UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2000

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 0-22427

HESKA CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware	77-0192527
[State or other jurisdiction of incorporation or organization]	[I.R.S. Employer Identification No.]
1613 Prospect Parkway Fort Collins, Colorado	80525
[Address of principal executive offices]	[Zip Code]

Registrant's telephone number, including area code: (970) 493-7272

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

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $.001 par value

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference to Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

The aggregate market value of voting stock held by non-affiliates of the Registrant was approximately $44,318,000 as of March 23, 2001 based upon the closing price on the Nasdaq National Market reported for such date. This calculation does not reflect a determination that certain persons are affiliates of the Registrant for any other purpose.

38,656,745 shares of the Registrant's Common Stock, $.001 par value, were outstanding at March 23, 2001.

DOCUMENTS INCORPORATED BY REFERENCE

Items 10 (as to directors), 11, 12 and 13 of Part III incorporate by reference information from the Registrant's Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the Registrant's 2001 Annual Meeting of Stockholders.

PART I

This Form 10-K contains forward-looking statements. These statements relate to our, and in some cases our partners', future plans, objectives, expectations, intentions and financial performance, and assumptions that underlie these statements. When used in this Form 10-K, terms such as "anticipates," "believes," "continue," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "should," or "will" or the negative of those terms or other comparable terms may identify forward-looking statements. These statements involve known and unknown risks, uncertainties and

other factors that may cause industry trends or our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. These factors include those listed under "Factors that May Affect Results," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Business" and elsewhere in this Form 10-K.

Although we believe that expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions, or circumstances on which any such statement is based. These forward-looking statements apply only as of the date of this Form 10-K.

ITEM 1. BUSINESS.

We discover, develop, manufacture and market companion animal health products. We have a sophisticated scientific effort devoted to applying biotechnology to create a broad range of pharmaceutical, vaccine and diagnostic products for the large and growing companion animal health market. In addition to our pharmaceutical, vaccine and diagnostic products, we also sell veterinary diagnostic and patient monitoring instruments and offer diagnostic services in the United States and Europe to veterinarians. Our primary manufacturing subsidiary, Diamond Animal Health, Inc., or Diamond, manufactures some of our companion animal products and food animal vaccine and pharmaceutical products which are marketed and distributed by third parties.

Our principal executive offices are located at 1613 Prospect Parkway, Fort Collins, Colorado 80525 and our telephone number is (970) 493-7272. We were incorporated in California in 1988. We reincorporated in Delaware in 1997.

ALLERCEPT, ALLERCEPT E-SCREEN, FLU AVERT I.N., HESKA, VET/OX, VET/E-Sig, VET/ECG, VET/IV, CHEM-ELITE and SOLO STEP are trademarks of Heska Corporation. This 10-K also refers to trademarks and trade names of other organizations.

ANIMAL HEALTH PRODUCTS

We presently sell a variety of companion animal health products, among the most significant of which are the following.

DIAGNOSTICS

Heartworm Diagnostics

Heartworm infections of dogs and cats are caused by the parasite, Dirofilaria immitis. This parasitic worm is transmitted in larval form to dogs and cats through the bite of an infected mosquito. Larvae develop into adult worms which live in the pulmonary arteries and heart of the host, where they can cause serious cardiovascular, pulmonary, liver and kidney disease.

In 1997, we developed a diagnostic test for heartworm infection in dogs. This test uses monoclonal antibodies reactive with heartworm antigens to detect the presence of these antigens in the blood of the infected dog. This test was first offered through our own veterinary diagnostic laboratory. A simple, rapid, and easy to use point-of-care version of this test, SOLO STEP CH, was introduced in Italy in 1998. In January 1999, we received regulatory clearance to sell SOLO STEP CH in the United States and introduced this product in the United States shortly thereafter. In March 2000, we received regulatory clearance to sell a batch test version of this product, SOLO STEP CH Batch Test Strips, and introduced this product in the United States shortly thereafter.

In 1997, we introduced a new test in our veterinary diagnostic laboratory for heartworm infections of cats which allowed veterinarians for the first time to accurately establish the prevalence of feline heartworm exposure in their practices. This test is highly sensitive and accurate, and identifies antibodies in cat serum that react with a recombinant heartworm antigen. In 1997, we introduced a rapid, point-of-care version of this test in Italy. After receiving regulatory clearance, we introduced this point-of-care feline heartworm test, SOLO STEP FH, in the United States in 1998.

Allergy

Allergy is common in companion animals, and it is estimated to affect approximately 10% to 15% of dogs. Clinical symptoms of allergy are variable, but are often manifested as persistent and serious skin disease in dogs and cats. Clinical management of allergic disease is problematic, as there are a large number of allergens that may give rise to these conditions. Although skin testing is often regarded as the most accurate diagnostic procedure, such tests are painful, subjective and inconvenient. The effectiveness of the immunotherapy that is prescribed to treat allergic disease is inherently limited by inaccuracies in the diagnostic process.

We have developed the HESKA ALLERCEPT Definitive Allergen Panels, a more accurate in vitro technology, to detect IgE, the antibody involved in most allergic reactions. This technology permits the design of tests that, in contrast to other in vitro tests, more accurately identify the animal's allergic responses to particular allergens. During 1997, we adapted this technology to our canine allergy tests. The ALLERCEPT Definitive Allergen Panels use a

recombinant version of the natural IgE receptor to screen the serum of potentially allergic animals for IgE directed against a panel of known allergens. A typical test panel consists primarily of various pollen, grass, mold and insect allergens.

We have also developed the HESKA ALLERCEPT E-SCREEN Test, a rapid and highly accurate screen for certain antibodies commonly associated with allergic disease. This product, which utilizes our proprietary patented technology, is designed to enable veterinarians to do point-of-care screens of dogs with allergic symptoms. In January 2001, we entered into a distribution agreement with Novartis Animal Health granting exculsive distribution rights for the E-Screen Test product in Europe.

VACCINES

Equine Influenza Vaccine

Equine influenza is a common viral disease of horses and is similar to human influenza. This disease poses a significant risk to the estimated six million horses in the United States. Infected horses have severe respiratory disease and diminished performance for an extended period following infection. We believe that approximately half of the six million horses in the United States receive vaccination. Most competitive equine influenza vaccines are administered as a component of a multi-purpose vaccine, intended to provide protection against multiple infectious diseases. Industry sources have estimated the total U.S. equine vaccine market at $50 million. We believe that other currently available vaccines for equine influenza are of limited efficacy. We have developed a unique vaccine for equine influenza, our FLU AVERT I.N. vaccine, which we believe has improved efficacy and duration of immunity compared to existing products. This product was approved by the USDA in November 1999 and was first sold to veterinarians in December 1999. In March 2001, we granted Novartis Animal Health Canada exclusive distribution rights for FLU AVERT I.N. vaccine in Canada.

Allergy Immunotherapy

Veterinarians who use our in vitro allergy testing services often purchase immunotherapy treatment sets for those animals with positive test results. These prescription treatment sets are formulated specifically for each allergic animal and contain only the allergens to which the animal has significant levels of IgE antibodies. The prescription formulations are administered in a series of injections, with doses increasing over several months, to ameliorate the allergic condition of the animal. Immunotherapy is generally continued for an extended time. We offer both canine and feline immunotherapy treatment products.

Feline Respiratory Disease

In 1997, we introduced in the United States a three-way modified live vaccine (HESKA Trivalent Intranasal/Intraocular Vaccine) for the three most common viral diseases of cats: calicivirus, rhinotracheitis virus and panleukopenia virus. This vaccine is administered without needle injection by dropping the liquid preparation into the eyes and nostrils of cats. While there is one competitive non-injectable two-way vaccine, all other competitive products are injectable formulations. The use of injectable vaccines in cats has become controversial due to the frequency of injection site-associated side effects. The most serious of these side effects are injection site sarcomas, tumors which, if untreated, are nearly always fatal. Our vaccines avoid injection site side effects and we believe they are very efficacious.

PHARMACEUTICALS

Canine Thyroid Supplement

Canine hypothyroidism is a serious disease that is usually caused by abnormalities of the thyroid gland. It is estimated that 3% to 4% of all dogs require thyroid hormone replacement therapy. Common clinical signs include dry, coarse, thin hair, possibly with patches of hair loss and pigment changes. The disease can affect multiple organ systems and cause recurrent infections.

In 1997, we introduced a chewable tablet for the treatment of hypothyroidism in dogs in the United States. These chewable tablets, which are administered daily for the life of the dog, provide levothyroxine sodium, a replacement therapy for the hormone normally produced by the dog.

Nutritional Supplements

Arising partly from our allergy expertise, in 1998, we developed and introduced in the United States a novel fatty acid supplement, HESKA F.A. Granules. The source of the fatty acids in this product, flaxseed oil, leads to high omega-3:omega-6 ratios of fatty acids. Diets high in omega-3 fatty acids are believed to lead to lower levels of inflammatory mediators. The HESKA F.A. Granules include vitamins and are formulated in a palatable flavor base that makes the product convenient and easy to administer.

MEDICAL INSTRUMENTS

We offer a broad line of veterinary diagnostic, monitoring and other instruments which are described below. We entered this line of business in March 1998, when we acquired a manufacturer and marketer of patient monitoring

and diagnostic instruments. Following that acquisition, we completed the development of various other instruments and entered into agreements for the distribution of additional instruments to veterinarians.

Diagnostic Instruments

Our line of diagnostic instruments includes the i-STAT Portable Clinical Analyzer, a hand-held, portable clinical analyzer that provides quick, easy analysis of blood gases and other key analytes, such as sodium, potassium and glucose, with whole blood. This past year we have introduced new i-STAT capability for measuring additional blood analytes and expanding the versatility of the instrument for veterinarians. In the United States we also market the Heska Vet Diff ABC Hematology Analyzer, an easy to use blood analyzer that measures such key parameters as white blood cell count, red blood cell count, platelet count and hemoglobin levels in animals. We also offer the Reflovet Clinical Analyzer, an easy to operate, cost effective blood chemistry analyzer that measures a broad range of animal blood analytes, such as amylase, creatinine, uric acid, bilirubin and glucose. Consumable supplies for the i-STAT, Vet ABC Hematology Analyzer and Reflovet are also provided to veterinarians through Heska sales and distribution channels.

In January 2001, we announced the introduction of our new Chem-Elite Advanced Chemistry System. The Chem-Elite System is a micro-processor controlled, programmable liquid chemistry analyzer designed for use in high volume veterinary practices. It gives veterinarians the ability to run individual tests, pre-programmed batteries of tests or customized profiles.

We also announced the introduction in March 2001 of the SPOTCHEM EZ Automated Chemistry Analyzer. The SPOTCHEM EZ is a compact desktop system used to measure all common blood chemistry components that are vital to veterinary medical diagnosis. It provides veterinarians with an easy to use, flexible and economical in-clinic chemistry system.

Monitoring and Other Instruments

The use by veterinarians of the types of patient monitoring products that are taken for granted in human medicine is becoming the state of the art in companion animal health. The centerpiece of our monitoring instrument product line are oxygen saturation monitors designed for monitoring animals under anesthesia: the VET/OX 4404 monitor and the VET/OX 4800 monitor, each of which includes a variety of additional monitoring parameters, such as pulse rate and strength, body temperature, respiration and ECG. We offer a proprietary esophageal ECG sensor, VET/E-Sig probe, for monitoring ECG, temperature and heart and breath sounds of anesthetized dogs. Our monitoring line also includes the VET/ECG 2000, a hand-held ECG monitor. We also offer the VET/IV 2.2 infusion pump, a compact, affordable IV pump that allows veterinarians to easily provide regulated infusion of blood or nutritional products for their patients.

VETERINARY DIAGNOSTIC LABORATORY

We have a veterinary diagnostic laboratory at our Fort Collins facility. This diagnostic laboratory currently offers our allergy diagnostics, canine and feline heartworm diagnostics and flea bite allergy assays, in addition to other diagnostic services. Our Fort Collins veterinary diagnostic laboratory is currently staffed by medical technologists experienced in animal disease and several additional technical staff.

We intend to continue to use our Fort Collins diagnostic laboratory both as a stand-alone service center for our customers and as an adjunct to our product development efforts. Many of the assays which we intend to develop in a point-of-care format are initially validated and made available in the veterinary diagnostic laboratory and will also remain available there after the introduction of the analogous point-of-care test.

FOOD ANIMAL PRODUCTS

In addition to manufacturing companion animal health products for marketing and sale by Heska, Diamond has completed the development of new food animal vaccines that were licensed by the USDA in the United States in 1998 and 1999. Diamond has entered into an agreement with a food animal products distributor, Agri Laboratories, Ltd., or AgriLabs, for the exclusive marketing and sale of these vaccines worldwide. AgriLabs currently has an arrangement with Intervet, International B.V., a division of Akzo Nobel, for the distribution of these vaccines worldwide. Diamond is the sole manufacturer of these products.

Diamond also manufactures vaccine products for a number of other animal health companies. This activity ranges from providing bulk vaccine antigens which are included in the vaccines which are manufactured by other companies to filling and finishing final products using bulk antigens provided by other animal health companies.

PRODUCT CREATION

We are committed to creating innovative products to address significant unmet health needs of companion animals. We create products both through internal research and development and through external collaborations. Internal research is managed by multidisciplinary product-associated project teams consisting of veterinarians, biologists, molecular and cellular biologists, biochemists and immunologists. We believe that we have one of the most sophisticated scientific efforts in the world devoted to applying biotechnology

to the creation of companion animal products.

We are also committed to identifying external product opportunities and creating business and technical collaborations that lead to the creation of other products. We believe that our active participation in scientific networks and our reputation for investing in research enhances our ability to acquire external product opportunities.

Our product pipeline currently includes numerous products in various stages of development. Products under development include several point-of-care diagnostic products, vaccines for infectious diseases in cats, dogs and horses and pharmaceutical products for allergy, cancer, osteoarthritis and flea control.

The vast majority of all our research and development resources are directed toward the development of new companion animal health products. We incurred expenses of $14.9 million, $17.0 million and $25.1 million in the years ended December 31, 2000, 1999 and 1998, respectively in support of our research and development activities.

SALES AND MARKETING

We presently market our products in the United States directly to veterinarians through the use of our field sales force, inside customer service/tele-sales force and veterinary distributors acting as contract sales agents. As of December 31, 2000, we had approximately 35 field sales representatives and field sales supervisors and 13 customer service/tele-sales representatives and supervisors. We have entered into sales agency relationships with 16 veterinary distributors and six direct sales distributors, although some of these distributors do not sell all of our products. In October 1999, we entered into an agreement with a third party to provide a contract sales force for the sale of our products to equine veterinarians. This agreement was terminated in November 2000. Internationally, we market our products to veterinarians primarily through distributors.

We estimate that there are approximately 30,000 veterinarians in the United States whose practices are devoted principally to small animal medicine. Those veterinarians practice in approximately 20,000 clinics in the United States. We market our products to these clinics primarily through the use of our field and telephone sales force, sales agents, direct sales distributors, trade shows and print advertising. During the past year, we sold our products to approximately 14,000 such clinics in the United States.

Some of the products which we have under research and development, if completed, may be marketed partially or wholly by third parties with whom we have collaborative agreements.

MANUFACTURING

Our products are manufactured by our Fort Collins, Diamond and CMG facilities and/or by third party manufacturers. Diamond's facility is a USDA and FDA licensed biological and pharmaceutical manufacturing facility in Des Moines, Iowa. We expect that we will manufacture most or all of our biological products at this facility, as well as most or all of our recombinant proteins and other proprietary reagents for our diagnostic products. CMG manufactures its allergy diagnostic products at its facility in Fribourg, Switzerland. Diamond's facility is subject to regulation and inspection by the USDA and the FDA. Our heartworm point-of-care diagnostic products are manufactured by Quidel Corporation and Diamond. Our canine and feline allergy immunotherapy treatment products are manufactured by Centaq, Inc. Our veterinary diagnostic and patient monitoring instruments, including our clinical and hematology analyzers and veterinary sensors, are manufactured by third party manufacturers.

In addition to manufacturing our proprietary products, Diamond manufactures animal health vaccine products for marketing and sale by other companies. Diamond currently has the capacity to manufacture more than 50 million doses of vaccine each year. Diamond's customers purchase products in both bulk and finished format, and Diamond performs all phases of manufacturing, including growth of the active bacterial and viral agents, sterile filling, lyophilization and packaging. In addition, Diamond offers to support its customers through research services, regulatory compliance services, validation support and distribution services.

COLLABORATIVE AGREEMENTS

Novartis

We have entered into several collaborative agreements with Novartis Animal Health. Novartis has various rights to manufacture and market any flea control vaccine or feline heartworm control vaccine product developed by us. In addition, we entered into a screening and development agreement under which we may undertake joint research and development activities in various fields and under which Novartis has the right to use certain of our materials on an exclusive or co-exclusive basis. We also entered into a right of first refusal agreement under which, prior to granting licenses to any third party to any products or technology developed or acquired by us for either companion animal or food animal applications, we must first notify and offer Novartis such rights. The screening and development agreement and right of first refusal agreement each terminate in 2005. We also entered into additional research and development agreements in specific areas.

Novartis has the exclusive right to distribute certain of our products in Japan, including our in-clinic feline and canine heartworm diagnostic products and feline viral vaccines, upon obtaining regulatory approval in Japan for such products. Novartis also granted us a right of first refusal to evaluate for possible development and marketing worldwide various new product technologies for the veterinary market as they may become available from Novartis. Novartis also has the exclusive right to distribute our ALLERCEPT E-Screen test in Europe and our FLU AVERT I.N. equine influenza vaccine in Canada.

Ralston Purina Company

We have a strategic alliance with Ralston Purina Company, the world's largest manufacturer of dry dog foods and dry and soft-moist cat foods. Ralston Purina holds exclusive rights to license our discoveries, know-how and technologies for innovative diets for dogs and cats. The first product from this strategic alliance was introduced by Ralston Purina in July 2000. This new product is a specialty diet for the nutritional management of feline diabetes mellitus. We receive a royalty from Ralston Purina on sales of this product.

INTELLECTUAL PROPERTY

We believe that patents, trademarks, copyrights and other proprietary rights are important to our business. We also rely upon trade secrets, know-how, continuing technological innovations and licensing opportunities to develop and maintain our competitive position.

We actively seek patent protection both in the United States and abroad. As of December 31, 2000, we owned, co-owned or had rights to 105 issued U.S. patents and 127 pending U.S. patent applications. Our issued U.S. patents primarily relate to allergy, flea control, heartworm, diagnostics or vaccine delivery technologies. Our pending patent applications primarily relate to allergy, flea control, heartworm, diagnostics, nutrition, cancer vaccine delivery or medical instrument technologies. Applications corresponding to pending U.S. applications have been or will be filed in other countries.

We also have obtained exclusive and non-exclusive licenses for numerous other patents held by academic institutions and biotechnology and pharmaceutical companies. The proprietary technologies of Diamond and CMG are primarily protected through trade secret protection of, for example, their manufacturing processes. In general, the intellectual property of Diamond's customers belongs to such customers.

GOVERNMENT REGULATION

Most of our products being developed will require licensing or approval by a governmental agency before marketing. In the United States, governmental regulation of animal health products is primarily provided by two agencies: the USDA and the FDA. Vaccines and point-of-care diagnostics for animals are considered veterinary biologics and are regulated by the Center for Veterinary Biologics, or CVB, of the USDA under the auspices of the Virus-Serum-Toxin Act. Alternatively, animal drugs, which generally include all synthetic compounds, are approved and monitored by the Center for Veterinary Medicine of the FDA under the auspices of the Federal Food, Drug and Cosmetic Act. A third agency, the Environmental Protection Agency, has jurisdiction over various products applied topically to animals or to premises to control external parasites.

Industry data indicates that it takes approximately four years and $1.0 million to license a conventional vaccine for animals from basic research through licensing. In contrast to vaccines, point-of-care diagnostics can typically be licensed by the USDA in about a year, with considerably less cost. However, vaccines or diagnostics that use innovative materials such as those resulting from recombinant DNA technology usually require additional time to license. The USDA licensing process involves the submission of several data packages. These packages include information on how the product will be manufactured, information on the efficacy and safety of the product in laboratory animal studies and information on performance of the product in field conditions.

Industry data indicates that it takes about 11 years and $5.5 million to develop a new drug for animals, from commencement of research to market introduction. Of this time, approximately three years is spent in animal studies and regulatory review process. However, unlike human drugs, neither preclinical studies nor a sequential phase system of studies are required. Rather, for animal drugs, studies for safety and efficacy may be conducted immediately in the species for which the drug is intended. Thus, there is no required phased evaluation of drug performance, and the Center for Veterinary Medicine will review data at appropriate times in the drug development process. In addition, the time and cost for developing companion animal drugs may be significantly less than for drugs for food producing animals, as food safety issues relating to tissue residue levels are not present.

