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FARO TECHNOLOGIES INC

Form 10-Q

May 01, 2019

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

# FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-23081

## FARO TECHNOLOGIES INC

(Exact Name of Registrant as Specified in Its Charter)

**Florida**

(State or other Jurisdiction of Incorporation or Organization)

**59-3157093**

(I.R.S. Employer Identification No.)

**250 Technology Park, Lake Mary, Florida**

(Address of Principal Executive Offices)

**32746**

(Zip Code)

**(407) 333-9911**

(Registrant's Telephone Number, including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES ☒ NO ☐

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

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐

Emerging growth company ☐

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

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

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

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

There were 17,328,630 shares of the registrant's common stock outstanding as of April 26, 2019.

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Quarterly Report on Form 10-Q

Quarter Ended March 31, 2019

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**CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2019 (unaudited)	December 31, 2018
<u>(in thousands, except share and per share data)</u>		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 110,696	\$ 108,783
Short-term investments	24,831	24,793
Accounts receivable, net	76,237	88,927
Inventories, net	74,586	65,444
Prepaid expenses and other current assets	24,210	28,795
Total current assets	310,560	316,742
Property and equipment:		
Machinery and equipment	80,586	76,048
Furniture and fixtures	6,141	6,749
Leasehold improvements	20,311	20,304
Property and equipment at cost	107,038	103,101
Less: accumulated depreciation and amortization	(76,188 )	(72,684 )
Property and equipment, net	30,850	30,417
Operating lease right-of-use asset	18,876	—
Goodwill	71,097	67,274
Intangible assets, net	29,507	33,054
Service and sales demonstration inventory, net	38,351	39,563
Deferred income tax assets, net	14,696	14,719
Other long-term assets	4,416	4,475
Total assets	\$ 518,353	\$ 506,244
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 14,351	\$ 20,093
Accrued liabilities	31,389	36,327
Income taxes payable	3,747	5,081
Current portion of unearned service revenues	34,189	32,878
Customer deposits	2,847	3,144
Lease liability	6,446	—
Total current liabilities	92,969	97,523
Unearned service revenues - less current portion	16,319	15,505
Lease liability - less current portion	14,363	—
Deferred income tax liabilities	2,541	736
Income taxes payable - less current portion	12,247	12,247
Other long-term liabilities	3,326	3,624
Total liabilities	141,765	129,635
Commitments and contingencies - See Note 16		
Shareholders' equity:		
Common stock - par value \$.001, 50,000,000 shares authorized; 18,731,586 and 18,676,059 issued, respectively; 17,317,875 and 17,253,011 outstanding, respectively	19	19
Additional paid-in capital	252,840	251,329
Retained earnings	175,178	175,353



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Accumulated other comprehensive loss	(20,047 )	(18,483 )
Common stock in treasury, at cost; 1,413,711 and 1,423,048 shares, respectively	(31,402 )	(31,609 )
Total shareholders' equity	376,588	376,609
Total liabilities and shareholders' equity	\$ 518,353	\$ 506,244
The accompanying notes are an integral part of these condensed consolidated financial statements.		

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

(in thousands, except share and per share data)	Three Months Ended	
	March 31, 2019	March 31, 2018
Sales		
Product	\$68,800	\$ 70,581
Service	24,817	22,253
Total sales	93,617	92,834
Cost of Sales		
Product	26,128	26,884
Service	12,470	12,164
Total cost of sales (exclusive of depreciation and amortization, shown separately below)	38,598	39,048
Gross Profit	55,019	53,786
Operating Expenses		
Selling and marketing	26,753	28,271
General and administrative	13,224	11,073
Depreciation and amortization	4,749	4,343
Research and development	9,935	9,406
Total operating expenses	54,661	53,093
Income from operations	358	693
Other expense (income)		
Interest income, net	(144)	(73)
Other expense, net	195	184
Income before income tax expense	307	582
Income tax expense	155	127
Net income	\$152	\$ 455
Net income per share - Basic	\$0.01	\$ 0.03
Net income per share - Diluted	\$0.01	\$ 0.03
Weighted average shares - Basic	17,280,361	16,837,754
Weighted average shares - Diluted	17,868,816	17,142,770

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

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**FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME  
(UNAUDITED)**

	Three Months Ended	
	March 31, 2019	March 31, 2018
<u>(in thousands)</u>		
Net income	\$ 152	\$455
Currency translation adjustments	(1,564 )	5,214
Comprehensive (loss) income	\$(1,412 )	\$5,669

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

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

<u>(in thousands)</u>	Three Months Ended March 31, 2019		March 31, 2018	
Cash flows from:				
Operating activities:				
Net income	\$ 152		\$ 455	
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation and amortization	4,749		4,343	
Stock-based compensation	2,564		1,553	
(Recoveries) provisions for bad debts, net	(100)	)	24	
Loss on disposal of assets	57		127	
Provision for excess and obsolete inventory	896		312	
Deferred income tax expense (benefit)	8		(128)	)
Change in operating assets and liabilities:				
Decrease (Increase) in:				
Accounts receivable	12,410		1,808	
Inventories	(10,908)	)	(5,208)	)
Prepaid expenses and other current assets	4,463		(936)	)
(Decrease) Increase in:				
Accounts payable, accrued liabilities, and lease liability	(9,172)	)	(4,846)	)
Income taxes payable	(1,323)	)	(2,571)	)
Customer deposits	(310)	)	(213)	)
Unearned service revenues	2,324		1,231	
Net cash provided by (used in) operating activities	5,810		(4,049)	)
Investing activities:				
Purchases of property and equipment	(1,543)	)	(2,243)	)
Payments for intangible assets	(529)	)	(650)	)

