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## **FORM 10-K**

**HESKA CORP - HSKA**

**Filed: March 06, 2017 (period: December 31, 2016)**

Annual report with a comprehensive overview of the company

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

**FORM 10-K**

(Mark One)



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

For the fiscal year ended December 31, 2016  
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**

(State or other jurisdiction of  
incorporation or organization)

**3760 Rocky Mountain Avenue  
Loveland, Colorado**

(Address of principal executive offices)

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

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

**Public Common Stock, \$0.01 par value**  
(Title of Class)

**77-0192527**  
(I.R.S. Employer  
Identification Number)

**80538**  
(Zip Code)

**The Nasdaq Stock Market LLC**  
(Name of Each Exchange on Which Registered)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act.

Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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 in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a small reporting company)

Smaller Reporting Company

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

The aggregate market value of voting common stock held by non-affiliates of the Registrant was approximately \$228,685,202 as of June 30, 2016 based upon the closing price on the Nasdaq Capital Market reported for such date. This calculation does not reflect a determination that certain persons are affiliates of the Registrant for any other purpose.

7,052,880 shares of the Registrant's Public Common Stock, \$.01 par value, were outstanding at March 2, 2017.

**DOCUMENTS INCORPORATED BY REFERENCE**

Items 10, 11, 12, 13 and 14 of Part III incorporate by reference information from the Registrant's definitive proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the Registrant's 2017 Annual Meeting of Stockholders.

## TABLE OF CONTENTS

	<u>Page</u>
<b><u>PART I</u></b>	<b>1</b>
Item 1. <a href="#"><u>Business</u></a>	1
Item 1A. <a href="#"><u>Risk Factors</u></a>	12
Item 1B. <a href="#"><u>Unresolved Staff Comments</u></a>	26
Item 2. <a href="#"><u>Properties</u></a>	26
Item 3. <a href="#"><u>Legal Proceedings</u></a>	26
Item 4. <a href="#"><u>Mine Safety Disclosures</u></a>	27
<b><u>PART II</u></b>	<b>28</b>
Item 5. <a href="#"><u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities</u></a>	28
Item 6. <a href="#"><u>Selected Financial Data</u></a>	30
Item 7. <a href="#"><u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u></a>	31
Item 7A. <a href="#"><u>Quantitative and Qualitative Disclosures about Market Risk</u></a>	42
Item 8. <a href="#"><u>Financial Statements and Supplementary Data</u></a>	43
Item 9. <a href="#"><u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u></a>	74
Item 9A. <a href="#"><u>Controls and Procedures</u></a>	74
Item 9B. <a href="#"><u>Other Information</u></a>	75
<b><u>PART III</u></b>	<b>75</b>
Item 10. <a href="#"><u>Directors, Executive Officers and Corporate Governance</u></a>	75
Item 11. <a href="#"><u>Executive Compensation</u></a>	76
Item 12. <a href="#"><u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u></a>	76
Item 13. <a href="#"><u>Certain Relationships and Related Transactions, and Director Independence</u></a>	76
Item 14. <a href="#"><u>Principal Accountant Fees and Services</u></a>	76
<b><u>PART IV</u></b>	<b>77</b>
Item 15. <a href="#"><u>Exhibits and Financial Statement Schedules</u></a>	77
Item 16. <a href="#"><u>Form 10-K Summary</u></a>	83
<a href="#"><u>Signatures</u></a>	84
<a href="#"><u>Exhibit Index</u></a>	85

HESKA, ALLERCEPT, HEMATRUE, SOLO STEP, THYROMED, VET/OX and VITALPATH are registered trademarks of Heska Corporation. TRI-HEART is a registered trademark of Intervet Inc., d/b/a Merck Animal Health, formerly known as Schering-Plough Animal Health Corporation ("Merck Animal Health"), which is a unit of Merck & Co., Inc., in the United States and is a registered trademark of Heska Corporation in other countries. DRI-CHEM is a registered trademark of FUJIFILM Corporation. This annual report on Form 10-K also refers to trademarks and trade names of other organizations.

## Statement Regarding Forward Looking Statements

This Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). For this purpose, any statements contained herein that are not statements of current or historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results could differ materially from those expressed or forecasted in any such forward-looking statements as a result of certain factors, including those set forth in "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business" and elsewhere in this Form 10-K. Readers are cautioned not to place undue reliance on these forward-looking statements.

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 the passage of time, any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based, except as otherwise required by applicable securities laws. These forward-looking statements apply only as of the date of this Form 10-K or for statements incorporated by reference from our 2017 proxy statement on Schedule 14A, as of the date of the Schedule 14A.

## PART I

### Item 1. Business.

*Unless we state otherwise or the context otherwise requires, the terms "Heska," "we," "our," "us" and the "Company" refer to Heska Corporation and its consolidated subsidiaries.*

#### Overview

We sell advanced veterinary diagnostic and specialty products. Our offerings include blood testing instruments and supplies, digital imaging products, software and services, vaccines, local and cloud-based data services, allergy testing and immunotherapy, and single-use offerings such as in-clinic diagnostic tests and heartworm preventive products. Our core focus is on the canine and feline healthcare space.

On February 24, 2013, we acquired a 54.6% interest in Cuattro Veterinary USA, LLC (the "Acquisition"), which was subsequently renamed Heska Imaging US, LLC ("US Imaging") and marked our entry into the veterinary imaging market in the United States.

On May 31, 2016, we acquired Cuattro Veterinary, LLC ("Cuattro International"), which was subsequently renamed Heska Imaging International, LLC ("International Imaging") and marked our entry into the international veterinary imaging market. Financial information broken out by geographic region is incorporated by reference to Note 13 to the financial statements included under Item 8 of this annual report on Form 10-K.

We were founded as Paravax, Inc. and incorporated in California in 1988. We changed our name to Heska Corporation in 1995, reincorporated in Delaware and completed our initial public offering in 1997.

Our principal executive offices are located at 3760 Rocky Mountain Avenue, Loveland, Colorado 80538, our telephone number is (970) 493-7272 and our internet address is www.heska.com.

## **Products and Services**

Our business is composed of two reportable segments, Core Companion Animal Health ("CCA") and Other Vaccines, Pharmaceuticals and Products ("OVP"). The CCA segment includes, primarily for canine and feline use, blood testing instruments and supplies, digital imaging products, software and services, local and cloud-based data services, allergy testing and immunotherapy, and single use offerings such as in-clinic diagnostic tests and heartworm preventive products. The OVP segment includes private label vaccine and pharmaceutical production, primarily for cattle but also for other species including equine, porcine, avian, feline and canine. All OVP products are sold by third parties under third party labels.

### **Core Companion Animal Health Segment**

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

#### ***Veterinary Blood Testing and Other Non-Imaging Instruments***

We offer a line of veterinary blood testing and other instruments, some of which are described below. We also market and sell consumable supplies for these instruments. Our line of veterinary instruments includes the following:

- *Blood Chemistry.* The Element DC<sup>®</sup> Veterinary Chemistry Analyzer (the "Element DC") is an easy-to-use, robust system that uses dry slide technology for blood chemistry and electrolyte analysis and has the ability to run 22 tests at a time with a single blood sample. Test slides are available as both pre-packaged panels as well as individual slides. The DRI-CHEM 7000 Veterinary Chemistry Analyzer (the "DRI-CHEM 7000") is a complementary chemistry offering, co-branded with FUJIFILM Corporation ("FUJIFILM"), with higher throughput, multiple patient staging and a "STAT" feature which provides emergency sample flexibility in critical cases. The Element DC and DRI-CHEM 7000 utilize the same test slides. We are supplied with the Element DC, the DRI-CHEM 7000 and affiliated test slides and supplies under a contractual agreement with FUJIFILM.
- *Hematology.* The Element HT5<sup>®</sup> Hematology Analyzer (the "HT5") is a true 5-part hematology analyzer which uses laser, impedance and colorimetric technologies to measure key parameters such as white blood cell count, red blood cell count, platelet count and hemoglobin levels in animals. The HT5, which we began shipping in January 2015, can generate results in less than a minute with 15  $\mu$ L of sample. We are supplied with the HT5 and affiliated reagents and supplies under a contractual agreement with Shenzhen Mindray Bio-Medical Electronics Co., Ltd. ("Mindray"). The HEMATTRUE Veterinary Hematology Analyzer (the "HEMATTRUE") is an easy-to-use and reliable 3-part hematology blood analyzer that we continue to offer to our customers. We are supplied HEMATTRUE instruments and affiliated reagents and supplies for the HEMATTRUE under a contractual agreement with Boule Medical AB ("Boule").
- *Blood Gases and Electrolytes.* The Element POC<sup>®</sup> Blood Gas & Electrolyte Analyzer ("EPOC") is a handheld, wireless analyzer which delivers rapid blood gas, electrolyte, metabolite, and basic blood chemistry testing. EPOC features test cards with room temperature storage which can offer results with less than 100  $\mu$ L of sample as well as WiFi and Bluetooth connectivity. We began to ship EPOC units to customers in October 2013. EPOC and affiliated consumables and supplies

are supplied to us under a contractual agreement with Alere North America, LLC, a unit of Alere Inc.

- *Immunodiagnosics.* The Element i Immunodiagnostic Analyzer ("Element i") utilizes fluorescence immunoassay technology to ensure sensitivity for accurate in-clinic detection of Total T4, TSH and Cortisol. The Element i is a benchtop technology with a test time of 10 minutes or less per analyte. Along with confidence in results, this measurement principle allows for simplified reagents and testing protocols. Element i units, which we began shipping in December 2015, are supplied to us under a contractual agreement with FUJIFILM.
- *IV Pumps.* The VET/IV 2.2 infusion pump is a compact, affordable IV pump that allows veterinarians to easily provide regulated infusion of fluids for their patients.

### ***Veterinary Imaging Instruments and Services***

We offer a line of veterinary imaging instruments and services, including:

*Digital Radiography Solutions.* Our digital radiography solutions are marketed and sold under the "Cuattro" brand name. We sell hardware including digital radiography detectors, acquisition workstation equipment, positioning aides such as tunnels and tables, viewing computers and other accessories along with embedded software and support, data hosting and other services. CloudDR™ solutions combine flat panel digital radiography acquisition with web-based image storage. Cloudbank™ is an automatic, secure, web-based image storage solution designed to interface with the software we sell. ViewCloud™ is a PACS (Picture Archival and Communications System) for Cloudbank for web or local viewing, reporting, planning and email sharing of studies on internet devices, including personal computers, tablet devices and smartphones. SupportCloud™ is a support package including call center voice and remote diagnostics, recovery and other services, such as the provision of warranty-related loaner units, to support CloudDR, Cloudbank and ViewCloud.

We also sell mobile digital radiography products, primarily for equine use. The Uno 6™ is a full powered, seamlessly integrated, portable digital radiography generator with an embedded touchscreen digital radiography acquisition computer based upon a patented design of Cuattro, LLC. The Slate 6™ is a mobile digital radiography acquisition console with a direct sunlight readable display, including multi-touch software. Slate 6 and Uno 6 have the ability to link to Digital Imaging and Communication in Medicine (DICOM) servers of all types as well as Cloudbank.

Cuattro, LLC provides us with the hardware, software and support, data hosting and other services for our digital radiography solutions under exclusive contractual arrangements in the United States and shares held by our President and Chief Executive Officer, Kevin S. Wilson, his spouse, Shawna M. Wilson ("Mrs. Wilson") and by trusts for the benefit of their children and family, comprise 100% ownership of Cuattro, LLC.

*Ultrasound Systems.* Our ultrasound products, including affiliated probes and peripherals, are provided to us under an exclusive agreement with Esaote USA ("Esaote"). We sell several different ultrasound products with varying features and corresponding price points, all under Esaote's trade names or logos. These offerings include the MyLab family of high performance systems and probes, for use in abdominal, cardiac and small parts applications in companion animal and equine patients as well as other species. The ultrasound products we sell generally seamlessly integrate with our Cloudbank and ViewCloud offerings for image storing and viewing.

### ***Point-of-Care Heartworm Diagnostic Tests***

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 that live in the pulmonary arteries and heart of the host, where they can cause serious cardiovascular, pulmonary, liver and kidney disease. Our canine and feline heartworm diagnostic tests use monoclonal antibodies or a recombinant heartworm antigen, respectively, to detect heartworm antigens or antibodies circulating in the blood of an infected animal.

We currently market and sell heartworm diagnostic tests for both dogs and cats. SOLO STEP CH for dogs and SOLO STEP FH for cats are available in point-of-care, single use formats that can be used by veterinarians on site. We also offer SOLO STEP CH Batch Test Strips, a rapid and simple point-of-care antigen detection test for dogs that allows veterinarians in larger practices to run multiple samples at the same time. We obtain SOLO STEP CH, SOLO STEP FH and SOLO STEP Batch Test Strips under a contractual agreement with Quidel Corporation ("Quidel").

### ***Heartworm Preventive Products***

We have an agreement with Merck Animal Health, a unit of Merck & Co., Inc., granting Merck Animal Health the exclusive distribution and marketing rights for our canine heartworm prevention product, TRI-HEART Plus Chewable Tablets, ultimately sold to or through veterinarians in the United States and Canada. TRI-HEART Plus Chewable Tablets (ivermectin/pyrantel) are indicated for use as a monthly preventive treatment of canine heartworm infection and for treatment and control of ascarid and hookworm infections. We manufacture TRI-HEART Plus Chewable Tablets at our Des Moines, Iowa production facility.

### ***Allergy Products and Services***

Allergy is common in companion animals, and it has been 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 can be 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 believe that our ALLERCEPT Definitive Allergen Panels provide the most accurate determination of which we are aware of the specific allergens to which an animal, such as a dog, cat or horse, is reacting. The panels use a highly specific recombinant version of the natural IgE receptor to test 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, insect and mite allergens. The test results serve as the basis for prescription ALLERCEPT Therapy Shots and ALLERCEPT Therapy Drops. We operate veterinary laboratories in Loveland, Colorado and Fribourg, Switzerland which both offer blood testing using our ALLERCEPT Definitive Allergen Panels.

We sell kits to conduct blood testing using our ALLERCEPT Definitive Allergen Panels to third-party veterinary diagnostic laboratories outside of the United States. We also sell products to screen for the presence of allergen-specific IgE to these customers - we sell kits to conduct preliminary blood testing using products based on our ALLERCEPT Definitive Allergen Panels as well as a similar test requiring less technical sophistication, our E-SCREEN Test. Animals testing positive for allergen-specific IgE using these screening tests are candidates for further evaluation using our ALLERCEPT Definitive Allergen Panels.

Veterinarians who use our ALLERCEPT Definitive Allergen Panels often purchase our ALLERCEPT Therapy Shots or ALLERCEPT Therapy Drops for those animals with positive test results. These prescription immunotherapy 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 subcutaneous injections (Shots) or by daily sublingual (under the tongue) administration (Drops), with doses increasing over several months, to ameliorate the allergic condition of the animal. Immunotherapy is generally continued for an extended time. We offer canine, feline and equine subcutaneous and sublingual immunotherapy treatment products. We believe our ALLERCEPT Therapy Drops offer a convenient alternative to subcutaneous injection, thereby increasing the likelihood of pet owner compliance.

#### **Other Vaccines, Pharmaceuticals and Products Segment**

We developed a line of bovine vaccines that are licensed by the United States Department of Agriculture ("USDA"). Historically, the largest distributor of these vaccines was Agri Laboratories, Ltd. ("AgriLabs"), who sold these vaccines primarily under the Titanium® and MasterGuard® brands. In November 2013, AgriLabs assigned the long-term agreement with us related to these vaccines to, and the agreement was assumed by, Eli Lilly and Company ("Eli Lilly") acting through Elanco. In January 2015, we signed a long-term Master Supply Agreement related to these vaccines with Eli Lilly acting through Elanco, thereby terminating the AgriLabs agreement previously assumed by Eli Lilly in November 2013.

We manufacture biological and pharmaceutical products for a number of other animal health companies. We manufacture products for animals other than cattle including horses, pigs, chickens, cats and dogs. Our offerings range from providing complete turnkey services which include research, licensing, production, labeling and packaging of products to providing any one of these services as needed by our customers as well as validation support and distribution services.

#### **Marketing, Sales and Customer Support**

We estimate that there are approximately 53,000 veterinarians in the United States whose practices are devoted principally to small animal medicine and these veterinarians practice in approximately 24,000 clinics in the United States. Veterinarians may obtain our products directly from us or indirectly through others. All our Core Companion Animal Health products ultimately are sold primarily to or through veterinarians. In many cases, veterinarians will markup their costs to the end user. The acceptance of our products by veterinarians is critical to our success.

We currently market our Core Companion Animal Health products in the United States to veterinarians through an outside field organization, a telephone sales force, independent third-party distributors, as well as through trade shows and print advertising and through other distribution relationships, such as Merck Animal Health in the case of our heartworm preventive. As of December 31, 2016, our outside field organization consisted of 36 individuals in various parts of the United States and our inside sales force consisted of 16 individuals.

We have a staff dedicated to customer and product support in our Core Companion Animal Health segment including veterinarians, technical support specialists and service technicians. Individuals from our product development group may also be used as a resource in responding to certain product inquiries.

Internationally, we market our Core Companion Animal Health products to veterinarians primarily through third-party veterinary diagnostic laboratories and independent third-party distributors.

All OVP products are marketed and sold by third parties under third-party labels.



We grant third parties rights to our intellectual property as well as our products, with our compensation often taking the form of royalties and/or milestone payments.

### **Manufacturing**

The majority of our revenue is from proprietary products manufactured by third parties. Third parties manufacture our veterinary instruments, including affiliated consumables and supplies, as well as other products including key components of our heartworm point-of-care diagnostic tests. Our chemistry and immunodiagnostic instruments and affiliated supplies are manufactured under contracts with FUJIFILM. Our hematology instruments and affiliated supplies are manufactured under contracts with Mindray and Boule. Our blood gas and electrolyte analyzers and affiliated supplies are supplied under a contract with Alere North America, LLC. Our digital radiography products are supplied under a contract with Cuattro, LLC, which typically buys its hardware products and components from third parties. Our ultrasound products are supplied under a contract with Esaote USA. Key components of our heartworm point-of-care diagnostic tests are manufactured under a contract with Quidel. We manufacture and supply Quidel with certain critical raw materials and perform the final packaging operations for these products.