After we have received regulatory licensing or approval for our products, numerous regulatory requirements apply. These include complying with the Good Manufacturing Practice regulations, which require us or our third party of manufacturers to follow elaborate testing, control, documentation and other quality assurance procedures. These regulations cover the manufacturing process, labeling requirements, the general prohibition against promoting products for unapproved or "off-label" uses and reporting of adverse events.

A number of animal health products are not regulated. For example, assays for use in a veterinary diagnostic laboratory and various medical instruments do not have to be licensed by either the USDA or FDA. Additionally, various botanically derived products, various nutritional products and grooming and supportive care products are exempt from significant regulation as long as they do not bear a therapeutic claim that represents the product as a drug.

For marketing outside the United States, we are also subject to foreign regulatory requirements governing regulatory licensing and approval for many of our products. The requirements governing product licensing and approval vary widely from country to country. Licensing and approval by comparable regulatory authorities of foreign countries must be obtained before marketing of those products in those countries. The approval process varies from country to country and the time required for such approvals may differ substantially from that required in the United States. We cannot be certain that approval of any of our products in one country will result in approvals in any other country.

COMPETITION

The market in which we compete is intensely competitive. Our competitors include independent animal health companies and major pharmaceutical companies that have animal health divisions. Companies with a significant presence in the companion animal health market, such as American Home Products, Bayer, IDEXX Laboratories, Inc., Intervet International B.V., Merial Ltd., Novartis, Pfizer Inc., Pharmacia Animal Health and Schering-Plough Corporation have developed or are developing products that do or would compete with our products. These competitors may have substantially greater financial, technical, research and other resources and larger, more established marketing, sales, distribution and service organizations than us. Moreover, such competitors may offer broader product lines and have greater name recognition than us. Novartis is our marketing partner and its agreement with us does not restrict its ability to develop and market competing products. In addition, IDEXX, which has products that compete with our heartworm diagnostic products, prohibits its distributors from selling competitiors' products, including ours. The market for companion animal health care products is highly fragmented, with discount stores and specialty pet stores accounting for a substantial percentage of such sales. As we currently distribute our products primarily through veterinarians, a substantial segment of the potential market may not be reached and we may not be able to offer our products at prices which are competitive with those of companies that distribute their products through retail channels.

The food animal vaccines sold by Diamond to AgriLabs compete with similar products offered by a number of other companies, some of which have substantially greater financial, technical, research and other resources than Diamond and more established marketing, sales, distribution and service organizations than AgriLabs.

EMPLOYEES

As of December 31, 2000, we and our subsidiaries employed 336 full-time persons, of whom 107 were in manufacturing, quality control, shipping and receiving, and materials management, 90 were in research, development, intellectual property and regulatory affairs, 57 were in management, finance, administration, legal, information systems, human resources and facilities management, 67 were in sales, marketing and customer service and 15 were in the diagnostic laboratories. None of our employees is covered by a collective bargaining agreement, and we believe our employee relations are good.

EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers and their ages as of March 20, 2001 are as follows:

NAME	AGE	POSITION
Robert B. Grieve, Ph.D.	49	Chairman of the Board and Chief Executive Officer
James H. Fuller	56	President and Chief Operating Officer
Ronald L. Hendrick	55	Executive Vice President, Chief Financial Officer and Secretary
Guiseppe Miozzari, Ph.D.	54	Managing Director, Heska AG (Europe)
Dan T. Stinchcomb, Ph.D.	47	Executive Vice President, Research and Development
Carol Talkington Verser, Ph.D.	48	Executive Vice President, Intellectual Property and Business Development

Robert B. Grieve, Ph.D., one of our founders, currently serves as Chief Executive Officer and Chairman of the Board. Dr. Grieve was named Chief Executive Officer effective January 1, 1999, Vice Chairman effective March 1992 and Chairman of the Board effective May 2000. Dr. Grieve also served as Chief Scientific Officer from December 1994 to January 1999 and Vice President,

Research and Development, from March 1992 to December 1994. He has been a member of our Board of Directors since 1990. He holds a Ph.D. degree from the University of Florida and M.S. and B.S. degrees from the University of Wyoming.

James H. Fuller has served as President and Chief Operating Officer since January 1999. Prior to joining us, Mr. Fuller served as Corporate Vice President of Allergan, Inc., a leading specialty pharmaceutical company, from 1994 through 1998. Prior to 1994, Mr. Fuller served in a number of sales and marketing positions at Allergan since 1974. He holds M.S. and B.S. degrees from the University of Southern California.

Ronald L. Hendrick serves as Executive Vice President, Chief Financial Officer and Secretary. He joined us in December 1998. From 1995 until December 1998, Mr. Hendrick was Executive Vice President and Chief Financial Officer of Xenometrix, Inc., a human biotechnology concern. From 1993 until 1995, Mr. Hendrick served as Vice President and Corporate Controller at Alexander & Alexander Services, Inc., a NYSE financial services firm, and before that he held a number of finance and accounting positions at Adolph Coors Company. He holds a M.B.A. from the University of Colorado and a B.A. degree from Michigan State University.

Giuseppe Miozzari, Ph.D., joined as Managing Director, Heska AG (Europe) in March 1997. From 1980 to March 1997, Dr. Miozzari served in senior research positions with Novartis, most recently as the Head of Research of the Animal Health Sector and prior to that, from 1980 to 1983, as Head of the Molecular Biology Research Unit in the Pharmaceuticals Division. Dr. Miozzari also served as Novartis' designate on our Board of Directors from April 1996 to March 1997. Dr. Miozzari holds Ph.D. and Dipl. Sc. Nat. degrees from the Federal Institute of Technology (ETH) in Zurich, Switzerland.

Dan T. Stinchcomb, Ph.D., was appointed Executive Vice President, Research and Deveoplement, in December 1999. Dr. Stinchcomb previously served as Vice President, Research from December 1998 to November 1999, and as Vice President, Biochemistry and Molecular Biology from May 1996 until December 1998. From July 1993 until May 1996, Dr. Stinchcomb was employed by Ribozyme Pharmaceuticals, Inc., most recently as Director of Biology Research. From 1988 until April 1993, Dr. Stinchcomb held various positions with Synergen, Inc. Prior to joining Synergen, Dr. Stinchcomb was an Associate Professor in Cellular and Developmental Biology at Harvard University. He holds a Ph.D. degree from Stanford University and a B.A. degree from Harvard University.

Carol Talkington Verser, Ph.D., was appointed Executive Vice President, Intellectual Property and Business Development in February 2001. From June 2000 until January 2001 she was Vice President, Intellectual Property and Business Development. From July 1996 to May 2000, she served us as Vice President, Intellectual Property. From July 1995 to June 1996, Dr. Verser served us as Director, Intellectual Property. From July 1991 to June 1995, Dr. Verser was a Patent Agent and Technical Specialist at Sheridan, Ross and McIntosh, an intellectual property law firm. Prior to July 1991, she was Director, Scientific Development and Laboratory Director at Biogrowth, Inc., currently a subsidiary of Insmed Inc. Dr. Verser holds a Ph.D. in cellular and developmental biology from Harvard University and a B.S. in biological sciences from the University of Southern California.

ITEM 2. PROPERTIES.

We currently lease an aggregate of approximately 64,000 square feet of administrative and laboratory space in four buildings located in Fort Collins, Colorado under leases expiring through 2005, with options to extend through 2010 for the larger facilities. We believe that our present Fort Collins facilities are adequate for our current and planned activities and that suitable additional or replacement facilities in the Fort Collins area are readily available on commercially reasonable terms should such facilities be needed in the future. Diamond's principal manufacturing facility in Des Moines, Iowa, consisting of 166,000 square feet of buildings on 34 acres of land, is owned by Diamond. Diamond also owns a 160-acre farm used principally for research purposes located in Carlisle, Iowa. Our European subsidiaries lease their facilities. We also currently lease approximately 19,500 square feet of office and manufacturing space in Waukesha, Wisconsin which we have vacated and are currently seeking to sublease.

ITEM 3. LEGAL PROCEEDINGS.

In November 1998, Synbiotics Corporation filed a lawsuit against us in the United States District Court for the Southern District of California in which it alleges that we infringe a patent owned by Synbiotics relating to heartworm diagnostic technology. No trial date has been set. We have obtained legal opinions from our outside patent counsel that our heartworm diagnostic products do not infringe the Synbiotics patent and that the patent is invalid. The opinions of non-infringement are consistent with the results of our internal evaluations related to the one remaining claim. In September 2000, the U.S. District Court hearing the case granted our request for a partial summary judgment, holding two of the Synbiotics patent claims to be invalid, leaving only one remaining claim.

While we believe that we have valid defenses to Synbiotics' allegations and intend to defend the action vigorously, there can be no assurance that an adverse result or settlement would not have a material adverse effect on our financial position, results of operations or cash flow.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Our common stock is quoted on the Nasdaq National Market under the symbol "HSKA." The following table sets forth the intraday high and low prices for our common stock as reported by the Nasdaq National Market, for the periods indicated below.

	HIGH	LOW
1999		
First Quarter	$ 6.000	$ 3.000
Second Quarter	5.125	2.250
Third Quarter	3.938	2.000
Fourth Quarter	2.938	1.375
2000		
First Quarter	5.563	2.063
Second Quarter	4.375	1.500
Third Quarter	4.469	1.750
Fourth Quarter	2.938	0.594
2001		
First Quarter (through March 23)	1.563	0.656

On March 23, 2001, the last reported sale price of our common stock was $1.469 per share. As of February 28, 2001, there were approximately 285 holders of record of our common stock and approximately 4,062 beneficial stockholders. We have never declared or paid cash dividends on our capital stock and do not anticipate paying any cash dividends in the foreseeable future. We currently intend to retain future earnings for the development of our business.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA.

The data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and related Notes included as Items 7 and 8 in this Form 10-K.

	YEAR ENDED DECEMBER 31,				
	2000	1999	1998	1997	1996
	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)				
CONSOLIDATED STATEMENT OF OPERATIONS DATA:					
Revenues:					
Products, net	$ 49,549	$ 50,291	$ 38,451	$ 26,725	$ 15,570
Research, development and other	3,126	885	1,321	2,578	1,946
Total revenues	52,675	51,176	39,772	29,303	17,516
Costs:					
Cost of goods sold	33,299	36,386	29,087	20,077	12,002
	19,376	14,790	10,685	9,226	5,514
		-		-	-
Operating Expenses:					
Selling and marketing	14,788	15,073	13,188	9,954	4,168
Research and development	14,929	17,042	25,126	20,343	14,513
General and administrative	9,457	11,231	11,939	13,192	5,514
Amortization of intangible assets and deferred compensation	903	2,228	2,745	2,500	1,289
Purchased research and development	-	-	-	2,399	-
Loss on sale of assets	204	2,593	1,287	-	-
Restructuring expenses	435	1,210	2,356	-	-
Total operating expenses	40,716	49,377	56,641	48,388	25,484
Loss from operations	(21,340)	(34,587)	(45,956)	(39,162)	(19,970)
Other income (expense)	(530)	(1,249)	1,682	298	721
Net loss	$ (21,870)	$ (35,836)	$ (44,274)	$ (38,864)	$ (19,249)
Basic net loss per share	$ (0.65)	$ (1.31)	$ (1.79)		

Unaudited pro forma basic net loss per share(1)				$ (2.42)	$ (1.53)
Shares used to compute basic net loss per share and unaudited pro forma basic net loss per share	33,782	27,290	24,693	16,042	12,609

	DECEMBER 31,				
	2000	1999	1998	1997	1996
	(IN THOUSANDS)				
CONSOLIDATED BALANCE SHEET DATA:					
Cash, cash equivalents and marketable securities	$ 5,658	$ 23,981	$ 51,930	$ 28,752	$ 23,721
Working capital	13,308	28,234	51,947	31,461	24,224
Total assets	39,160	71,168	98,054	69,020	45,651
Long-term obligations	3,819	5,346	11,367	10,754	5,077
Accumulated deficit	(174,472)	(152,602)	(116,766)	(72,492)	(33,628)
Total stockholders' equity	25,100	45,439	67,114	43,850	32,671

(1) All shares of convertible preferred stock were automatically converted to common stock upon closing of the Company's initial public offering in July 1997. The Company has reflected the conversion of convertible preferred stock into 11,289 shares of common stock on a pro forma basis as if the shares had been outstanding during 1997 and 1996.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with "Selected Consolidated Financial Data" and the Consolidated Financial Statements and related Notes included in Items 6 and 8 of this Form 10-K.

This discussion contains forward-looking statements that involve risks and uncertainties. Such statements, which include statements concerning future revenue sources and concentration, gross margins, research and development expenses, selling and marketing expenses, general and administrative expenses, capital resources, additional financings or borrowings and additional losses, are subject to risks and uncertainties, including, but not limited to, those discussed below and elsewhere in this Form 10-K, particulary in "Factors that May Affect Results," that could cause actual results to differ materially from those projected.

OVERVIEW

We discover, develop, manufacture and market companion animal health products. We have a sophisticated scientific effort devoted to applying biotechnology to create a broad range of pharmaceutical, vaccine and diagnostic products for the large and growing companion animal health market. In addition to our pharmaceutical, vaccine and diagnostic products, we also sell veterinary diagnostic and patient monitoring instruments and offer diagnostic services in the United States and Europe to veterinarians. Our primary manufacturing subsidiary, Diamond Animal Health, Inc., or Diamond, manufactures some of our companion animal products and food animal vaccine and pharmaceutical products which are marketed and distributed by third parties.

From our inception in 1988 until early 1996, our operating activities related primarily to research and development activities, entering into collaborative agreements, raising capital and recruiting personnel. Prior to 1996, we had not received any revenues from the sale of products. During 1996, we grew from being primarily a research and development concern to a fully-integrated research, development, manufacturing and marketing company. We accomplished this by acquiring Diamond, a licensed pharmaceutical and biological manufacturing facility in Des Moines, Iowa, hiring key employees and support staff, establishing marketing and sales operations to support our products introduced in 1996, and designing and implementing more sophisticated operating and information systems. We also expanded the scope and level of our scientific and business development activities, increasing the opportunities for new products. In 1997, we introduced 13 additional products and expanded in the United States through the acquisition of Center, an FDA and USDA licensed manufacturer of allergy immunotherapy products located in New York, and internationally through the acquisitions of Heska UK, a veterinary diagnostic laboratory in England and CMG in Switzerland, which manufactures and markets allergy diagnostic products for use in veterinary and human medicine, primarily in Europe. Each of our acquisitions during this period was accounted for under the purchase method of accounting and accordingly, our financial statements reflect the operations of these businesses only for the periods subsequent to the acquisitions. In July 1997, we established a new subsidiary, Heska AG, located near Basel, Switzerland, for the purpose of managing our European operations.

During the first quarter of 1998 we acquired a manufacturer and marketer of patient monitoring devices. The financial results of this entity have been consolidated with ours under the pooling-of-interests accounting method for all

periods presented. These operations were consolidated with our existing operations in Fort Collins, Colorado and Des Moines, Iowa as of December 31, 1999, and our facility in Waukesha, Wisconsin was closed.

We sold our subsidiary in the United Kingdom, Heska UK, in March 2000. In June 2000, we completed the sale of Center.

We have incurred net losses since our inception and anticipate that we will continue to incur additional net losses in the near term as we introduce new products, expand our sales and marketing capabilities and continue our research and development activities. Cumulative net losses from inception in 1988 through December 31, 2000 have totaled $174.5 million.

Our ability to achieve profitable operations will depend primarily upon our ability to successfully market our existing products, commercialize products that are currently under development and develop new products. Most of our products are subject to long development and regulatory approval cycles, and we may not successfully develop, manufacture or market these products. We also may not attain profitability or, if achieved, may not remain profitable on a quarterly or annual basis in the future. Until we attain positive cash flow, we may continue to finance operations with additional equity and debt financing. Such financing may not be available when required or may not be obtained under favorable terms. See the discussion later in this section titled "Factors That May Affect Results" for a more in-depth explanation of risks faced by us.

RESULTS OF OPERATIONS

Years Ended December 31, 2000 and 1999

Total revenues, which include product revenues, sponsored research and development and other revenues, increased 3% to $52.7 million in 2000 compared to $51.2 million in 1999. The total reported revenue included approximately $3.2 million in 2000 and $13.4 million in 1999 from businesses sold and non-strategic product lines discontinued during 2000. Sales to one customer, AgriLabs, represented 17% of total revenues in 2000.

Product revenues decreased 2% to $49.5 million in 2000 compared to $50.3 million in 1999. For the year ended December 31, 2000, product revenue from our continuing core business increased 26%. This continuing core business consists of the following business components: pharmaceutical, vaccine and diagnostic (PVD) products, veterinary monitoring and diagnostic instrumentation and Diamond Animal Health, our manufacturing subsidiary. The fiscal 2000 increase was attributable to strong growth in our veterinary medical instrument products and to increases in our proprietary pharmaceuticals, vaccines and diagnostics. Diamond also posted solid revenue growth during the year.

Revenues from sponsored research and development and other increased to $3.1 million in 2000 from $900,000 in 1999. Included in the total for 2000 is revenue from the sale of our worldwide rights to the PERIOceutic Gel product. Revenues from sponsored research and development increased due to an increase in the number of funded research projects.

Cost of goods sold totaled $33.3 million in 2000 compared to $36.4 million in 1999, and the resulting gross profit from product sales for 2000 increased to $16.3 million from $13.9 million in 1999.
Our gross margin percentage was 33% in 2000, compared to 28% in 1999. During 2000, our gross margin improved as our product mix included a higher percentage of proprietary products with higher gross margins. Also during fiscal 2000 and late in fiscal 1999, we sold businesses and eliminated various product lines that did not meet gross profit expectations.

Selling and marketing expenses remained relatively flat with $14.8 million in 2000 as compared to $15.1 million in 1999, due to the sale of certain businesses offset by the introduction and marketing costs for new products. Selling and marketing expenses consist primarily of salaries, commissions and benefits for sales and marketing personnel, commissions paid to contract sales personnel and expenses of product advertising and promotion. We expect selling and marketing expenses to increase as sales volumes increase and new products are introduced to the marketplace, but to decrease as a percentage of total revenues in future years.

Research and development expenses decreased to $14.9 million in 2000 from $17.0 million in 1999. The decrease is due to additional focus on companion animal product opportunities and tight cost control. Research and development expenses are expected to decrease as a percentage of total revenues in future years.

General and administrative expenses decreased to $9.5 million in 2000 from $11.2 million in 1999. The decrease in 2000 is due to the sale of certain businesses and tight cost control at all operations. General and administrative expenses are expected to decrease as a percentage of total revenues in future years.

Amortization of intangible assets and deferred compensation decreased to $903,000 in 2000 from $2.2 million in 1999. The amortization of intangibles resulted in a non-cash charge to operations of $255,000 and $1.6 million in 2000 and 1999, respectively. The decrease is due to the sale of Heska UK and the write-down of certain intangible assets in 1999. The amortization of deferred compensation resulted in a non-cash charge to operations in 2000 of approximately $648,000 compared to $629,000 in 1999. The deferred compensation

represents the difference between the exercise price of options issued to employees during 1996 and 1997 and the deemed value of the common stock for accounting purposes on the date of grant. Compensation costs, equal to the fair value of the options on the date of grant, were recognized over the service period. The deferred compensation has been fully amortized as of December 31, 2000.

The loss on sale of assets in 2000 reflects the write-down to net book value of certain assets held for sale, offset by the gain on the sale of Center of approximately $151,000.

During the first quarter of 2000, we recorded a $435,000 restructuring charge related to the rationalization of our business operations at Diamond. Diamond reduced the size of its workforce and vacated a warehouse and distribution facility no longer needed when we decided to discontine manufacturing of certain low margin human healthcare products.

Interest income decreased to just under $1.0 million in 2000 as compared to $1.6 million in 1999 as we continued to fund our operations with available cash. Interest income is expected to decrease in the future as we continue to use cash to fund our business operations. Interest expense decreased to $1.2 million in 2000 from $1.9 million in 1999 as we reduced our debt and capital leases by nearly $8.5 million during the year. Other expense decreased to $400,000 in 2000 from nearly $1.0 million in 1999 due primarily to lower losses realized on the sale of certain long-term interest-bearing government securities during the current year.