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Acquisition of businesses	—		(3,966)	)
Net cash used in investing activities	(2,072)	)	(6,859)	)
Financing activities:				
Payments on finance leases	(90)	)	(46)	)
Payments of contingent consideration for acquisitions	(250)	)	—	
Payments for taxes related to net share settlement of equity awards	(1,138)	)	—	
Proceeds from issuance of stock related to stock 292 option exercises			6,785	
Net cash (used in) provided by financing activities	(1,186)	)	6,739	
Effect of exchange rate changes on cash and cash equivalents	(639)	)	2,035	
Increase (decrease) in cash and cash equivalents	1,913		(2,134)	)
Cash and cash equivalents, beginning of period	108,783		140,960	
Cash and cash equivalents, end of period	\$ 110,696		\$ 138,826	

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

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**FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**(UNAUDITED)**

	Common Stock		Additional	Retained	Accumulated	Common	Total
(in thousands, except share data)	Shares	Amounts	Paid-in Capital	Earnings	Other Comprehensive (Loss) Income	Stock in Treasury	
BALANCE DECEMBER 31, 2018	17,253,011	\$ 19	\$ 251,329	\$ 175,353	\$ (18,483 )	\$ (31,609 )	\$ 376,609
Net income				152			152
Currency translation adjustment, net of income tax					(1,564 )		(1,564 )
Stock-based compensation			2,564				2,564
Common stock issued, net of shares withheld for employee taxes	64,864	—	(1,053 )			207	(846 )
Cumulative effect of the adoption of ASU 2016-02				(327 )			(327 )
BALANCE MARCH 31, 2019	17,317,875	\$ 19	\$ 252,840	\$ 175,178	\$ (20,047 )	\$ (31,402 )	\$ 376,588

	Common Stock		Additional	Retained	Accumulated	Common	Total
(in thousands, except share data)	Shares	Amounts	Paid-in Capital	Earnings	Other Comprehensive (Loss) Income	Stock in Treasury	
BALANCE DECEMBER 31, 2017	16,796,884	\$ 18	\$ 223,055	\$ 168,624	\$ (7,822 )	\$ (31,809 )	\$ 352,066
Net income				455			455
Currency translation adjustment, net of income tax					5,214		5,214
Stock-based compensation			1,553				1,553
Common stock issued, net of shares withheld for employee taxes	158,795	—	6,601			75	6,676
Cumulative effect of the adoption of ASU 2014-09				2,365			2,365
BALANCE MARCH 31, 2018	16,955,679	\$ 18	\$ 231,209	\$ 171,444	\$ (2,608 )	\$ (31,734 )	\$ 368,329

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

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**FARO TECHNOLOGIES, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(UNAUDITED)

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

**NOTE 1 – DESCRIPTION OF BUSINESS**

FARO Technologies, Inc. and its subsidiaries (collectively “FARO,” the “Company,” “us,” “we” or “our”) design, develop, manufacture, market and support software driven, three-dimensional (“3D”) measurement and imaging solutions. This technology permits high-precision 3D measurement, imaging and comparison of parts and complex structures within production and quality assurance processes. Our devices are used for inspection of components and assemblies, rapid prototyping, reverse engineering, documenting large volume or structures in 3D, surveying and construction, as well as for investigation and reconstruction of accident sites or crime scenes. We sell the majority of our products through a direct sales force across a broad number of customers in a range of manufacturing, industrial, architecture, surveying, building information modeling, construction, public safety forensics, cultural heritage, dental, and other applications. Our FaroArm®, FARO ScanArm®, FARO Laser Tracker™, FARO Cobalt Array Imager, FARO Laser Projector, and their companion CAM2®, BuildIT, and BuildIT Projector software solutions, provide for Computer-Aided Design (“CAD”) based inspection, factory-level statistical process control, high-density surveying and laser-guided assembly and production. Together, these products integrate the measurement, quality inspection, and reverse engineering functions with CAD and 3D software to improve productivity, enhance product quality, and decrease rework and scrap in the manufacturing process, mainly supporting applications in our 3D Manufacturing vertical. Our FARO Focus, FARO ScanPlan and FARO Scanner Freestyle<sup>3D</sup> X laser scanners, and their companion FARO SCENE, BuildIT, FARO As-Built™, and FARO Zone public safety forensics software offerings, are utilized for a wide variety of 3D modeling, documentation and high-density surveying applications in our Construction Building Information Modeling (“Construction BIM”) and Public Safety Forensics verticals. Our FARO ScanArm®, FARO Cobalt Array Imager, FARO Scanner Freestyle<sup>3D</sup> X laser scanners and their companion SCENE software, and other 3D-structured light scanning solutions specific to the dental industry also enable a fully digital workflow used to capture real world geometry for the purpose of empowering design, enabling innovation, and speeding up the design cycle, supporting our 3D Design vertical. Our line of galvanometer-based scan heads and laser scan controllers are used in a variety of laser applications and are integrated into larger components and systems, supporting our Photonics vertical.