Our facility in Des Moines, Iowa is a USDA, Food and Drug Administration ("FDA"), and Drug Enforcement Agency ("DEA") licensed biological and pharmaceutical manufacturing facility. This facility currently has the capacity to manufacture more than 50 million doses of vaccine each year. We expect that we will, for the foreseeable future, manufacture most or all of our pharmaceutical and biological products at this facility, as well as most or all of our recombinant proteins and other proprietary reagents for our diagnostic tests. We currently manufacture our canine heartworm prevention product, our allergy treatment products and all our OVP segment products at this facility. Our OVP segment's customers purchase products in both finished and bulk format, and we perform all phases of manufacturing, including growth of the active bacterial and viral agents, sterile filling, lyophilization and packaging at this facility. We manufacture our various allergy products at our Des Moines facility, our Loveland facility and our Fribourg facility. We believe the raw materials for products we manufacture are available from more than one source.

### **Product Development**

We are committed to providing innovative products to address health needs of companion animals. We may obtain such products from external sources, external collaboration or internal research and development.

We are committed to identifying external product opportunities and creating business and technical collaborations that lead to high value veterinary 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. We have collaborated, and intend to continue to do so, with a number of companies and universities. Examples of such collaborations include:

- Quidel for the development of SOLO STEP CH Cassettes, SOLO STEP CH Batch Test Strips and SOLO STEP FH Cassettes;
- Mindray for the development of veterinary applications for the ELEMENT HT5 Veterinary Hematology Analyzer and associated reagents; and
- FUJIFILM for the development of veterinary applications for the Element DC Veterinary Chemistry Analyzer and associated slides and supplies.

Internal research and development is managed on a case-by-case basis. We employ individuals with expertise in various applicable areas and will form multidisciplinary product-associated teams as appropriate. We incurred expenses of \$2.1 million, \$1.7 million and \$1.4 million in the years ended December 31, 2016, 2015 and 2014, respectively, in support of our research and development activities.

### **Intellectual Property**

We believe that patents, trademarks, copyrights and other proprietary rights represent opportunities to grow our business and maintain or enhance our competitive position. We also rely upon trade secrets, know-how, continuing technological innovations and licensing opportunities to develop and maintain our competitive position. The proprietary technologies of our OVP segment are primarily protected through trade secret protection of, for example, our manufacturing processes in this area.

We actively seek patent protection both in the United States and abroad. Our issued patent portfolios primarily relate to heartworm control, flea control, allergy, infectious disease vaccines, diagnostic and detection tests, immunomodulators, instrumentation, nutrition, pain control and vaccine delivery technologies. As of December 31, 2016, we owned, co-owned or had rights to 103 issued U.S. patents expiring at various dates from January 2017 to May 2028 and had no pending U.S. patent applications. Our corresponding foreign patent portfolio as of December 31, 2016 included 80 issued patents in various foreign countries expiring at various dates from March 2017 to August 2024 and had no pending applications.

We also have obtained exclusive and non-exclusive licenses for numerous other patents held by academic institutions and for profit companies.

### **Seasonality**

Our fourth quarter results in any given year are typically stronger than those for any other quarter. We expect this trend to continue in the future as it is a historical trend within our digital imaging business.

### **Government Regulation**

Although the majority of our revenue is from the sale of unregulated items, many of our products or products that we may develop are, or may be, subject to extensive regulation by governmental authorities in the United States, including the USDA and the FDA, and by similar agencies in other countries. These regulations govern, among other things, the development, testing, manufacturing, labeling, storage, pre-market approval, advertising, promotion, sale and distribution of our products. Satisfaction of these requirements can take several years to achieve and the time needed to satisfy them may vary substantially, based on the type, complexity and novelty of the product. Any product that we develop must receive all relevant regulatory approval or clearances, if required, before it may be marketed in a particular country. The following summarizes the major U.S. government agencies that regulate animal health products:

- *USDA.* Vaccines and certain single use, point-of-care diagnostics are considered veterinary biologics and are therefore regulated by the Center for Veterinary Biologics, or CVB, of the USDA. Industry data indicates that it takes approximately four years and in excess of \$1.0 million to license a conventional vaccine for animals from basic research through licensing. In contrast to vaccines, single use, point-of-care diagnostics can typically be licensed by the USDA in about two years, at 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 and target animal studies and information on performance of the product in field conditions.

- *FDA.* Pharmaceutical products, which typically include synthetic compounds, are approved and monitored by the Center for Veterinary Medicine of the FDA. Under the Federal Food, Drug and Cosmetic Act, the same statutory standard for FDA approval applies to both human and animal drugs: demonstrated safety, efficacy and compliance with FDA manufacturing standards. 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. The process can be costly and time consuming, requiring up to \$100 million and seven to ten years to sell an animal drug in the market. In addition, the time and cost for developing companion animal drugs may be significantly less than for drugs for livestock animals, which generally have enhanced standards designed to ensure safety in the food chain.
- *EPA.* Products that are applied topically to animals or to premises to control external parasites are regulated by the Environmental Protection Agency, or EPA.

After we have received regulatory licensing or approval for our products, numerous regulatory requirements typically apply. Among the conditions for certain regulatory approvals is the requirement that our manufacturing facilities or those of our third-party manufacturers conform to current Good Manufacturing Practices or other manufacturing regulations, which include requirements relating to quality control and quality assurance as well as maintenance of records and documentation. The USDA, FDA and foreign regulatory authorities strictly enforce manufacturing regulatory requirements through periodic inspections and/or reports.

A number of our animal health products are not regulated. For example, certain products such as our ALLERCEPT panels are not regulated by either the USDA or FDA. Similarly, none of our veterinary instruments requires regulatory approval to be marketed and sold in the United States.

We have pursued regulatory approval outside the United States based on market demographics of foreign countries. For marketing outside the United States, we are subject to foreign regulatory requirements governing regulatory licensing and approval for many of our products. Licensing and approval by comparable regulatory authorities of foreign countries must be obtained before we can market products in those countries. Product licensing approval processes and requirements vary 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.

To date, we or our distributors have sought regulatory approval for certain of our products in Canada, which is governed by the Canadian Center for Veterinary Biologics, or CCVB; in Japan, which is governed by the Japanese Ministry of Agriculture, Forestry and Fisheries, or MAFF; in Australia, which is governed by the Australian Department of Agriculture, Fisheries and Forestry, or ADAFF; in South Africa, which is governed by the Republic of South Africa Department of Agriculture, or RSADA; and in certain other countries requiring such approval.

Core Companion Animal Health products previously discussed which have received regulatory approval in the United States and/or elsewhere are summarized below:

Products	Country	Regulated	Agency	Status
ALLERCEPT Allergy Treatment Sets	United States	Yes	USDA	Licensed
	Canada	Yes	CCVB	Licensed
SOLO STEP CH	United States	Yes	USDA	Licensed
	EU	No-in most countries		
	Canada	Yes	CCVB	Licensed
	Japan	Yes	MAFF	Licensed
	Australia	Yes	ADAFF	Licensed
SOLO STEP CH Batch Test Strips	United States	Yes	USDA	Licensed
	Canada	Yes	CCVB	Licensed
SOLO STEP FH	United States	Yes	USDA	Licensed
	Canada	Yes	CCVB	Licensed
	Australia	Yes	ADAFF	Licensed
TRI-HEART Plus Heartworm Preventive	United States	Yes	FDA	Licensed
	Japan	Yes	MAFF	Licensed
	South Korea	Yes	NVRQS	Licensed

## Competition

Our market is intensely competitive. Our competitors include independent animal health companies and major pharmaceutical companies that have animal health divisions. We also compete with independent, third-party distributors, including distributors who sell products under their own private labels. In the point-of-care diagnostic testing market, our major competitors include IDEXX Laboratories, Inc. ("IDEXX"), Abaxis, Inc. ("Abaxis") and Zoetis Inc. ("Zoetis"). The products manufactured by our OVP segment for sale by third parties compete with similar products offered by a number of other companies, some of which have substantially greater financial, technical, research and other resources than us and may have more established marketing, sales, distribution and service organizations than our OVP segment's customers. Companies with a significant presence in the animal health market such as Bayer AG, CEVA Santé Animale, Eli Lilly, Merck, Sanofi, Vétoquinol S.A., Virbac S.A. and Zoetis may be marketing or developing products that compete with our products or would compete with them if successfully developed. These and other competitors and potential competitors may have substantially greater financial, technical, research and other resources and larger, more established marketing, sales, distribution and service organizations than we do. Our competitors may offer broader product lines and have greater name recognition than we do.

## Environmental Regulation

In connection with our product development activities and manufacturing of our biological, pharmaceutical and diagnostic and detection products, we are subject to federal, state and local laws, rules, regulations and policies governing the use, generation, manufacture, storage, handling and disposal of certain materials, biological specimens and wastes. Although we believe that we have complied with these laws, regulations and policies in all material respects and have not been required to take any significant action to correct any noncompliance, we may be required to incur significant costs to comply with environmental and health and safety regulations in the future. Although we believe that our safety procedures for handling and disposing of such materials comply with the standards prescribed by state and federal regulations, the risk of accidental contamination or injury from these materials cannot be eliminated. In the event of such an accident, we could be held liable for any damages that result and any such liability could exceed our resources.

## Employees

As of December 31, 2016, we and our subsidiaries employed 327 people, of whom 140 were focused in production and technical and logistical services, including instrumentation service, 125 in sales, marketing and customer support, 58 in general and administrative services, such as finance, and 4 in product development. We believe that our ability to attract and retain skilled personnel is critical to our success.

None of our employees are covered by a collective bargaining agreement, and we believe our employee relations are good.

### Where You Can Find Additional Information

Our principal executive offices are located 3760 Rocky Mountain Avenue, Loveland, Colorado 80538, our telephone number is 970-493-7272, and our Internet address is [www.heska.com](http://www.heska.com). Reference to our website in this Annual Report on Form 10-K are inactive textual references only and the content of our website should not be deemed incorporated by reference for any purpose.

Because we believe it provides useful information in a cost-effective manner to interested investors, we make available free of charge, via a link on our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practical after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (the "SEC").

In addition, you may review a copy of this annual report on Form 10-K, including exhibits and any schedule filed therewith, and obtain copies of such materials at prescribed rates, at the Securities and Exchange Commission's Public Reference Room in Room 1580, 100 F Street, NE, Washington, D.C. 20549-0102. You may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission maintains a website (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding registrants, such as Heska Corporation, that file electronically with the Securities and Exchange Commission.

### Executive Officers of the Registrant

Our executive officers and their ages as of March 2, 2017 are as follows:

Name	Age	Position
Kevin S. Wilson	44	Chief Executive Officer and President
John McMahan	51	Vice President, Chief Financial Officer
Jason A. Napolitano	48	Chief Operating Officer, Chief Strategist and Secretary
Michael J. McGinley, Ph.D.	56	President, Biologicals & Pharmaceuticals
Nancy Wisnewski, Ph.D.	54	Executive Vice President, Diagnostic Operations and Product Development
Steven M. Eyl	51	Executive Vice President, Global Sales and Marketing
Steven M. Asakowicz	51	Executive Vice President, Companion Animal Health Sales
Rodney A. Lippincott	43	Executive Vice President, Companion Animal Health Sales

*Kevin S. Wilson* was appointed President and Chief Executive Officer effective March 31, 2014. He previously served as our President and Chief Operating Officer from February 2013. Mr. Wilson became a member of our Board of Directors in May 2014. Mr. Wilson is a founder, member and officer of Cuattro, LLC. Since 2008, he has been involved in developing technologies for radiographic imaging with Cuattro, LLC and as a founder of Cuattro Software, LLC, Cuattro Medical, LLC and Cuattro Veterinary, LLC. Mr. Wilson served on the board of various private, non-profit, and educational organizations from 2005 to 2011. He was a founder of Sound Technologies, Inc., a diagnostic imaging company, in 1996. After Sound Technologies, Inc. was sold to VCA Antech, Inc. in 2004, Mr. Wilson served as Chief Strategy Officer for VCA Antech, Inc. until 2006. Mr. Wilson attended Saddleback College.

*John McMahon, CPA*, was appointed Vice President and Chief Financial Officer in September 2016 and designated the Company's principal accounting officer in November 2015. He previously served as Vice President, Financial Operations and Controller from October 2015 to September 2016. From March 2014 to May 2015 he was employed by Pinnacle Ag Holdings, LLC as Vice President, Corporate Controller. Mr. McMahon previously worked as Vice President, Corporate Controller for Advanced Energy Industries from 2008 to 2014 and for Danka Office Imaging from June 2005 to June 2008 as Senior Vice President, Corporate Controller. Mr. McMahon holds an MBA in Finance from California State University, East Bay and a BS in Communications from Kutztown University.

*Jason A. Napolitano* was appointed Chief Strategist in September 2016 and Chief Operating Officer in October 2015. He previously served as Executive Vice President and Chief Financial Officer from May 2002 to September 2016. He was appointed our Secretary in February 2009, having previously served as our Secretary from May 2002 to December 2006. Prior to joining us formally, he was a financial consultant. From 1990 to 2001, Mr. Napolitano held various positions at Credit Suisse First Boston, an investment bank, including Vice President in health care investment banking and Director in mergers and acquisitions. He holds a BS degree from Yale University.

*Michael J. McGinley, Ph.D.* was appointed President, Biologicals & Pharmaceuticals in February 2013. He previously served as President and Chief Operating Officer from January 2009 to February 2013, Vice President, Global Operations from April through December 2008, Vice President, Operations and Technical Affairs and General Manager, Heska Des Moines from January 2002 to April 2008 and in other positions beginning in June 1997. Prior to joining the Company, Dr. McGinley held positions with Bayer Animal Health and Fort Dodge Laboratories. He holds Ph.D. and MS degrees in Immunobiology from Iowa State University and successfully completed the Advanced Management Program at the Harvard Business School in 2008.

*Nancy Wisniewski, Ph.D.* was appointed Executive Vice President, Diagnostic Operations and Product Development in September 2016. She previously served as Executive Vice President, Product Development and Customer Service from April 2011 to September 2016 and as Vice President, Product Development and Technical Customer Service from December 2006 to April 2011. From January 2006 to November 2006, Dr. Wisniewski was Vice President, Research and Development. Dr. Wisniewski held various positions in Heska's Research and Development organization between 1993 and 2005. She holds a Ph.D. in Parasitology/Biochemistry from the University of Notre Dame and a BS in Biology from Lafayette College.

*Steven M. Eyl* was appointed Executive Vice President, Global Sales and Marketing in September 2016. He previously served as our Executive Vice President, Commercial Operations from May 2013 to September 2016. Mr. Eyl was a principal of Eyl Business Services, a consulting firm, from January 2012 to May 2013. He was President of Sound Technologies, Inc. ("Sound") from 2000 to 2011, including after Sound's acquisition by VCA Antech, Inc. in 2004. Mr. Eyl has an extensive background in medical technology sales. He is a graduate of Indiana University.

*Steven M. Asakowicz* was appointed Executive Vice President, Companion Animal Health Sales in February 2013. From July 2011 to February 2013, he was employed by Cuattro, LLC as Vice President, Sales – US Veterinary and sold exclusively on behalf of Cuattro Veterinary USA, LLC. Mr. Asakowicz previously worked as Sales Director for Sound Technologies, Inc. ("Sound") from November 2002 to June 2011, including after Sound was acquired by VCA Antech, Inc. in 2004. Prior to entering the animal health market, Mr. Asakowicz spent 3.5 years employed by Smith Micro Software, Inc. as a Sales Manager and spent 7.5 years employed by AirTouch Cellular and PacTel Cellular (currently Verizon Wireless) as a Corporate Account Executive. Mr. Asakowicz holds a B.A. degree from San Diego State University.

*Rodney A. Lippincott* was appointed Executive Vice President, Companion Animal Health Sales in February 2013. From July 2011 to February 2013, he was employed by Cuattro, LLC as Vice President, Sales – US Veterinary and sold exclusively on behalf of Cuattro Veterinary USA, LLC. Mr. Lippincott held various positions including Sales Director for Sound Technologies, Inc., a unit of VCA Antech, Inc., from September 2007 to June 2011. Prior to entering the animal health market, Mr. Lippincott spent 13.5 years employed by Smith Micro Software, Inc. and held positions including US and International Sales Manager and Director of Marketing. Mr. Lippincott attended Saddleback College and completed the Executive Education Marketing Management Program at Stanford University, Graduate School of Business.

#### **Item 1A. Risk Factors**

Our future operating results may vary substantially from period to period due to a number of factors, many of which are beyond our control. The following discussion highlights some of these factors and the possible impact of these factors on future results of operations. The risks and uncertainties described below are not the only ones we face. Additional risks or uncertainties not presently known to us or that we deem to be currently immaterial also may impair our business operations. If any of the following factors actually occur, our business, financial condition or results of operations could be harmed. In that case, the price of our Public Common Stock could decline and investors in our Public Common Stock could experience losses on their investment.