Years Ended December 31, 1999 and 1998

Total revenues, which include product revenues, sponsored research and development and other revenues, increased 29% to $51.2 million in 1999 compared to $39.8 million in 1998. Product revenues increased 31% to $50.3 million in 1999 compared to $38.5 million in 1998. The growth in revenues during 1999 was primarily due to sales of new products introduced during 1999 and increased sales of our existing products. Sales to one customer, Bayer, represented 12% of total revenues in 1999 pursuant to a take-or-pay contract with Bayer that expired in February 2000. A portion of these sales were replaced under an agreement with AgriLabs.

Revenues from sponsored research and development and other decreased to $900,000 in 1999 from $1.3 million in 1998. Fluctuations in revenues from sponsored research and development are generally the result of changes in the number of funded research projects.

Cost of goods sold totaled $36.4 million in 1999 compared to $29.1 million in 1998, and the resulting gross profit from product sales for 1999 increased to $13.9 million from $9.4 million in 1998. Our gross margin percentage was 28% in 1999, compared to 24% in 1998. During 1999, the gross profit margin improved as our product mix included a higher percentage of proprietary products with higher gross profit margins. Also during fiscal 1999, we eliminated various product lines that did not meet gross profit expectations.

Research and development expenses decreased to $17.0 million in 1999 from $25.1 million in 1998. The decrease in 1999 was primarily due to reductions in our internal research and development activities, resulting from our restructuring in December 1998, and our decision to eliminate or defer research projects which appeared to have greater long-term risk or lower market potential.

Selling and marketing expenses increased to $15.1 million in 1999 from $13.2 million in 1998. This increase reflects primarily the expansion of our sales and marketing organization and costs associated with the introduction and marketing of new products.

General and administrative expenses decreased to $11.2 million in 1999 from $11.9 million in 1998. The decrease in 1999 was primarily due to reductions in staffing and expenditures, resulting from our restructuring in December 1998.

Amortization of intangible assets and deferred compensation decreased to $2.2 million in 1999 from $2.7 million in 1998. Intangible assets resulted primarily from our 1997 and 1996 business acquisitions and are being amortized over lives of 2 to 10 years. The amortization of deferred compensation resulted in a non-cash charge to operations in 1999 of approximately $629,000 compared to $736,000 in 1998.

The loss on assets held for disposition of $2.6 million recorded in 1999 reflects the write-down of certain tangible and intangible assets to their expected net realizable values. Included in the loss was $1.0 million related to the sale of Heska UK, a write-off of $580,000 in book value of assets held for sale resulting from our decision to discontinue contract manufacturing of certain low margin human healthcare products for third parties at Diamond and a write-off of $1.0 million in book value of certain intangible and tangible assets no longer considered strategic and held for sale or other disposition.

During the third quarter of 1999, we recognized a charge to operations of approximately $1.2 million related to our decision to consolidate the operations of our Waukesha, Wisconsin facility into our existing operations in Fort Collins, Colorado and Des Moines, Iowa. The charge was primarily for personnel severance costs and the cost of closing the facility in Waukesha, Wisconsin.

Interest income decreased to $1.6 million in 1999 from $3.2 million in 1998 as a result of reduced cash available for investment as we funded our business operations. Interest income is expected to decline in the future as we continue to use cash to fund our business operations. Interest expense decreased slightly to $1.9 million in 1999 from $2.0 million in 1998. Other expense of nearly $1.0 million in 1999 is due primarily to the loss realized on the sale of certain long-term, interest-bearing government securities.

LIQUIDITY AND CAPITAL RESOURCES

Our primary source of liquidity at December 31, 2000 was $5.7 million in cash, cash equivalents and marketable securities and our asset-based revolving line of credit. In June 2000, we entered into the two-year credit facility with Wells Fargo Business Credit, an affiliate of Wells Fargo Bank. This credit facility requires us to maintain various minimum financial covenants including book net worth, net income and cash balances or liquidity levels. In March 2001, we negotiated new covenants under this line of credit. At March 27, 2001, our available borrowing capacity was approximately $5.0 million. In February 2001, we sold 4,573,000 shares of our common stock through a private placement offering and received net proceeds of $5.3 million.

Net cash used in operating activities was $15.9 million in 2000, compared to $33.2 million in 1999. Accounts payable decreased by $2.6 million in 2000 primarily due to the lower inventory levels. Inventory levels decreased by $2.4 million in 2000, due to a program to reduce inventory levels at Diamond.

Net cash flows from investing activities provided us with $25.2 million during 2000, compared to $20.3 million of cash provided in 1999. The cash provided in 2000 resulted primarily from the sale of $20.0 million of marketable securities and the sale of Center for approximately $6.0 million. It was used to fund our current year operations and debt repayments. Expenditures for property and equipment totaled $1.2 million for 2000 compared to $3.3 million in 1999. We have historically used, and anticipate that we will continue to use, capital equipment lease and debt facilities to finance equipment purchases and, if possible, leasehold improvements. We currently expect to spend approximately $1.5 million in 2001 for capital equipment, including expenditures to upgrade certain manufacturing operations to improve efficiencies and to assure ongoing compliance with regulatory requirements. We expect to finance these expenditures through available cash, equipment leases and secured debt facilities.

Net cash flows from financing activities used $7.6 million in cash in 2000, compared to generating $8.4 million in 1999. Our primary use of cash in 2000 was the repayment of debt and capital lease obligations totaling nearly $8.5 million. The primary source of cash in 1999 was the public offering of common stock in December which provided us with net proceeds of approximately $13.3 million. We also borrowed an additional $971,000 under our available credit facilities. We used cash to repay $6.5 million of debt and capital lease obligations.

Our primary short-term needs for capital, which are subject to change, are for our continuing research and development efforts, our sales, marketing and administrative activities, working capital associated with increased product sales and capital expenditures relating to developing and expanding our manufacturing operations. Our future liquidity and capital requirements will depend on numerous factors, including the extent to which our present and future products gain market acceptance, the extent to which products or technologies under research or development are successfully developed, the timing of regulatory actions regarding our products, the costs and timing of expansion of sales, marketing and manufacturing activities, the cost, timing and business management of current and potential acquisitions and contingent liabilities associated with such acquisitions, the procurement and enforcement of patents important to our business and the results of competition.

We believe that our available cash, cash equivalents and marketable securities, together with cash from operations, available borrowings and borrowings we expect to be available under our revolving line of credit facility will be sufficient to satisfy our projected cash requirements into 2002, although we may raise additional funds at or before such time. If necessary, we expect to raise these additional funds through one or more of the following: (1) sale of additional securities; (2) sale of various assets; (3) licensing of technology; and (4) sale of various products or marketing rights. If we cannot raise the additional funds through these options on acceptable terms or with the necessary timing, management could also reduce discretionary spending to decrease our cash burn rate and extend the currently available cash, cash equivalents, marketable securities and available borrowings. See "Factors that May Affect Results."

On February 6, 2001, we sold 4,573,000 shares of common stock through a private placement offering and received net proceeds of approximately $5.3 million.

NET OPERATING LOSS CARRYFORWARDS

As of December 31, 2000, we had a net operating loss carryforward, or NOL, of approximately $154.6 million and approximately $3.1 million of research and development tax credits available to offset future federal income taxes. The NOL and tax credit carryforwards, which are subject to alternative minimum tax limitations and to examination by the tax authorities, expire from 2003 to 2020. Our acquisition of Diamond resulted in a "change of ownership" under the

provisions of Section 382 of the Internal Revenue Code of 1986, as amended. As such, we will be limited in the amount of NOL's incurred prior to the merger that we may utilize to offset future taxable income. This limitation will total approximately $4.7 million per year for periods subsequent to the Diamond acquisition. Similar limitations also apply to utilization of research and development tax credits to offset taxes payable. We believe that this limitation may affect the eventual utilization of our total NOL carryforwards.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, Revenue Recognition. SAB 101 clarifies the SEC staff's views in applying generally accepted accounting principles to selected revenue recognition issues. We adopted SAB 101 during the quarter ended December 31, 2000. The adoption of SAB 101 did not have a material impact on our financial statements, and therefore, did not result in the recording of a cumulative effect of change in accounting principles as if SAB 101 had been adopted on January 1, 2000, or the restatement of the previously reported quarterly results for 2000.

We do not expect the adoption of any other standards recently issued by the Financial Accounting Standards Board or the Securities and Exchange Commission to have a material impact on our financial position or results of operations.

FACTORS THAT MAY AFFECT RESULTS

We have a history of losses and may never achieve profitability.

We have incurred net losses since our inception in 1988 and, as of December 31, 2000, we had an accumulated deficit of $174.5 million. We anticipate that we will continue to incur additional operating losses in the near term. These losses have resulted principally from expenses incurred in our research and development programs and from general and administrative and sales and marketing expenses. Even if we achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis.

We may need additional capital in the future.

We have incurred negative cash flow from operations since inception in 1988. We do not expect to generate positive cash flow sufficient to fund our operations in the near term. Moreover, based on our current projections, we may need to raise additional capital in the future. If necessary, we expect to raise this additional capital through one or more of the following:

* sale of additional securities;
* sale of various assets;
* licensing of technology; and
* sale of various products or marketing rights.

Additional capital may not be available on acceptable terms, if at all. Furthermore, any additional equity financing would likely be dilutive to stockholders, and additional debt financing, if available, may include restrictive covenants which may limit our currently planned operations and strategies. If adequate funds are not available, we may be required to curtail our operations significantly and reduce discretionary spending to extend the currently available cash resources, or to obtain funds by entering into collaborative agreements or other arrangements on unfavorable terms. If we fail to generate adequate funding on acceptable terms when we need to, our business could be substantially harmed.

We have limited resources to devote to product development and commercialization. If we are not able to devote resources to product development and commercialization, we may not be able to develop our products.

Our strategy is to develop a broad range of products addressing companion animal healthcare. We believe that our revenue growth and profitability, if any, will substantially depend upon our ability to:

* improve market acceptance of our current products;
* complete development of new products; and
* successfully introduce and commercialize new products.

We have introduced some of our products only recently and many of our products are still under development. Because we have limited resources to devote to product development and commercialization, any delay in the development of one product or reallocation of resources to product development

efforts that prove unsuccessful may delay or jeopardize the development of our other product candidates. If we fail to develop new products and bring them to market, our ability to generate revenues will decrease.

In addition, our products may not achieve satisfactory market acceptance, and we may not successfully commercialize them on a timely basis, or at all. If our products do not achieve a significant level of market acceptance, demand for our products will not develop as expected and it is unlikely that we ever will become profitable.

We must obtain and maintain costly regulatory approvals in order to market our products.

Many of the products we develop and market are subject to extensive regulation by one or more of the United States Department of Agriculture, or USDA, the Food and Drug Administration, or FDA, the Environmental Protection Agency, or EPA, and foreign regulatory authorities. These regulations govern, among other things, the development, testing, manufacturing, labeling, storage, premarket approval, advertising, promotion, sale and distribution of our products. Satisfaction of these requirements can take several years and time needed to satisfy them may vary substantially, based on the type, complexity and novelty of the product. The effect of government regulation may be to delay or to prevent marketing of our products for a considerable period of time and to impose costly procedures upon our activities. We have experienced in the past, and may experience in the future, difficulties that could delay or prevent us from obtaining the regulatory approval or license necessary to introduce or market our products. Regulatory approval of our products may also impose limitations on the indicated or intended uses for which our products may be marketed.

Among the conditions for regulatory approval is the requirement that our manufacturing facilities or those of our third party manufacturers conform to current Good Manufacturing Practices. The FDA and foreign regulatory authorities strictly enforce Good Manufacturing Practices requirements through periodic inspections. We can provide no assurance that any regulatory authority will determine that our manufacturing facilities or those of our third party manufacturers will conform to Good Manufacturing Practices requirements. Failure to comply with applicable regulatory requirements can result in sanctions being imposed on us or the manufacturers of our products, including warning letters, product recalls or seizures, injunctions, refusal to permit products to be imported into or exported out of the United States, refusals of regulatory authorities to grant approval or to allow us to enter into government supply contracts, withdrawals of previously approved marketing applications, civil fines and criminal prosecutions.

Factors beyond our control may cause our operating results to fluctuate, and since many of our expenses are fixed, this fluctuation could cause our stock price to decline.

We believe that our future operating results will fluctuate on a quarterly basis due to a variety of factors, including:

* the introduction of new products by us or by our competitors;
* market acceptance of our current or new products;
* regulatory and other delays in product development;
* product recalls;
* competition and pricing pressures from competitive products;
* manufacturing delays;
* shipment problems;
* product seasonality; and
* changes in the mix of products sold.

We have high operating expenses for personnel, new product development and marketing. Many of these expenses are fixed in the short term. If any of the factors listed above cause our revenues to decline, our operating results could be substantially harmed.

Our operating results in some quarters may not meet the expectations of stock market analysts and investors. In that case, our stock price probably would decline.

We must maintain various financial and other covenants under our revolving line of credit agreement.

Under our revolving line of credit agreement with Wells Fargo Business Credit, Inc., we are required to comply with various financial and non-financial covenants, and we have made various representations and warranties. Among the financial covenants are requirements for monthly minimum book net worth, minimum quarterly net income and minimum cash balances or liquidity levels. Failure to comply with any of the covenants, representations or warranties would negatively impact our ability to borrow under the agreement. Our inability to borrow to

fund our operations could materially harm our business.

A small number of large customers account for a large percentage of our revenues, and the loss of any of them could harm our operating results.

We currently derive a substantial portion of our revenues from sales by our subsidiary Diamond, which manufactures various of our products and products for other companies in the animal health industry. Revenues from Diamond customers, AgriLabs and Bayer, comprised approximately 17% and 12% of our total revenues for the years ended December 31, 2000 and 1999, respectively. If we are not successful in maintaining our relationships with our customers and obtaining new customers, our business and results of operations will suffer.

We operate in a highly competitive industry, which could render our products obsolete or substantially limit the volume of products that we sell. This would limit our ability to compete and achieve profitability.

We compete with independent animal health companies and major pharmaceutical companies that have animal health divisions. Companies with a significant presence in the animal health market, such as American Home Products, Bayer, IDEXX Laboratories, Inc., Intervet International B.V., Merial Ltd., Novartis, Pfizer Inc., Pharmacia Animal Health and Schering Plough Corporation, have developed or are developing products that compete with our products or would compete with them if developed. These competitors may have substantially greater financial, technical, research and other resources and larger, better-established marketing, sales, distribution and service organizations than us. In addition, IDEXX, which has products that compete with our heartworm diagnostic products, prohibits its distributors from selling competitors' products, including ours. Our competitors frequently offer broader product lines and have greater name recognition than we do. Our competitors may develop or market technologies or products that are more effective or commercially attractive than our current or future products, or that would render our technologies and products obsolete. Further, additional competition could come from new entrants to the animal healthcare market. Moreover, we may not have the financial resources, technical expertise or marketing, distribution or support capabilities to compete successfully. If we fail to compete successfully, our ability to achieve profitability will be limited.

We have limited experience in marketing our products, and may be unable to commercialize our products.

The market for companion animal healthcare products is highly fragmented, with discount stores and specialty pet stores accounting for a substantial percentage of sales. Because we sell our companion animal health products only to veterinarians, we may fail to reach a substantial segment of the potential market, and we may not be able to offer our products at prices which are competitive with those of companies that distribute their products through retail channels. We currently market our products to veterinarians through a direct sales force and through third parties. To be successful, we will have to continue to develop and train our direct sales force or rely on marketing partnerships or other arrangements with third parties to market, distribute and sell our products. We may not successfully develop and maintain marketing, distribution or sales capabilities, and we may not be able to make arrangements with third parties to perform these activities on satisfactory terms. If we fail to develop a successful marketing strategy, our ability to commercialize our products and generate revenues will decrease.

We have granted third parties substantial marketing rights to our products under development. If our current third party marketing agreements are not successful, or if we are unable to develop our own marketing capabilities or enter into additional marketing agreements in the future, we may not be able to develop and commercialize our products.

Our agreements with our corporate marketing partners generally contain no minimum purchase requirements in order for them to maintain their exclusive or co-exclusive marketing rights. Novartis, Eisai or Ralston Purina or any other collaborative party may not devote sufficient resources to marketing our products. Furthermore, there is nothing to prevent Novartis, Eisai or Ralston Purina or any other collaborative party from pursuing alternative technologies or products that may compete with our products. If we fail to develop and maintain our own marketing capabilities, we may find it necessary to continue to rely on potential or actual competitors for third party marketing assistance. Third party marketing assistance may not be available in the future on reasonable terms, if at all. If any of these events occur, we may not be able to develop and commercialize our products and our revenues will decline.

We may face costly intellectual property disputes.

Our ability to compete effectively will depend in part on our ability to develop and maintain proprietary aspects of our technology and either to operate without infringing the proprietary rights of others or to obtain rights to technology owned by third parties. We have United States and foreign-issued patents and are currently prosecuting patent applications in the United States and with various foreign countries. Our pending patent applications may not result in the issuance of any patents or that any issued patents will offer protection against competitors with similar technology. Patents we receive may be challenged, invalidated or circumvented in the future or the rights created by those patents may not provide a competitive advantage. We also rely on trade secrets, technical know-how and continuing invention to develop and maintain our competitive position. Others may independently develop substantially equivalent

proprietary information and techniques or otherwise gain access to our trade secrets.

The biotechnology and pharmaceutical industries have been characterized by extensive litigation relating to patents and other intellectual property rights. In 1998, Synbiotics Corporation filed a lawsuit against us alleging infringement of a Synbiotics patent relating to heartworm diagnostic technology, and this litigation remains ongoing. We may become subject to additional patent infringement claims and litigation in the United States or other countries or interference proceedings conducted in the United States Patent and Trademark Office to determine the priority of inventions. The defense and prosecution of intellectual property suits, USPTO interference proceedings, and related legal and administrative proceedings are costly, time-consuming and distracting. We may also need to pursue litigation to enforce any patents issued to us or our collaborative partners, to protect trade secrets or know-how owned by us or our collaborative partners, or to determine the enforceability, scope and validity of the proprietary rights of others. Any litigation or interference proceeding will result in substantial expense to us and significant diversion of the efforts of our technical and management personnel. Any adverse determination in litigation or interference proceedings could subject us to significant liabilities to third parties. Further, as a result of litigation or other proceedings, we may be required to seek licenses from third parties which may not be available on commercially reasonable terms, if at all.

We license technology from a number of third parties. The majority of these license agreements impose due diligence or milestone obligations on us, and in some cases impose minimum royalty and/or sales obligations on us, in order for us to maintain our rights under these agreements. Our products may incorporate technologies that are the subject of patents issued to, and patent applications filed by, others. As is typical in our industry, from time to time we and our collaborators have received, and may in the future receive, notices from third parties claiming infringement and invitations to take licenses under third party patents. It is our policy that when we receive such notices, we conduct investigations of the claims they assert. With respect to the notices we have received to date, we believe, after due investigation, that we have meritorious defenses to the infringement claims asserted. Any legal action against us or our collaborators may require us or our collaborators to obtain one or more licenses in order to market or manufacture affected products or services. However, we cannot assure you that we or our collaborators will be able to obtain licenses for technology patented by others on commercially reasonable terms, that we will be able to develop alternative approaches if unable to obtain licenses, or that the current and future licenses will be adequate for the operation of our businesses. Failure to obtain necessary licenses or to identify and implement alternative approaches could prevent us and our collaborators from commercializing our products under development and could substantially harm our business.

We have limited manufacturing experience and capacity and rely substantially on third party manufacturers. The loss of any third party manufacturers could limit our ability to launch our products in a timely manner, or at all.

To be successful, we must manufacture, or contract for the manufacture of, our current and future products in compliance with regulatory requirements, in sufficient quantities and on a timely basis, while maintaining product quality and acceptable manufacturing costs. In order to increase our manufacturing capacity, we acquired Diamond in April 1996.

We currently rely on third parties to manufacture those products we do not manufacture at our Diamond facility. We currently have supply agreements with Quidel Corporation for various manufacturing services relating to our point-of-care diagnostic tests, with Centaq, Inc. for the manufacture of our own allergy immunotherapy treatment products and with various manufacturers for the supply of our veterinary diagnostic and patient monitoring instruments. Our manufacturing strategy presents the following risks:

* Delays in the scale-up to quantities needed for product development could delay regulatory submissions and commercialization of our products in development;

* Our manufacturing facilities and those of some of our third party manufacturers are subject to ongoing periodic unannounced inspection by regulatory authorities, including the FDA, USDA and other federal and state agency's for compliance with strictly enforced Good Manufacturing Practices regulations and similar foreign standards, and we do not have control over our third party manufacturers' compliance with these regulations and standards;

* If we need to change to other commercial manufacturing contractors for certain of our products, additional regulatory licenses or approvals must be obtained for these contractors prior to our use. This would require new testing and compliance inspections. Any new manufacturer would have to be educated in, or develop substantially equivalent processes necessary for the production of our

products;

* If market demand for our products increases suddenly, our current manufacturers might not be able to fulfill our commercial needs, which would require us to seek new manufacturing arrangements and may result in substantial delays in meeting market demand; and

* We may not have intellectual property rights, or may have to share intellectual property rights, to any improvements in the manufacturing processes or new manufacturing processes for our products.