We report our segment information in accordance with the provisions of Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 280, *Segment Reporting* (“FASB ASC Topic 280”). We evaluate business performance based upon several metrics, using revenue growth and segment profit as the primary financial measures.

Since the end of the first quarter of 2018, the following changes were made to our verticals and reporting segments:

• In the third quarter of 2018, we merged the historical Factory Metrology and 3D Machine Vision verticals into one vertical named “3D Factory” for greater consistency with our realigned reporting segments.

In the third quarter of 2018, we segregated the operations of our acquisitions of Laser Control Systems Limited (“Laser Control Systems”) and Lanmark Controls, Inc. (“Lanmark”), along with the operations resulting from our acquisition of substantially all of the assets of Instrument Associates, LLC d/b/a Nutfield Technology, into a vertical that we named “Photonics.” The creation of this vertical enables us to better focus on our product range directed at laser steering. These operations were historically reported in the 3D Factory reporting segment in the first six months of 2018 and the historical Factory Metrology reporting segment in 2017 and are now included in the Emerging Verticals (formerly known as “Other”) reporting segment.

• In the third quarter of 2018, we renamed our Product Design vertical “3D Design.”

• In the fourth quarter of 2018, we renamed our 3D Factory vertical and reporting segment “3D Manufacturing.”

There has been no change in our total consolidated financial condition or results of operations previously reported as a result of these changes in our verticals and reportable segments. The amounts related to our reporting segment information for the three months ended March 31, 2018 have been restated throughout this Quarterly Report on Form

10-Q to reflect the changes in our reporting segments. Each of our reporting segments continues to employ consistent accounting policies.



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We now report our activities in the following three reportable segments:

The 3D Manufacturing reporting segment contains solely our 3D Manufacturing vertical and provides both standardized and customized solutions for 3D measurement and inspection in an industrial or manufacturing environment. Applications include alignment, part inspection, dimensional analysis, first article inspection, incoming and in-process inspection, machine calibration, non-contact inspection, robot calibration, tool building and set-up, and assembly guidance.

The Construction BIM reporting segment contains solely our Construction BIM vertical and provides solutions for as-built data capturing and 3D visualization in building information modeling applications, allowing our customers in the architecture, engineering and construction markets to quickly and accurately extract two-dimensional (“2D”) and 3D measurement points. Applications include as-built documentation, construction monitoring, surveying, asset and facility management, and heritage preservation.

The Emerging Verticals reporting segment includes our 3D Design, Public Safety Forensics, and Photonics verticals. Our 3D Design vertical provides advanced 3D solutions to capture and edit 3D shapes of products, people and/or environments for design purposes in product development, computer graphics and dental and medical applications. Our Public Safety Forensics vertical provides solutions to public safety officials and professionals to capture environmental or situational scenes in 2D and 3D for crime, crash and fire scene investigations and environmental safety evaluations. Our Photonics vertical develops and markets galvanometer-based laser measurement products and solutions.

All operating segments that do not meet the criteria to be reportable segments are aggregated in the Emerging Verticals reporting segment and have been combined based on the aggregation criteria and quantitative thresholds in accordance with the provisions of FASB ASC Topic 280. Our reporting segments have been determined in accordance with our internal management structure, which is based on operating activities. Each segment is responsible for its own product management, sales, strategy and profitability. See Note 15 – Segment Reporting for further information.

### NOTE 2 – PRINCIPLES OF CONSOLIDATION

Our condensed consolidated financial statements include the accounts of FARO Technologies, Inc. and its subsidiaries, all of which are wholly-owned. All intercompany transactions and balances have been eliminated. The financial statements of our foreign subsidiaries are translated into U.S. dollars using exchange rates in effect at period-end for assets and liabilities and average exchange rates during each reporting period for results of operations. Adjustments resulting from financial statement translations are reflected as a separate component of accumulated other comprehensive loss. Foreign currency transaction gains and losses are included in net income.

### NOTE 3 – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements and notes thereto have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. These condensed consolidated financial statements include all normal recurring accruals and adjustments considered necessary by management for a fair presentation in conformity with U.S. GAAP. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. The condensed consolidated results of operations for the three months ended March 31, 2019 are not necessarily indicative of results that may be expected for the year ending December 31, 2019 or any future period.

The information included in this Quarterly Report on Form 10-Q, including the interim condensed consolidated financial statements and the accompanying notes, should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018. The accompanying December 31, 2018 condensed consolidated balance sheet has been derived from those audited consolidated financial statements. As described in Note 1 – Description of Business, after the first quarter of 2018, we changed our reporting segment structure. Amounts related to our reporting segment information

for the three months ended March 31, 2018 have been restated throughout this Quarterly Report on Form 10-Q to reflect the changes in our reporting segments.