***We have significant related party transactions, including the planned purchase of the minority interest in Heska Imaging US, LLC via a put option which has been exercised.***

Under the Amended and Restated Operating Agreement of Heska Imaging (the "Operating Agreement"), should Heska Imaging ("US Imaging") meet certain performance criteria, the unit holders who hold 45.4% of US Imaging that we do not own (the "Imaging Minority") have been granted a put option to sell us all of the Imaging Minority's position in US Imaging following the audit of our financial statements for 2016. Required performance criteria have been met and we have been given notice that the put option is being exercised. We have 90 days from the receipt of notice to deliver payment (any applicable payment in aggregate to be defined as the "Put Payment") for the Imaging Minority's position, and we consider notice to have been received immediately prior to the filing of this Form 10-K with the SEC. We plan to deliver the Put Payment and obtain the Imaging Minority's position in US Imaging on May 31, 2017. Based on US Imaging's 2016 financial performance, the Put Payment is to be for a value of \$13.8 million if we deliver all cash or up to \$14.6 million if we deliver a combination of cash and the maximum contractually allowable value of stock. While we have the right to deliver up to 55% of the consideration in our Public Common Stock under certain circumstances, such stock is to be valued based on 90% of market value (the "Delivery Stock Value") and is limited to approximately 650 thousand shares in any case. If the Delivery Stock Value per share is less than the market value per share of our Public Common Stock at the time of the Acquisition, we do not have the right to deliver any Public Common Stock as consideration. While we have reported the Put Payment at \$14.6 million for financial reporting purposes, which contemplates our delivery of 55% of the Put Payment consideration in Public Common Stock, no final decision by our Board of Directors as to the relative use of cash and stock has been made and we may not be able to deliver any stock based on the Delivery Stock Value at the time of closing, as discussed above. If we are unable to deliver any stock for the Put Payment, it would likely put a strain on our financial position and require us to use our line of credit or raise additional capital and would likely limit our ability to pursue acquisitions and other strategic development activities. There is no guarantee that our line of credit will be available in all circumstances or that additional capital will be available if needed on reasonable terms, if at all.

Under the terms of the Operating Agreement, US Imaging is to be managed by a three-person board of managers, two of which are to be appointed by Heska Corporation and one of which is to be appointed by Kevin S. Wilson, a founder of Heska Imaging who has also been Heska Corporation's Chief Executive Officer

and President since March 31, 2014. The current board of managers consists of Mr. Wilson, Jason A. Napolitano, Heska Corporation's Chief Operating Officer, Chief Strategist and Secretary and Nancy Wisniewski, Ph.D., Heska Corporation's Executive Vice President, Diagnostic Operations & Product Development. Until the earlier of (1) our acquiring 100% of the units of US Imaging pursuant to the puts and/or calls discussed above or (2) the sixth anniversary of the Acquisition, US Imaging may only take the following actions, among others, by unanimous consent of the board of managers: (i) issue securities, (ii) incur, guarantee, prepay, refinance, renew, modify or extend debt, (iii) enter into material contracts, (iv) hire or terminate an officer or amend the terms of their employment, (v) make a distribution other than a tax or liquidation distribution, (vi) enter into a material acquisition or disposition arrangement or a merger, (vii) lease or acquire an interest in real property, (viii) convert or reorganize US Imaging, or (ix) amend its certificate of formation or the Operating Agreement. This unanimous consent provision may hinder our ability to optimize the value of our investment in US Imaging in certain circumstances. We expect to make a distribution payment required under the Operating Agreement related to the profitability of US Imaging since January 1, 2013 (the "Distribution Payment") on April 1, 2017.

We negotiated at arm's length as part of the acquisition, an Amended and Restated Master License Agreement and a Supply Agreement between US Imaging and Cuattro, LLC. Mr. Wilson has an interest in these agreements and any time and resources devoted to monitoring and overseeing this relationship may prevent us from deploying such time and resources on more productive matters.

Mr. Wilson's employment agreement with us acknowledges that Mr. Wilson has business interests in Cuattro, LLC, Cuattro Software, LLC and Cuattro Medical, LLC which may require a portion of his time, resources and attention in his working hours. If Mr. Wilson is distracted by these or other business interests, he may not contribute as much as he otherwise would have to enhancing our business, to the detriment of our shareholder value. Mr. Wilson is the spouse of Shawna M. Wilson ("Mrs. Wilson"). Mr. Wilson, Mrs. Wilson and trusts for their children and family own a majority interest in Cuattro Medical, LLC. In addition, including shares held by Mrs. Wilson and by trusts for the benefit of Mr. and Mrs. Wilson's children and family, Mr. Wilson also owns a 100% interest in Cuattro, LLC, the largest supplier to Heska Imaging Global, LLC ("Global Imaging"), our wholly-owned subsidiary. Cuattro, LLC owns a 100% interest in Cuattro Software, LLC.

Cuattro, LLC has charged US Imaging \$3.6 million from January 1, 2016 through May 31, 2016 and has charged Global Imaging \$10.9 million from June 1, 2016 through December 31, 2016, primarily related to digital imaging products, for which there is an underlying supply contract with minimum purchase obligations, software and services as well as other operating expenses; Heska Corporation has charged US Imaging \$5.3 million during 2016, primarily related to sales and other administrative expenses; and Heska Corporation has charged Cuattro, LLC \$0.2 million during 2016, primarily related to facility usage and other services.

At December 31, 2016, US Imaging had a \$1.6 million note receivable, including accrued interest, from International Imaging, which is due on June 15, 2019 and which eliminates in consolidation of the Company's financial statements. This note was previously listed as "Note receivable - related party" on the Company's consolidated balance sheets and the note receivable was assumed as part of the Company's acquisition of Cuattro International. At December 31, 2016, Heska Corporation had accounts receivable from US Imaging of \$5.6 million, including accrued interest; Heska Corporation had net accounts receivable from Cuattro, LLC of \$22 thousand; Global Imaging had net prepaid receivables from US Imaging of \$1.2 million; and US Imaging had a net receivable due from Cuattro, LLC of \$78 thousand. All monies owed accrue interest at the same interest rate Heska Corporation pays under its credit and security agreement with Wells Fargo once past due with the exception of the note receivable, which accrues at this rate to its maturity date.



Mrs. Wilson, Clint Roth, DVM, Mr. Asakowicz, Mr. Lippincott, Mr. Wilson and Cuattro, LLC own approximately 29.75%, 8.39%, 4.09%, 3.07%, 0.05% and 0.05% of US Imaging, respectively, each are a member of US Imaging, and each have an interest in the Put Payment and Distribution Payment discussed above. If Mr. Wilson, Mr. Asakowicz or Mr. Lippincott is distracted by these holdings or interests, they may not contribute as much as they otherwise would have to enhancing our business, to the detriment of our shareholder value. While the Operating Agreement was negotiated at arm's length as part of the Acquisition, and requires that none of the members shall cause US Imaging to operate its business in any manner other than the ordinary course of business, any time and resources devoted to monitoring and overseeing this relationship may prevent us from deploying such time and resources on more productive matters.

***We may face costly legal disputes, including related to our intellectual property or technology or that of our suppliers or collaborators.***

We may face legal disputes related to our business. For example, on March 12, 2015, a complaint was filed against us by Shaun Fauley in the United States District Court Northern District of Illinois alleging our transmittal of unauthorized faxes in violation of the federal Telephone Consumer Protection Act of 1991, as amended by the Junk Fax Prevention Act of 2005, as a class action seeking stated damages of the greater of actual monetary loss or five hundred dollars per violation. Even if meritless, these disputes may require significant expenditures on our part and could entail a significant distraction to members of our management team or other key employees. Insurance coverage may not cover any costs required to litigate a legal dispute or an unfavorable ruling or settlement. A legal dispute leading to an unfavorable ruling or settlement, whether or not insurance coverage may be available for any portion thereof, could have significant material adverse consequences on our business. We may have to use legal means and incur affiliated costs to secure the benefits to which we are entitled, such as to collect payment for goods shipped to third parties, which would reduce our income as compared to what it otherwise would have been.

We may become subject to patent infringement claims and litigation in the United States or other countries or interference proceedings conducted in the United States Patent and Trademark Office, or USPTO, to determine the priority of inventions. The defense and prosecution of intellectual property suits, USPTO interference proceedings and related legal and administrative proceedings are likely to be costly, time-consuming and distracting. As is typical in our industry, from time to time we and our collaborators and suppliers have received, and may in the future receive, notices from third parties claiming infringement and invitations to take licenses under third-party patents. Any legal action against us or our collaborators or suppliers may require us or our collaborators or suppliers to obtain one or more licenses in order to market or manufacture effected products or services. However, we or our collaborators or suppliers may not be able to obtain licenses for technology patented by others on commercially reasonable terms, or at all, or to develop alternative approaches to access or replace such technology if unable to obtain licenses or current and future licenses may not be adequate, any of which could substantially harm our business.

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 proceedings will likely 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.

***If the third parties who have substantial marketing rights for certain of our historical products, existing products or future products under development are not successful in marketing those products, then our sales and financial position may suffer.***

We are party to an agreement with Merck Animal Health, which grants Merck Animal Health exclusive distribution and marketing rights for our canine heartworm preventive product, TRI-HEART Plus Chewable Tablets, ultimately sold to or through veterinarians in the United States and Canada. Historically, a significant portion of our OVP segment's revenue has been generated from the sale of certain bovine vaccines, which have been sold primarily under the Titanium® and MasterGuard® brands. We have a supply agreement with Eli Lilly and its affiliates operating through Elanco for the production of these vaccines. Either of these marketing partners may not devote sufficient resources to marketing our products and our sales and financial position could suffer significantly as a result. Revenue from Merck & Co., Inc. ("Merck") entities, including Merck Animal Health, represented 11% of our 2016 revenue. Revenue from Eli Lilly entities, including Elanco, represented 12% of our 2016 revenue. If Merck Animal Health personnel fail to market, sell and support our heartworm preventive sufficiently or if Elanco personnel fail to market, sell and support the bovine vaccines we produce and sell to Elanco sufficiently, our sales could decline significantly. Furthermore, there may be nothing to prevent these partners from pursuing alternative technologies, products or supply arrangements, including as part of mergers, acquisitions or divestitures. For example, we believe a unit of Merck has obtained FDA approval for a canine heartworm preventive product with additional claims compared with our TRI-HEART Plus Chewable Tablets, but which we believe is not currently being marketed actively. Should Merck decide to emphasize sales and marketing efforts of this product rather than our TRI-HEART Plus Chewable Tablets or cancel our agreement regarding canine heartworm preventive distribution and marketing, our sales could decline significantly. In another example, if Elanco were to emphasize sales and marketing efforts for bovine vaccines other than those we produce or cancel our supply agreement and produce the vaccines we supply to it by itself, our sales could decline significantly. Third-party marketing assistance may not be available in the future on reasonable terms, if at all. If the third parties with marketing rights for our products were to merge or go out of business, the sale and promotion of our products could be diminished.

***We rely substantially on third-party suppliers. The loss of products or delays in product availability from one or more third-party suppliers could substantially harm our business.***

To be successful, we must contract for the supply of, or manufacture ourselves, current and future products of appropriate quantity, quality and cost. Such products must be available on a timely basis and be in compliance with any regulatory requirements. Similarly, we must provide ourselves, or contract for the supply of, certain services. Such services must be provided in a timely and appropriate manner. Failure to do any of the above could substantially harm our business.

We rely on third-party suppliers to manufacture those products we do not manufacture ourselves and to provide services we do not provide ourselves. Proprietary products provided by these suppliers represent a majority of our revenue. We currently rely on these suppliers for our blood testing instruments and consumable supplies for these instruments, for our imaging products and related software and services, for key components of our point-of-care diagnostic tests as well as for the manufacture of other products.

The loss of access to products from one or more suppliers could have a significant, negative impact on our business. Major suppliers who sell us proprietary products who are responsible for more than 5% of our LTM revenue are FUJIFILM Corporation and Cuattro, LLC. None of these suppliers sold us products which were responsible for more than 25% of our LTM revenue, although products purchased from one of these suppliers was responsible for more than 20% of our LTM revenue and products purchased from another was responsible for more than 15% of our LTM revenue. We often purchase products from our suppliers under agreements that are of limited duration or potentially can be terminated on an annual basis. In the case

of our blood testing instruments and our digital radiography solutions, post-termination, we are typically entitled to non-exclusive access to consumable supplies, or ongoing non-exclusive access to products and services to meet the needs of an existing customer base, respectively, for a defined period upon expiration of exclusive rights, which could subject us to competitive pressures in the period of non-exclusive access. Although we believe we will be able to maintain a supply of our major product and service offerings in the near future, there can be no assurance that our suppliers will meet their obligations under any agreements we may have in place with them or that we will be able to compel them to do so. Risks of relying on suppliers include:

- *Inability to meet minimum obligations.* Current agreements, or agreements we may negotiate in the future, may commit us to certain minimum purchase or other spending obligations. It is possible we will not be able to create the market demand to meet such obligations, which could create a drain on our financial resources and liquidity. Some such agreements may require minimum purchases and/or sales to maintain product rights and we may be significantly harmed if we are unable to meet such requirements and lose product rights.
- *Loss of exclusivity.* In the case of our blood testing instruments, if we are entitled to non-exclusive access to consumable supplies for a defined period upon expiration of exclusive rights, we may face increased competition from a third party with similar non-exclusive access or our former supplier, which could cause us to lose customers and/or significantly decrease our margins and could significantly affect our financial results. In addition, current agreements, or agreements we may negotiate in the future, with suppliers may require us to meet minimum annual sales levels to maintain our position as the exclusive distributor of these products. We may not meet these minimum sales levels and maintain exclusivity over the distribution and sale of these products. If we are not the exclusive distributor of these products, competition may increase significantly, reducing our revenues and/or decreasing our margins.
- *Changes in economics.* An underlying change in the economics with a supplier, such as a large price increase or new requirement of large minimum purchase amounts, could have a significant, adverse effect on our business, particularly if we are unable to identify and implement an alternative source of supply in a timely manner.
- *The loss of product rights upon expiration or termination of an existing agreement.* Unless we are able to find an alternate supply of a similar product, we would not be able to continue to offer our customers the same breadth of products and our sales and operating results would likely suffer. In the case of an instrument supplier, we could also potentially suffer the loss of sales of consumable supplies, which would be significant in cases where we have built a significant installed base, further harming our sales prospects and opportunities. Even if we were able to find an alternate supply for a product to which we lost rights, we would likely face increased competition from the product whose rights we lost being marketed by a third party or the former supplier and it may take us additional time and expense to gain the necessary approvals and launch an alternative product.
- *High switching costs.* In our blood testing instrument products, we could face significant competition and lose all or some of the consumable revenues from the installed base of those instruments if we were to switch to a competitive instrument. If we need to change to other commercial manufacturing contractors for certain of our regulated products, additional regulatory licenses or approvals generally must be obtained for these contractors prior to our use. This would require new testing and compliance inspections prior to sale, thus resulting in potential delays. Any new manufacturer would have to be educated in, or develop, substantially equivalent processes necessary for the production of our products. We likely would have to train our sales

force, distribution network employees and customer support organization on the new product and spend significant funds marketing the new product to our customer base.

- *The involuntary or voluntary discontinuation of a product line.* Unless we are able to find an alternate supply of a similar product in this or similar circumstances with any product, we would not be able to continue to offer our customers the same breadth of products and our sales would likely suffer. Even if we are able to identify an alternate supply, it may take us additional time and expense to gain the necessary approvals and launch an alternative product, especially if the product is discontinued unexpectedly.
- *Inconsistent or inadequate quality control.* We may not be able to control or adequately monitor the quality of products we receive from our suppliers. Poor quality items could damage our reputation with our customers.
- *Limited capacity or ability to scale capacity.* If market demand for our products increases suddenly, our current suppliers 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. If we consistently generate more demand for a product than a given supplier is capable of handling, it could lead to large backorders and potentially lost sales to competitive products that are readily available. This could require us to seek or fund new sources of supply, which may be difficult to find or may require terms that are less advantageous if available at all.
- *Regulatory risk.* Our manufacturing facility and those of some of our third-party suppliers are subject to ongoing periodic unannounced inspection by regulatory authorities, including the FDA, USDA and other federal, state and foreign agencies for compliance with strictly enforced Good Manufacturing Practices, regulations and similar foreign standards. We do not have control over our suppliers' compliance with these regulations and standards. Regulatory violations could potentially lead to interruptions in supply that could cause us to lose sales to readily available competitive products. If one of our suppliers is unable to provide a raw material or finished product due to regulatory issues, it could have a material adverse financial impact on our business and could expose us to legal action if we are unable to perform on contracts to our customers involving related products.
- *Developmental delays.* We may experience delays in the scale-up quantities needed for product development that could delay regulatory submissions and commercialization of our products in development, causing us to miss key opportunities.
- *Limited geographic rights.* We typically do not have global geographic rights to products supplied by third parties. If we were to determine a market opportunity in a geography where we did not have distribution rights and were unable to obtain such rights from the supplier, it might hamper our ability to succeed in such geography and our sales and profits would be lower than they otherwise would have been.
- *Limited intellectual property rights.* We typically do not have intellectual property rights, or may have to share intellectual property rights, to the products supplied by third parties and any improvements to the manufacturing processes or new manufacturing processes for these products.

Potential problems with suppliers such as those discussed above could substantially decrease sales, lead to higher costs and/or damage our reputation with our customers due to factors such as poor quality goods or delays in order fulfillment, resulting in our being unable to sell our products effectively and substantially harming our business.

***The loss of significant customers who, for example, are historically large purchasers or who are considered leaders in their field could damage our business and financial results.***

Revenue from Butler Animal Health Supply, LLC d/b/a Henry Schein Animal Health ("Henry Schein") represented approximately 13% and 10% of our consolidated revenue for the years ended December 31, 2016 and 2015, respectively. Revenue from Merck entities, including Merck Animal Health, represented approximately 11% each for the years ended December 31, 2016 and 2015 and 12% for the year ended December 31, 2014. Revenue from Eli Lilly entities, including Elanco, represented approximately 12%, 12% and 11% for the years ended December 31, 2016, 2015, and 2014, respectively. No other customer accounted for more than 10% of our consolidated revenue for the years ended December 31, 2016, 2015 or 2014.

Henry Schein represented 16% of our consolidated accounts receivable at December 31, 2016. Merck entities represented approximately 11% and 13% of our consolidated accounts receivable at December 31, 2016 and 2015, respectively. Eli Lilly entities, including Elanco, represented approximately 15% and 20% of our consolidated accounts receivable at December 31, 2016 and 2015, respectively. No other customer accounted for more than 10% of our consolidated accounts receivable at December 31, 2016 or 2015.