Any of these factors could delay commercialization of our products under development, interfere with current sales, entail higher costs and result in our being unable to effectively sell our products.

Our agreements with various suppliers of the veterinary medical instruments require us to meet minimum annual sales levels to maintain our position as the exclusive distributor of these instruments. We may not meet these minimum sales levels in the future, and maintain exclusivity over the distribution and sale of these products. If we are not the exclusive distributor of these products, competition may increase.

We depend on partners in our research and development activities. If our current partnerships and collaborations are not successful, we may not be able to develop our technologies or products.

For various of our proposed products, we are dependent on collaborative partners to successfully and timely perform research and development activities on our behalf. These collaborative partners may not complete research and development activities on our behalf in a timely fashion, or at all. If our collaborative partners fail to complete research and development activities, or fail to complete them in a timely fashion, our ability to develop technologies and products will be impacted negatively and our revenues will decline.

We depend on key personnel for our future success. If we lose our key personnel or are unable to attract and retain additional personnel, we may be unable to achieve our goals.

Our future success is substantially dependent on the efforts of our senior management and scientific team. The loss of the services of members of our senior management or scientific staff may
significantly delay or prevent the achievement of product development and other business objectives. Because of the specialized scientific nature of our business, we depend substantially on our ability to attract and retain qualified scientific and technical personnel. There is intense competition among major pharmaceutical and chemical companies, specialized biotechnology firms and universities and other research institutions for qualified personnel in the areas of our activities. If we lose the services of, or fail to recruit, key scientific and technical personnel, the growth of our business could be substantially impaired.

We may face product returns and product liability litigation and the extent of our insurance coverage is limited. If we become subject to product liability claims resulting from defects in our products, we may fail to achieve market acceptance of our products and our business could be harmed.

The testing, manufacturing and marketing of our current products as well as those currently under development entail an inherent risk of product liability claims and associated adverse publicity. Following the introduction of a product, adverse side effects may be discovered. Adverse publicity regarding such effects could affect sales of our other products for an indeterminate time period. To date, we have not experienced any material product liability claims, but any claim arising in the future could substantially harm our business. Potential product liability claims may exceed the amount of our insurance coverage or may be excluded from coverage under the terms of the policy. We may not be able to continue to obtain adequate insurance at a reasonable cost, if at all. In the event that we are held liable for a claim against which we are not indemnified or for damages exceeding the $10 million limit of our insurance coverage or which results in significant adverse publicity against us, we may lose revenue and fail to achieve market acceptance.

We may be held liable for the release of hazardous materials, which could result in extensive costs which would harm our business.

Our products and development programs involve the controlled use of hazardous and biohazardous materials, including chemicals, infectious disease agents and various radioactive compounds. Although we believe that our safety procedures for handling and disposing of such materials comply with the standards prescribed by applicable local, state and federal regulations, we cannot completely eliminate the risk of accidental contamination or injury from these materials. In the event of such an accident, we could be held liable for any fines, penalties, remediation costs or other damages that result. Our liability for the release of hazardous materials could exceed our resources, which could lead to a shut down of our operations. In addition, we may incur substantial costs to comply with environmental regulations as we expand our manufacturing capacity.

We expect to experience volatility in our stock price, which may affect our ability to raise capital in the future or make it difficult for investors to sell their shares.

The securities markets have from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. The market prices of securities of many publicly-held biotechnology companies have in the past been, and can in the future be expected to be, especially volatile. For example, in the last twelve months our closing stock price has ranged from a low of $0.59375 to a high of $4.50. Fluctuations in the trading price or liquidity of our common stock may adversely affect our ability to raise capital through future equity financings. Factors that may have a significant impact on the market price and marketability of our common stock include:

* announcements of technological innovations or new products by us or by our competitors;
* our quarterly operating results;
* releases of reports by securities analysts;
* developments or disputes concerning patents or proprietary rights;
* regulatory developments;
* developments in our relationships with collaborative partners;
* changes in regulatory policies;
* litigation;
* economic and other external factors; and
* general market conditions.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted. If a securities class action suit is filed against us, we would incur substantial legal fees and our management's attention and resources would be diverted from operating our business in order to respond to the litigation.

If we fail to meet Nasdaq National Market listing requirements, our common stock will be delisted and become illiquid.

Our common stock is currently listed on the Nasdaq National Market. Nasdaq has requirements we must meet in order to remain listed on the Nasdaq National Market. If we continue to experience losses from our operations or we are unable to raise additional funds, we might not be able to maintain the standards for continued quotation on the Nasdaq National Market, including a minimum bid price requirement of $1.00. If the minimum bid price of our common stock were to remain below $1.00 for 30 consecutive trading days, or if we were unable to continue to meet Nasdaq's standards for any other reason, our common stock could be delisted from the Nasdaq National Market.

If as a result of the application of these listing requirements, our common stock were delisted from the Nasdaq National Market, our stock would become harder to buy and sell. Further, our stock could be subject to what are known as the "penny stock" rules. The penny stock rules place additional requirements on broker-dealers who sell or make a market in such securities. Consequently, if we were removed from the Nasdaq National Market, the ability or willingness of broker-dealers to sell or make a market in our common stock might decline. As a result, the ability for investors to resell shares of our common stock could be adversely affected.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk represents the risk of loss that may impact the financial position, results of operations or cash flows due to adverse changes in financial and commodity market prices and rates. We are exposed to market risk in the areas of changes in United States and foreign interest rates and changes in foreign currency exchange rates as measured against the United States dollar. These exposures are directly related to our normal operating and funding activities. Historically, and as of December 31, 2000, we have not used derivative instruments or engaged in hedging activities.

Interest Rate Risk

The interest payable on certain of our lines of credit and other borrowings is variable based on the United States prime rate, or LIBOR, and, therefore, affected by changes in market interest rates. At December 31, 2000, approximately $2.9 million was outstanding on these lines of credit and other borrowings with a weighted average interest rate of 10.75%. We manage interest rate risk by investing excess funds principally in cash equivalents or marketable securities which bear interest rates that reflect current market yields. Additionally, we monitor interest rates and at December 31, 2000 had sufficient cash balances to pay off the lines-of-credit should interest rates increase significantly. As a result, we do not believe that reasonably possible near-term changes in interest rates will result in a material effect on our future earnings, financial position or cash flows.

Foreign Currency Risk

At December 31, 2000, we had a wholly-owned subsidiary located in Switzerland. Sales from these operations are denominated in Swiss Francs or Euros, thereby creating exposures to changes in exchange rates. The changes in the Swiss/U.S. exchange rate or Euro/U.S. exchange rate may positively or negatively affect our sales, gross margins and retained earnings. We do not believe that reasonably possible near-term changes in exchange rates will result in a material effect on future earnings, fair values or cash flows, and therefore, have chosen not to enter into foreign currency hedging instruments. Such an approach may not be successful, especially in the event of a significant and sudden decline in the value of the Swiss Franc or Euro.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Heska Corporation:

We have audited the accompanying consolidated balance sheets of Heska Corporation (a Delaware corporation) and subsidiaries as of December 31, 2000 and 1999, and the related consolidated statements of operations and comprehensive loss, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Heska Corporation and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule of valuation and qualifying accounts is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states in all

material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

/s/ Arthur Andersen LLP

Denver, Colorado,
January 31, 2001, except with
respect to the matters
discussed in Note 15, as to
which the dates are February 6,
2001 and March 27, 2001.

HESKA CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(dollars in thousands)

ASSETS

	DECEMBER 31,	
	2000	1999
Current assets:		
Cash and cash equivalents	$ 3,176	$ 1,499
Marketable securities	2,482	22,482
Accounts receivable, net of allowance for doubtful accounts of $431 and $188, respectively	8,433	9,652
Inventories, net	8,716	13,957
Other current assets	742	1,027
Total current assets	23,549	48,617
Property and equipment, net	12,901	19,574
Intangible assets, net	1,457	1,629
Restricted marketable securities and other assets	1,253	1,348
Total assets	$ 39,160	$ 71,168

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 3,370	$ 6,928
Accrued liabilities	4,258	4,369
Deferred revenue	467	930
Current portion of capital lease obligations	584	604
Current portion of long-term debt	1,562	7,552
Total current liabilities	10,241	20,383
Capital lease obligations, net of current portion	138	718
Long-term debt, net of current portion	2,670	4,428
Deferred revenue and other long-term liabilities	1,011	200
Total liabilities	14,060	25,729
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.001 par value, 25,000,000 shares authorized; none outstanding	-	-
Common stock, $.001 par value, 40,000,000 shares authorized; 34,072,640 and 33,436,669 shares issued and outstanding, respectively	34	33
Additional paid-in capital	199,789	199,156
Deferred compensation	-	(648)
Stock subscription receivable from officers	-	(124)
Accumulated other comprehensive income	(251)	(376)
Accumulated deficit	(174,472)	(152,602)
Total stockholders' equity	25,100	45,439
Total liabilities and stockholders' equity	$ 39,160	$ 71,168

See accompanying notes to consolidated financial statements

HESKA CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(in thousands, except per share amounts)

	YEAR ENDED DECEMBER 31,		
	2000	1999	1998
Revenues:			
Products, net	$ 49,549	$ 50,291	$ 38,451
Research, development and other	3,126	885	1,321
Total revenues	52,675	51,176	39,772
Cost of goods sold	33,299	36,386	29,087
	19,376	14,790	10,685
Operating expenses:			
Selling and marketing	14,788	15,073	13,188
Research and development	14,929	17,042	25,126
General and administrative	9,457	11,231	11,939
Amortization of intangible assets and deferred compensation	903	2,228	2,745
Loss on sale of assets	204	2,593	1,287
Restructuring expenses	435	1,210	2,356
Total operating expenses	40,716	49,377	56,641
Loss from operations	(21,340)	(34,587)	(45,956)
Other income			
Interest income	986	1,611	3,183
Interest expense	(1,155)	(1,857)	(2,009)
Other, net	(361)	(1,003)	508
Net loss	(21,870)	(35,836)	(44,274)
Other comprehensive income (loss):			
Foreign currency translation adjustments	(121)	(88)	2
Unrealized gain (loss) on marketable securities	246	(376)	85
Other comprehensive income (loss)	125	(464)	87
Comprehensive loss	$(21,745)	$(36,300)	$(44,187)
Basic and diluted net loss per share	$ (0.65)	$ (1.31)	$ (1.79)
Shares used to compute basic and diluted net loss per share	33,782	27,290	24,693

See accompanying notes to consolidated financial statements

HESKA CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except per share data)

	COMMON STOCK		ADDITIONAL PAID-IN	DEFERRED
	SHARES	AMOUNT	CAPITAL	COMPENSATION
Balances, December 31, 1997	19,491	$ 19	$ 118,447	$ (1,967)
Issuance of common stock for cash	3	-	6	-
Issuance of common stock upon the Company's follow-on public offering, net	5,250	5	48,595	-
Issuance of common stock and warrants for cash	1,165	1	14,999	-
Issuance of common stock in exchange for assets and in repayment of debt	206	-	2,262	-
Issuance of common stock for services	32	-	461	-
Cashless exercise of warrants to purchase common stock	5	-	-	-
Issuance of common stock related to options, the ESPP and other	306	1	347	-
Deferred compensation related to stock options	-	-	46	(46)
Amortization of deferred compensation	-	-	-	736
Interest on stock subscription receivable	-	-	-	-

Payments received on stock subscription receivable	-	-	-	-
Foreign currency translation adjustments	-	-	-	-
Unrealized gain on marketable securities	-	-	-	-
Net loss	-	-	-	-
Balances, December 31, 1998	26,458	26	185,163	(1,277)
Issuance of common stock for services	17	-	116	-
Cashless exercise of warrants to purchase common stock	5	-	-	-
Issuance of common stock upon the Company's follow-on public offering, net	6,500	7	13,282	-
Issuance of common stock related to options, the ESPP and other	457	-	595	-
Amortization of deferred compensation	-	-	-	629
Interest on stock subscription receivable	-	-	-	-
Payments received on stock subscription receivable	-	-	-	-
Foreign currency translation adjustments	-	-	-	-
Unrealized loss on marketable securities	-	-	-	-
Net loss	-	-	-	-
Balances, December 31, 1999	33,437	33	199,156	(648)
Issuance of common stock related to options, the ESPP and other	636	1	633	-
Amortization of deferred compensation	-	-	-	648
Interest/payments on stock subscription receivable	-	-	-	-
Foreign currency translation adjustments	-	-	-	-
Unrealized gain on marketable securities	-	-	-	-
Net loss	-	-	-	-
Balances, December 31, 2000	34,073	$ 34	$ 199,789	$ -

	STOCK SUBSCRIPTION RECEIVABLE	ACCUMULATED OTHER COMPREHENSIVE INCOME	ACCUMULATED DEFICIT	TOTAL STOCKHOLDERS' EQUITY
Balances, December 31, 1997	$ (158)	$ 1	$ (72,492)	$ 43,850
Issuance of common stock for cash	-	-	-	6
Issuance of common stock upon the Company's follow-on public offering, net	-	-	-	48,600
Issuance of common stock and warrants for cash	-	-	-	15,000
Issuance of common stock in exchange for assets and in repayment of debt	-	-	-	2,262
Issuance of common stock for services	-	-	-	461
Cashless exercise of warrants to purchase common stock	-	-	-	-
Issuance of common stock related to options, the ESPP and other	-	-	-	348
Deferred compensation related to stock options	-	-	-	-
Amortization of deferred compensation	-	-	-	736
Interest on stock subscription receivable	(13)	-	-	(13)
Payments received on stock subscription receivable	51	-	-	51
Foreign currency translation adjustments	-	2	-	2
Unrealized gain on marketable securities	-	85	-	85
Net loss	-	-	(44,274)	(44,274)
Balances, December 31, 1998	(120)	88	(116,766)	67,114
Issuance of common stock for services	-	-	-	116
Cashless exercise of warrants to purchase common stock	-	-	-	-
Issuance of common stock upon the Company's follow-on public offering, net	-	-	-	13,289
Issuance of common stock related to options, the ESPP and other	-	-	-	595
Amortization of deferred compensation	-	-	-	629
Interest on stock subscription receivable	(7)	-	-	(4)
Payments received on stock subscription receivable	3	-	-	-
Foreign currency translation adjustments	-	(88)	-	(88)
Unrealized loss on marketable securities	-	(376)	-	(376)
Net loss	-	-	(35,836)	(35,836)
Balances, December 31, 1999	(124)	(376)	(152,602)	45,439
Issuance of common stock related to options, the ESPP and other	-	-	-	634
Amortization of deferred compensation	-	-	-	648
Interest/payments on stock subscription receivable	124	-	-	124

Foreign currency translation adjustments	-	(121)	-	(121)
Unrealized gain on marketable securities	-	246	-	246
Net loss	-	-	(21,870)	(21,870)
Balances, December 31, 2000	$ -	$ (251)	$ (174,472)	$ 25,100

See accompanying notes to consolidated financial statements

HESKA CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	YEAR ENDED DECEMBER 31		
	2000	1999	1998
CASH FLOWS USED IN OPERATING ACTIVITIES:			
Net loss	$ (21,870)	$ (35,836)	$ (44,274)
Adjustments to reconcile net loss to cash used in operating activities:			
Depreciation and amortization	4,066	3,864	3,600
Amortization of intangible assets and deferred compensation	903	2,228	2,745
Loss on disposition of assets	445	2,215	2
Changes in operating assets and liabilities:			
Accounts receivable, net	155	(2,993)	(1,177)
Inventories, net	2,380	(1,760)	(1,608)
Other long-term assets	(229)	(1,092)	-
Other assets	18	(293)	406
Accounts payable	(2,551)	(614)	1,189
Accrued liabilities	449	498	896
Deferred revenue	(463)	274	502
Other	-	194	(365)
Other long-term liabilities	811	124	(37)
Net cash used in operating activities	(15,886)	(33,191)	(38,121)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Cash withdrawn from restricted cash account	-	238	-
Additions to intangible assets	-	-	(549)
Purchase of marketable securities	-	(21,229)	(123,842)
Proceeds from sale of marketable securities	20,000	44,300	96,248
Proceeds from sale of subsidiary	6,000	-	-
Proceeds from disposition of property and equipment	406	262	-
Purchases of property and equipment	(1,207)	(3,296)	(6,470)
Net cash provided by (used in) investing activities	25,199	20,275	(34,613)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of common stock	634	13,884	64,505
Proceeds from stock subscription receivable	124	3	51
Proceeds from borrowings	136	971	10,171
Repayments of debt and capital lease obligations	(8,484)	(6,464)	(6,804)
Net cash provided by (used in) financing activities	(7,590)	8,394	67,923
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(46)	100	53
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,677	(4,422)	(4,758)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	1,499	5,921	10,679
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 3,176	$ 1,499	$ 5,921

See accompanying notes to consolidated financial statements

1. ORGANIZATION AND BUSINESS

Heska Corporation ("Heska" or the "Company") is primarily focused on the discovery, development, manufacturing and marketing of companion animal health products. In addition to manufacturing certain of Heska's companion animal health products, the Company's primary manufacturing subsidiary, Diamond Animal Health, Inc. ("Diamond"), manufactures food animal vaccine and pharmaceutical products that are marketed and distributed by third parties. The Company also offers diagnostic services to veterinarians at its Fort Collins, Colorado and CMG-Heska Allergy Products S.A. ("CMG"), a Swiss corporation, locations.

From the Company's inception in 1988 until early 1996, the Company's operating activities related primarily to research and development activities, entering into collaborative agreements, raising capital and recruiting personnel. Prior to 1996, the Company had not received any revenues from the sale of products. During 1996, Heska grew from being primarily a research and development concern to a fully-integrated research, development, manufacturing and marketing company. The Company accomplished this by acquiring Diamond, a licensed pharmaceutical and biological manufacturing facility in Des Moines, Iowa, hiring key employees and support staff, establishing marketing and sales operations to support new Heska products, and designing and implementing more sophisticated operating and information systems. The Company also expanded the scope and level of its scientific and business development activities, increasing the opportunities for new products. In 1997, the Company introduced additional products and expanded in the United States through the acquisition of Center, a Food and Drug Administration ("FDA") and United States Department of Agriculture ("USDA") licensed manufacturer of allergy immunotherapy products located in Port Washington, New York, and internationally through the acquisitions of Heska UK Limited ("Heska UK", formerly Bloxham Laboratories Limited), a veterinary diagnostic laboratory in Teignmouth, England and CMG (formerly Centre Medical des Grand'Places S.A.) in Fribourg, Switzerland, which manufactures and markets allergy diagnostic products for use in veterinary and human medicine, primarily in Europe. Each of the Company's acquisitions during this period was accounted for under the purchase method of accounting and accordingly, the Company's financial statements reflect the operations of these businesses only for the periods subsequent to the respective acquisitions. In July 1997, the Company established a new subsidiary, Heska AG, located near Basel, Switzerland, for the purpose of managing its European operations.

During the first quarter of 1998 the Company acquired Heska Waukesha (formerly Sensor Devices, Inc.), a manufacturer and marketer of patient monitoring devices used in both animal health and human applications. The financial results of Heska Waukesha have been consolidated with those of the Company under the pooling-of-interests accounting method for all periods presented.

During 1999 and 2000, the Company restructured and refocused its business. The operations of Heska Waukesha were combined with existing operations in Fort Collins, Colorado and Des Moines, Iowa during the fourth quarter of 1999. The Heska Waukesha facility was closed in December 1999. In March 2000, the Company sold Heska UK. The Company recorded a loss on disposition of approximately $1.0 million during 1999 for this sale. In June 2000, the Company sold Center. The Company recognized a gain on the sale of approximately $151,000.

The Company has incurred net losses since its inception and anticipates that it will continue to incur additional net losses in the near term as it introduces new products, expands its sales and marketing capabilities and continues its research and development activities. Cumulative net losses from inception of the Company in 1988 through December 31, 2000 have totaled $174.5 million. During the year ended December 31, 2000, the Company incurred a loss of approximately $21.9 million and used cash of approximately $15.9 million for operations.