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NOTE 4 – IMPACT OF RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Impact of Recently Adopted Accounting Standards

In February 2016, the FASB issued Accounting Standards Update (“ASU”) No. 2016-02, *Leases (Topic 842)* (“ASU 2016-02”), which is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements to enable users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. ASU 2018-11, *Lease Topic 842: Targeted Improvements*, was issued by the FASB in July 2018 and allows for a cumulative-effect adjustment transition method of adoption. The new guidance is effective for fiscal years beginning after December 15, 2018 and interim periods within those years. We adopted ASU 2016-02 effective as of January 1, 2019 utilizing the cumulative-effect adjustment transition method of adoption, which resulted in the recognition on our condensed consolidated balance sheet as of March 31, 2019 of \$18.9 million of right-of-use assets for operating leases, \$19.9 million of lease liability for operating leases, \$0.9 million of property and equipment, net for finance leases and \$0.9 million of lease liability for finance leases under which we function as a lessee. We elected certain practical expedients available under the transition provisions to (i) allow aggregation of non-lease components with the related lease components when evaluating accounting treatment, (ii) apply the modified retrospective adoption method, utilizing the simplified transition option, which allows us to continue to apply the legacy guidance in FASB ASC Topic 840, including its disclosure requirements, in the comparative periods presented in the year of adoption, and (iii) use hindsight in determining the lease term (that is, when considering our options to extend or terminate the lease and to purchase the underlying asset) and in assessing impairment of our right-of-use assets. The adoption of ASU 2016-02 also required us to include any initial direct costs, which are incremental costs that would not have been incurred had the lease not been obtained, in the right-of-use assets. The recognition of these costs in connection with our adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

Impact of Recently Issued Accounting Standards

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* (“ASU 2017-04”), which is intended to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under the current guidance, performance of Step 2 requires us to calculate the implied fair value of goodwill by following procedures that would be required to determine the fair value of assets acquired and liabilities assumed in a business combination. Under the new guidance, we will perform our goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge will be recognized for the amount by which the carrying amount exceeds the reporting unit’s fair value up to the amount of the goodwill allocated to the reporting unit. The new guidance also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform Step 2 of the goodwill impairment test if it fails the qualitative assessment. As a result, all reporting units will be subject to the same impairment assessment. We will still have the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. ASU 2017-04 becomes effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted for annual or any interim goodwill impairment tests after January 1, 2017. The amendments in this ASU will be applied on a prospective basis. Disclosure of the nature and reason for the change in accounting principle is required upon transition. This disclosure is required in the first annual period and in the interim period within the first annual period when we initially adopt the amendments in this ASU. We plan to adopt this guidance for our fiscal year ending December 31, 2020. We do not expect that the adoption of this guidance will have a material impact on our condensed consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASU 2016-13”), which requires the measurement and recognition of expected credit losses for financial assets held at amortized cost. ASU 2016-13 replaces the existing incurred loss impairment model with an expected loss model that requires the use of forward-looking information to calculate credit loss estimates. It also eliminates the concept of other-than-temporary impairment and requires credit losses related to available-for-sale debt securities to be recorded through an allowance for credit losses rather than as a reduction in the

amortized cost basis of the securities. These changes will result in earlier recognition of credit losses. We will adopt ASU 2016-13 effective January 1, 2020. We are currently evaluating the effect of the adoption of ASU 2016-13, but we do not expect that the adoption of this guidance will have a material impact on our condensed consolidated financial statements.

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## NOTE 5 – REVENUES

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

	For the Three Months Ended March 31,	
	2019	2018
<b>Product sales</b>		
Product transferred to customers at a point in time	\$68,800	\$70,581
Product transferred to customers over time	—	—
	\$68,800	\$70,581

	For the Three Months Ended March 31,	
	2019	2018
<b>Service sales</b>		
Service transferred to customers at a point in time	\$11,854	\$9,452
Service transferred to customers over time	12,963	12,801
	\$24,817	\$22,253

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

	For the Three Months Ended March 31,	
	2019	2018
<b>Total sales to external customers</b>		
United States	\$35,848	\$37,302
EMEA (1)	31,100	29,680
APAC (1)	23,337	22,589
Other Americas (1)	3,332	3,263
	\$93,617	\$92,834

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

For revenue related to our measurement and imaging equipment and related software, we allocate the contract price to performance obligations based on our best estimate of the standalone selling price. We make this allocation estimate utilizing data from the sale of our applicable products and services to customers separately in similar circumstances, with the exception of software licenses. With respect to software licenses, we use the residual method for allocating the contract price to performance obligations relating to software licenses. Revenue related to our measurement and imaging equipment and related software is generally recognized upon shipment from our facilities or when delivered to the customer location, as determined by the agreed upon shipping terms, at which time we are entitled to payment and title and control has passed to the customer. Software arrangements generally include short-term maintenance that is considered post-contract support (“PCS”), which is considered to be a separate performance obligation. We generally establish a standalone sales price for this PCS component based on our maintenance renewal rate. Maintenance renewals, when sold, are recognized on a straight-line basis over the term of the maintenance agreement. Payment for products and services is collected within a short period of time following transfer of control or commencement of

delivery of services, as applicable.