The loss of significant customers who, for example, are historically large purchasers or who are considered leaders in their field could damage our business, reputation, and financial results.

***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 maintain sustained profitability.***

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. We also compete with independent, third-party distributors, including distributors who sell products under their own private labels. In the point-of-care diagnostic testing market, our major competitors include IDEXX Laboratories, Inc. ("IDEXX"), Abaxis Inc. ("Abaxis"), and Zoetis Inc. ("Zoetis"). The products manufactured by our OVP segment for sale by third parties compete with similar products offered by a number of other companies, some of which have substantially greater financial, technical, research and other resources than us and may have more established marketing, sales, distribution and service organizations than those of our OVP segment customers. Competitors may have facilities with similar capabilities to our OVP segment, which they may operate and sell at a lower unit price to customers than our OVP segment does, which could cause us to lose customers. Companies with a significant presence in the companion animal health market, such as Bayer AG, CEVA Santé Animale, Eli Lilly, Merck, Sanofi, Vétoquinol S.A. and Virbac S.A. may be marketing or developing products that compete with our products or would compete with them if developed. These and other competitors and potential competitors may have substantially greater financial, technical, research and other resources and larger, more established marketing, sales and service organizations than we do. For example, if Zoetis devotes its significant commercial and financial resources to growing its market share in the veterinary allergy market, our allergy-related sales could suffer significantly. Our competitors may offer broader product lines and have greater name recognition than we do. Our competitors may also 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 health care market. Moreover, we may not have the financial resources, technical expertise or marketing, sales or support capabilities to compete successfully. One of our competitors, Abaxis, has announced agreements with units of VCA Inc. ("VCA") for the long-term supply of blood chemistry testing products to VCA-owned veterinary clinics and for the co-marketing of Abaxis' blood chemistry testing products with VCA's veterinary diagnostic laboratory offering, which may serve to intensify competition and lower our margins as well as limit our prospects to sell blood chemistry testing products to VCA-owned veterinary clinics.

If we fail to compete successfully, our ability to achieve sustained profitability will be limited and sustained profitability, or profitability at all, may not be possible.

***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 other key personnel, including our Chief Executive Officer and President, Kevin Wilson. The loss of the services of members of our senior management or other key personnel may significantly delay or prevent the achievement of our business objectives. Although we have employment agreements with many of these individuals, all are at-will employees, which means that either the employee or Heska may terminate employment at any time without prior notice. If we lose the services of, or fail to recruit, key personnel, the growth of our business could be substantially impaired. We do not maintain key person life insurance for any of our senior management or key personnel.

***We may be unable to market and sell our products successfully.***

We may not develop and maintain marketing and/or sales capabilities successfully, and we may not be able to make arrangements with third parties to perform these activities on satisfactory terms. If our marketing and sales strategy is unsuccessful, our ability to sell our products will be negatively impacted and our revenues will decrease. This could result in the loss of distribution rights for products or failure to gain access to new products and could cause damage to our reputation and adversely affect our business and future prospects.

The market for companion animal healthcare products is highly fragmented. Because our CCA proprietary products are generally available only to veterinarians or by prescription and our medical instruments require technical training to operate, we ultimately sell all our CCA products primarily to or through veterinarians. The acceptance of our products by veterinarians is critical to our success. Changes in our ability to obtain or maintain such acceptance or changes in veterinary medical practice could significantly decrease our anticipated sales. As the vast majority of cash flow to veterinarians ultimately is funded by pet owners without private insurance or government support, our business may be more susceptible to severe economic downturns than other health care businesses which rely less on individual consumers.

We have entered into agreements with independent third party distributors, including Henry Schein, which we anticipated to market and sell our products to a greater degree than in the recent past. Independent third-party distributors may be effective in increasing sales of our products to veterinarians, although we would expect a corresponding lower gross margin as such distributors typically buy products from us at a discount to end user prices. It is possible new or existing independent third-party distributors could cannibalize our direct sales efforts and lower our total gross margin. For us to be effective when working with an independent third-party distributor, the distributor must agree to market and/or sell our products and we must provide proper economic incentives to the distributor as well as contend effectively for the time, energy and focus of the employees of such distributor given other products the distributor may be carrying, potentially including those of our competitors. If we fail to be effective with new or existing independent third-party distributors, our financial performance may suffer.

***We intend to pursue acquisitions and other strategic development opportunities, which may not result as desired and could be detrimental to our financial position.***

We intend to pursue acquisitions and other strategic development opportunities. The ultimate business and financial performance of these opportunities may not create, and may end up adversely affecting materially, the value we hope to enhance by pursuing them. Any acquisition may significantly underperform relative to our financial expectations and may serve to diminish rather than enhance shareholder value.

The success of any acquisition will depend on, among other things, our ability to integrate assets and personnel acquired in these transactions and to apply our internal controls process to these acquired businesses. The integration of acquisitions may require significant attention from our management, and the diversion of management's attention and resources could have a material adverse effect on our ability to manage our business. Furthermore, we may not realize the degree or timing of benefits we anticipated when we first entered into the acquisition transaction. If actual integration costs are higher than amounts originally anticipated, if we are unable to integrate the assets and personnel acquired in an acquisition as anticipated, or if we are unable to fully benefit from anticipated synergies, our business, financial condition, results of operations, and cash flows could be materially adversely affected. Furthermore, it is possible we will use management time and resources to pursue opportunities we ultimately are unable or decide not to consummate, in which case, we may not be able to utilize such management time and resources on what may have proved to be more productive matters in other areas of our business.

***We have historically not consistently generated positive cash flow from operations, may need additional capital and any required capital may not be available on reasonable terms or at all.***

We may be required to raise additional capital in the future. If necessary, we expect to raise these additional funds by borrowing under our revolving line of credit, the increased sale of customer leases, the sale of equity securities or the issuance of new term debt secured by the same category of assets as the term loans which we fully repaid in 2010. There is no guarantee that additional capital will be available from these sources on reasonable terms, if at all, and certain of these sources may require approval by existing lenders. Under our credit and security agreement with Wells Fargo, we are required to comply with various covenants, both financial and non-financial, in order to borrow under the agreement. The availability of borrowings under this agreement is expected to be important to continue to fund our operations. A key financial covenant is based on a fixed charge coverage ratio, as defined in the credit and security agreement with Wells Fargo. Although we believe we will be able to maintain compliance with all these covenants and any covenants we may negotiate in the future, there can be no assurance thereof. We have not always been able to maintain compliance with all covenants under our credit and security agreement with Wells Fargo. Although Wells Fargo has granted us a waiver of non-compliance in each case, there can be no assurance we will be able to obtain similar waivers or other modifications if needed in the future on economic terms, if at all. Failure to comply with any of the covenants, representations or warranties, or failure to modify them to allow future compliance, could result in our being in default and could cause all outstanding borrowings under our credit and security agreement to become immediately due and payable, or impact our ability to borrow under the agreement. In addition, Wells Fargo has discretion in setting the advance rates which we may borrow against eligible assets. Accordingly, funds we expect to be available under our existing revolving line of credit may not be available and other lenders could refuse to provide us with additional debt financing. Financial institutions and other potentially interested parties may not be interested in purchasing our customer leases on economic terms, or at all. The public markets may be unreceptive to equity financings and we may not be able to obtain additional private equity or debt financing. Any equity financing would likely be dilutive to stockholders and additional debt financing, if available, may include restrictive covenants and increased interest rates that would limit our currently planned operations and strategies. Furthermore, even if additional

capital is available, it may not be of the magnitude required to meet our needs under these or other scenarios. If additional funds are required and are not available, it would likely have a material adverse effect on our business, financial condition and our ability to continue as a going concern.

***Our future revenues depend on successful product development, commercialization and/or market acceptance, any of which can be slower than we expect or may not occur.***

The product development and regulatory approval process for many of our potential products is extensive and may take substantially longer than we anticipate. Research projects may fail. New products that we may be developing for the veterinary marketplace may not perform consistently within our expectations. 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 other product candidates. If we fail to successfully develop new products and bring them to market in a timely manner, our ability to generate additional revenue will decrease.

Even if we are successful in the development of a product or obtain rights to a product from a third-party supplier, we may experience delays or shortfalls in commercialization and/or market acceptance of the product. For example, veterinarians may be slow to adopt a product, a product may not achieve the anticipated technical performance in field use or there may be delays in producing large volumes of a product. The former is particularly likely where there is no comparable product available or historical precedent for such a product. The ultimate adoption of a new product by veterinarians, the rate of such adoption and the extent veterinarians choose to integrate such a product into their practice are all important factors in the economic success of any new products and are factors that we do not control to a large extent. If our products do not achieve a significant level of market acceptance, demand for our products will not develop as expected and our revenues will be lower than we anticipate.

***Our stock price has historically experienced high volatility, and could do so in the future, including experiencing a material price decline resulting from a large sale in a short period of time.***

Should a relatively large shareholder decide to sell a large number of shares in a short period of time, it could lead to an excess supply of our shares available for sale and correspondingly result in a significant decline in our stock price.

The securities markets have experienced significant price and volume fluctuations and the market prices of securities of many small cap companies have in the past been, and can in the future be expected to be, especially volatile. During the twelve months ended December 31, 2016, the closing stock price of our Public Common Stock has ranged from a low of \$27.05 to a high of \$72.85. Fluctuations in the trading price or liquidity of our Public 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 Public Common Stock include:

- stock sales by large stockholders or by insiders;
- changes in the outlook for our business;
- our quarterly operating results, including as compared to expected revenue or earnings and in comparison to historical results;
- termination, cancellation or expiration of our third-party supplier relationships;
- announcements of technological innovations or new products by our competitors or by us;
- litigation;
- regulatory developments, including delays in product introductions;
- developments or disputes concerning patents or proprietary rights;
- availability of our revolving line of credit and compliance with debt covenants;



- releases of reports by securities analysts;
- 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, it is likely 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.

On May 4, 2010, our shareholders approved an amendment (the "Amendment") to our Restated Certificate of Incorporation. The Amendment places restrictions on the transfer of our stock that could adversely affect our ability to use our domestic Federal Net Operating Loss carryforward ("NOL"). In particular, the Amendment prevents the transfer of shares without the approval of our Board of Directors if, as a consequence, an individual, entity or groups of individuals or entities would become a 5-percent holder under Section 382 of the Internal Revenue Code of 1986, as amended, and the related Treasury regulations, and also prevents any existing 5-percent holder from increasing his or her ownership position in the Company without the approval of our Board of Directors. Any transfer of shares in violation of the Amendment (a "Transfer Violation") shall be void *ab initio* under the our Restated Certificate of Incorporation, as amended (our "Certificate of Incorporation") and our Board of Directors has procedures under our Certificate of Incorporation to remedy a Transfer Violation including requiring the shares causing such Transfer Violation to be sold and any profit resulting from such sale to be transferred to a charitable entity chosen by the Company's Board of Directors in specified circumstances. The Amendment could have an adverse impact on the value and trading liquidity of our stock if certain buyers who would otherwise have bid on or purchased our stock, including buyers who may not be comfortable owning stock with transfer restrictions, do not bid on or purchase our stock as a result of the Amendment. In addition, because some corporate takeovers occur through the acquirer's purchase, in the public market or otherwise, of sufficient shares to give it control of a company, any provision that restricts the transfer of shares can have the effect of preventing a takeover. The Amendment could discourage or otherwise prevent accumulations of substantial blocks of shares in which our stockholders might receive a substantial premium above market value and might tend to insulate management and the Board of Directors against the possibility of removal to a greater degree than had the Amendment not passed.

***Obtaining and maintaining regulatory approvals in order to market our products may be costly and delay the marketing and sales of our products. Failure to meet all regulatory requirements could cause significant losses from affected inventory and the loss of market share.***

Many of the products we develop, market or manufacture may subject us to extensive regulation by one or more of the USDA, the FDA, the EPA and foreign and other regulatory authorities. These regulations govern, among other things, the development, testing, manufacturing, labeling, storage, pre-market approval, advertising, promotion and sale of some 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 decision by a regulatory authority to regulate a currently non-regulated product or product area could significantly impact our revenue and have a corresponding adverse impact on our financial performance and position while we attempt to comply with the new regulation, if such compliance is possible at all.

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 may not be able to estimate the time to obtain required regulatory approvals accurately and such approvals may require significantly more time than we anticipate. 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. Such delays in approval may cause us to forego a significant portion of a new product's sales in its first year due to seasonality and advanced booking periods associated with certain products. Regulatory approval of our products may also impose limitations on the indicated or intended uses for which our products may be marketed.

Difficulties in making established products to all regulatory specifications may lead to significant losses related to affected inventory as well as market share. Among the conditions for certain regulatory approvals is the requirement that our facilities and/or the facilities of our third-party manufacturers conform to current Good Manufacturing Practices and other requirements. If any regulatory authority determines that our manufacturing facilities or those of our third-party manufacturers do not conform to appropriate manufacturing requirements, we or the manufacturers of our products may be subject to sanctions, including, but not limited to, warning letters, manufacturing suspensions, 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. Furthermore, third parties may perceive procedures required to obtain regulatory approval objectionable and may attempt to disrupt or otherwise damage our business as a result. In addition, certain of our agreements may require us to pay penalties if we are unable to supply products, including for failure to maintain regulatory approvals.

Any of these events, alone or in combination with others, could damage our business.

***Interpretation of existing legislation, regulations and rules, including financial accounting standards, or implementation of future legislation, regulations and rules could cause our costs to increase or could harm us in other ways.***

We prepare our financial statements in conformance with United States generally accepted accounting principles, or U.S. GAAP. These accounting principles are established by and are subject to interpretation by the SEC, the FASB and others who interpret and create accounting policies. A change in those policies can have a significant effect on our reported results and may affect our reporting of transactions completed before a change is made effective. Such changes may adversely affect our reported financial results and the way we conduct our business, or have a negative impact on us if we fail to track such changes.

If our regulators and/or auditors adopt or interpret more stringent standards than we anticipate, we could experience unanticipated changes in our reported financial statements, including but not limited to restatements, which could adversely affect our business due to litigation and investor confidence in our financial statements. In addition, changes in the underlying circumstances to which we apply given accounting standards and principles may affect our results of operations and have a negative impact on us. For example, we review goodwill recognized on our consolidated balance sheets at least annually and if we were to conclude there was an impairment of goodwill, we would reduce the corresponding goodwill to its estimated fair value and recognize a corresponding expense in our statement of operations. This impairment and corresponding expense could be as large as the total amount of goodwill recognized on our consolidated balance sheets, which was \$26.6 million at December 31, 2016. There can be no assurance that future goodwill impairments will not occur if projected financial results are not met, or otherwise.

The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") has increased our required administrative actions and expenses as a public company since its enactment. The general and administrative costs of complying with Sarbanes-Oxley will depend on how it is interpreted over time. Of particular concern are the level of standards for internal control evaluation and reporting adopted under Section 404 of Sarbanes-Oxley. If our regulators and/or auditors adopt or interpret more stringent standards than we anticipate, we and/or our auditors may be unable to conclude that our internal controls over financial reporting are designed and operating effectively, which could adversely affect investor confidence in our financial statements and cause

our stock price to decline. Even if we and our auditors are able to conclude that our internal control over financial reporting is designed and operating effectively in such a circumstance, our general and administrative costs are likely to increase. For example, in both 2016 and 2015, we were required to have our independent registered public accountant conduct an audit of our internal control over financial reporting because as of June 30 of both years our stock market value was above a certain level prescribed by regulation. This increased our general and administrative costs from what they otherwise would have been.

Similarly, we are required to comply with the SEC's mandate to provide interactive data using the eXtensible Business Reporting Language as an exhibit to certain SEC filings. Compliance with this mandate has required a significant time investment, which has and may in the future preclude some of our employees from spending time on more productive matters. In addition, actions by other entities, such as enhanced rules to maintain our listing on the Nasdaq Capital Market, could also increase our general and administrative costs or have other adverse effects on us, as could further legislative, regulatory or rule-making action or more stringent interpretations of existing legislation, regulations and rules.

***We often depend on third parties for products we intend to introduce in the future. If our current relationships and collaborations are not successful, we may not be able to introduce the products we intend to introduce in the future.***

We are often dependent on third parties and collaborative partners to successfully and timely perform research and development activities to successfully develop new products. We routinely discuss Heska marketing in the veterinary market instruments being developed by third parties for use in the human health care market. In the future, one or more of these third parties or collaborative partners may not complete research and development activities in a timely fashion, or at all. Even if these third parties are successful in their research and development activities, we may not be able to come to an economic agreement with them. If these third parties or collaborative partners fail to complete research and development activities or fail to complete them in a timely fashion, or if we are unable to negotiate economic agreements with such third parties or collaborative partners, our ability to introduce new products will be impacted negatively and our revenues may decline.

***Many of our expenses are fixed and if factors beyond our control cause our revenue to fluctuate, this fluctuation could cause greater than expected losses, cash flow and liquidity shortfalls.***

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

- supply of products from third-party suppliers or termination, cancellation or expiration of such relationships;
- competition and pricing pressures from competitive products;
- the introduction of new products or services by our competitors or by us;
- large customers failing to purchase at historical levels;
- fundamental shifts in market demand;
- manufacturing delays;
- shipment problems;
- information technology problems, which may prevent us from conducting our business effectively, or at all, and may also raise our costs;
- regulatory and other delays in product development;
- product recalls or other issues which may raise our costs;
- changes in our reputation and/or market acceptance of our current or new products; and
- changes in the mix of products sold.

We have high operating expenses, including those related to personnel. Many of these expenses are fixed in the short term and may increase over time. If any of the factors listed above cause our revenues to decline, our operating results could be substantially harmed.