The Company's primary short-term needs for capital, which are subject to change, are for its continuing research and development efforts, its sales, marketing and administrative activities, working capital associated with increased product sales and capital expenditures relating to developing and expanding its manufacturing operations. The Company's ability to achieve profitable operations will depend primarily upon its ability to successfully market its products, commercialize products that are currently under development and develop new products. Most of the Company's products are subject to long development and regulatory approval cycles and there can be no guarantee that the Company will successfully develop, manufacture or market these products. There can also be no guarantee that the Company will attain profitability or, if achieved, will remain profitable on a quarterly or annual basis in the future. Until the Company attains positive cash flow, the Company may continue to finance operations with additional equity and debt financing. There can be no guarantee that such financing will be available when required or will be obtained under favorable terms.

The Company believes that its available cash, cash equivalents and marketable securities, together with cash from operations, available borrowings and borrowings expected to be available under its revolving line of credit facility will be sufficient to satisfy projected cash requirements into 2002, although it may raise additional funds at or before such time. Thereafter, if cash generated from operations is insufficient to satisfy its cash requirements, the Company will need to raise additional captial to continue its business operations. If necessary, the Company expects to raise these additional funds through one or more of the following: (1) sale of additional securities; (2) sale of various assets; (3) licensing of technology; and (4) sale of various products or marketing rights. If the Company cannot raise the additional funds through these options on acceptable terms or with the necessary timing, management could also reduce discretionary spending to decrease the Company's cash burn rate and extend the currently available cash, cash equivalents, marketable securities and available borrowings. See Note 15.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company and of its wholly-owned subsidiaries since their respective dates of acquisitions when accounted for under the purchase method of accounting, and for all periods presented when accounted for under the pooling-of-interests method of accounting. All material intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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.

Cash and Cash Equivalents

Cash and cash equivalents are stated at cost, which approximates market, and include short-term highly liquid investments with original maturities of less than three months.

Marketable Securities and Restricted Investments

The Company classifies its marketable securities as "available-for-sale" and, accordingly, carries such securities at aggregate fair value. Unrealized gains or losses, if material, are included as a component of accumulated other comprehensive income.

At December 31, 2000 these securities, consisting entirely of U.S. government agency obligations, had an aggregate amortized cost, using specific identification, of $2.8 million, with a maximum maturity of approximately three years. At December 31, 1999 these securities had an aggregate amortized cost, using specific identification, of $23.1 million, a maximum maturity of approximately 4 years and consisted of $7.8 million of U.S. government agency obligations and $15.3 million of U.S. corporate commercial paper. The fair market value of marketable securities at December 31, 2000 and 1999 was approximately $2.8 million and $22.8 million, respectively. Marketable securities at both December 31, 2000 and 1999 included approximately $281,000 of restricted investments held as collateral for capital leases (See Note 4) and $2.5 million and $22.5 million of short-term marketable securities, respectively. The Company realized losses on the sale of certain marketable securities of $111,000 and $943,000 in 2000 and 1999, respectively, and a gain of $216,000 in 1998.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents, marketable securities and accounts receivable. The Company maintains the majority of its cash, cash equivalents and marketable securities with financial institutions that management believes are creditworthy in the form of demand deposits, U.S. government agency obligations and U.S. corporate commercial paper. The Company has no significant off-balance sheet concentrations of credit risk such as foreign exchange contracts, options contracts or other foreign hedging arrangements. Its accounts receivable balances are due primarily from domestic veterinary clinics and individual veterinarians, and both domestic and international corporations.

Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, short-term trade receivables and payables, notes receivable and notes payable. The carrying values of cash and cash equivalents and short-term trade receivables and payables approximate fair value. The fair value of notes payable is estimated based on current rates available for similar debt with similar maturities and collateral, and at December 31, 2000, approximates the carrying value.

Inventories, net

Inventories are stated at the lower of cost or market using the first-in, first-out method. If the cost of inventories exceeds fair market value, provisions are made for the difference between cost and fair market value.

Inventories, net of provisions, consist of the following (in thousands):

	DECEMBER 31,	
	2000	1999
Raw materials	$ 2,596	$ 3,436
Work in process	2,904	6,640
Finished goods	3,822	4,191
Less reserves for losses	(606)	(310)

	$ 8,716	$ 13,957

Derivative Instruments and Hedging Activities

During 2001, the Company will adopt the provisions of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. The Statement establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at fair value. The Statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedging criteria are met. The Company does not expect that the adoption of this Statement will have a material impact on its reported earnings or comprehensive income.

Property, Equipment and Intangible Assets

Property and equipment are recorded at cost and depreciated on a straight-line or declining balance basis over the estimated useful lives of the related assets. Amortization of assets acquired under capital leases is included with depreciation expense on owned assets.

Leasehold improvements are amortized over the applicable lease period or their estimated useful lives, whichever is shorter. Maintenance and repairs are charged to expense when incurred, and major renewals and improvements are capitalized.

Intangible assets primarily consist of various assets arising from business combinations and are amortized using the straight-line method over the period of expected benefit.

The Company periodically reviews the appropriateness of the remaining life of its property, equipment and intangible assets considering whether any events have occurred or conditions have developed which may indicate that the remaining life requires adjustment. After reviewing the appropriateness of the remaining life and the pattern of usage of these assets, the Company then assesses their overall recoverability by determining if the net book value can be recovered through undiscounted future operating cash flows. Absent any unfavorable findings, the Company continues to amortize and depreciate its property, equipment and intangible assets based on the existing estimated life. During 2000, the Company's review of property, equipment and intangible assets determined that a write-down to fair market value of $355,000 for equipment was needed. In 1999, the Company's review of property, equipment and intangible assets determined that a write-down to fair market value of $1.0 million for equipment and $372,000 for intangible assets was needed. These amounts were recorded as part of the loss on sale of assets in the accompanying statement of operations.

Property and equipment consist of the following (in thousands):

	ESTIMATED USEFUL LIFE	DECEMBER 31, 2000	DECEMBER 31, 1999
Land	N/A	$ 377	$ 435
Building	10 to 20 years	2,677	4,154
Machinery and equipment	3 to 15 years	19,426	22,503
Leasehold improvements	7 to 15 years	4,066	3,482
		26,546	30,574
Less accumulated depreciation and amortization		(13,645)	(11,000)
		$ 12,901	$ 19,574

Depreciation and amortization expense for property and equipment was $4.1 million, $3.9 million and $3.6 million for the years ended December 31, 2000, 1999 and 1998, respectively.

Intangible assets consist of the following (in thousands):

	ESTIMATED USEFUL LIFE	DECEMBER 31, 2000	DECEMBER 31, 1999
Customer lists and market presence	7 years	$ 1,705	$ 2,848
Other intangible assets	2 to 5 years	793	394

	2,498	3,242
Less accumulated amortization	(1,041)	(1,613)
	$ 1,457	$ 1,629

The customer lists and market presence resulted from the Company's 1997 acquisition of CMG. The remaining intangible assets resulted primarily from the acquisitions of certain assets in 1998. Amortization expense for intangible assets was $255,000, $1.6 million and $2.0 million for the years ended December 31, 2000, 1999 and 1998, respectively.

Revenue Recognition

Product revenues are recognized at the time goods are shipped to the customer with an appropriate provision for returns and allowances.

License revenues received under arrangements to license patent rights or technology rights are deferred and amortized over the life of the related arrangement. Royalties are recognized as products are sold to customers.

The Company recognizes revenue from sponsored research and development over the life of the contract as research activities are performed. The revenue recognized is the lesser of revenue earned under a percentage of completion method based on total expected revenues or actual non-refundable cash received to date under the agreement. In connection with these sponsored research and development agreements, the Company has recognized $1.4 million, $900,000 and $1.3 million of research and development revenue for the years ended December 31, 2000, 1999 and 1998, respectively.

In addition to its direct sales force, the Company utilizes both distributors and sales agency organizations to sell its products. Distributors purchase goods from the Company, take title to those goods and resell them to their customers in the distributors' territory. Sales agents maintain inventories of goods on consignment from the Company and sell these goods on behalf of the Company to customers in the sales agents' territory. The Company recognizes revenue at the time goods are sold to the customers by the sales agents. Sales agents are paid a fee for their services, which include maintaining product inventories, sales activities, billing and collections. Fees earned by sales agents are netted against revenues generated by these entities.

In December 1999, the SEC issued SAB No. 101, Revenue Recognition. SAB 101 clarifies the SEC staff's views in applying generally accepted accounting principles to selected revenue recognition issues. We adopted SAB 101 during the quarter ended December 31, 2000. The adoption of SAB 101 did not have a material impact on our financial statements, and therefore, did not result in the recording of a cumulative effect of change in an accounting principle as if SAB 101 had been adopted on January 1, 2000, or the restatement of the previously reported quarterly results for 2000.

Cost of Sales

Royalties payable in connection with certain research, development and licensing agreements (See Note 9) are reflected in cost of sales as incurred.

Basic and Diluted Net Loss Per Share

Basic net loss per common share is computed using the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed using the sum of the weighted average number of shares of common stock outstanding and, if not anti-dilutive, the effect of outstanding stock options and warrants determined using the treasury stock method. At December 31, 2000, securities that have been excluded from diluted net loss per share because they would be anti-dilutive are outstanding options to purchase 3,964,668 shares of the Company's common stock and warrants to purchase 1,165,000 shares of the Company's common stock.

Foreign Currency Translation

The functional currency of the Company's international subsidiaries is the Swiss Franc ("CHF"). Assets and liabilities of the Company's international subsidiaries are translated using the exchange rate in effect at the balance sheet date. Revenue and expense accounts are translated using an average of exchange rates in effect during the period. Cumulative translation gains and losses, if material, are shown in the consolidated balance sheets as a separate component of stockholders' equity. Exchange gains and losses arising from transactions denominated in foreign currencies (i.e., transaction gains and losses) are recognized in current operations. The Company does not generally enter into any forward contracts or hedging transactions.

3. BUSINESS ACQUISITION

Acquisition of Heska Waukesha. In March 1998 the Company completed its acquisition of all of the outstanding shares of Heska Waukesha, a manufacturer and marketer of medical sensor products, in a transaction valued at approximately $8.9 million using the pooling-of-interests accounting method. The Company issued 639,622 shares of its common stock and

also reserved an additional 147,898 shares of its common stock for issuance in connection with outstanding Heska Waukesha options that were assumed by the Company in the merger. Accordingly, in 1998, the consolidated financial statements of the Company were restated to include the accounts of Heska Waukesha for all prior periods presented. There were no adjustments required to the net assets or previously reported results of operations of the Company or Heska Waukesha as a result of the adoption of the same accounting practices by the respective entities.

4. CAPITAL LEASE OBLIGATIONS

The Company has entered into certain capital lease agreements for laboratory equipment, office equipment, machinery and equipment, and computer equipment and software. For the years ended December 31, 2000 and 1999, the Company had capitalized machinery and equipment under capital leases with a gross value of approximately $2.5 million and $2.5 million and net book value of approximately $740,000 and $1.2 million, respectively. The capitalized cost of the equipment under capital leases is included in the accompanying balance sheets under the respective asset classes. Under the terms of the Company's lease agreements, the Company is required to make monthly payments of principal and interest through the year 2004, at interest rates ranging from 4.05% to 20.00% per annum. The equipment under the capital leases serves as security for the leases.

The Company has a capital lease with a commercial bank which requires the Company to pledge cash or investments as additional collateral for the lease. The lease agreement, which has a borrowing limit of $2.0 million calls for a collateral balance equal to 25% of the borrowed amount when the Company's annual revenues reach $28.0 million. The lease also requires the Company to maintain minimum levels of cash and cash equivalent balances throughout the term of the lease. At both December 31, 2000 and 1999, the Company was in compliance with all covenants of the master lease and held restricted U.S. Treasury Bonds of approximately $281,000 as additional collateral under the lease.

The future annual minimum required payments under capital lease obligations as of December 31, 2000 were as follows (in thousands):

YEAR ENDING DECEMBER 31,	
2001	$ 615
2002	111
2003	40
2004	6
Total minimum lease payments	772
Less amount representing interest	(50)
Present value of net minimum lease payments	722
Less current portion	(584)
Total long-term capital lease obligations	$ 138

5. RESTRUCTURING EXPENSES

During the first quarter of fiscal 2000, the Company initiated a cost reduction and restructuring plan at its Diamond subsidiary. The restructuring resulted from the rationalization of Diamond's business including a reduction in the size of its workforce and the Company's decision to vacate a leased warehouse and distribution facility no longer needed after the Company's decision to discontinue contract manufacturing of certain low margin human healthcare products. The charge to operations of approximately $435,000 related primarily to personnel severance costs for 12 individuals and the costs associated with closing the leased facility, terminating the lease and abandoning certain leasehold improvements. The facility was closed in April 2000.

In August 1999, the Company announced plans to consolidate its Heska Waukesha operations with existing operations in Fort Collins, Colorado and Des Moines, Iowa. This consolidation was based on the Company's determination that significant operating efficiencies could be achieved through the combined operations. The Company recognized a charge to operations of approximately $1.2 million for this consolidation. These expenses related primarily to personnel severance costs for 40 individuals and the costs associated with facilities being closed and excess equipment, primarily at the Company's Waukesha, Wisconsin location. This facility was closed in December 1999.

Shown below is a reconciliation of restructuring costs for the year ended December 31, 2000 (in thousands):

	Balance at December 31, 1999	Additions for the Fiscal Year Ended December 31, 2000	Payments/ Charges through December 31, 2000	Balance at December 31, 2000
Severance pay, benefits and relocation expenses	$ 429	$ 121	$ (550)	$ -
Noncancellable leased facility closure costs	694	314	(832)	176
Total	$ 1,123	$ 435	$ (1,382)	$ 176

The balance of $176,000 and $1.1 million is included in accrued liabilities in the accompanying consolidated balance sheets as of December 31, 2000 and 1999, respectively.

6. LONG-TERM DEBT

Long-term debt consists of the following (in thousands):

	DECEMBER 31, 2000	DECEMBER 31, 1999
Heska, Diamond, Center and Heska Waukesha obligations:		
Equipment financing due in monthly installments through November 2001, and final payments due March 2001 through January 2002, with stated interest rates between 2.7% and 17.9%, secured by certain equipment and fixtures	$ 1,218	$ 3,642
Center obligations:		
Promissory note to former owner of Center due in July 2000, with quarterly interest payments at a stated interest rate of prime (8.5% at December 1999) plus 0.75%, paid in full in June 2000	-	3,464
Diamond obligations:		
Promissory note to the Iowa Department of Economic Development ("IDED"), due in annual installments through June 2004, with a stated interest rate of 3.0% and a 9.5% imputed interest rate, net	54	67
Promissory note to the City of Des Moines, due in monthly installments through May 2004, with a stated interest rate of 3% and a 9.5% imputed interest rate, net	75	97
$2,500 commercial bank line of credit, due September 2001, with monthly interest payments at prime (8.5% at December 1999) plus 1.75%, replaced by corporate line of credit in April 2000	-	917
Real estate mortgage loan with a commercial bank, due in monthly installments through September 2003, with a stated interest rate of prime (9.5% and 8.5% at December 2000 and 1999, respectively) plus 1.25% at December 2000 and 1.75% at December 1999	1,973	2,175
Term loan with a commercial bank, secured by machinery and equipment, due in monthly installments through December 2004, with a stated interest rate of prime plus 1.25% at December 31, 2000 (10.75%) and prime plus 1.75% at December 31, 1999 (10.25%)	912	1,200
Heska UK obligations:		
Real estate mortgage due in monthly principal payments and quarterly interest payments through December 2006, with a stated interest rate of a bank's base rate (8.5% at December 1999) plus 2.75%, denominated in pounds sterling, transferred in the sale of Heska UK	-	142
CMG obligations:		
CHF150 commercial bank line of credit, due upon demand, with quarterly interest payments, with a stated interest rate of 5.5%, plus 0.25% per quarter, cancelled in January 2000	-	145
CHF400 commercial bank line of credit, due upon demand, with quarterly interest payments, with a stated interest rate of 6.0%, plus 0.25% per quarter	-	131
	4,232	11,980
Less installments due within one year	(1,562)	(7,552)
	$ 2,670	$ 4,428

In June 2000, the Company entered into a two-year expanded credit facility

with Wells Fargo Business Credit, Inc., an affiliate of Wells Fargo Bank. The credit facility includes an asset-based revolving line of credit. Under the agreement, the Company is required to comply with certain financial and non-financial covenants. Among the financial covenants are requirements for monthly minimum book net worth, quarterly minimum net income and minimum cash balances or liquidity levels. The Company was in compliance with all financial covenants at December 31, 2000. See Note 15.

Amounts due under the Company's equipment term loan, real estate mortgage loan and revolving credit facility are payable to a commercial bank and are secured by a first security interest in essentially all of the Company's assets.

The IDED and City of Des Moines promissory notes are secured by a first security interest in essentially all assets of Diamond except assets acquired through capital leases and are included as cross-collateralized obligations by the respective lenders. The IDED has subordinated all of its security interest in these assets to a commercial bank providing credit to the Company. The City of Des Moines has subordinated up to $15 million of its security interest in these assets to the same commercial bank. These notes were assumed as a result of the 1996 Diamond acquisition.

The Company's other debt instruments are secured by the assets of the respective subsidiaries and general corporate guarantees by Heska Corporation.

Maturities of long-term debt as of December 31, 2000 were as follows (in thousands):

YEAR ENDING DECEMBER 31,	
2001	$ 1,562
2002	727
2003	463
2004	456
2005	228
Thereafter	796
	$ 4,232

7. ACCRUED PENSION LIABILITY

Diamond has a noncontributory defined benefit pension plan covering all employees who have met the eligibility requirements. The plan provides monthly benefits based on years of service which are subject to certain reductions if the employee retires before reaching age 65. Diamond's funding policy is to make the minimum annual contribution that is required by applicable regulations. Effective October 1992, Diamond froze the plan, restricting new participants and benefits for future service.

The following table sets forth the plan's funded status and amounts recognized in the accompanying balance sheets (in thousands):

	DECEMBER 31,	
	2000	1999
Change in benefit obligation:		
Benefit obligation, beginning	$ 1,171	$ 1,126
Service cost	-	-
Interest cost	80	76
Actuarial loss	(39)	31
Benefits paid	(85)	(62)
Benefit obligation, ending	1,127	1,171
Change in plan assets:		
Fair value of plan assets, beginning	971	1,050
Actual return on plan assets	68	(17)
Employer contribution	-	-
Benefits paid	(85)	(62)
Fair value of plan assets, ending	954	971
Funded status	(173)	(200)
Unrecognized net actuarial loss	234	274

Prepaid benefit cost	$ 61	$ 74
Additional minimum liability disclosures:		
Accrued benefit liability	$ (173)	$ (200)
Components of net periodic benefit costs:		
Service cost	$ -	$ -
Interest cost	80	77
Expected return on plan assets	(73)	(79)
Recognized net actuarial loss	7	2
Net periodic benefit cost	$ 14	$ -

Assumptions used by Diamond in the determination of the pension plan information consisted of the following:

	DECEMBER 31,	
	2000	1999
Discount rate	7.00%	7.00%
Expected long-term rate of return on plan assets	7.75%	7.75%

8. INCOME TAXES

As of December 31, 2000 the Company had approximately $154.6 million of net operating loss ("NOL") carryforwards for income tax purposes and approximately $3.1 million of research and development tax credits available to offset future federal income tax, subject to limitations for alternative minimum tax. The NOL and credit carryforwards are subject to examination by the tax authorities and expire in various years from 2003 through 2020. The Tax Reform Act of 1986 contains provisions that may limit the NOL and credit carryforwards available for use in any given year upon the occurrence of certain events, including significant changes in ownership interest. A change in ownership of a company of greater than 50% within a three-year period results in an annual limitation on the Company's ability to utilize its NOL carryforwards from tax periods prior to the ownership change. The acquisition of Diamond in April 1996 resulted in such a change of ownership and the Company estimates that the resulting NOL carryforward limitation will be approximately $4.7 million per year for periods subsequent to April 19, 1996. The Company believes that this limitation may affect the eventual utilization of its total NOL carryforwards.

The Company's NOL's represent a previously unrecognized tax benefit. Recognition of these benefits requires future taxable income, the attainment of which is uncertain, and therefore, a valuation allowance has been established for the entire tax benefit and no benefit for income taxes has been recognized in the accompanying consolidated statements of operations.