Further, customers frequently purchase extended warranties with the purchase of measurement equipment and related software. Warranties are considered a performance obligation when services are transferred to a customer over time, and, as such, we recognize revenue on a straight-line basis over the warranty term. Extended warranty sales include contract periods that extend between one month and three years.

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We capitalize commission expenses related to deliverables transferred to a customer over time and amortize such costs ratably over the term of the contract. As of March 31, 2019, the deferred cost asset related to deferred commissions was approximately \$2.8 million. For classification purposes, \$1.9 million and \$0.9 million are comprised within the Prepaid expenses and other current assets and Other long-term assets, respectively, on our condensed consolidated balance sheet as of March 31, 2019. As of March 31, 2018, the deferred cost asset related to deferred commissions was approximately \$2.5 million. For classification purposes, \$1.8 million and \$0.7 million were comprised within the Prepaid expenses and other current assets and Other long-term assets, respectively, on our condensed consolidated balance sheet as of March 31, 2018.

The unearned service revenue liabilities reported on our condensed consolidated balance sheets reflect the contract liabilities to satisfy the remaining performance obligations for extended warranties and software maintenance. The current portion of unearned service revenues on our condensed consolidated balance sheets is what we expect to recognize to revenue within twelve months after the applicable balance sheet date relating to extended warranty and software maintenance contract liabilities. The Unearned service revenues - less current portion on our condensed consolidated balance sheets is what we expect to recognize to revenue extending beyond twelve months after the applicable balance sheet date relating to extended warranty and software maintenance contract liabilities. During the three months ended March 31, 2019, we recognized \$10.8 million of service revenue that was deferred on our condensed consolidated balance sheet as of December 31, 2018. During the three months ended March 31, 2018, we recognized \$9.0 million of service revenue that was deferred on our consolidated balance sheet as of December 31, 2017.

The nature of certain of our contracts gives rise to variable consideration, which may be constrained, primarily related to an allowance for sales returns. We are required to estimate the contract asset related to sales returns and record a corresponding adjustment to Cost of Sales. Our allowance for sales returns was approximately \$0.1 million as of both March 31, 2019 and March 31, 2018.

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

### NOTE 6 – STOCK-BASED COMPENSATION

Stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date. For awards with only a service condition, we expense stock-based compensation using the straight-line method over the requisite service period for the entire award. For awards with both performance and service conditions, we expense the stock-based compensation on a straight-line basis over the requisite service period taking into account the probability that we will satisfy the performance condition.

We have two compensation plans that provide for the granting of stock options and other share-based awards to key employees and non-employee members of the Board of Directors (the “Board”). The 2009 Equity Incentive Plan (the “2009 Plan”) and the 2014 Equity Incentive Plan (the “2014 Plan”) provide for granting options, restricted stock, restricted stock units or stock appreciation rights to employees and non-employee directors. In May 2018, our shareholders approved an amendment to the 2014 Plan, which increased the number of shares available for issuance under the 2014 Plan by 1,000,000 shares. A maximum of 2,974,543 shares are available for issuance under the 2014 Plan, as amended, plus the number of shares (not to exceed 891,960) that were underlying awards outstanding under the 2004 Equity Incentive Plan (the “2004 Plan”) and the 2009 Plan as of May 29, 2014 that thereafter terminate or expire unexercised or are canceled, forfeited or lapse for any reason. No awards were outstanding under the 2004 Plan as of March 31, 2019, and no further grants will be made under the 2004 Plan or the 2009 Plan.

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

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

Our annual grants in February 2019 consisted of performance-based restricted stock units and time-based restricted stock units. Our annual grants in March 2018 consisted of time-based stock options and time-based restricted stock units. The number of stock options and/or restricted stock units granted was based on the employee's individual objectives, performance against operational metrics assigned to the employee and overall contribution to the Company over the last year.

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

For 2018 grants, stock options vest in three equal annual installments beginning one year after the grant date and time-based restricted stock unit awards vest in full on the three-year anniversary of the grant date. The fair value of these stock-based awards is determined by using (a) the Black-Scholes option valuation model in the case of stock options or (b) the current market price of our common stock on the grant date in the case of restricted stock units. The Black-Scholes option and Monte Carlo Simulation valuation models incorporate assumptions as to stock price volatility, the expected life of options or awards, a risk-free interest rate and dividend yield. The weighted-average grant-date fair value of the performance-based restricted stock units that were granted during the three months ended March 31, 2019 and valued using the Monte Carlo Simulation valuation model was \$62.74. No performance-based restricted stock units were granted during the three months ended March 31, 2018. For performance-based restricted



stock units granted during the three months ended March 31, 2019 valued using the Monte Carlo Simulation valuation model, we used the following assumptions:

	Three Months Ended March 31, 2019
Risk-free interest rate	2.48%
Expected dividend yield	— %
Expected volatility	45.0%
Weighted-average expected volatility	45.0%

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The weighted-average grant-date fair value of the stock options that were granted during the three months ended March 31, 2018 and valued using the Black-Scholes option valuation model was \$23.43 per option. No stock options were granted during the three months ended March 31, 2019. For stock options granted during the three months ended March 31, 2018 valued using the Black-Scholes option valuation model, we used the following assumptions:

	Three Months Ended March 31, 2018	
Risk-free interest rate	2.65	%
Expected dividend yield	—	%
Expected term of option	4	years
Expected volatility	45.0	%
Weighted-average expected volatility	45.0	%

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

A summary of stock option activity and weighted-average exercise prices during the three months ended March 31, 2019 follows:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value as of March 31, 2019
Outstanding at January 1, 2019	792,943	\$ 47.59		
Granted	—	—		
Forfeited or expired	(65,868 )	54.23		
Exercised	(8,513 )	34.18		
Outstanding at March 31, 2019	718,562	\$ 47.38	4.3	\$ 3,118
Options exercisable at March 31, 2019	540,597	\$ 46.57	2.6	\$ 2,410

The total intrinsic value of stock options exercised during the three months ended March 31, 2019 and March 31, 2018 was \$0.1 million and \$2.7 million, respectively. The fair value of stock options vested during the three months ended March 31, 2019 and March 31, 2018 was \$2.7 million and \$3.1 million, respectively.

The following table summarizes the restricted stock and restricted stock unit activity and weighted average grant-date fair values for the three months ended March 31, 2019:

	Shares	Weighted-Average Grant Date Fair Value
Non-vested at January 1, 2019	311,000	\$ 42.66
Granted	172,324	45.32
Forfeited	(8,453 )	44.36
Vested	(82,930 )	34.47
Non-vested at March 31, 2019	391,941	\$ 45.53

We recorded total stock-based compensation expense of \$2.6 million and \$1.6 million for the three months ended March 31, 2019 and March 31, 2018, respectively.

As of March 31, 2019, there was \$15.9 million of total unrecognized stock-based compensation expense related to non-vested stock-based compensation arrangements. The expense is expected to be recognized over a weighted average period of 2.1 years.



Table of Contents**NOTE 7 – SHORT-TERM INVESTMENTS**

Short-term investments at March 31, 2019 consisted of U.S. Treasury Bills totaling \$24.8 million, consisting of \$10.9 million maturing on June 6, 2019, \$4.9 million maturing on June 20, 2019 and \$9.0 million maturing on September 12, 2019, respectively. The interest rates on the U.S. Treasury Bills held on March 31, 2019 that are maturing on June 6, 2019, June 20, 2019, and September 12, 2019 were 2.4%, 2.3%, and 2.3%, respectively. Short-term investments at December 31, 2018 consisted of U.S. Treasury Bills totaling \$24.8 million, consisting of \$9.0 million that matured on March 14, 2019, \$10.9 million maturing on June 6, 2019, and \$4.9 million maturing on June 20, 2019. The interest rates on the U.S. Treasury Bills held on December 31, 2018 that matured on March 14, 2019 and that are maturing on June 6, 2019 and June 20, 2019 were 2.2%, 2.4%, and 2.3%, respectively. The investments are classified as held-to-maturity and recorded at cost plus accrued interest, which approximates fair value. We do not intend to sell these investments, and it is not more likely than not that we will be required to sell the investments before we recover their amortized cost bases.

**NOTE 8 – ACCOUNTS RECEIVABLE**

Accounts receivable consist of the following:

	As of March 31, 2019	As of December 31, 2018
Accounts receivable	\$77,879	\$90,675
Allowance for doubtful accounts	(1,642 )	(1,748 )
Total	\$76,237	\$88,927

**NOTE 9 – INVENTORIES**

Inventories are stated at the lower of cost or net realizable value using the first-in first-out (FIFO) method. We have three principal categories of inventory: 1) manufactured product to be sold; 2) sales demonstration inventory - completed product used to support our sales force, for demonstrations and held for sale; and 3) service inventory - completed product and parts used to support our service department and held for sale. Shipping and handling costs are classified as a component of cost of sales in our condensed consolidated statements of operations. Sales demonstration inventory is held by our sales representatives for up to three years, at which time it would be refurbished and transferred to finished goods as used equipment, stated at the lower of cost or net realizable value. We expect these refurbished units to remain in finished goods inventory and sold within 12 months at prices that produce reduced gross margins. Service inventory is used to provide a temporary replacement product to a customer covered by a premium warranty when the customer's unit requires service or repair and as training equipment. Service inventory is available for sale; however, management does not expect service inventory to be sold within 12 months and, as such, classifies this inventory as a long-term asset. Service inventory that we utilize for training or repairs and which we deem as no longer available for sale is transferred to fixed assets at the lower of cost or net realizable value and depreciated over its remaining life, typically three years.

Inventories consist of the following:

	As of March 31, 2019	As of December 31, 2018
Raw materials	\$43,406	\$ 39,859
Finished goods	31,180	25,585
Inventories, net	\$74,586	\$ 65,444
Service and sales demonstration inventory, net	\$38,351	\$ 39,563

**NOTE 10 – EARNINGS PER SHARE**

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding. Diluted earnings per share is computed by also considering the impact of potential common stock on both net income

and the weighted average number of shares outstanding. Our potential common stock consists of employee stock options, restricted stock units and performance-based awards. Our potential common stock is included in the diluted earnings per share calculation when adding such potential common stock would not be anti-dilutive.