***Our Public Common Stock is listed on the Nasdaq Capital Market and we may not be able to maintain that listing, which may make it more difficult for you to sell your shares. In addition, we have less than 300 holders of record, which would allow us to terminate voluntarily the registration of our common stock with the SEC and after which we would no longer be eligible to maintain the listing of our Public Common Stock on the Nasdaq Capital Market.***

Our Public Common Stock is listed on the Nasdaq Capital Market. The Nasdaq has several quantitative and qualitative requirements companies must comply with to maintain this listing. While we believe, we are currently in compliance with all Nasdaq requirements, there can be no assurance we will continue to meet Nasdaq listing requirements, that Nasdaq will interpret these requirements in the same manner we do if we believe we meet the requirements, or that Nasdaq will not change such requirements or add new requirements to include requirements we do not meet in the future. If we are delisted from the Nasdaq Capital Market, our Public Common Stock may be considered a penny stock under the regulations of the SEC and would therefore be subject to rules that impose additional sales practice requirements on broker-dealers who sell our securities. The additional burdens imposed upon broker-dealers may discourage broker-dealers from effecting transactions in our Public Common Stock, which could severely limit market liquidity of the Public Common Stock and any stockholder's ability to sell our securities in the secondary market. This lack of liquidity would also likely make it more difficult for us to raise capital in the future.

We have less than 300 holders of record as of our latest information, a fact which would make us eligible to terminate voluntarily the registration of our common stock with the SEC and therefore suspend our reporting obligations with the SEC under the Exchange Act and become a non-reporting company. If we were to cease reporting with the SEC, we would no longer be eligible to maintain the listing of our common stock on the Nasdaq Capital Market, which we would expect to materially adversely affect the liquidity and market price for our common stock.

***We may not be able to continue to achieve sustained profitability or increase profitability on a quarterly or annual basis.***

Prior to 2005, we incurred net losses on an annual basis since our inception in 1988 and, as of December 31, 2016, we had an accumulated deficit of \$151.8 million. Relatively small differences in our performance metrics may cause us to generate an operating or net loss in future periods. Our ability to continue to be profitable in future periods will depend, in part, on our ability to increase sales in our CCA segment, including maintaining and growing our installed base of instruments and related consumables, to maintain or increase gross margins and to limit the increase in our operating expenses to a reasonable level as well as avoid or effectively manage any unanticipated issues. We may not be able to generate, sustain or increase profitability on a quarterly or annual basis. If we cannot achieve or sustain profitability for an extended period, we may not be able to fund our expected cash needs, including the repayment of debt as it comes due, or continue our operations.

*We may face product returns and product liability litigation in excess of, or not covered by, our insurance coverage or indemnities and/or warranties from our suppliers. 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 sales could substantially decline.*

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, be required to make substantial payments which could exceed our financial capacity and/or lose or fail to achieve market acceptance.

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

Certain of our products and development programs produced at our Des Moines, Iowa facility involve the controlled use of hazardous and bio hazardous materials, including chemicals and infectious disease agents. 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 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 shutdown of our operations, significant remediation costs and potential legal liability. In addition, we may incur substantial costs to comply with environmental regulations if we choose to expand our manufacturing capacity.

**Item 1B. Unresolved Staff Comments.**

Not applicable.

**Item 2 Properties.**

Our principal administrative and research and development activities are located in Loveland, Colorado. We currently lease approximately 60,000 square feet at a facility in Loveland, Colorado under an agreement which expires in 2023. Our principal production facility located in Des Moines, Iowa, consists of 168,000 square feet of buildings on 34 acres of land, which we own. We also own a 175-acre farm used principally for testing products, located in Carlisle, Iowa. Our European facility in Fribourg, Switzerland has approximately 6,000 square feet leased under an agreement which expires in 2022.

**Item 3 Legal Proceedings.**

From time to time, we may be involved in litigation related to claims arising out of our operations. On March 12, 2015, a complaint was filed against us by Shaun Fauley in the United States District Court Northern District of Illinois alleging our transmittal of unauthorized faxes in violation of the federal Telephone Consumer Protection Act of 1991, as amended by the Junk Fax Prevention Act of 2005, as a class

action seeking stated damages of the greater of actual monetary loss or five hundred dollars per violation. We intend to defend the Company vigorously in this matter. As of December 31, 2016, we were not a party to any other legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on our business, financial condition or operating results.

**Item 4**                    **Mine Safety Disclosures.**

Not applicable.

## PART II

### Item 5 Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

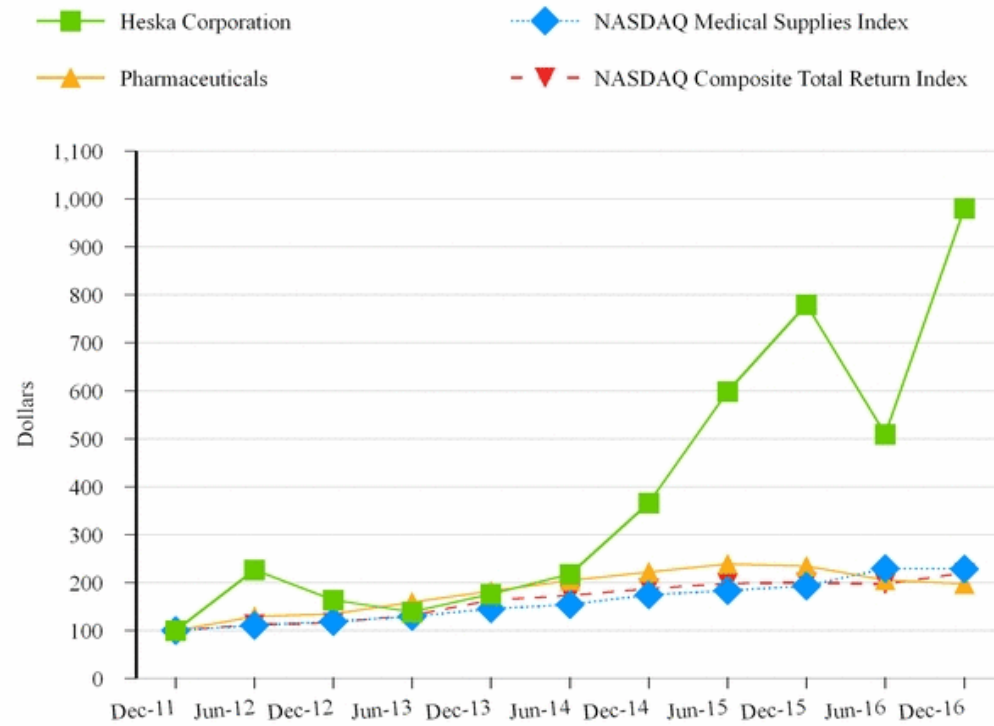
Our Public Common Stock is quoted on the Nasdaq Capital Market under the symbol "HSKA." The following table sets forth the high and low sales prices for our Public Common Stock as reported by the Nasdaq Capital Market for the periods indicated below:

	<u>High</u>	<u>Low</u>
<b>2015</b>		
First Quarter	\$ 26.68	\$ 15.58
Second Quarter	\$ 32.98	\$ 23.22
Third Quarter	\$ 35.72	\$ 26.73
Fourth Quarter	\$ 40.29	\$ 27.59
<b>2016</b>		
First Quarter	\$ 38.29	\$ 27.00
Second Quarter	\$ 40.73	\$ 26.26
Third Quarter	\$ 57.41	\$ 37.49
Fourth Quarter	\$ 74.33	\$ 46.51
<b>2017</b>		
First Quarter (through March 2, 2017)	\$ 95.98	\$ 70.84

As of February 28, 2017, there were approximately 256 holders of record of our Public Common Stock, including approximately 119 participant accounts of Cede & Co.'s position held with our registrar, and approximately 3,900 beneficial stockholders. We do not anticipate any dividend payments in the foreseeable future.

### STOCK PRICE PERFORMANCE GRAPH

The following graph provides a comparison over the five-year period ended December 31, 2016 of the cumulative total shareholder return from a \$100 investment in the Company's common stock with the NASDAQ Medical Supplies Index and the NASDAQ Composite Total Return:



	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16
Heska Corporation	\$ 100	\$ 163	\$ 176	\$ 366	\$ 780	\$ 981
NASDAQ Medical Supplies Index	\$ 100	\$ 118	\$ 145	\$ 174	\$ 193	\$ 228
NASDAQ Composite Total Return Index	\$ 100	\$ 116	\$ 163	\$ 187	\$ 200	\$ 220



**Item 6 Selected Financial Data.**

The selected consolidated statements of income and consolidated balance sheets data have been derived from our consolidated financial statements. The information set forth below is not necessarily indicative of the results of future operations and 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, respectively, in this Form 10-K.

	2016	2015	2014	2013	2012
<b>(In thousands, except per share data)</b>					
<b>Consolidated Statements of Income Data:</b>					
Revenue	\$ 130,083	\$ 104,597	\$ 89,837	\$ 78,339	\$ 72,805
Operating income (loss)	16,533	8,557	2,911	(1,430)	2,158
Income (loss) before income taxes	16,504	8,427	2,950	(1,393)	2,023
Net income (loss) attributable to Heska Corporation	<u>\$ 10,508</u>	<u>\$ 5,239</u>	<u>\$ 2,603</u>	<u>\$ (1,196)</u>	<u>\$ 1,203</u>
<b>Earnings (loss) per share attributable to Heska Corporation:</b>					
Basic earnings (loss) per share attributable to Heska Corporation	\$ 1.55	\$ 0.80	\$ 0.44	\$ (0.21)	\$ 0.23
Diluted earnings (loss) per share attributable to Heska Corporation	\$ 1.43	\$ 0.74	\$ 0.41	\$ (0.21)	\$ 0.22
Basic weighted-average common shares outstanding	6,783	6,509	5,951	5,755	5,326
Diluted weighted-average common shares outstanding	7,361	7,074	6,409	5,755	5,489
<b>Consolidated Balance Sheets Data:</b>					
Total assets	\$ 130,844	\$ 109,719	\$ 96,844	\$ 93,553	\$ 66,826

**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 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 profit margins, selling and marketing expenses, research and development 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, particularly in Item 1A "Risk Factors," that could cause actual results to differ materially from those projected. The forward-looking statements set forth in this Form 10-K are as of the close of business on March 2, 2017, and we undertake no duty and do not intend to update this information, except as required by applicable securities laws.

**Overview**

We sell advanced veterinary diagnostic and specialty products. Our offerings include blood testing instruments and supplies, digital imaging products, software and services, vaccines, local and cloud-based data services, allergy testing and immunotherapy, and single-use offerings such as in-clinic diagnostic tests and heartworm preventive products. Our core focus is on supporting veterinarians in the canine and feline healthcare space.

Our business consists of two reportable segments, Core Companion Animal Health ("CCA"), which represented 83% of our 2016 revenue and Other Vaccines, Pharmaceuticals and Products ("OVP"), which represented 17% of our 2016 revenue.

The CCA segment includes, primarily for canine and feline use, blood testing instruments and supplies, digital imaging products, software and services, local and cloud-based data services, allergy testing and immunotherapy, and single use offerings such as in-clinic diagnostic tests and heartworm preventive products.

Blood testing and other non-imaging instruments and supplies represented approximately 38% of our 2016 revenue. Many products in this area involve placing an instrument in the field and generating future revenue from consumables, including items such as supplies and service, as that instrument is used. Approximately 28% of our 2016 revenue resulted from the sale of such consumables to an installed base of instruments and approximately 10% of our 2016 revenue was from hardware revenue. A loss of, or disruption in, the supply of consumables we are selling to an installed base of instruments could substantially harm our business. All of our blood testing and other non-imaging instruments and supplies are supplied by third parties, who typically own the product rights and supply the product to us under marketing and/or distribution agreements. In many cases, we have collaborated with a third party to adapt a human instrument for veterinary use. Major products in this area include our instruments for chemistry, hematology, blood gas, and immunodiagnostic testing and their affiliated operating consumables. Revenue from products in these three areas, including revenues from consumables, represented approximately 34% of our 2016 revenue.

Imaging hardware, software and services represented approximately 23% of 2016 revenue. Digital radiography is the largest product offering in this area, which also includes ultrasound instruments. Digital radiography solutions typically consist of a combination of hardware and software placed with a customer, often combined with an ongoing service and support contract. With our acquisition of Cuattro Veterinary, LLC, subsequently renamed Heska Imaging International, LLC ("International Imaging"), we now sell our imaging solutions both in the United States and internationally. Our experience has been that most of the

revenue is generated at the time of sale in this area, in contrast to the blood testing category discussed above where ongoing consumable revenue is often a larger component of economic value as a given blood testing instrument is used.

Other CCA revenue, including single use diagnostic and other tests, pharmaceuticals and biologicals as well as research and development, licensing and royalty revenue, represented approximately 22% of our 2016 revenue. Since items in this area are often single use by their nature, our typical aim is to build customer satisfaction and loyalty for each product, generate repeat annual sales from existing customers and expand our customer base in the future. Products in this area are both supplied by third parties and provided by us. Major products and services in this area include heartworm diagnostic tests and preventives, and allergy test kits, allergy immunotherapy and testing. Combined revenue from heartworm-related products and allergy-related products represented 21% of our 2016 revenue.

We consider the CCA segment to be our core business and devote most of our management time and other resources to improving the prospects for this segment. Maintaining a continuing, reliable and economic supply of products we currently obtain from third parties is critical to our success in this area. Virtually all of our sales and marketing expenses occur in the CCA segment. The majority of our research and development spending is dedicated to this segment as well.

All of our CCA products are ultimately sold primarily to or through veterinarians. In many cases, veterinarians will mark up their costs to their customer. The acceptance of our products by veterinarians is critical to our success. CCA products are sold directly to end users by us as well as through distribution relationships, such as our agreement with Intervet Inc., d/b/a Merck Animal Health ("Merck Animal Health"), the sale of kits to conduct blood testing to third-party veterinary diagnostic laboratories and independent third-party distributors. Revenue from direct sales and distribution relationships represented approximately 61% and 39%, respectively, of CCA 2016 revenue.

The OVP segment includes our 168,000 square foot USDA- and FDA-licensed production facility in Des Moines, Iowa. We view this facility as an asset which could allow us to control our cost of goods on any pharmaceuticals and vaccines that we may commercialize in the future. We have increased integration of this facility with our operations elsewhere. For example, virtually all our U.S. inventory, excluding our imaging products, is now stored at this facility and related fulfillment logistics are managed there. CCA segment products manufactured at this facility are transferred at cost and are not recorded as revenue for our OVP segment. We view OVP reported revenue as revenue primarily to cover the overhead costs of the facility and to generate incremental cash flow to fund our CCA segment.

Our OVP segment includes private label vaccine and pharmaceutical production, primarily for cattle but also for other species including equine, porcine, avian, feline and canine. All OVP products are sold by third parties under third-party labels.

Historically, a significant portion of our OVP segment's revenue has been generated from the sale of certain bovine vaccines, which have been sold primarily under the Titanium® and MasterGuard® brands. We have an agreement with Eli Lilly and Company ("Eli Lilly") and its affiliates operating through Elanco for the production of these vaccines. Our OVP segment also produces vaccines and pharmaceuticals for other third parties.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations is based upon the consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires

management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenue and expense during the periods. These estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. We have identified those critical accounting policies used in reporting our financial position and results of operations based upon a consideration of those accounting policies that involve the most complex or subjective decisions or assessment. We consider the following to be our critical accounting policies.

### **Revenue Recognition**

We generate our revenue through the sale of products, as well as through licensing of technology product rights, royalties and sponsored research and development. Our policy is to recognize revenue when the applicable revenue recognition criteria have been met, which generally include the following:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services rendered;
- Price is fixed or determinable; and
- Collectability is reasonably assured.

Revenue from the sale of products is recognized after both the goods are shipped to the customer and acceptance has been received, if required, with an appropriate provision for estimated returns and allowances. We do not permit general returns of products sold. Certain of our products have expiration dates. Our policy is to exchange certain outdated, expired product with the same product. We record an accrual for the estimated cost of replacing the expired product expected to be returned in the future, based on our historical experience, adjusted for any known factors that reasonably could be expected to change historical patterns, such as regulatory actions which allow us to extend the shelf lives of our products. Revenue from both direct sales to veterinarians and sales to independent third-party distributors are generally recognized when goods are shipped. Our products are shipped complete and ready to use by the customer. The terms of the customer arrangements generally pass title and risk of ownership to the customer at the time of shipment. Certain customer arrangements provide for acceptance provisions. Revenue for these arrangements is not recognized until the acceptance has been received or the acceptance period has lapsed. We reduce our revenue by the estimated cost of any rebates, allowances or similar programs, which are used as promotional programs.

Recording revenue from the sale of products involves the use of estimates and management judgment. We must make a determination at the time of sale whether the customer has the ability to make payments in accordance with arrangements. While we do utilize past payment history, and, to the extent available for new customers, public credit information in making our assessment, the determination of whether collectability is reasonably assured is ultimately a judgment decision that must be made by management. We must also make estimates regarding our future obligation relating to returns, rebates, allowances and similar other programs.

License revenue under arrangements to sell or license product rights or technology rights is recognized as obligations under the agreement are satisfied, which generally occurs over a period of time. Generally, licensing revenue is deferred and recognized over the estimated life of the related agreements, products, patents or technology. Nonrefundable licensing fees, marketing rights and milestone payments received under contractual arrangements are deferred and recognized over the remaining contractual term using the straight-line method.

Recording revenue from license arrangements involves the use of estimates. The primary estimate made by management is determining the useful life of the related agreement, product, patent or technology. We evaluate all of our licensing arrangements by estimating the useful life of either the product or the technology, the length of the agreement or the legal patent life and defer the revenue for recognition over the appropriate period.

We may enter into arrangements that include multiple elements. Such arrangements may include agreements allowing for the usage of an instrument and a given level of consumables for one monthly payment. In these situations, we must determine whether the various elements meet the criteria to be accounted for as separate elements. If the elements cannot be separated, revenue is recognized once revenue recognition criteria for the entire arrangement have been met or over the period that the Company's obligations to the customer are fulfilled, as appropriate. If the elements are determined to be separable, the revenue is allocated to the separate elements based on relative fair value and recognized separately for each element when the applicable revenue recognition criteria have been met. In accounting for these multiple element arrangements, we must make determinations about whether elements can be accounted for separately and make estimates regarding their relative fair values.