The components of net loss were as follows (in thousands):

	Year Ended December 31,	
	2000	1999
Domestic	$ (20,642)	$ (32,087)
Foreign	(1,228)	(3,749)
	$ (21,870)	$ (35,836)

Temporary differences that give rise to the components of deferred tax assets are as follows (in thousands):

	December 31,	
	2000	1999
Current deferred tax assets (liabilities):		
Inventory valuation and reserves	$ 268	$ 281
Accrued compensation	121	111
Restructuring reserve	254	430
Other	182	51

	825	873
Valuation allowance	(825)	(873)
Total current deferred tax assets (liabilities)	-	-
Noncurrent deferred tax assets (liabilities):		
Research and development credits	3,126	2,744
Deferred revenue	17	268
Pension liability	19	77
Amortization of intangible assets	314	711
Loss on assets held for sale	(35)	594
Property and equipment	(875)	(511)
Net operating loss carryforwards	58,874	48,786
	61,440	52,669
Valuation allowance	(61,440)	(52,669)
Total noncurrent deferred tax assets (liabilities)	$ -	$ -

The components of the income tax expense (benefit) are as follows (in thousands):

	Year Ended December 31, 2000	1999
Deferred income tax benefit:		
Federal	$ (7,265)	$ (10,886)
State	(969)	(1,452)
Foreign	(490)	(735)
Total benefit	(8,724)	(13,073)
Valuation allowance	8,724	13,073
Total income tax expense (benefit)	$ -	$ -

The Company's income tax benefit relating to losses, respectively, for the periods presented differ from the amounts that would result from applying the federal statutory rate to those losses as follows:

	Year Ended December 31, 2000	1999
Statutory federal tax rate	(34%)	(34%)
State income taxes, net of federal benefit	(4%)	(4%)
Amortization of deferred compensation	1%	1%
Change in valuation allowance	37%	37%
Effective income tax rate	0%	0%

9. COMMITMENTS AND CONTINGENCIES

In November 1998, Synbiotics Corporation ("Synbiotics") filed a lawsuit against the Company in the United States District Court for the Southern District of California in which it alleges that the Company infringed a patent owned by Synbiotics relating to heartworm diagnostic technology. The Company has answered the complaint and no trial date has been set. The Company has obtained legal opinions from outside patent counsel that its heartworm diagnostic products do not infringe the Synbiotics patent and that the patent is invalid. The opinions of non-infringement are consistent with the results of the Company's internal evaluations. In September 2000, the U.S. District Court hearing the case granted the Company's request for a partial summary judgment, holding two of the Synbiotics patent claims to be invalid, leaving only one remaining claim. While management believes that the Company has valid defenses to Synbiotics' allegations and intends to defend the action vigorously, there can be no assurance that an adverse result or settlement would not have a material adverse effect on the Company's financial position, its results of operations or cash flow.

The Company holds certain rights to market and manufacture all products

developed or created under certain research, development and licensing agreements with various entities. In connection with such agreements, the Company has agreed to pay the entities royalties on net product sales. In the years ended December 31, 2000, 1999 and 1998, royalties of $931,000, $1.0 million and $52,000 became payable under these agreements, respectively.

The Company contracts with various parties that conduct research and development on the Company's behalf. In return, the Company generally receives the right to commercialize any products resulting from these contracts. In the event the Company licenses any technology developed under these contracts, the Company will generally be obligated to pay royalties at specified percentages of future sales of products utilizing the licensed technology.

The Company has entered into operating leases for its office and research facilities and certain equipment with future minimum payments as of December 31, 2000 as follows (in thousands):

YEAR ENDING DECEMBER 31,	
2001	$ 878
2002	878
2003	799
2004	666
2005	108
	$ 3,329

The Company had rent expense of $1.0 million, $1.1 million and $1.4 million in 2000, 1999 and 1998, respectively.

10. CAPITAL STOCK

Common Stock

In February 2001, the Company completed a private placement of 4.57 million shares of common stock at a price of $1.247 per share, providing the Company with net proceeds of approximately $5.3 million.

In December 1999, the Company completed a public offering of 6.5 million shares of common stock at a price of $2.063 per share, providing the Company with net proceeds of approximately $13.3 million.

In July 1998, the Company issued 1.165 million shares of the Company's common stock to Ralston Purina Company, for $14.75 million in cash, and also issued, for an additional cash payment of $250,000, warrants to purchase an additional 1.165 million shares of the Company's common stock. The exercise price of the warrants was $12.67 for the first year of the warrants, increasing by 20% per year for each of the second and third years of the warrants. The warrants were exercisable immediately as of July 30, 1998 and expire in three years with respect to any unexercised shares.

In July 1998, the Company issued 205,619 shares of common stock to Bayer Corporation ("Bayer") in consideration for the acquisition by Diamond of certain assets, including land and buildings formerly leased by Diamond from Bayer, and as repayment in full of certain indebtedness of Diamond to Bayer, in a transaction valued at approximately $2.3 million.

In March 1998, the Company completed its follow-on public offering of 5,750,000 shares of common stock (including 500,000 shares offered by a stockholder of the Company and an underwriters' over-allotment option exercised for 750,000 shares) at a price of $9.875 per share, providing the Company with net proceeds of approximately $48.6 million.

Stock Option Plans

The Company has a stock option plan which authorizes granting of stock options and stock purchase rights to employees, officers, directors and consultants of the Company to purchase shares of common stock. In 1997, the board of directors adopted the 1997 Stock Incentive Plan and terminated two prior option plans. However, options granted and unexercised under the prior plans are still outstanding. All shares remaining available for grant under the terminated plans were rolled into the 1997 Plan. In addition, all shares which are subsequently cancelled under the prior plans are rolled into the 1997 Plan on a quarterly basis. The number of shares reserved for issuance under the 1997 Plan increases automatically on January 1 of each year by a number equal to the lesser of (a) 1,500,000 shares or (b) 5% of the shares of common stock outstanding on the immediately preceding December 31. The number of shares reserved for issuance under all plans as of January 1, 2001 was 7,643,853.

The stock options granted by the board of directors may be either incentive stock options ("ISOs") or non-qualified stock options ("NQs"). The purchase

price for options under all of the plans may be no less than 100% of fair market value for ISOs or 85% of fair market value for NQs. Options granted will expire no later than the tenth anniversary subsequent to the date of grant or three months following termination of employment, except in cases of death or disability, in which case the options will remain exercisable for up to twelve months. Under the terms of the 1997 Plan, in the event the Company is sold or merged, options granted will either be assumed by the surviving corporation or vest immediately.

SFAS No. 123 ("SFAS 123")

SFAS 123, Accounting for Stock-Based Compensation, defines a fair value based method of accounting for employee stock options, employee stock purchases, or similar equity instruments. However, SFAS 123 allows the continued measurement of compensation cost for such plans using the intrinsic value based method prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), provided that pro forma disclosures are made of net income or loss, assuming the fair value based method of SFAS 123 had been applied. The Company has elected to account for its stock-based compensation plans under APB 25; accordingly, for purposes of the pro forma disclosures presented below, the Company has computed the fair values of all options granted during 2000, 1999 and 1998, using the Black-Scholes pricing model and the following weighted average assumptions:

	2000	1999	1998
Risk-free interest rate	6.26%	5.63%	5.28%
Expected lives	7.59 years	3.5 years	3.8 years
Expected volatility	94%	91%	89%
Expected dividend yield	0%	0%	0%

To estimate expected lives of options for this valuation, it was assumed options will be exercised at varying schedules after becoming fully vested dependent upon the income level of the option holder. For measurement purposes, options have been segregated into three income groups, and estimated exercise behavior of option recipients varies from six months to one and one half years from the date of vesting, dependent on income group (less highly compensated employees are expected to have shorter holding periods). All options are initially assumed to vest. Cumulative compensation cost recognized in pro forma basic net income or loss with respect to options that are forfeited prior to vesting is adjusted as a reduction of pro forma compensation expense in the period of forfeiture. Fair value computations are highly sensitive to the volatility factor assumed; the greater the volatility, the higher the computed fair value of the options granted.

The total fair value of options granted was computed to be approximately $1.7 million, $3.8 million and $8.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. The amounts are amortized ratably over the vesting periods of the options. Pro forma stock-based compensation, net of the effect of forfeitures, was $2.2 million, $3.6 million and $3.9 million for 2000, 1999 and 1998, respectively.

A summary of the Company's stock option plans is as follows:

	YEAR ENDED DECEMBER 31,					
	2000		1999		1998	
	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at beginning of period	4,246,183	$ 4.6994	3,209,317	$ 5.1203	2,570,533	$ 1.9053
Granted	753,700	$ 3.3453	1,725,480	$ 3.4876	1,304,443	$ 10.6166
Cancelled	(600,228)	$ 6.5438	(329,820)	$ 6.6815	(315,543)	$ 5.9544
Exercised	(434,967)	$ 1.0904	(358,794)	$ 0.8148	(350,116)	$ 1.2188
Outstanding at end of period	3,964,668	$ 4.4979	4,246,183	$ 4.6994	3,209,317	$ 5.1203
Exercisable at end of period	2,274,489	$ 4.6293	1,973,349	$ 4.1737	1,531,895	$ 2.9417

The weighted average estimated fair value of options granted during the years ended December 31, 2000, 1999 and 1998 were $2.3277, $2.1814 and $6.7635, respectively.

In 1998 the Company also granted stock options to non-employees in exchange

for consulting services, recording deferred compensation of $46,000 based on the estimated fair value of the options at the date of grant. Deferred compensation was amortized over the applicable service periods. The amortization of deferred compensation resulted in a non-cash charge to operations of $648,000, $629,000 and $736,000 in the years ended December 31, 2000, 1999 and 1998, respectively.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2000:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
EXERCISE PRICES	NUMBER OF OPTIONS OUTSTANDING AT DECEMBER 31, 2000	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE IN YEARS	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER OF OPTIONS EXERCISABLE AT DECEMBER 31, 2000	WEIGHTED AVERRAGE EXERCISE PRICE
$0.25 - $0.35	223,066	4.23	$ 0.3381	223,066	$ 0.3381
$1.20 - $1.20	557,766	5.61	$ 1.2000	551,046	$ 1.2000
$1.31 - $2.00	613,815	8.77	$ 1.9478	174,817	$ 1.8678
$2.06 - $3.37	432,465	8.13	$ 3.0018	211,766	$ 3.0108
$3.69 - $3.88	535,644	9.02	$ 3.6969	136,421	$ 3.7144
$3.94 - $5.25	549,743	7.76	$ 5.0084	282,824	$ 5.0507
$5.37 - $11.75	500,313	7.86	$ 6.5105	283,837	$ 6.9641
$11.88 - $15.00	551,856	7.07	$ 11.9659	410,712	$ 11.9736
$0.25 - $15.00	3,964,668	7.55	$ 4.4979	2,274,489	$ 4.6293

Employee Stock Purchase Plan (the "ESPP")

Under the 1997 Employee Stock Purchase Plan, the Company is authorized to issue up to 750,000 shares of common stock to its employees. Employees of the Company and its U.S. subsidiaries who are expected to work at least 20 hours per week and five months per year are eligible to participate. Under the terms of the plan, employees can choose to have up to 10% of their annual base earnings withheld to purchase the Company's common stock. The purchase price of the stock is 85% of the lower of its beginning-of-enrollment period or end-of-measurement period market price. Each enrollment period is two years, with six month measurement periods ending June 30 and December 31.

For the years ended December 31, 2000, 1999 and 1998, the weighted-average fair value of the purchase rights granted was $0.91, $1.24 and $4.57 per share, respectively. Pro forma stock-based compensation, net of the effect of adjustments, was approximately $112,462, $96,000 and $268,000 in 2000, 1999 and 1998, respectively, for the ESPP.

Pro Forma Basic Net Loss per Share under SFAS 123

If the Company had accounted for all of its stock-based compensation plans in accordance with SFAS 123, the Company's net loss would have been reported as follows (in thousands, except per share amounts):

	YEAR ENDED DECEMBER 31,		
	2000	1999	1998
Net loss:			
As reported	$ (21,870)	$ (35,836)	$ (44,274)
Pro forma	(24,143)	$ (39,564)	$ (48,442)
Basic net loss per share:			

As reported	$ (0.65)	$ (1.31)	$ (1.79)
Pro forma	$ (0.71)	$ (1.45)	$ (1.96)

Stock Warrants

In July 1998, the Company issued warrants to purchase 1.165 million shares of the Company's common stock in connection with the private placement with Ralston Purina described previously. The exercise price of the warrants was $12.67 for the first year of the warrants, increasing by 20% per year for each of the second and third years of the warrants. The warrants were exercisable immediately as of July 30, 1998 and expire in three years with respect to any unexercised shares.

11. MAJOR CUSTOMERS

The Company had sales of greater than 10% of total revenue to only one customer during the years ended December 31, 2000, 1999 and 1998. The customer which represented 17% of total revenues in 2000, and a different customer which represented 12% and 15% of total revenues in 1999 and 1998, respectively, purchased vaccines from Diamond.

12. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

	YEAR ENDED DECEMBER 31,		
	2000	1999	1998
	(IN THOUSANDS)		
Cash paid for interest	$ 1,155	$ 1,857	$ 1,999
Non-cash investing and financing activities:			
Issuance of common stock in exchange for assets and as repayment of debt	-	-	2,262
Purchase of assets under direct capital lease financing	45	193	86

13. SEGMENT REPORTING

The Company divides its operations into three reportable segments. Companion Animal Health includes the operations of Heska, Heska Waukesha (through 1999), CMG and Heska AG. Food Animal Health includes the operations of Diamond Animal Health. Allergy Treatment includes the operations of Center, which was sold in June 2000.

Summarized financial information concerning the Company's reportable segments is shown in the following table (in thousands). The "Other" column includes the elimination of intercompany transactions and other items as noted.

	COMPANION ANIMAL HEALTH	FOOD ANIMAL HEALTH	ALLERGY TREATMENT	OTHER	TOTAL
2000:					
Revenues	$ 31,684	$ 19,907	$ 3,353	$ (2,269)	$ 52,675
Operating income (loss)	(22,065)	1,539	(24)	(790) (a)	(21,340)
Total assets	53,109	17,533	-	(31,482)	39,160
Capital expenditures	724	483	-	-	1,207
Depreciation and amortization	2,277	1,577	212	-	4,066

(a) Includes the write-down of certain fixed assets to their expected net realizable values, resulting in a loss of $355,000 and restructuring expenses of $435,000 (See Note 5).

	COMPANION ANIMAL HEALTH	FOOD ANIMAL HEALTH	ALLERGY TREATMENT	OTHER	TOTAL

1999:					
Revenues	$ 29,282	$ 18,149	$ 7,105	$ (3,360)	$ 51,176
Operating income (loss)	(27,878)	(2,534)	(372)	(3,803 (b)	(34,587)
Total assets	89,199	22,185	6,376	(46,592)	71,168
Capital expenditures	743	2,368	185	-	3,296
Depreciation and amortization	2,155	1,294	415	-	3,864

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(b) Includes the write-down of certain tangible and intangible assets to their expected net realizable values, resulting from a loss on assets held for disposition of $2.6 million and restructuring expenses of $1.2 million (See Note 5).

	COMPANION ANIMAL HEALTH	FOOD ANIMAL HEALTH	ALLERGY TREATMENT	OTHER	TOTAL
1998:					
Revenues	$ 18,610	$ 18,250	$ 7,374	$ (4,462)	$ 39,772
Operating income (loss)	(39,196)	86	(672)	(6,174) (c)	(45,956)
Total assets	102,895	21,884	6,682	(33,407)	98,054
Capital expenditures	1,995	3,686	789	-	6,470
Depreciation and amortization	2,406	890	304	-	3,600

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(c) Includes the write-down of certain tangible and intangible assets to their expected net realizable values, resulting from a loss on assets held for disposition of $1.3 million, restructuring expenses of $2.4 million (See Note 5) and inventory write-downs of $1.5 million.

The Company manufactures and markets its products in two major geographic areas, North America and Europe. The Company's primary manufacturing facilities are located in North America. Revenues earned in North America are attributable to Heska, Diamond, Heska Waukesha (through 1999) and Center (through June 2000). Revenues earned in Europe are primarily attributable to Heska UK (through January 2000), CMG and Heska AG. There have been no significant exports from North America or Europe.

During each of the years presented, European subsidiaries purchased products from North America for sale to European customers. Transfer prices to international subsidiaries are intended to allow the North American companies to produce profit margins commensurate with their sales and marketing efforts. Certain information by geographic area is shown in the following table (in thousands). The "Other" column includes the elimination of intercompany transactions.

	NORTH AMERICA	EUROPE	OTHER	TOTAL
2000:				
Revenues	$ 52,580	$ 2,364	$ (2,269)	$ 52,675
Operating income (loss)	(20,444)	(896)	-	(21,340)
Total assets	68,130	2,512	(31,482)	39,160
Capital expenditures	1,082	125	-	1,207
Depreciation and amortization	3,956	110	-	4,066
1999				
Revenues	$ 50,336	$ 4,200	$ (3,360)	$ 51,176
Operating income (loss)	(27,431)	(3,353)	(3,803)	(34,587)
Total assets	114,165	3,595	(46,592)	71,168
Capital expenditures	3,292	4	-	3,296
Depreciation and amortization	3,701	163	-	3,864
1998				
Revenues	$ 40,573	$ 3,661	$ (4,462)	$ 39,772
Operating income (loss)	(37,386)	(2,396)	(6,174)	(45,956)
Total assets	127,004	4,457	(33,407)	98,054
Capital expenditures	6,190	280	-	6,470
Depreciation and amortization	3,009	591	-	3,600

14. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following summarizes selected quarterly financial information for each of the two years in the period ended December 31, 2000 (amounts in thousands except per share data).

	Q1	Q2	Q3	Q4	TOTAL
2000:					
Total revenues	$ 14,363	$ 14,243	$ 12,708	$ 11,362	$ 52,675
Gross profit from product sales	4,001	4,250	3,944	4,055	16,250
Net loss	(5,929)	(5,703)	(4,731)	(5,507)	(21,870)
Net loss per share - basic and diluted	(0.18)	(0.17)	(0.14)	(0.16)	(0.65)
1999:					
Total revenues	$ 11,051	$ 12,878	$ 13,067	$ 14,180	$ 51,176
Gross profit from product sales	3,301	4,267	4,213	2,124	13,905
Net loss	(7,883)	(6,931)	(8,323)	(12,699)	(35,836)
Net loss per share - basic and diluted	(0.30)	(0.26)	(0.31)	(0.44)	(1.31)

15. SUBSEQUENT EVENTS

On February 6, 2001, the Company sold 4,573,000 shares of common stock through a private placement offering with net proceeds to the Company of approximately $5.3 million. The Company has agreed to register the shares issued under the private placement as soon as practicable.

On March 23, 2001, the Company re-negotiated the covenants under its revolving line of credit facility. The Company's ability to borrow under this agreement varies based upon available cash, eligible accounts receivable and eligible inventory. The minimum liquidity (cash plus excess capacity) required to be maintained has been reduced to $3 million during 2001. As of March 23, 2001, the Company's available borrowing capacity was approximately $5 million.

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

Not applicable.

PART III

Certain information required by Part III is incorporated by reference to our definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for our 2001 Annual Meeting of Stockholders.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The information required by this section is incorporated by reference to the information in the sections entitled "Election of Directors-Directors and Nominees for Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement. The required information concerning our executive officers is contained in the section entitled "Executive Officers of the Registrant" in Part I of this Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by this section is incorporated by reference to the information in the sections entitled "Election of Directors-Directors' Compensation" and "Executive Compensation" in the Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The information required by this section is incorporated by reference to the information in the section entitled "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information required by this section is incorporated by reference to the information in the section entitled "Certain Transactions and Relationships" in the Proxy Statement.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) The following documents are filed as a part of this Form 10-K.

(1) FINANCIAL STATEMENTS:

Reference is made to the Index to Consolidated Financial Statements under Item 8 in Part II of this Form 10-K.

(2) FINANCIAL STATEMENT SCHEDULES:

Schedule II - Valuation and Qualifying Accounts.

SCHEDULE II

HESKA CORPORATION AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS

	BALANCE AT BEGINNING OF YEAR	ADDITIONS CHARGED TO COSTS AND EXPENSES	OTHER ADDITIONS	DEDUCTIONS	BALANCE AT END OF YEAR
ALLOWANCE FOR DOUBTFUL ACCOUNTS					
Year ended:					
December 31, 2000	$ 188	$ 320	-	$ (77) (a)	$ 431
December 31, 1999	$ 93	$ 122	-	$ (27) (a)	$ 188
December 31, 1998	$ 96	$ 9	-	$ (12) (a)	$ 93
ALLOWANCE FOR RESTRUCTURING CHARGES					
Year ended:					
December 31, 2000	$ 1,123	$ 435	-	(1,382) (a)	$ 176
December 31, 1999	$ 1,631	$ 1,210	-	$ (1,718) (a)	$ 1,123
December 31, 1998	-	$ 2,356	-	$ (725) (a)	$ 1,631

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(a) Write-offs of uncollectible accounts and payments for personnel severance costs and facility closing costs.