Performance-based awards are included in the computation of diluted earnings per share only to the extent that the underlying performance conditions (and any applicable market condition) (i) are satisfied as of the end of the reporting period or (ii) would be considered satisfied if the end of the reporting period were the end of the related contingency period and the result would be dilutive under the treasury stock method. When we report a net loss for the period presented, the calculation of diluted net loss per share excludes our potential common stock, as the effect would be anti-dilutive.

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For the three months ended March 31, 2019, there were approximately 372,326 shares issuable upon the exercise of options and the contingent vesting of performance-based restricted stock units that were excluded from the dilutive calculations, as they were anti-dilutive. For the three months ended March 31, 2018, there were approximately 655,944 shares issuable upon the exercise of options that were excluded from the dilutive calculations, as they were anti-dilutive.

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		March 31, 2018	
	March 31, 2019		March 31, 2018	
	Shares	Per-Share Amount	Shares	Per-Share Amount
Basic earnings per share	17,280,365	\$ 0.01	16,837,754	\$ 0.03
Effect of dilutive securities	588,451	—	305,016	—
Diluted earnings per share	17,868,816	\$ 0.01	17,142,770	\$ 0.03

**NOTE 11 – ACCRUED LIABILITIES**

Accrued liabilities consist of the following:

	As of March 31, 2019	As of December 31, 2018
Accrued compensation and benefits	\$13,902	\$17,745
Accrued warranties	2,474	2,571
Professional and legal fees	2,304	2,154
Taxes other than income	3,344	3,550
General services administration contract contingent liability (see Note 16)	5,347	5,267
Other accrued liabilities	4,018	5,040
	\$31,389	\$36,327

Activity related to accrued warranties was as follows:

	Three Months Ended	
	March 31, 2019	March 31, 2018
Balance, beginning of period	\$2,571	\$2,628
Provision for warranty expense	878	914
Fulfillment of warranty obligations	(975)	(1,067)
Balance, end of period	\$2,474	\$2,475

**NOTE 12 – INCOME TAXES**

For the three months ended March 31, 2019, we recorded an income tax expense of \$0.2 million compared with income tax expense of \$0.1 million for the three months ended March 31, 2018. Our effective tax rate was 50.5% for the three months ended March 31, 2019 compared with 21.8% in the prior year period. The changes in our income tax expense and our effective tax rate were primarily due to the mix of jurisdictions where we earned pretax book income or incurred a pretax book loss during the three months ended March 31, 2019 compared to the same period in the prior year.

Our quarterly estimate of our annual effective tax rate, and our quarterly provision for income tax expense, are subject to significant variation due to numerous factors, including variability in accurately predicting our pretax and taxable income or loss and the mix of jurisdictions to which they relate, as well as the amount of pretax income or loss

recognized during the quarter.

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## NOTE 13 – FAIR VALUE MEASUREMENTS

Our financial instruments include cash and cash equivalents, short-term investments, accounts receivable, customer deposits, accounts payable and accrued liabilities. The carrying amounts of such financial instruments approximate their fair value due to the short-term nature of these instruments.

Liabilities measured at fair value on a recurring basis are categorized in the tables below based upon the lowest level of significant input to the valuations:

As of March 31,  
2019  
Level 1   Level 2   Level 3

## Liabilities:

Contingent consideration (1)	\$—	—\$5,205
Total	\$—	—\$5,205

As of December 31,  
2018  
Level 1   Level 2   Level 3

## Liabilities:

Contingent consideration (1)	\$—	—\$5,531
Total	\$—	—\$5,531

Contingent consideration liability represents arrangements to pay the former owners of certain companies we acquired based on the former owners attaining future product release milestones. We use a probability-weighted discounted cash flow model to estimate the fair value of contingent consideration liabilities. These probability weightings are developed internally and assessed on a quarterly basis. The remaining undiscounted maximum payment under these arrangements was \$5.6 million as of March 31, 2019. We paid \$0.3 million as part of these arrangements during the three months ended March 31, 2019, which was the primary reason for the change in the fair value of the contingent consideration from December 31, 2018 to March 31, 2019.



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

On April 27, 2018, we invested \$1.8 million in present4D GmbH (“present4D”), a software solutions provider for professional virtual reality presentations and training environments, in the form of an equity capital contribution. This contribution represents a minority investment in present4D. This investment’s business purpose is to coordinate the design and development of modules supporting compatibility with virtual reality for our existing software offerings. As of our investment date, present4D was thinly capitalized and lacked sufficient equity to finance its activities without additional subordinated financial support and is classified as a VIE. We do not have power over decisions that significantly affect present4D’s economic performance and do not represent its primary beneficiary. After April 27, 2020, present4D may request additional equity financing up to \$1.8 million from us in exchange for additional share capital, which additional equity financing would be at our discretion. We have not provided support to present4D during the periods presented outside of our initial investment of \$1.8 million. At this time, we do not intend to provide future support to present4D, but we will continue to evaluate whether we intend to obtain the aforementioned additional share capital in the future. Our 16.5% portion of present4D’s net loss for the three month period ended March 31, 2019 was less than \$0.1 million. Present4D is currently accounted for using the equity method of accounting. Our equity in the net loss from this equity-method investment is recorded as loss with a corresponding decrease in the investment. Our investment in this unconsolidated VIE at March 31, 2019 and December 31, 2018 was \$1.7 million and is included in Other long-term assets in our condensed consolidated balance sheets as of March 31, 2019 and December 31, 2018.