### **Allowance for Doubtful Accounts**

We maintain an allowance for doubtful accounts receivable based on client-specific allowances, as well as a general allowance. Specific allowances are maintained for clients which are determined to have a high degree of collectability risk based on such factors, among others, as: (i) the aging of the accounts receivable balance; (ii) the client's past payment history; (iii) a deterioration in the client's financial condition, evidenced by weak financial condition and/or continued poor operating results, reduced credit ratings, and/or a bankruptcy filing. In addition to the specific allowance, the Company maintains a general allowance for credit risk in its accounts receivable which is not covered by a specific allowance. The general allowance is established based on such factors, among others, as: (i) the total balance of the outstanding accounts receivable, including considerations of the aging categories of those accounts receivable; (ii) past history of uncollectable accounts receivable write-offs; and (iii) the overall creditworthiness of the client base. A considerable amount of judgment is required in assessing the realizability of accounts receivable. Should any of the factors considered in determining the adequacy of the overall allowance change, an adjustment to the provision for doubtful accounts receivable may be necessary.

### **Inventories**

Inventories are stated at the lower of cost or net realizable value, cost being determined on the first-in, first-out method. Inventories are written down if the estimated net realizable value of an inventory item is less than its recorded value. We review the carrying cost of our inventories by product each quarter to determine the adequacy of our reserves for excess/obsolete inventory. In accounting for inventories we must make estimates regarding the estimated net realizable value of our inventory. This estimate is based, in part, on our forecasts of future sales and shelf life of products.

## Deferred Tax Assets – Valuation Allowance

A portion of our deferred tax assets, specifically our domestic federal net operating loss carryforwards ("NOL"), are reduced by a valuation allowance based on an assessment of available evidence if we are unable to conclude that it is more likely than not that some or all of the related deferred tax assets will be realized. If we are able to conclude it is more likely than not that we will realize a future benefit from a deferred tax asset against which we previously recorded a valuation allowance, we will reduce the related valuation allowance by an amount equal to the estimated quantity of income taxes we would pay in cash if we were not to utilize the deferred tax asset in the future. The first time this occurs in a given jurisdiction, it will result in an increase in the net deferred tax asset on our consolidated balance sheets and an income tax benefit of equal magnitude in our statement of operations in the period we make the determination. In future periods, we will then recognize as income tax expense the estimated amount of income taxes we would have paid in cash had we not utilized the related deferred tax asset. The corresponding journal entry will be a reduction of our deferred tax asset.

## Results of Operations

Our analysis presented below is organized to provide the information we believe will facilitate an understanding of our historical performance and relevant trends going forward. Our results of operations include the results of International Imaging for the period of June 1, 2016 through December 31, 2016. This discussion should be read in conjunction with our consolidated financial statements, including the notes thereto, in Item 8 of this annual report on Form 10K.

The following table sets forth, for the periods indicated, certain data derived from our consolidated statements of income (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Revenue	\$ 130,083	\$ 104,597	\$ 89,837
Gross Profit	53,892	44,213	35,715
Operating expenses	37,359	35,656	32,804
Operating income	16,533	8,557	2,911
Interest and other expense (income), net	29	130	(39)
Income before income taxes	16,504	8,427	2,950
Provision for income taxes	4,339	2,908	1,351
Net income	12,165	5,519	1,599
Net income (loss) attributable to non-controlling interest	1,657	280	(1,004)
Net income attributable to Heska Corporation	\$ 10,508	\$ 5,239	\$ 2,603

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

	Years Ended December 31,		
	2016	2015	2014
Revenue	100.0%	100.0%	100.0 %
Gross Profit	41.4%	42.3%	39.8 %
Operating expenses	28.7%	34.1%	36.5 %
Operating income	12.7%	8.2%	3.2 %
Interest and other expense (income), net	—%	0.1%	—%
Income before income taxes	12.7%	8.1%	3.3 %
Provision for income taxes	3.3%	2.8%	1.5 %
Net income	9.4%	5.3%	1.8 %
Net income (loss) attributable to non-controlling interest	1.3%	0.3%	(1.1)%
Net income attributable to Heska Corporation	8.1%	5.0%	2.9 %

### **Revenue**

Total revenue increased 24% to \$130.1 million in 2016 compared to \$104.6 million in 2015. Total revenue increased 16% to \$104.6 million in 2015 compared to \$89.8 million in 2014.

CCA segment revenue increased 27% to \$107.4 million in 2016 compared to \$84.2 million in 2015. The increase was driven primarily by greater sales of our digital imaging products, including those of newly-acquired International Imaging, increased sales of our heartworm preventive products and increased sales of our instruments and their associated consumables. These increases were partially offset by declines in sales of our heartworm diagnostic tests and allergy testing and treatments. CCA segment revenue increased 16% to \$84.2 million in 2015 compared to \$72.4 million in 2014. The increase was driven primarily by greater sales of our instruments and their associated consumables, partially offset by a decline in sales of our heartworm diagnostic tests.

OVP segment revenue increased 11% to \$22.7 million in 2016 compared to \$20.3 million in 2015 and increased 16% to \$20.3 million in 2015 compared to \$17.5 million in 2014. The increase in both periods presented was driven primarily by greater revenue from our contract with Elanco.

### **Gross Profit**

Gross profit increased 22% to \$53.9 million in 2016 compared to \$44.2 million in 2015. Gross margin percent, which we derive by dividing gross profit by total revenue, decreased to 41.4% in 2016 compared to 42.3% in 2015. This lower gross margin percentage was driven primarily by unfavorable product mix in our OVP segment as well as incremental sales from International Imaging, which contributes slightly lower gross margins than our domestic imaging products.

Gross profit increased 24% to \$44.2 million in 2015 compared to \$35.7 million in 2014. Gross margin percent increased to 42.3% in 2015 compared to 39.8% in 2014. The lower gross margin percentage was driven primarily by unfavorable product mix in our OVP segment.

### ***Operating Expenses***

Selling and marketing expenses increased 4% to \$22.1 million in 2016 compared to \$21.3 million in 2015 and increased 11% to \$21.3 million in 2015 compared to \$19.2 million in 2014. The increase in both periods was driven primarily by commissions paid on higher sales levels, particularly on our digital radiography sales and instrument placements.

Research and development expenses increased 29% to \$2.1 million in 2016, compared to \$1.7 million in 2015 and increased 17% to \$1.7 million in 2015, as compared to \$1.4 million in 2014. The increase in both periods was driven primarily by spending on product development for digital radiography solutions.

General and administrative expenses increased 4% to \$13.1 million in 2016, compared to \$12.7 million in 2015. The increase was driven primarily by intangible amortization expense related to our acquisition of International Imaging. General and administrative expenses increased 3% to \$12.7 million in 2015, as compared to \$12.2 million in 2014. The increase was driven primarily by a one-time \$0.9 million charge that was incurred in the third quarter of 2015 for certain accelerated restricted stock vesting and payments related to the early termination of our Executive Chair's employment agreement.

### ***Interest and Other Expense (Income), Net***

Interest and other expense (income), net, was an expense of \$29 thousand in 2016, as compared to an expense of \$130 thousand in 2015 and income of \$39 thousand in 2014.

The decrease in expense in 2016 as compared to 2015 was driven primarily by income received from the sale of an equity investment during the first quarter of 2016. This income was offset by minimum interest payments made on our line of credit and greater foreign currency losses.

The increase in expense from 2014 to 2015 was driven primarily by greater foreign currency losses.

### ***Income Tax Expense***

In 2016, we had total income tax expense of \$4.3 million, including \$3.9 million in domestic deferred income tax expense, a non-cash item primarily related to our domestic NOL position, and \$0.4 million in current income tax expense. In 2015, we had total income tax expense of \$2.9 million, including \$1.3 million in domestic deferred income tax expense, a non-cash item primarily related to our domestic NOL position, and \$1.6 million in current income tax expense. In 2014, we had total income tax expense of \$1.4 million, including \$1.3 million in domestic deferred income tax expense, and \$47 thousand in current income tax expense. Greater income before income taxes was a key factor in our increasing tax expense from year to year. The impact of greater income before income taxes in 2016 was somewhat offset by additional tax benefits of \$0.8 million related to employee share-based payment awards which are now recorded as income tax benefit or expense in earnings effective with ASU 2016-09, which we adopted in the second quarter of 2016.

### ***Net Income attributable to Heska Corporation***

Net income attributable to Heska Corporation was \$10.5 million in 2016, as compared to a net income attributable to Heska Corporation of \$5.2 million in 2015 and net income attributable to Heska Corporation of \$2.6 million in 2014. The difference between this line item and "Net Income (Loss)" is the net income or loss attributable to our minority interest in Heska Imaging, which was net income of \$1.7 million in 2016, net income of \$0.3 million in 2015 and net loss of \$1.0 million in 2014.



### ***Impact of Inflation***

In recent years, inflation has not had a significant impact on our operations.

### **Liquidity, Capital Resources and Financial Condition**

We believe that adequate liquidity and cash generation is important to the execution of our strategic initiatives. Our ability to fund our operations, acquisitions, capital expenditures, and product development efforts may depend on our ability to generate cash from operating activities which is subject to future operating performance, as well as general economic, financial, competitive, legislative, regulatory, and other conditions, some of which are beyond our control. Our primary sources of liquidity are our available cash, cash generated from current operations and availability under our credit facilities noted below.

For the year ended December 31, 2016, we had net income of \$12.2 million and net cash provided by operations of \$5.9 million. At December 31, 2016, we had \$10.8 million of cash and cash equivalents, working capital of \$22.9 million and \$0.7 million outstanding borrowings under our revolving line of credit, discussed below.

At December 31, 2016, we had a \$15.0 million asset-based revolving line of credit with Wells Fargo which has a maturity date of December 31, 2017 as part of our credit and security agreement with Wells Fargo. At December 31, 2016, we had \$0.7 million of borrowings outstanding on this line of credit. Our ability to borrow under this line of credit varies based upon available cash, eligible accounts receivable and eligible inventory. On December 31, 2016, any interest on borrowings due was to be charged at a stated rate of three month LIBOR plus 2.25% and payable monthly. We are required to comply with various financial and non-financial covenants, and we have made various representations and warranties under our agreement with Wells Fargo. A key financial covenant is based on a fixed charge coverage ratio, as defined in our agreement with Wells Fargo. Failure to comply with any of the covenants, representations or warranties could result in our being in default on the loan and could cause all outstanding amounts payable to Wells Fargo to become immediately due and payable or impact our ability to borrow under the agreement. We were in compliance with all financial covenants as of December 31, 2016 and our available borrowing capacity based upon eligible accounts receivable and eligible inventory under our revolving line of credit was approximately \$12.9 million.

A summary of our cash provided by and used in operating, investing and financing activities is as follows (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Net cash provided by operating activities	\$ 5,855	\$ 2,125	\$ 5,554
Net cash used in investing activities	(3,302)	(3,773)	(2,331)
Net cash provided by (used in) financing activities	1,403	2,726	(3,271)
Effect of currency translation on cash	(52)	(43)	(113)
Increase (decrease) in cash and cash equivalents	3,904	1,035	(161)
Cash and cash equivalents, beginning of the period	6,890	5,855	6,016
Cash and cash equivalents, end of the period	\$ 10,794	\$ 6,890	\$ 5,855

Net cash provided by operating activities was \$5.9 million in 2016 as compared to net cash provided by operating activities of \$2.1 million in 2015, a favorable increase of approximately \$3.7 million. The change was driven primarily by a \$6.6 million increase in net income, a \$2.6 million increase in the use of our deferred tax asset, a \$2.5 million favorable decrease in cash used for inventory, some of which related to

inventory transferred to property, plant and equipment as rental units, a \$1.0 million increase in cash provided by accrued liabilities and other non-current assets and a \$0.5 million increase in depreciation and amortization. These factors were partially offset by a \$5.5 million increase in cash used in deferred revenue and other non-current assets and a \$3.7 million unfavorable increase in cash used for accounts payable. Net cash provided by operating activities was \$2.1 million in 2015 as compared to net cash provided by operating activities of \$5.6 million in 2014, an unfavorable decrease of approximately \$3.4 million. The change was driven primarily by a \$3.7 million increase in cash used for accounts receivable, a \$2.3 million increase in cash used for deferred revenue and other long term liabilities, which included a \$3.0 million milestone payment received in 2014 but not 2015, a \$2.2 million increase in cash used in other non-current assets, which included the impact of increased capital lease activity under new marketing programs, and a \$1.6 million increase in cash used for inventory in 2015, some of which related to inventory transferred to property, plant and equipment as rental units. These factors were somewhat offset by a \$3.9 million increase in net income and a \$2.2 million increase in cash provided by accounts payable.

Net cash used in investing activities was \$3.3 million in 2016 as compared to net cash used in investing activities of \$3.8 million in 2015, a favorable decrease of approximately \$0.5 million. The change was driven primarily by a \$0.4 million favorable decrease in purchases of property and equipment and \$0.1 million of proceeds from the sale of an equity investment. Net cash used in investing activities was \$3.8 million in 2015 as compared to net cash used in investing activities of \$2.3 million in 2014, an unfavorable increase of approximately \$1.4 million. The change was driven primarily by an increase in purchases of property and equipment.

Net cash provided by financing activities was \$1.4 million in 2016 as compared to net cash provided by financing activities of \$2.7 million in 2015, an unfavorable decrease of approximately \$1.3 million. The change was driven primarily by a \$1.5 million change related to the accounting for additional tax benefits for employee share-based payment awards, which in 2016 were recorded as income tax benefit in earnings as compared to 2015, when they were carried on the balance sheet and classified as part of cash provided by financing activities. Net cash provided by financing activities was \$2.7 million in 2015 as compared to net cash used in financing activities of \$3.3 million in 2014, a favorable change of approximately \$6.0 million. The change was driven primarily by use of our revolving line of credit, from which we borrowed \$0.1 million in 2015 as compared to repaying \$4.8 million in 2014.

Under the Amended and Restated Operating Agreement of US Imaging (the "Operating Agreement"), should US Imaging meet certain performance criteria, the Imaging Minority has been granted a put option to sell us all of the Imaging Minority's position in US Imaging following the audit of our financial statements for 2016. Required performance criteria have been met and we have been given notice that the put option is being exercised. We have 90 days from the receipt of notice to deliver payment (any applicable payment in aggregate to be defined as the "Put Payment") for the Imaging Minority's position, and we consider notice to have been received immediately prior to the filing of this Form 10-K with the SEC. We plan to deliver the Put Payment and obtain the Imaging Minority's position in US Imaging on May 31, 2017. Based on US Imaging's 2016 financial performance, the Put Payment is to be for a value of \$13.8 million if we deliver all cash or up to \$14.6 million if we deliver a combination of cash and the maximum contractually allowable value of stock. While we have the right to deliver up to 55% of the consideration in our Public Common Stock under certain circumstances, such stock is to be valued based on 90% of market value (the "Delivery Stock Value") and is limited to approximately 650 thousand shares in any case. If the Delivery Stock Value per share is less than the market value per share of our Public Common Stock at the time of the Acquisition, we do not have the right to deliver any Public Common Stock as consideration. While we have reported the Put Payment at \$14.6 million for financial reporting purposes, which contemplates our delivery of 55% of the Put Payment consideration in Public Common Stock, no final decision by our Board of Directors as to the relative use of cash and stock has been made and we may not be able to deliver any stock based on the

Delivery Stock Value at the time of closing, as discussed above. The estimated Put Payment value of \$14.6 million is listed as "Obligation to purchase minority interest" on the Company's consolidated balance sheets as of December 31, 2016.

At December 31, 2016, US Imaging had a \$1.6 million note receivable, including accrued interest, from International Imaging, which is due on June 15, 2019 and which eliminates in consolidation of the Company's financial statements. This note was previously listed as "Note receivable – related party" on the Company's consolidated balance sheets and the note receivable was assumed as part of the Company's acquisition of International Imaging.

At December 31, 2016, Heska Corporation had accounts receivable from US Imaging of \$5.6 million, including accrued interest, which eliminates in consolidation of the Company's financial statements; US Imaging had a net receivable due from Cuattro, LLC of \$0.1 million, which is included in "Due from – related parties" on the Company's consolidated balance sheets; Global Imaging had net prepaid receivables from US Imaging of \$1.2 million which eliminates in consolidation of the Company's financial statements; and all monies owed accrue interest at the same interest rate Heska Corporation pays under its credit and security agreement with Wells Fargo once past due with the exception of the note receivable, which accrues at this rate to its maturity date.

At December 31, 2016, we had other borrowings outstanding totaling \$78 thousand, all of which were obligations of a US Imaging loan from De Lage Landen Financial Services, Inc. ("DLL"). The note bears an interest rate of 6% and is due in equal monthly payments, including principal and interest, of \$13 thousand through June 2017. The note may be prepaid prior to maturity, but is subject to a surcharge in such a circumstance. The principal associated with this note of approximately \$78 thousand is listed as "other short term borrowings" on our consolidated balance sheets as it is due within a year.

Our financial plan for 2017 indicates that our available cash and cash equivalents, together with cash from operations and borrowings expected to be available under our revolving line of credit, will be sufficient to fund our operations for the foreseeable future as well as finance the purchase of the Imaging Minority as described above. Additionally, we would consider additional acquisitions if we felt they were consistent with our strategic direction. However, our actual results may differ from this plan, and we may be required to consider alternative strategies. We may be required to raise additional capital in the future. If necessary, we expect to raise these additional funds through the increased sale of customer leases, the sale of equity securities or the issuance of new term debt. There is no guarantee that additional capital will be available from these sources on acceptable terms, if at all, and certain of these sources may require approval by existing lenders. See "Risk Factors" in Item 1A of this Form 10-K for a discussion of some of the factors that affect our capital raising alternatives.