3) EXHIBITS:

The exhibits listed below are required by Item 601 of Regulation S-K. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this Form 10-K has been identified.

Exhibit Number	Notes	Description of Document
3(i)(d)	(9)	Restated Certificate of Incorporation of the Registrant
3(ii)		Bylaws of the Registrant
4.2	(1)	First Amended Investors' Rights Agreement by and among Registrant and certain stockholders of Registrant dated as of April 12, 1996.
4.2(a)	(6)	Waiver and Amendment to first Amended Investors' Rights Agreement among the Company and certain other parties.
4.2(b)	(6)	Second Waiver and Amendment to first Amended Investors' Rights Agreement among the Company and certain other parties.
4.2(c)	(6)	Third Waiver and Amendment to first Amended Investors' Rights Agreement among the Company and certain other parties.
4.3	(1)	Form of warrant to purchase Series C Preferred Stock.
4.4	(1)	Form of warrant to purchase Series D Preferred Stock.
4.5	(5)	Company Stock Warrant Purchase Agreement dated as of July 29, 1998 between the Company and Ralston Purina Company.
10.1H	(1)	Collaborative Agreement between Registrant and Eisai Co., Ltd. dated January 25, 1993.
10.2H	(1)	Canine Heartworm Cooperation Agreement between Registrant and Bayer AG dated as of June 10, 1994.
10.3H	(1)	Feline Toxoplasmosis Cooperation Agreement between Registrant and Bayer AG dated as of June 10, 1994.
10.5H	(1)	Screening and Development Agreement between Ciba-

		Geigy Limited and Registrant, dated as of April 12, 1996.
10.6	(1)	Right of First Refusal Agreement between Ciba-Geigy Limited and Registrant, dated as of April 12, 1996.
10.7	(1)	Marketing Agreement between Registrant and Ciba-Geigy Limited dated as of April 12, 1996.
10.8H	(1)	Marketing Agreement between Registrant and Ciba-Geigy Corporation dated as of April 12, 1996.
10.9H	(1)	Manufacturing and Supply Agreement between and among Diamond Animal Health, Inc., Agrion Corporation, Diamond Scientific Co. and Miles Inc. dated December 31, 1993 and Amendment and Extension thereto dated September 1, 1995.
10.9(a)H	(5)	Second Amendment to Manufacturing and Supply Agreement between Diamond Animal Health, Inc. and Bayer Corporation dated February 26, 1998.
10.10*	(1)	Employment Agreement between Registrant and Robert B. Grieve dated January 1, 1994, as amended March 4, 1997.
10.10(a)	*	Amended and Restated Employment Agreement with Robert B. Grieve dated as of February 22, 2000.
10.14H	(2)	Supply Agreement between Registrant and Quidel Corporation dated July 3, 1997.
10.18*	(1)	Form of Indemnification Agreement entered into between Registrant and its directors and certain officers.
10.19*	(1)	1997 Incentive Stock Plan of Registrant.
10.20*	(1)	Forms of Option Agreement.
10.21*	(1)	1997 Employee Stock Purchase Plan of Registrant.
10.22	(1)	Lease Agreement dated March 8, 1994 between Sharp Point Properties, LLC and Registrant.
10.23	(1)	Lease Agreement dated as of June 27, 1996 between GB Ventures and Registrant.
10.24	(1)	Lease Agreement dated as of July 11, 1996 between GB Ventures and Registrant.
10.26*	(3)	Employment Agreement between Registrant and Giuseppe Miozzari dated July 1, 1997.
10.26(a)	*	Amended and Restated Employment Agreement between Registrant and Giuseppe Miozzari dated June 9, 2000.
10.28*	(7)	Employment Agreement between Registrant and Ronald L. Hendrick dated December 1, 1998.
10.29*	(7)	Employment Agreement between Registrant and James H. Fuller dated January 18, 1999.
10.30*	(7)	Separation Agreement between Registrant and Fred M. Schwarzer dated December 14, 1998.
10.31*	(7)	Consulting Services and Confidentiality Agreement between Registrant and Fred M. Schwarzer dated December 14, 1998.
10.34H	(7)	Exclusive Distribution Agreement dated as of August 18, 1998 between the Company and Novartis Agro K.K.
10.35	(7)	Right of First Refusal Agreement dated as of August 18, 1998 between the Company and Novartis Animal Health, Inc.
10.37*	(8)	Consultant Services and Confidentiality Agreement between Registrant and Seward Pharm, LLC dated December 1, 1999.
10.39	(9)	Second Amended and Restated Credit and Security Agreement by and between Heska Corporation, Diamond Animal Health, Inc., Center Laboratories, Inc. and Wells Fargo Business Credit, Inc., dated as of June 14, 2000.
10.40*	(9)	Employment agreement by and between Registrant and Dan T. Stinchcomb dated as of May 1, 2000.
10.41*	(9)	Employment agreement by and between Registrant and Carol Talkington Verser dated as of May 1, 2000.
10.42*		Management Incentive Compensation Plan
21.1		Subsidiaries of the Company.
23.1		Consent of Arthur Andersen LLP.
24.1		Power of Attorney (See page 60 of this Form 10-K).

Notes
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* Indicates management contract or compensatory plan or arrangement.

H Confidential treatment has been granted with respect to certain portions of these agreements.

(1) Filed with Registrant's Registration Statement on Form S-1 (File No. 333-25767).

(2) Filed with the Registrant's Form 10-Q for the quarter ended September 30, 1997.

(3) Filed with Registrant's Registration Statement on Form S-1 (File No. 333-44835).

(4) Filed with the Registrant's Form 10-K for the year ended December 31, 1998.

(5) Filed with the Registrant's Form 10-Q for the quarter ended March 31, 1998.
(6) Filed with the Registrant's Form 10-Q for the quarter ended September 30, 1998.
(7) Filed with the Registrant's Form 10-Q for the quarter ended June 30, 1999.
(8) Filed with the Registrant's Form 10-K for the year ended December 31, 1999.
(9) Filed with the Registrant's Form 10-Q for the quarter ended June 30, 2000.

(b) Reports on Form 8-K:

There were no Reports on Form 8-K filed by the Company during the quarter ended December 31, 2000.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 23, 2001.

HESKA CORPORATION

By /s/ ROBERT B. GRIEVE
Robert B. Grieve
Chairman of the Board and
Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Robert B. Grieve, Ronald L. Hendrick, Michael A. Bent and A. Lynn DeGeorge, and each of them, his or her true and lawful attorneys-in-fact, each with full power of substitution, for him or her in any and all capacities, to sign any amendments to this report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact or their substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated:

Name	Title	Date
/s/ Robert B. Grieve Robert B. Grieve	Chairman of the Board and Chief Executive Officer (Principal Executive Officer) and Director	March 23, 2001
/s/ Ronald L. Hendrick Ronald L. Hendrick	Chief Financial Officer, Executive Vice President and Secretary (Principal Financial and Accounting Officer)	March 23, 2001
/s/ Fred M. Schwarzer Fred M. Schwarzer	Director	March 23, 2001
/s/ A. Barr Dolan A. Barr Dolan	Director	March 23, 2001
/s/ Lyle A. Hohnke Lyle A. Hohnke	Director	March 23, 2001
/s/ Edith W. Martin Edith W. Martin	Director	March 23, 2001
/s/ William A. Aylesworth William A. Aylesworth	Director	March 23, 2001
s/ Lynnor B. Stevenson	Director	March 23, 2001

Lynnor B. Stevenson

/s/ John F. Sasen, Sr. - ------------------------- John F. Sasen, Sr.	Director	March 23, 2001

B Y L A W S

OF

HESKA CORPORATION

(a Delaware corporation)

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ARTICLE I

Offices

1.1 Principal Office. The registered office of the corporation shall be 1209 Orange Street, Wilmington, Delaware, and the name of the initial registered agent in charge thereof is The Corporation Trust Company.

1.2 Additional Offices. The corporation may also have offices at such other places, either within or without the State of Delaware, as the Board of Directors (the "Board") may from time to time designate or the business of the corporation may require.

ARTICLE 2

Meeting of Stockholders

2.1 Place of Meeting. Meetings of stockholders may be held at such place, either within or without of the State of Delaware, as may be designated by or in the manner provided in these Bylaws, or, if not so designated, at the registered office of the corporation or the principal executive offices of the corporation.

2.2 Annual Meeting. Annual meetings of stockholders shall be held each year at such date and time as shall be designated from time to time by the Board and stated in the notice of the meeting. At such annual meetings, the stockholders shall elect by a plurality vote the number of directors equal to the number of directors of the class whose term expires at such meetings (or, if fewer, the number of directors properly nominated and qualified for election) to hold office until the third succeeding annual meeting of stockholders after their election. The stockholders shall also transact such other business as may properly be brought before the meetings.

To be properly brought before the annual meeting, business must be either (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board or the Chief Executive Officer, (b) otherwise properly brought before the meeting by or at the direction of the Board or the Chief Executive Officer, or (c) otherwise properly brought before the meeting by a stockholder of record. In addition to any other applicable requirements, for business to be properly brought before the annual meeting by a stockholder, the stockholder must have given timely notice thereof in writing to the Secretary of the corporation. To be timely, a stockholder's notice must be delivered personally or deposited in the United States mail, or delivered to a common carrier for transmission to the recipient or actually transmitted by the person giving the notice by electronic means to the recipient or sent by other means of written communication, postage or delivery charges prepaid in all such cases, and received at the principal executive offices of the corporation, addressed to the attention of the Secretary of the corporation, not less than 60 days nor more than 90 days prior to the scheduled date of the meeting (regardless of any postponements, deferrals or adjournments of that meeting to a later date); provided, however, that in the event that less than 70 days' notice or prior public disclosure of the date of the scheduled meeting is given or made to stockholders, notice by the

stockholder to be timely must be so received not later than the earlier of (a) the close of business on the 10th day following the day on which such notice of the date of the scheduled annual meeting was mailed or such public disclosure was made, whichever first occurs, and (b) two days prior to the date of the scheduled meeting. A stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual meeting (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (ii) the name and record address of the stockholder proposing such business, (iii) the class, series and number of shares of the corporation that are owned beneficially by the stockholder, and (iv) any material interest of the stockholder in such business. Notwithstanding anything in these Bylaws to the contrary, no business shall be conducted at the annual meeting except in accordance with the procedures set forth in this Section; provided, however, that nothing in this Section shall be deemed to preclude discussion by any stockholder of any business properly brought before the annual meeting.

The Chairman of the Board of the corporation (or such other person presiding at the meeting in accordance with these Bylaws) shall, if the facts warrant, determine and declare to the meeting that business was not properly brought before the meeting in accordance with the provisions of this Section, and if he or she should so determine, he or she shall so declare to the meeting and any such business not properly brought before the meeting shall not be transacted.

2.3 Special Meetings. Special meetings of the stockholders may be called for any purpose or purposes, unless otherwise prescribed by statute or by the Restated Certificate of Incorporation, only at the request of the Chairman of the Board, by the Chief Executive Officer of the corporation or by a resolution duly adopted by the affirmative vote of a majority of the Board. Such request shall state the purpose or purposes of the proposed meeting. Business transacted at any special meeting shall be limited to matters relating to the purpose or purposes stated in the notice of meeting.

2.4 Action Without a Meeting. Any action which may be taken at any annual or special meeting of the stockholders of this corporation may be taken without a meeting, without prior notice, and without a vote, if a consent or consents in writing, setting forth the action or actions so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. Such consent or consents shall be delivered to the corporation by hand or certified mail, return receipt requested, to its principal executive office, or to an officer or agent of the corporation having custody of the book in which proceedings of meetings of stockholders are recorded.

2.5 Notice of Meetings. Except as otherwise required by law, written notice of stockholders' meetings, stating the place, date and time of the meeting and, in the case of a special meeting, the purpose or purposes for which such special meeting is called, shall be given to each stockholder entitled to vote at such meeting not less than ten (10) nor more than sixty (60) days prior to the meeting.

When a meeting is adjourned to another place, date or time, written notice need not be given of the adjourned meeting if the place, date and time thereof are announced at the meeting at which the adjournment is taken; provided, however, that if the date of any adjourned meeting is more than thirty (30) days after the date for which the meeting was originally noticed, or if a new record date is fixed for the adjourned meeting, written notice of the place, date and time of the adjourned meeting shall be given in conformity herewith. At any adjourned meeting, any business may be transacted which might have been transacted at the original meeting.

Whenever, under the provisions of Delaware law or of the Restated Certificate of Incorporation or of these Bylaws, notice is required to be given to any stockholder it shall not be construed to mean personal notice, but such notice may be given in writing, by mail, addressed to such director or stockholder, at his or her address as it appears on the records of the corporation, with postage thereon prepaid, and such notice shall be deemed to be given at the time when the same shall be deposited in the United States mail.

Whenever any notice is required to be given under the provisions of Delaware law or of the Restated Certificate of Incorporation or of these Bylaws, a waiver thereof in writing, signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed

equivalent thereto.

2.6 Business Matter of a Special Meeting. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice, except to the extent such notice is waived or is not required.

2.7 List of Stockholders. The officer in charge of the stock ledger of the corporation or the transfer agent shall prepare and make, at least ten (10) days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten (10) days prior to the meeting, at a place within the city where the meeting is to be held, which place, if other than the place of the meeting, shall be specified in the notice of the meeting. The list shall also be produced and kept at the place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present in person thereat.

2.8 Organization and Conduct of Business. The Chairman of the Board or, in his or her absence, the Chief Executive Officer of the corporation or, in their absence, such person as the Board may have designated or, in the absence of such a person, such person as may be chosen by the holders of a majority of the shares entitled to vote who are present, in person or by proxy, shall call to order any meeting of the stockholders and act as Chairman of the meeting. In the absence of the Secretary of the corporation, the Secretary of the meeting shall be such person as the Chairman appoints.

The Chairman of any meeting of stockholders shall determine the order of business and the procedure at the meeting, including such regulation of the manner of voting and the conduct of discussion as seems to him or her in order.

2.9 Quorum and Adjournments. Except where otherwise provided by law or the Restated Certificate of Incorporation or these Bylaws, the holders of a majority of the stock issued and outstanding and entitled to vote, present in person or represented in proxy, shall constitute a quorum at all meetings of the stockholders. The stockholders present at a duly called or held meeting at which a quorum is present may continue to do business until adjournment, notwithstanding the withdrawal of enough stockholders to have less than a quorum if any action taken (other than adjournment) is approved by at least a majority of the shares required to constitute a quorum. At such adjourned meeting at which a quorum is present or represented, any business may be transacted which might have been transacted at the meeting as originally notified. If, however, a quorum shall not be present or represented at any meeting of the stockholders, the stockholders entitled to vote thereat who are present in person or represented by proxy shall have the power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present or represented.

2.10 Voting Rights. Unless otherwise provided in the Restated Certificate of Incorporation, each stockholder shall at every meeting of the stockholders be entitled to one vote in person or by proxy for each share of the capital stock having voting power held by such stockholder.

2.11 Majority Vote. When a quorum is present at any meeting, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which by express provision of the statutes or of the Restated Certificate of Incorporation or of these Bylaws, a different vote is required in which case such express provision shall govern and control the decision of such question.

2.12 Record Date for Stockholder Notice and Voting.

(i) For purposes of determining the stockholders entitled to notice of any meeting or to vote, or entitled to receive payment of any dividend or other distribution, or entitled to exercise any right in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the Board may fix, in advance, a record date, which shall not be more than sixty (60) days nor less than ten (10) days before the date of any such meeting nor more than sixty (60) days before any other action. If the Board does not so fix a record date, the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close

of business on the business day next preceding the day on which notice is given or, if notice is waived, at the close of business on the business day next preceding the day on which the meeting is held.

(ii) For purposes of determining the stockholders entitled to consent to corporate action in writing without a meeting, the Board may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the Board, and which date shall not be more than ten (10) days after the date upon which the resolution fixing such record date is adopted by the Board. If no record date has been fixed by the Board, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting, when no prior action by the Board is required under Delaware law, shall be the first date on which a signed written consent setting forth the action taken or proposed to be taken is delivered to the corporation by hand or certified mail, return receipt requested, to its principal executive office, or to an officer or agent of the corporation having custody of the book in which proceedings of meetings of stockholders are recorded. If no record date has been fixed by the Board and prior action by the Board is required under Delaware law, the record date for determining stockholders entitled to consent to corporate action in writing without a meeting shall be the close of business on the day on which the Board adopts the resolution taking such prior action.

2.13 Proxies. To the extent permitted by law, any stockholder of record may appoint a person or persons to act as the stockholder's proxy or proxies at any stockholder meeting for the purpose of representing and voting the stockholders' shares. The stockholder may make this appointment by any means the General Corporation Law of the State of Delaware specifically authorizes, and by any other means the Secretary of the corporation may permit. A validly executed proxy which does not state that it is irrevocable shall continue in full force and effect unless (i) revoked by the person executing it, before the vote pursuant to that proxy, by a writing delivered to the corporation stating that the proxy is revoked or by a subsequent proxy executed by, or attendance at the meeting and voting in person by, the person executing the proxy; or (ii) written notice of the death or incapacity of the maker of that proxy is received by the corporation before the vote pursuant to that proxy is counted; provided, however, that no proxy shall be valid after the expiration of three years from the date of the proxy, unless otherwise provided in the proxy.

2.14 Inspectors of Election. The corporation shall, in advance of any meeting of stockholders, appoint one or more inspectors of election to act at the meeting and make a written report thereof. The corporation may designate one or more persons to act as alternate inspectors to replace any inspector who fails to act. If no inspector or alternate is able to act at a meeting of stockholders, the person presiding at the meeting shall appoint one or more inspectors to act at the meeting. Each inspector, before entering upon the discharge of his or her duties, shall take and sign an oath faithfully to execute the duties of inspector with strict impartiality and according to the best of his or her ability.

ARTICLE 3

Directors

3.1 Number, Election, Tenure and Qualifications. The Board of the corporation shall consist of not less than five (5) members nor more than nine (9) members and shall be divided into three classes, designated as Class I, Class II and Class III, as nearly equal in number as possible. The Board consists of eight (8) members, with Class I consisting of two (2) directors, Class II consisting of three (3) directors and Class III consisting of three (3) directors, and the exact number of members of any future Board, and the exact number of directors in each Class, shall be determined from time to time by resolution of the Board. Notwithstanding the foregoing, additional directorships resulting from an increase in the number of directors shall be apportioned among the classes as equally as possible.

Only persons who are nominated in accordance with the following procedures shall be eligible for election as directors. Nominations of persons for election to the Board at the annual meeting, by or at the direction of the Board, may be made by any nominating committee or person appointed by the Board; nominations may also be made by any stockholder of record of the corporation entitled to vote for the election of directors at the

meeting who complies with the notice procedures set forth in this Section. Such nominations, other than those made by or at the direction of the Board, shall be made pursuant to timely notice in writing to the Secretary of the corporation. To be timely, a stockholder's notice shall be delivered personally or deposited in the United States mail, or delivered to a common carrier for transmission to the recipient or actually transmitted by the person giving the notice by electronic means to the recipient or sent by other means of written communication, postage or delivery charges prepaid in all such cases, and received at the principal executive offices of the corporation addressed to the attention of the Secretary of the corporation not less than 60 days nor more than 90 days prior to the scheduled date of the meeting (regardless of any postponements, deferrals or adjournments of that meeting to a later date); provided, however, that, in the case of an annual meeting and in the event that less than 70 days' notice or prior public disclosure of the date of the scheduled meeting is given or made to stockholders, notice by the stockholder to be timely must be so received not later than the earlier of (a) the close of business on the 10th day following the day on which such notice of the date of the scheduled meeting was mailed or such public disclosure was made, whichever first occurs, or (b) two days prior to the date of the scheduled meeting. Such stockholder's notice to the Secretary shall set forth (a) as to each person whom the stockholder proposes to nominate for election or reelection as a director, (i) the name, age, business address and residence address of the person, (ii) the principal occupation or employment of the person, (iii) the class, series and number of shares of capital stock of the corporation that are owned beneficially by the person, (iv) a statement as to the person's citizenship, and (v) any other information relating to the person that is required to be disclosed in solicitations for proxies for election of directors pursuant to Section 14 of the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder; and (b) as to the stockholder giving the notice, (i) the name and record address of the stockholder and (ii) the class, series and number of shares of capital stock of the corporation that are owned beneficially by the stockholder. The corporation may require any proposed nominee to furnish such other information as may reasonably be required by the corporation to determine the eligibility of such proposed nominee to serve as director of the corporation. No person shall be eligible for election as a director of the corporation unless nominated in accordance with the procedures set forth herein.