**NOTE 15 – SEGMENT REPORTING**

We have three reportable segments: 3D Manufacturing, Construction BIM, and Emerging Verticals. These segments are based upon the vertical markets that we currently serve. Business activities that do not meet the criteria to be reportable segments are aggregated in the Emerging Verticals segment.

We develop, manufacture, market, support and sell CAD-based quality assurance products integrated with CAD-based inspection and statistical process control software and 3D documentation systems in each of these reportable segments. These activities represent more than 99% of consolidated sales.

Our Chief Operating Decision Maker (CODM), our Chief Executive Officer, evaluates segment performance and allocates resources based upon profitable growth. We use segment profit to evaluate the performance of our reportable segments. Segment profit is calculated as gross profit, net of selling and marketing expenses, for the reporting segment. Our definition of segment profit may not be comparable to similarly-titled measures reported by other companies.

Our segment structure presented below represents a change from the prior year as further described in Note 1 – Description of Business. The amounts for the three months ended March 31, 2018 have been restated to reflect the change in our reporting segments. Each of our reporting segments continues to employ consistent accounting policies. The following tables present information about our reportable segments, including a reconciliation of segment profit to income from operations included in the condensed consolidated statements of operations for the three months ended March 31, 2019 and 2018:

	3D Manufacturing	Construction BIM	Emerging Verticals	Total
Three Months Ended March 31, 2019				
Total sales	\$ 56,567	\$ 25,440	\$ 11,610	\$ 93,617
Segment profit	\$ 19,170	\$ 8,427	\$ 669	\$ 28,266
General and administrative				13,224
Depreciation and amortization				4,749

Research and development	9,935
Income from operations	\$358

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	3D Manufacturing	Construction BIM	Emerging Verticals	Total
Three Months Ended March 31, 2018				
Total sales	\$ 60,657	\$ 22,682	\$ 9,495	\$ 92,834
Segment profit	\$ 18,425	\$ 6,451	\$ 639	\$ 25,515
General and administrative				11,073
Depreciation and amortization				4,343
Research and development				9,406
Income from operations				\$ 693

## NOTE 16 – COMMITMENTS AND CONTINGENCIES

**Purchase Commitments** — We enter into purchase commitments for products and services in the ordinary course of business. These purchases generally cover production requirements for 60 to 120 days as well as materials necessary to service customer units through the product lifecycle and for warranty commitments. As of March 31, 2019, we had approximately \$45.0 million in purchase commitments that are expected to be delivered within the next 12 months.

**Legal Proceedings** — We are not involved in any legal proceedings, including routine litigation arising in the normal course of business, that we believe will have a material adverse effect on our business, financial condition or results of operations.

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

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

Over the six-year period ended December 31, 2018, our sales to the Government under the GSA Contracts were approximately \$53.5 million in the aggregate. As a result of the GSA Matter, for fourth quarter 2018, we reduced our total sales by a \$4.8 million estimated cumulative sales adjustment, representative of the last six years of estimated overcharges to the Government under the GSA Contracts. In addition, for the fourth quarter of 2018, we recorded \$0.5 million of imputed interest related to the estimated cumulative sales adjustment, which increased other expense and resulted in an estimated total liability of \$5.3 million for the GSA Matter.

For the three months ended March 31, 2019, we recorded \$0.1 million of imputed interest related to the estimated cumulative sales adjustment for the six-year period ended December 31, 2018. Our estimated total liability for the GSA Matter is based on our preliminary review as of the date of this Quarterly Report on Form 10-Q and is subject to change based on the results of the Review being conducted by our outside legal counsel and discussions with the Government.

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

**NOTE 17 – LEASES**

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

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

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

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

The components of lease expense were as follows:

	Three Months Ended March 31, 2019
Operating lease cost	\$ 1,969

Finance lease cost:

Amortization of ROU assets	92
Interest on lease liabilities	\$ 12
Total finance lease cost	\$ 104

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

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Supplemental balance sheet information related to leases was as follows:

	As of March 31, 2019
<b>Operating leases:</b>	
Operating lease right-of-use asset	\$18,876
Current operating lease liability	\$6,139
Operating lease liability - less current portion	13,782
Total operating lease liability	\$19,921
<b>Finance leases:</b>	
Property and equipment, at cost	\$1,692
Accumulated depreciation	(839 )
Property and equipment, net	\$853
Current finance lease liability	\$307
Finance lease liability - less current portion	581
Total finance lease liability	\$888
<b>Weighted Average Remaining Lease Term:</b>	
Operating leases	4.8 years
Finance leases	3 years
<b>Weighted Average Discount Rate:</b>	
Operating leases	5.18 %
Finance leases	5.06