#### *Effect of currency translation on cash*

Net effect of foreign currency translations on cash changed \$9 thousand to a \$52 thousand negative impact in 2016 as compared to a \$43 thousand negative impact in 2015. The net effect of foreign currency translation on cash changed \$70 thousand to a \$43 thousand negative impact in 2015 from a \$113 thousand negative impact in 2014. These effects are related to changes in exchange rates between the US Dollar and the Swiss Franc, which is the functional currency of our Swiss subsidiary.

#### **Off Balance Sheet Arrangements**

We have no off balance sheet arrangements or variable interest entities.

#### **Contractual Obligations**

The following table sets forth our future payments due under contractual obligations as of December 31, 2016 (in thousands):

	<b>Total</b>	<b>Less Than 1 Year</b>	<b>1 - 3 Years</b>	<b>4 - 5 Years</b>	<b>After 5 Years</b>
Operating leases	\$ 12,445	\$ 2,090	\$ 3,780	\$ 3,373	\$ 3,202
Obligation to purchase minority interest	6,245	6,245	—	—	—
Unconditional purchase obligations	976	638	338	—	—
Long-term debt	78	78	—	—	—
Line of credit	672	672	—	—	—
Interest payments on debt	86	86	—	—	—
<b>Total</b>	<b>\$ 20,502</b>	<b>\$ 9,809</b>	<b>\$ 4,118</b>	<b>\$ 3,373</b>	<b>\$ 3,202</b>

In addition to those agreements considered above where our contractual obligation is fixed, we are party to commercial agreements which may require us to make milestone payments under certain circumstances. Any milestone obligations which we believe are likely to be triggered but are not yet paid are included in "Unconditional Purchase Obligations" in the table above. We do not believe other potential milestone obligations, some of which we consider to be of remote likelihood of ever being triggered, will have a material impact on our liquidity, capital resources or financial condition in the foreseeable future.

The line item entitled "Obligation to purchase minority interest" indicates our estimate of the cash portion that may be used to settle the purchase of the minority interest in US Imaging under a series of performance-based puts as described above.

### Net Operating Loss Carryforwards

As of December 31, 2016, we had a net domestic operating loss carryforward, or NOL, of approximately \$96.0 million, a domestic alternative minimum tax credit carryforward of approximately \$0.5 million and a domestic research and development tax credit carryforward of approximately \$0.4 million for federal income tax purposes. Our federal NOL is expected to expire as follows if unused: \$90.0 million in 2018 through 2022, \$5.5 million in 2024 and 2025 and \$0.5 million in 2027 and later. The NOL and tax credit carryforwards are subject to alternative minimum tax limitations and to examination by the tax authorities. In addition, we had a "change of ownership" as defined under the provisions of Section 382 of the Internal Revenue Code of 1986, as amended (an "Ownership Change"). We believe the latest Ownership Change occurred at the time of our initial public offering in July 1997.

### Recent Accounting Pronouncements

From time to time, the Financial Accounting Standards Board ("FASB") or other standards setting bodies issue new accounting pronouncements. Updates to the FASB Accounting Standards Codification ("ASC") are communicated through issuance of an Accounting Standards Update ("ASU"). Unless otherwise discussed, we believe that the impact of recently issued guidance, whether adopted or to be adopted in the future, is not expected to have a material impact on our Consolidated Financial Statements upon adoption.

To understand the impact of recently issued guidance, whether adopted or to be adopted, please review the information provided in Note 1- *Operations and Summary of Significant Accounting Policies* to our Consolidated Financial Statements included in Item 8 of this Form 10-K.

**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.

**Interest Rate Risk**

At December 31, 2016, there was approximately \$0.7 million outstanding on our line of credit with Wells Fargo. We also had approximately \$10.8 million of cash and cash equivalents at December 31, 2016, the majority of which was invested in liquid interest bearing accounts. We had no interest rate hedge transactions in place on December 31, 2016. We completed an interest rate risk sensitivity analysis based on the above and an assumed one-percentage point decrease in interest rates would have an approximate \$101 thousand negative impact on our pre-tax earnings based on our outstanding balances as of December 31, 2016.

**Foreign Currency Risk**

Our investment in foreign assets consists primarily of our investment in our Swiss subsidiary. Foreign currency risk may impact our results of operations. In cases where we purchase inventory in one currency and sell corresponding products in another, our gross margin percentage is typically at risk based on foreign currency exchange rates. In addition, in cases where we may be generating operating income in foreign currencies, the magnitude of such operating income when translated into U.S. dollars will be at risk based on foreign currency exchange rates. Our agreements with suppliers and customers vary significantly in regard to the existence and extent of currency adjustment and other currency risk sharing provisions. We had no foreign currency hedge transactions in place on December 31, 2016.

We have a wholly-owned subsidiary in Switzerland which uses the Swiss Franc as its functional currency. We purchase inventory in foreign currencies, primarily Euros, and sell corresponding products in U.S. dollars. We also sell products in foreign currencies, primarily Euros and Japanese Yen, where our inventory costs are largely in U.S. dollars. We also have entered into contracts for which payments are adjusted for changes in foreign currency rates, including the Chinese Yuan. Based on our 2016 results of operations, currency holdings and currency-related prepaid accounts, accounts receivable and accounts payable (all of which, including currency holdings, we will refer to as "Currency Accounts") as of December 31, 2016 and the functional currency of the accounting entity where such Currency Accounts are held, the expected impact on our consolidated statements of income, if foreign currency exchange rates were to strengthen/weaken by 25% against the dollar, would be a resulting gain/loss in operating income of approximately \$400 thousand and a currency loss/gain of \$393 thousand, if all other currencies were to strengthen/weaken by 25% against the Swiss Franc, would be a resulting loss/gain in operating income of approximately \$35 thousand and a currency gain/loss of \$415 thousand, if all other currencies were to strengthen/weaken by 25% against the Euro, would be a resulting loss/gain in operating income of approximately \$313 thousand and a currency loss/gain of \$801 thousand, and if all other currencies were to strengthen/weaken by 25% against the Yuan, the resulting loss/gain in operating income would be approximately \$649 thousand, but no resulting currency loss/gain.

**Item 8. Financial Statements and Supplementary Data.**

**HESKA CORPORATION**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	<b>Page</b>
<a href="#">Report of Independent Registered Public Accounting Firm</a>	<a href="#">44</a>
<a href="#">Consolidated Balance Sheets</a>	<a href="#">45</a>
<a href="#">Consolidated Statements of Income</a>	<a href="#">46</a>
<a href="#">Consolidated Statements of Comprehensive Income</a>	<a href="#">47</a>
<a href="#">Consolidated Statements of Stockholders' Equity</a>	<a href="#">48</a>
<a href="#">Consolidated Statements of Cash Flows</a>	<a href="#">49</a>
<a href="#">Notes to Consolidated Financial Statements</a>	<a href="#">50</a>

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
Heska Corporation and Subsidiaries  
Loveland, Colorado

We have audited the accompanying consolidated balance sheets of Heska Corporation and Subsidiaries (the “Company”) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders’ equity, and cash flows for each of the years in the three-year period ended December 31, 2016. We also have audited the Company’s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control-Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). The Company’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company’s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heska Corporation and Subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control-Integrated Framework (1992)* issued by COSO.

EKS&H LLLP

March 3, 2017  
Denver, Colorado

**HESKA CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except per share amounts)

	December 31,	
	2016	2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 10,794	\$ 6,890
Accounts receivable, net of allowance for doubtful accounts of \$237 and \$189, respectively	20,857	15,935
Due from – related parties	100	308
Inventories, net	20,395	16,101
Other current assets	3,127	2,028
Total current assets	55,273	41,262
Property and equipment, net	16,581	17,020
Note receivable – related party	—	1,516
Goodwill	26,647	20,910
Other intangible assets, net	2,346	56
Deferred tax asset, net	21,122	25,883
Other long-term assets	8,875	3,072
Total assets	\$ 130,844	\$ 109,719
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 7,154	\$ 7,624
Accrued liabilities	6,469	5,416
Current portion of deferred revenue	3,439	5,461
Obligation to purchase minority interest	14,602	—
Line of credit	672	143
Other short-term borrowings, including current portion of long-term note payable	78	159
Total current liabilities	32,414	18,803
Long-term note payable, net of current portion	—	69
Deferred revenue, net of current portion, and other	11,455	11,572
Total liabilities	43,869	30,444
Commitments and contingencies (Note 10)		
Non-Controlling Interest	—	15,747
Stockholders' equity:		
Preferred stock, \$.01 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, \$.01 par value, 9,000,000 shares authorized, none issued or outstanding	—	—
Public common stock, \$.01 par value, 9,000,000 shares authorized, 7,026,051 and 6,625,287 shares issued and outstanding, respectively	70	66
Additional paid-in capital	238,635	227,267
Accumulated other comprehensive income	97	187
Accumulated deficit	(151,827)	(163,992)
Total stockholders' equity	86,975	63,528
Total liability and stockholders' equity	\$ 130,844	\$ 109,719

See accompanying notes to consolidated financial statements.



**HESKA CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share amounts)

	Year Ended December 31,		
	2016	2015	2014
<b>Revenue:</b>			
Core companion animal health	\$ 107,398	\$ 84,249	\$ 72,354
Other vaccines, pharmaceuticals and products	22,685	20,348	17,483
Total revenue, net	130,083	104,597	89,837
<b>Cost of revenue</b>			
	76,191	60,384	54,122
<b>Gross profit</b>	53,892	44,213	35,715
<b>Operating expenses:</b>			
Selling and marketing	22,092	21,339	19,159
Research and development	2,147	1,658	1,414
General and administrative	13,120	12,659	12,231
Total operating expenses	37,359	35,656	32,804
<b>Operating income</b>	16,533	8,557	2,911
Interest and other expense (income), net	29	130	(39)
<b>Income before income taxes</b>	16,504	8,427	2,950
<b>Income tax expense:</b>			
Current income tax expense	407	1,581	47
Deferred income tax expense	3,932	1,327	1,304
Total income tax expense	4,339	2,908	1,351
<b>Net income</b>	12,165	5,519	1,599
Net income (loss) attributable to non-controlling interest	1,657	280	(1,004)
<b>Net income attributable to Heska Corporation</b>	<u>\$ 10,508</u>	<u>\$ 5,239</u>	<u>\$ 2,603</u>
<b>Basic earnings per share attributable to Heska Corporation</b>			
	<u>\$ 1.55</u>	<u>\$ 0.80</u>	<u>\$ 0.44</u>
<b>Diluted earnings per share attributable to Heska Corporation</b>			
	<u>\$ 1.43</u>	<u>\$ 0.74</u>	<u>\$ 0.41</u>
<b>Weighted average outstanding shares used to compute basic earnings per share attributable to Heska Corporation</b>			
	<u>6,783</u>	<u>6,509</u>	<u>5,951</u>
<b>Weighted average outstanding shares used to compute diluted earnings per share attributable to Heska Corporation</b>			
	<u>7,361</u>	<u>7,074</u>	<u>6,409</u>

See accompanying notes to consolidated financial statements.

**HESKA CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(in thousands)

	Year Ended December 31,		
	2016	2015	2014
Net income	\$ 12,165	\$ 5,519	\$ 1,599
Other comprehensive income (expense):			
Minimum pension liability	75	(129)	—
Sale of equity investment	(90)	44	3
Foreign currency translation	(75)	(11)	(300)
Comprehensive income	<u>12,075</u>	<u>5,423</u>	<u>1,302</u>
Comprehensive income (loss) attributable to non-controlling interest	1,657	280	(1,004)
Comprehensive income attributable to Heska Corporation	<u>\$ 10,418</u>	<u>\$ 5,143</u>	<u>\$ 2,306</u>

See accompanying notes to consolidated financial statements.

**HESKA CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(in thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balances January 1, 2014	5,846	\$ 58	\$ 217,588	\$ 580	\$ (171,110)	\$ 47,116
Net loss	—	—	—	—	1,599	1,599
Issuance of common stock related to options, ESPP and other	496	5	1,443	—	—	1,448
Recognition of stock based compensation	—	—	1,653	—	—	1,653
Excess tax benefit from stock-based compensation	—	—	228	—	—	228
Stock issued for Heska Imaging	—	—	3,405	—	—	3,405
Stock issued for Heska Imaging Mark to Market	—	—	(2,020)	—	—	(2,020)
Unrealized gain on available for sale investments	—	—	—	3	—	3
Foreign currency translation adjustments	—	—	—	(300)	—	(300)
Balances, December 31, 2014	6,342	\$ 63	\$ 222,297	\$ 283	\$ (169,511)	\$ 53,132
Net income	—	—	—	—	5,519	5,519
Issuance of common stock related to options, ESPP and other	283	3	1,255	—	—	1,258
Recognition of stock based compensation	—	—	2,269	—	—	2,269
Excess tax benefit from stock-based compensation	—	—	1,514	—	—	1,514
Unrealized gain on available for sale investments	—	—	—	44	—	44
Foreign currency translation adjustments	—	—	—	(11)	—	(11)
Balances, December 31, 2015	6,625	\$ 66	\$ 227,267	\$ 187	\$ (163,992)	\$ 63,528
Net income	—	—	—	—	12,165	12,165
Issuance of common stock related to the acquisition of Cuatro Veterinary International, LLC	175	2	6,347	—	—	6,349
Issuance of common stock related to options, ESPP and other	226	2	1,616	—	—	1,618
Recognition of stock based compensation	—	—	2,260	—	—	2,260
Accretion of non-controlling interest	—	—	1,145	—	—	1,145
Minimum pension liability adjustments	—	—	—	75	—	75
Sale of equity investment	—	—	—	(90)	—	(90)
Foreign currency translation adjustments	—	—	—	(75)	—	(75)
Balances, December 31, 2016	7,026	\$ 70	\$ 238,635	\$ 97	\$ (151,827)	\$ 86,975

See accompanying notes to consolidated financial statements.

**HESKA CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Year Ended December 31,		
	2016	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 12,165	\$ 5,519	\$ 1,599
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	4,645	4,187	3,712
Deferred tax expense	3,932	1,327	1,304
Stock based compensation	2,260	2,269	1,653
Unrealized (gain) loss on foreign currency translation	(3)	36	(81)
Changes in operating assets and liabilities:			
Accounts receivable	(4,700)	(4,216)	(510)
Inventories	(4,731)	(7,240)	(5,592)
Other current assets	88	(238)	(73)
Accounts payable	(688)	3,059	900
Accrued liabilities and other	1,005	43	814
Other non-current assets	(5,818)	(2,430)	(263)
Deferred revenue and other	(2,300)	(191)	2,091
Net cash provided by operating activities	5,855	2,125	5,554
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from sale of equity investment	115	—	—
Purchases of property and equipment	(3,417)	(3,773)	(2,337)
Proceeds from disposition of property and equipment	—	—	6
Net cash used in investing activities	(3,302)	(3,773)	(2,331)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from issuance of common stock, net of distributions	1,620	1,258	1,430
Proceeds from (repayments of) line of credit borrowings, net	530	95	(4,751)
Repayments of other debt	(747)	(141)	(178)
Excess tax benefit from stock-based compensation	—	1,514	228
Net cash provided by (used in) financing activities	1,403	2,726	(3,271)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(52)	(43)	(113)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,904	1,035	(161)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	6,890	5,855	6,016
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 10,794</u>	<u>\$ 6,890</u>	<u>\$ 5,855</u>
<b>NON-CASH TRANSACTIONS:</b>			
Common stock issued as partial consideration of acquisition of Cuattro Veterinary International, LLC	\$ 6,349	\$ —	\$ —

See accompanying notes to consolidated financial statements.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Heska Corporation and its wholly-owned and majority-owned subsidiaries ("Heska", the "Company", "we" or "our") sell advanced veterinary diagnostic and specialty products. Our offerings include blood testing instruments and supplies, digital imaging products, software and services, vaccines, local and cloud-based data services, allergy testing and immunotherapy, and single-use offerings such as in-clinic diagnostic tests and heartworm preventive products. Our core focus is on supporting veterinarians in the canine and feline healthcare space.

*Basis of Presentation*

Our consolidated financial statements include our accounts and the accounts of our wholly-owned subsidiaries and majority-owned subsidiaries since their respective dates of acquisitions. All intercompany accounts and transactions have been eliminated in consolidation. Where our ownership of a subsidiary is less than 100%, the non-controlling interest is reported on our consolidated balance sheets. The non-controlling interest in our consolidated net income is reported as "Net income (loss) attributable to non-controlling interest" on our consolidated statements of income. Our consolidated financial statements are stated in United States dollars and have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP").

*Use of Estimates*

The preparation of financial statements in conformity with U.S. GAAP 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. Significant estimates are required when establishing the allowance for doubtful accounts and the provision for excess or obsolete inventory, in determining the period over which our obligations are fulfilled under agreements to license product rights and/or technology rights, evaluating long-lived and intangible assets for impairment, determining the allocation of purchase price under purchase accounting, estimating the expense associated with the granting of stock options, determining the value of our non-controlling interest and in determining the need for, and the amount of, a valuation allowance on deferred tax assets.

*Concentration of Credit Risk*

Financial instruments that potentially subject us to a concentration of credit risk consist of cash and cash equivalents and accounts receivable. We maintain the majority of our cash and cash equivalents with financial institutions that management believes are creditworthy in the form of demand deposits. We have no significant off-balance-sheet concentrations of credit risk such as foreign exchange contracts, options contracts or other foreign currency hedging arrangements. Our accounts receivable balances are due largely from distribution partners, domestic veterinary clinics and individual veterinarians and other animal health companies.

Henry Schein represented 16% of our consolidated accounts receivable at December 31, 2016. Merck entities represented approximately 11% and 13% of our consolidated accounts receivable at December 31, 2016 and 2015, respectively. Eli Lilly entities, including Elanco, represented approximately 15% and 20% of our consolidated accounts receivable at December 31, 2016 and 2015, respectively. No other customer accounted for more than 10% of our consolidated accounts receivable at December 31, 2016 or 2015.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

We have established an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends, and other information.