In connection with any annual meeting, the Chairman of the Board (or such other person presiding at such meeting in accordance with these Bylaws) shall, if the facts warrant, determine and declare to the meeting that a nomination was not made in accordance with the foregoing procedure, and if he should so determine, he shall so declare to the meeting and the defective nomination shall be disregarded.

Directors shall serve as provided in the Restated Certificate of Incorporation of the corporation. Directors need not be stockholders.

3.2 Vacancies. Vacancies and newly created directorships resulting from any increase in the authorized number of directors may be filled by a majority of the directors then in office, though less than a quorum, or by a sole remaining director, and the directors so chosen shall hold office until the next annual election at which the term of the class to which they have been elected expires and until their successors are duly elected and shall qualify, unless sooner displaced. If there are no directors in office, then an election of directors may be held in the manner provided by statute. In the event of a vacancy in the Board, the remaining directors, except as otherwise provided by law or these bylaws, may exercise the powers of the full Board until the vacancy is filled.

3.3 Resignation and Removal. Any director may resign at any time upon written notice to the corporation at its principal place of business or to the Chief Executive Officer or the Secretary. Such resignation shall be effective upon receipt of such notice unless the notice specifies such resignation to be effective at some other time or upon the happening of some other event. Any director or the entire Board may be removed, but only for cause, by the holders of a majority of the shares then entitled to vote at an election of directors, unless otherwise specified by law or the Restated Certificate of Incorporation.

3.4 Powers. The business of the corporation shall be managed by or under the direction of the Board which may exercise all such powers of the corporation and do all such lawful acts and things which are not by statute or by the Restated Certificate of Incorporation or by these Bylaws directed or required to be exercised or done by the stockholders.

3.5 Place of Meetings. The Board may hold meetings, both regular and special, either within or without the State of Delaware.

3.6 Annual Meetings. The annual meetings of the Board shall be held immediately following the annual meeting of stockholders, and no notice of such meeting shall be necessary to the Board, provided a quorum shall be present. The annual meetings shall be for the purposes of organization, and an election of officers and the transaction of other business.

3.7 Regular Meetings. Regular meetings of the Board may be held without notice at such time and place as may be determined from time to time by the Board.

3.8 Special Meetings. Special meetings of the Board may be called by the Chairman of the Board, the Chief Executive Officer or by a majority of the Board upon one (1) day's notice to each director and can be delivered either personally, or by telephone, express delivery service (so that the scheduled delivery date of the notice is at least one (1) day in advance of the meeting), telegram or facsimile transmission, and on five (5) day's notice, by mail. The notice need not describe the purpose of the special meeting.

3.9 Quorum and Adjournments. At all meetings of the Board, a majority of the directors then in office shall constitute a quorum for the transaction of business, and the act of a majority of the directors present at any meeting at which there is a quorum shall be the act of the Board, except as may otherwise be specifically provided by law or the Restated Certificate of Incorporation. If a quorum is not present at any meeting of the Board, the directors present may adjourn the meeting from time to time, without notice other than announcement at the meeting at which the adjournment is taken, until a quorum shall be present. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved of by at least a majority of the required quorum for that meeting.

3.10 Action Without Meeting. Unless otherwise restricted by the Restated Certificate of Incorporation or these Bylaws, any action required or permitted to be taken at any meeting of the Board or of any committee thereof may be taken without a meeting, if all members of the Board or committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the Board or committee.

3.11 Telephone Meetings. Unless otherwise restricted by the Restated Certificate of Incorporation or these Bylaws, any member of the Board or any committee may participate in a meeting by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation in a meeting shall constitute presence in person at the meeting.

3.12 Waiver of Notice. Notice of a meeting need not be given to any director who signs a waiver of notice or a consent to holding the meeting or an approval of the minutes thereof, whether before or after the meeting, or who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to such director. All such waivers, consents and approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

3.13 Fees and Compensation of Directors. Unless otherwise restricted by the Restated Certificate of Incorporation or these Bylaws, the Board shall have the authority to fix the compensation of directors. The directors may be paid their expenses, if any, of attendance at each meeting of the Board and may be paid a fixed sum for attendance at each meeting of the Board or a stated salary as director. No such payment shall preclude any director from serving the corporation in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

3.14 Rights of Inspection. Any director shall have the right to examine the corporation's stock ledger, a list of its stockholders and its other books and records for a purpose reasonably related to his or her position as a director.

ARTICLE 4

Committees of Directors

4.1 Selection. The Board may, by resolution passed by a majority of the entire Board, designate one or more committees, each committee to consist of one or more of the directors of the corporation. The Board may designate one or more directors as

alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee.

In the absence or disqualification of a member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or she or they constitute a quorum, may unanimously appoint another member of the Board to act at the meeting in the place of any such absent or disqualified member.

4.2 Power. Any such committee, to the extent provided by law and to the extent provided in the resolution of the Board, shall have and may exercise all the powers and authority of the Board in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it.

4.3 Committee Minutes. Each committee shall keep regular minutes of its meetings and report the same to the Board when required.

ARTICLE 5

Officers

5.1 Officers Designated. The officers of the corporation shall be chosen by the Board and shall be a Chief Executive Officer, a President, a Secretary and a Chief Financial Officer. The Board may also choose a Chairman of the Board, one or more Vice Presidents, and one or more assistant Secretaries. Any number of offices may be held by the same person, unless the Restated Certificate of Incorporation or these Bylaws otherwise provide.

5.2 Appointment of Officers. The officers of the corporation, except such officers as may be appointed in accordance with the provisions of Section 5.3 or 5.5 of this Article 5, shall be chosen in such manner and shall hold their offices for such terms as are prescribed by these Bylaws or determined by the Board. Each officer shall hold his or her office until his or her successor is elected and qualified or until his or her earlier resignation or removal. This section does not create any rights of employment or continued employment. The corporation may secure the fidelity of any or all of its officers or agents by bond or otherwise.

5.3 Subordinate Officers. The Board may appoint, and may empower the Chief Executive Officer to appoint, such other officers and agents as the business of the corporation may require, each of whom shall hold office for such period, have such authority and perform such duties as are provided in the Bylaws or as the Board may from time to time determine.

5.4 Removal and Resignation of Officers. Subject to the rights, if any, of an officer under any contract of employment, any officer may be removed, either with or without cause, by an affirmative vote of the majority of the Board, at any regular or special meeting of the Board, or, except in case of an officer chosen by the Board, by any officer upon whom such power of removal may be conferred by the Board.

Any officer may resign at any time by giving written notice to the corporation. Any resignation shall take effect at the date of the receipt of that notice or at any later time specified in that notice; and, unless otherwise specified in that notice, the acceptance of the resignation shall not be necessary to make it effective. Any resignation is without prejudice to the rights, if any, of the corporation under any contract to which the officer is a party.

5.5 Vacancies in Offices. A vacancy in any office because of death, resignation, removal, disqualification or any other cause shall be filled in the manner prescribed in these Bylaws for regular appointment to that office.

5.6 Compensation. The salaries of all officers of the corporation shall be fixed from time to time by the Board and no officer shall be prevented from receiving a salary because he or she is also a director of the corporation.

5.7 The Chairman of the Board. The Chairman of the Board, if such an officer be elected, shall, if present, perform such other powers and duties as may be assigned to him or her from time to time by the Board. If there is no elected Chief Executive Officer, the Chairman of the Board shall also be the Chief Executive Officer of the Corporation and shall have the powers and duties prescribed in Section 5.8 of this Article 5.

5.8 The Chief Executive Officer. Subject to such supervisory powers, if any, as may be given by the Board to the

Chairman of the Board, if there be such an officer, the Chief Executive Officer of the Corporation, shall preside at all meetings of the stockholders and in the absence of the Chairman of the Board, or if there be none, at all meetings of the Board, shall have general and active management of the business of the Corporation and shall see that all orders and resolutions of the Board are carried into effect. He or she shall execute bonds, mortgages and other contracts requiring a seal, under the seal of the Corporation, except where required or permitted by law to be otherwise signed and executed and except where the signing and execution thereof shall be expressly delegated by the Board to some other officer or agent of the Corporation.

5.9 The President. The President, shall in the absence of the Chief Executive Officer or in the event of his or her disability or refusal to act, perform the duties of the Chief Executive Officer, and when so acting, shall have the powers of and subject to all the restrictions upon the Chief Executive Officer. The President shall perform such other duties and have such other powers as may from time to time be prescribed for him or her by the Board, Chief Executive Officer, the Chairman of the Board or these Bylaws.

5.10 The Vice President. The Vice President (or in the event there be more than one, the Vice Presidents in the order designated by the directors, or in the absence of any designation, in the order of their election), shall, in the absence of the President or in the event of his or her disability or refusal to act, perform the duties of the President, and when so acting, shall have the powers of and subject to all the restrictions upon the President. The Vice President(s) shall perform such other duties and have such other powers as may from time to time be prescribed for them by the Board, the Chief Executive Officer, the Chairman of the Board or these Bylaws.

5.11 The Secretary. The Secretary shall attend all meetings of the Board and the stockholders and record all votes and the proceedings of the meetings in a book to be kept for that purpose and shall perform like duties for the standing committees, when required. The Secretary shall give, or cause to be given, notice of all meetings of stockholders and special meetings of the Board, and shall perform such other duties as may from time to time be prescribed by the Board, the Chairman of the Board or the Chief Executive Officer, under whose supervision he or she shall act. The Secretary shall have custody of the seal of the corporation, and the Secretary, or an Assistant Secretary, shall have authority to affix the same to any instrument requiring it, and, when so affixed, the seal may be attested by his or her signature or by the signature of such Assistant Secretary. The Board may give general authority to any other officer to affix the seal of the corporation and to attest the affixing thereof by his or her signature. The Secretary shall keep, or cause to be kept, at the principal executive office or at the office of the corporation's transfer agent or registrar, as determined by resolution of the Board, a share register, or a duplicate share register, showing the names of all stockholders and their addresses, the number and classes of shares held by each, the number and date of certificates issued for the same and the number and date of cancellation of every certificate surrendered for cancellation.

5.12 The Assistant Secretary. The Assistant Secretary, or if there be more than one, the Assistant Secretaries in the order designated by the Board (or in the absence of any designation, in the order of their election) shall, in the absence of the Secretary or in the event of his or her inability or refusal to act, perform the duties and exercise the powers of the Secretary and shall perform such other duties and have such other powers as may from time to time be prescribed by the Board.

5.13 The Chief Financial Officer. The Chief Financial Officer shall have the custody of the Corporate funds and securities and shall keep full and accurate accounts of receipts and disbursements in books belonging to the corporation and shall deposit all moneys and other valuable effects in the name and to the credit of the corporation in such depositories as may be designated by the Board. The Chief Financial Officer shall disburse the funds of the corporation as may be ordered by the Board, taking proper vouchers for such disbursements, and shall render to the Chief Executive Officer and the Board, at its regular meetings, or when the Board so requires, an account of all his or her transactions as Chief Financial Officer and of the financial condition of the corporation.

ARTICLE 6

Stock Certificates

6.1 Certificates for Shares. The shares of the corporation

shall be represented by certificates or shall be uncertificated. Certificates shall be signed by, or in the name of the corporation by, the Chairman of the Board, the President or a Vice President and by the Chief Financial Officer, the Secretary or an Assistant Secretary of the corporation.

Within a reasonable time after the issuance or transfer of uncertificated stock, the corporation shall send to the registered owner thereof a written notice containing the information required by the General Corporation Law of the State of Delaware or a statement that the corporation will furnish without charge to each stockholder who so requests the powers, designations, preferences and relative participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

6.2 Signatures on Certificates. Any or all of the signatures on a certificate may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if he or she were such officer, transfer agent or registrar at the date of issue.

6.3 Transfer of Stock. Upon surrender to the corporation or the transfer agent of the corporation of a certificate of shares duly endorsed or accompanied by proper evidence of succession, assignation or authority to transfer, it shall be the duty of the corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its books. Upon receipt of proper transfer instructions from the registered owner of uncertificated share, such uncertificated shares shall be canceled and issuance of new equivalent uncertificated shares or certificated shares shall be made to the person entitled thereto and the transaction shall be recorded upon the books of the corporation.

6.4 Registered Stockholders. The corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and to hold liable for calls and assessments a percent registered on its books as the owner of shares, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

6.5 Lost, Stolen or Destroyed Certificates. The Board may direct that a new certificate or certificates be issued to replace any certificate or certificates theretofore issued by the corporation alleged to have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen or destroyed. When authorizing the issue of a new certificate or certificates, the Board may, in its discretion and as a condition precedent to the issuance thereof, require the owner of the lost, stolen or destroyed certificate or certificates, or his or her legal representative, to advertise the same in such manner as it shall require, and/or to give the corporation a bond in such sum as it may direct as indemnity against any claim that may be made against the corporation with respect to the certificate alleged to have been lost, stolen or destroyed.

ARTICLE 7

General Provisions

7.1 Dividends. Dividends upon the capital stock of the corporation, subject to any restrictions contained in the General Corporation Law of the State of Delaware or the provisions of the Restated Certificate of Incorporation, if any, may be declared by the Board at any regular or special meeting. Dividends may be paid in cash, in property or in shares of the capital stock, subject to the provisions of the Restated Certificate of Incorporation.

7.2 Dividend Reserve. Before payment of any dividend, there may be set aside out of any funds of the corporation available for dividends such sum or sums as the directors from time to time, in their absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the corporation, or for such other purpose as the directors shall think conducive to the interest of the corporation, and the directors may modify or abolish any such reserve in the manner in which it was created.

7.3 Checks. All checks or demands for money and notes of the corporation shall be signed by such officer or officers or such other person or persons as the Board may from time to time designate.

7.4 Corporate Seal. The Board may provide a suitable seal, containing the name of the corporation, which seal shall be in charge of the Secretary. If and when so directed by the Board or a committee thereof, duplicates of the seal may be kept and used by the Chief Financial Officer or by any Assistant Secretary.

7.5 Execution of Corporate Contracts and Instruments. The Board, except as otherwise provided in these Bylaws, may authorize any officer or officers, or agent or agents, to enter into any contract or execute any instrument in the name of and on behalf of the corporation; such authority may be general or confined to specific instances. Unless so authorized or ratified by the Board or within the agency power of an officer, no officer, agent or employee shall have any power or authority to bind the corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or for any amount.

7.6 Representation of Shares of Other Corporations. The Chief Executive Officer, President or any Vice President or the Secretary or any Assistant Secretary of this corporation is authorized to vote, represent and exercise on behalf of this corporation all rights incident to any and all shares of any corporation or corporations standing in the name of this corporation. The authority herein granted to said officers to vote or represent on behalf of this corporation any and all shares held by this corporation in any other corporation or corporations may be exercised either by such officers in person or by any other person authorized so to do by proxy or power of attorney duly executed by said officers.

ARTICLE 8

Miscellaneous

8.1 Stock Options. . Without the affirmative vote of the holders of more than fifty percent (50%) of the voting power of all of the then outstanding shares of the stock of the corporation entitled to vote generally in the election of directors, voting together as a single class, the corporation shall not grant to any officer of the corporation any stock options at less than the closing market price on the date of grant or reduce the price of any options which either (i) were granted as a non-qualified stock option grant to an incoming employee or vendor or (ii) were granted under any of the corporation's existing or future stock option plans, provided, however, that the foregoing shall not preclude the corporation from issuing new, lower priced options issued from a stock option plan to persons holding higher priced options from such plan, provided further, however, that if such new lower priced options are granted in exchange for such higher priced options, the shares covered by such higher priced options shall be canceled or surrendered and not available for re-grant under such stock option plan.

8.2 Amendments. The Board of Directors is expressly empowered to adopt, amend or repeal these Bylaws, provided, however, that any adoption, amendment or repeal of these Bylaws by the Board of Directors shall require the approval of at least sixty-six and two-thirds percent (66-2/3%) of the total number of authorized directors (whether or not there exist any vacancies in previously authorized directorships at the time any resolution providing for adoption, amendment or repeal is presented to the board). The stockholders shall also have power to adopt, amend or repeal these Bylaws, provided, however, that in addition to any vote of the holders of any class or series of stock of this corporation required by law or by the Restated Certificate of Incorporation of this corporation, the affirmative vote of the holders of more than fifty percent (50%) of the voting power of all of the then outstanding shares of the stock of the corporation entitled to vote generally in the election of directors, voting together as a single class, shall be required for such adoption, amendment or repeal by the stockholders of any provisions of these Bylaws. Notwithstanding the foregoing sentence, the affirmative vote of the holders of at least sixty-six and two-thirds percent (66 2/3%) of the voting power of all of the then outstanding shares of the stock of the corporation entitled to vote generally in the election of directors, voting together as a single class, shall be required for the amendment or repeal of Article 3.1 of these Bylaws.

Notwithstanding the foregoing paragraph or any provision of the Restated Certificate of Incorporation, Section 8.1 of these Bylaws may only be amended by the affirmative vote of the holders

of more than fifty percent (50%) of the voting power of all of the then outstanding shares of the stock of the corporation entitled to vote generally in the election of directors, voting together as a single class.

HESKA CORPORATION
MANAGEMENT INCENTIVE COMPENSATION PLAN
2001

This plan is intended to provide incentives to the senior management of Heska Corporation for the achievement of goals and objectives that are essential to the growth and continued success of the Company. This management incentive compensation ("MIC") plan replaces in its entirety the 1999 Heska Corporation Executive Bonus Plan.

The MIC plan target payouts for 2001 are based on a percentage of the individuals base pay earned during the year 2001, excluding any other commissions, bonuses, relocation payments or other forms of compensation not considered part of the employees base pay.

For individuals becoming eligible for participation in the MIC plan after January 1, all MIC calculations shall be based on the amount of base pay earned while a plan participant; earnings prior to becoming a plan participant shall be excluded. Any individual becoming eligible to participate in the MIC plan after June 30, must have Compensation Committee approval.

The plan targets for 2001 are as follows:

Chief Executive Officer	60% of base pay
Chief Operating Officer	50% of base pay
Chief Financial Officer	35% of base pay
Executive Vice Presidents	35% of base pay
Vice Presidents	30% of base pay
Directors	25% of base pay

The total MIC target for each participant shall be earned based on the achievement of the following objectives:

Net Income (Loss)	50% of target earned
Total Revenue	25% of target earned
Discretionary	25% of target earned
Total MIC Target	100% of target earned

The Net Income (Loss) objective and Total Revenue objective shall be based on the final approved 2001 Consolidated Budget for the Company. The Discretionary objective shall be based on individual contributions as determined by the Chief Executive Officer, for all plan participants other than the CEO, and as determined by the Compensation Committee for the CEO.

NET INCOME (LOSS) OBJECTIVE

The amount of the Net Income (Loss) objective earned shall be determined as follows:

ACTUAL NET LOSS AS % OF BUDGET	AMOUNT OF OBJECTIVE EARNED
115 % or greater	0%
106 % to 115%	50%
101% to 105%	75%
100%	100%
For every 1% above budget	Increase amount earned by 1%

TOTAL REVENUE OBJECTIVE

The amount of the Total Revenue objective earned shall be determined as follows:

ACTUAL REVENUE AS % OF BUDGET	AMOUNT OF OBJECTIVE EARNED
Less than 85 %	0%
85 % to 94%	50%
95% to 99%	75%
100%	100%
For every 1% above budget	Increase amount earned by 1%

The total MIC payment earned by any participant shall not exceed 200% of their base pay.

All MIC amounts earned shall be paid in cash only after the Compensation Committee has reviewed management's calculations of such bonus payouts, in conjunction with the audited financial statements for the year in question. MIC Plan participants must remain employees of Heska Corporation or one of its affiliates in a position which qualifies for

MIC Plan participation, through December 31, 2001 in order to be eligible to earn any payouts under this plan.

Exhibit 23.1

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As Independent Public Accountants, we hereby consent to the incorporation of our report included in this Form 10-K for Heska Corporation and Subsidiaries into the Company's previously filed registration statement file no. 333-55602.

/s/ Arthur Andersen LLP

Denver, Colorado,
March 29, 2001.