

- Implemented additional training on FCPA and other matters for employees and a confidential compliance reporting system.

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

Item 1A. Risk Factors

In addition to the other information set forth in this Form 10-Q, you should carefully consider the factors discussed under Risk Factors in the Company s Form 10-K for the year ended December 31, 2006 as filed with the Securities and Exchange Commission. These risks could materially and adversely affect the Company s business, financial condition, and results of operations. The risks described in the Company s Form 10-K for the year ended December 31, 2006 are not the only risks it faces. The Company s operations could also be affected by additional factors that are not presently known to the Company or by factors that it currently considers immaterial to its business.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

31-A	Certification of the President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31-B	Certification of the Principal Financial and Accounting Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32-A	Certification of the President and Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32-B	Certification of the Principal Financial and Accounting Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

FARO Technologies, Inc.
(Registrant)

Date: November 2, 2007

By: /s/ Keith S. Bair
Keith S. Bair
Senior Vice President and Chief Financial Officer
(Duly Authorized Officer and Principal Financial Officer)