*Accounts Receivable and Allowance for Doubtful Accounts*

Accounts receivable are recorded at net realizable value. From time to time, our customers are unable to meet their payment obligations. We continuously monitor our customers' credit worthiness and use our judgment in establishing a provision for estimated credit losses based upon our historical experience and any specific customer collection issues that we have identified. While such credit losses have historically been within our expectations and the provisions established, there is no assurance that we will continue to experience the same credit loss rates that we have in the past. A significant change in the liquidity or financial position of our customers could have a material adverse impact on the collectability of accounts receivable and our future operating results.

Changes in allowance for doubtful accounts are summarized as follows (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Balances at beginning of period	\$ 189	\$ 216	\$ 209
Additions - charged to expense	163	83	143
Deductions - write offs, net of recoveries	(115)	(110)	(136)
Balances at end of period	<u>\$ 237</u>	<u>\$ 189</u>	<u>\$ 216</u>

*Cash and Cash Equivalents*

Cash and cash equivalents are stated at cost, which approximates market value, and include short-term, highly liquid investments with original maturities of less than three months. We valued our Euro and Japanese Yen cash accounts at the spot market foreign exchange rate as of each balance sheet date, with changes due to foreign exchange fluctuations recorded in current earnings. We held 2,778,614 and 1,779,910 Euros at December 31, 2016 and 2015, respectively. We held 1,252,221 and 1,252,221 Yen at December 31, 2016 and 2015, respectively. We held 172,743 and 127,507 Swiss Francs at December 31, 2016 and 2015, respectively. We held 26,477 and 26,477 Canadian Dollars at December 31, 2016 and 2015, respectively. The majority of our cash and cash equivalents are held at U.S.-based or Swiss-based financial institutions in accounts not insured by governmental entities.

*Fair Value of Financial Instruments*

Our financial instruments consist of cash and cash equivalents, short-term trade receivables and payables and the Company's revolving line of credit. The carrying values of cash and cash equivalents and short-term trade receivables and payables approximate fair value because of the short-term nature of the instruments. The fair value of our line of credit balance is estimated based on current rates available for similar debt with similar maturities and collateral, and at December 31, 2016 and 2015, approximates the carrying value due primarily to the floating rate of interest on such debt instruments.

*Inventories*

Inventories are stated at the lower of cost or net realizable value using the first-in, first-out method. Inventory we manufacture includes the cost of material, labor and overhead. If the cost of inventories exceeds estimated net realizable value, provisions are made to reduce the carrying value to estimated net realizable value.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

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

	December 31,	
	2016	2015
Raw materials	\$ 10,807	\$ 8,531
Work in process	3,820	2,839
Finished goods	7,087	6,122
Allowance for excess or obsolete inventory	(1,319)	(1,391)
	\$ 20,395	\$ 16,101

*Property and Equipment*

Property and equipment is stated at cost, net of accumulated depreciation. The costs of additions and improvements are capitalized, while maintenance and repairs are charged to expense as incurred. When an item is sold or retired, the cost and related accumulated depreciation is relieved, and the resulting gain or loss, if any, is recognized in the consolidated statements of income. We provide for depreciation primarily using the straight-line method by charges to income in amounts that allocate the cost of property and equipment over their estimated useful lives as follows:

Asset Classification	Estimated Useful Life
Building	10 to 20 years
Machinery and equipment	3 to 15 years
Leasehold and building improvements	7 to 15 years

We capitalize certain costs incurred in connection with developing or obtaining software designated for internal use based on three distinct stages of development. Qualifying costs incurred during the application development stage, which consist primarily of internal payroll and direct fringe benefits and external direct project costs, including labor and travel, are capitalized and amortized on a straight-line basis over the estimated useful life of the asset. Costs incurred during the preliminary project and post and post-implementation and operation phases are expensed as incurred. These costs are general and administrative in nature and related primarily to the determination of performance requirements, data conversion and training.

*Goodwill, Intangible and Other Long-Lived Assets*

We assess goodwill for impairment annually, at the reporting unit level, in the fourth quarter and whenever events or circumstances indicate impairment may exist. In evaluating goodwill for impairment, we have the option to first assess the qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. If, after assessing the totality of events or circumstances, we determine that is more likely than not that the fair value of a reporting is less than its carrying amount, we would then perform step one of the two-step impairment test; otherwise, no further impairment test would be required. In contrast, we can opt to bypass the qualitative assessment for any reporting unit in any period and proceed directly to step one of the two-step impairment test. Doing so does not preclude us from performing the qualitative assessment in any subsequent period.

In the fourth quarter of 2016, we performed a qualitative assessment of the goodwill residing within the assets of our CCA segment and determined that no indications of impairment existed.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Intangible assets are valued based on estimates of future cash flows and amortized over their estimated useful lives. We continually evaluate whether events and circumstances have occurred that indicate the remaining estimated useful life of intangible assets as well as other long-lived assets may warrant revision, or that the remaining balance of these assets may not be recoverable. When deemed necessary, we complete this evaluation by comparing the carrying amount of the assets with the estimated undiscounted future cash flows associated with them. If such evaluations indicate that the future undiscounted cash flows of amortizable long-lived assets are not sufficient to recover the carrying value of such assets, the assets are adjusted to their estimated fair values.

The estimation of useful lives and expected cash flows requires us to make significant judgments regarding future periods that are subject to some factors outside of our control. Changes in these estimates can result in significant revisions to our carrying value of these assets and may result in material charges to our results of operations.

*Revenue Recognition*

We generate our revenue through the sale of products, as well as through licensing of technology product rights, royalties and sponsored research and development. Our policy is to recognize revenue when the applicable revenue recognition criteria have been met, which generally include the following:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services rendered;
- Price is fixed or determinable; and
- Collectability is reasonably assured.

Revenue from the sale of products is recognized after both the goods are shipped to the customer and acceptance has been received, if required, with an appropriate provision for estimated returns and allowances. We do not permit general returns of products sold. Certain of our products have expiration dates. Our policy is to exchange certain outdated, expired product with the same product. We record an accrual for the estimated cost of replacing the expired product expected to be returned in the future, based on our historical experience, adjusted for any known factors that reasonably could be expected to change historical patterns, such as regulatory actions which allow us to extend the shelf lives of our products. Revenue from both direct sales to veterinarians and sales to independent third-party distributors are generally recognized when goods are shipped. Our products are shipped complete and ready to use by the customer. The terms of the customer arrangements generally pass title and risk of ownership to the customer at the time of shipment. Certain customer arrangements provide for acceptance provisions. Revenue for these arrangements is not recognized until the acceptance has been received or the acceptance period has lapsed. We reduce our revenue by the estimated cost of any rebates, allowances or similar programs, which are used as promotional programs.

Recording revenue from the sale of products involves the use of estimates and management judgment. We must make a determination at the time of sale whether the customer has the ability to make payments in accordance with arrangements. While we do utilize past payment history, and, to the extent available for new customers, public credit information in making our assessment, the determination of whether collectability is reasonably assured is ultimately a judgment decision that must be made by management. We must also make estimates regarding our future obligation relating to returns, rebates, allowances and similar other programs.



**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

License revenue under arrangements to sell or license product rights or technology rights is recognized as obligations under the agreement are satisfied, which generally occurs over a period of time. Generally, licensing revenue is deferred and recognized over the estimated life of the related agreements, products, patents or technology. Nonrefundable licensing fees, marketing rights and milestone payments received under contractual arrangements are deferred and recognized over the remaining contractual term using the straight-line method.

Recording revenue from license arrangements involves the use of estimates. The primary estimate made by management is determining the useful life of the related agreement, product, patent or technology. We evaluate all of our licensing arrangements by estimating the useful life of either the product or the technology, the length of the agreement or the legal patent life and defer the revenue for recognition over the appropriate period.

We may enter into arrangements that include multiple elements. Such arrangements may include agreements allowing for the usage of an instrument and a given level of consumables for one monthly payment. In these situations, we must determine whether the various elements meet the criteria to be accounted for as separate elements. If the elements cannot be separated, revenue is recognized once revenue recognition criteria for the entire arrangement have been met or over the period that the Company's obligations to the customer are fulfilled, as appropriate. If the elements are determined to be separable, the revenue is allocated to the separate elements based on relative fair value and recognized separately for each element when the applicable revenue recognition criteria have been met. In accounting for these multiple element arrangements, we must make determinations about whether elements can be accounted for separately and make estimates regarding their relative fair values.

In addition to our direct sales force, we utilize distributors to sell our products. Distributors purchase goods from us, take title to those goods and resell them to their customers in the distributors' territory.

Upfront payments we receive under arrangements for product, patent or technology rights in which we retain an interest in the underlying product, patent or technology are initially deferred, and revenue is subsequently recognized over the estimated life of the agreement, product, patent or technology. Similarly, upfront payments we receive under agreements where we are obligated to maintain a product or technology sold to a third party and/or transfer know-how or technology to a third party are initially deferred and revenue is subsequently recognized over the estimated life of the agreement. Milestone payments related to an improvement in a product in which we retain an interest in the product are initially deferred and recognized over the estimated life of the agreement or product. We received upfront and milestone payments totaling \$3.0 million in 2014. We did not receive any such payments in 2016 or 2015. Revenue from royalties is recognized once we are informed of sales on which we are entitled to royalties.

*Stock-Based Compensation*

Accounting for stock-based compensation requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. We estimate the fair value of all stock options and awards on the date of grant using the Black-Scholes pricing model, which is affected by our stock price, as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the estimated term of the awards, the estimated term of the awards, which is dependent in part on employee option exercise behaviors, risk free interest rates and expected dividends. Our expected volatility assumption is based on the historical closing prices of our stock over a period equivalent to the expected life of the options.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

*Advertising Costs*

Advertising costs are expensed as incurred and are included in sales and marketing expenses. Advertising expenses were \$0.2 million for the year ended December 31, 2016 and \$0.1 million for each of the years ended December 31, 2015 and 2014.

*Income Taxes*

The Company records a current provision for income taxes based on estimated amounts payable or refundable on tax returns filed or to be filed each year. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates, in each tax jurisdiction, expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date. The overall change in deferred tax assets and liabilities for the period measures the deferred tax expense or benefit for the period. Deferred tax assets are reduced by a valuation allowance based on a judgmental assessment of available evidence if the Company is unable to conclude that it is more likely than not that some or all of the deferred tax assets will be realized.

*Foreign Currency Translation*

The functional currency of our Swiss subsidiary is the Swiss Franc. Assets and liabilities of our Swiss subsidiary are translated using the exchange rate in effect at the balance sheet date. Revenue and expense accounts and cash flows are translated using an average of exchange rates in effect during the period. Cumulative translation gains and losses 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 as a component of other income (expense) in current operations, as are exchange gains and losses on intercompany transactions expected to be settled in the near term.

*Taxes Collected from Customers*

In the course of doing business we collect various taxes from customers including, but not limited to, sales taxes. It is our policy to record revenue net of taxes collected from customers in our consolidated statements of income.

*Shipping and Handling Costs*

Amounts billed to customers for shipping and handling are recorded in sales. Shipping and handling costs incurred by us for the delivery of products to customers are included in cost of sales.

*Recent Accounting Pronouncements*

In March 2016, the Financial Accounting Standards Board ("FASB") issued guidance codified in Accounting Standards ASU, ("ASU") Topic 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting". The update simplifies several aspects related to the accounting for share-based payment transactions, including the accounting for income taxes, statutory tax withholding requirements and classification on the statement of cash flows. The update is effective for annual and interim reporting periods beginning after December 15, 2016, with early adoption permitted. We early adopted the standard during the second quarter of 2016 and are therefore required to report the impacts

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

as though the standard had been adopted on January 1, 2016. Accordingly, we recognized additional income tax benefits as an increase to earnings of \$0.8 million (\$0.11 per diluted share) in the twelve months ended December 31, 2016. The update did not impact any periods prior to January 1, 2016, as we applied the changes to the standard on a prospective basis.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)", which supersedes ASC 840, Leases, and creates a new topic, ASC 842, Leases. This update requires lessees to recognize a lease liability and a lease asset for all leases, including operating leases, with a term greater than 12 months on its balance sheet. The update also expands the required quantitative and qualitative disclosures surrounding leases. This update is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, with early adoption permitted. This update will be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We are currently evaluating the effect of this update on our consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11 "Inventory - Simplifying the Measurement of Inventory (Topic 330)". This update required an entity to measure inventory within the scope of the update at the lower of cost and net realizable value, and defines net realizable value as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for interim and annual periods beginning after December 15, 2016, with early adoption permitted, and is to be applied on a prospective basis. We early adopted this standard with no impact to our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)". Upon the effective date, the ASU replaces almost all existing revenue recognition guidance, including industry specific guidance, in U.S. GAAP. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date". The amendments in this update deferred the effective date for implementation of ASU 2014-09 by one year and are now effective for annual and interim reporting periods beginning after December 15, 2017. The new standard permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). We currently anticipate adopting the standard using the modified retrospective method. We are still in the process of completing our analysis on the impact this guidance will have on our consolidated financial statements and related disclosures.

## **2. ACQUISITION AND RELATED PARTY ITEMS**

On May 31, 2016, the Company closed a transaction (the "Merger") to acquire Cuatro Veterinary, LLC ("Cuatro International") from Kevin S. Wilson, and all of the members of Cuatro International (the "Members"). Pursuant to the Merger, the Company issued 175,000 shares of the Company's common stock, \$0.01 par value per share (the "Common Stock"), to the Members on the Closing Date, at an aggregate value equal to approximately \$6.3 million based on the adjusted closing price per share of the Common Stock as reported on the Nasdaq Stock Market on the Merger closing date. These shares were issued to the Members in a private placement in reliance upon an exemption from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(a)(2) thereof and the safe harbor provided by Rule 506 of Regulation D promulgated thereunder. Effective on the Merger closing date, each of the Members executed lock-up agreements with the Company that restricted their ability to sell any of the shares of Common Stock received in the Merger until 180 days after the Merger closing date. In addition, the Company assumed approximately \$1.5 million in debt as part of the transaction.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Mr. Wilson is a founder of Cuattro International, Cuattro, LLC, Cuattro Software, LLC and Cuattro Medical, LLC. Mr. Wilson, Mrs. Wilson and trusts for the benefit of Mr. and Mrs. Wilson's children and family own a 100% interest in Cuattro, LLC and a majority interest in Cuattro Medical, LLC. Cuattro, LLC owns a 100% interest in Cuattro Software, LLC and, prior to the Merger, owned a majority interest in Cuattro International.

The Company recorded assets acquired and assets assumed at their estimated fair values. Intangible assets were valued based on a report from an independent third party.

The following summarizes the aggregate consideration paid by the Company and the allocation of the purchase price (in thousands):

Common stock issued - 175,000 shares	\$	6,347
Debt assumed		1,535
Total fair value of consideration transferred	\$	<u>7,882</u>
Accounts receivable	\$	222
Inventories		39
Due from Cuattro, LLC		963
Property and equipment		80
Other tangible assets		164
Deferred tax asset		56
Intangible assets		2,521
Goodwill		5,783
Accounts payable		(112)
Deferred tax liability		(905)
Other assumed liabilities		(929)
Total fair value of consideration transferred	\$	<u>7,882</u>

Intangible assets acquired, amortization method and estimated useful lives as of May 31, 2016 was as follows (dollars in thousands):

	Useful Life	Amortization Method	Fair Value
Customer relationships	6.67	Straight-line	\$2,521

Cuattro International is a provider to international markets of digital radiography technologies for veterinarians. As a leading provider of advanced veterinary diagnostic and specialty products, we made the acquisition in an effort to combine Cuattro International's international reach with our domestic success in the imaging and blood testing markets in the United States. International markets represent a significant portion of worldwide veterinary revenues for which we intend to compete.

As of the closing date of the Merger, Cuattro International was renamed Heska Imaging International, LLC, and the Company's interest in both Heska Imaging International, LLC ("International Imaging") and Heska Imaging US, LLC ("US Imaging") was transferred to the Company's wholly-owned subsidiary, Heska Imaging Global, LLC ("Global Imaging").

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

On February 24, 2013, the Company acquired a 54.6% interest in Cuattro Veterinary USA, LLC (the "Acquisition"), which was subsequently renamed Heska Imaging US, LLC ("US Imaging). The remaining minority position (45.4)% in US Imaging is subject to purchase by Heska under performance-based puts and calls following the audit of either our 2016 and 2017 financial statements. Required performance criteria have been met in 2016 and we have been given notice that the put option is being exercised. We have 90 days from the receipt of notice to deliver payment (any applicable payment in aggregate to be defined as the "Put Payment") for the Imaging Minority's position, and we consider notice to have been received immediately prior to the filing of this Form 10-K with the SEC. We plan to deliver the Put Payment and obtain the Imaging Minority's position in US Imaging on May 31, 2017. Based on US Imaging's 2016 financial performance, the Put Payment is to be for a value of \$13.8 million if we deliver all cash or up to \$14.6 million if we deliver a combination of cash and the maximum contractually allowable value of stock. While we have the right to deliver up to 55% of the consideration in our Public Common Stock under certain circumstances, such stock is to be valued based on 90% of market value (the "Delivery Stock Value") and is limited to approximately 650 thousand shares in any case. If the Delivery Stock Value per share is less than the market value per share of our Public Common Stock at the time of the Acquisition, we do not have the right to deliver any Public Common Stock as consideration. While we have reported the Put Payment at \$14.6 million for financial reporting purposes, which contemplates our delivery of 55% of the Put Payment consideration in Public Common Stock, no final decision by our Board of Directors as to the relative use of cash and stock has been made and we may not be able to deliver any stock based on the Delivery Stock Value at the time of closing, as discussed above. The estimated Put Payment value of \$14.6 million, which had been listed as "Non-controlling interest" on our consolidated balance sheets and accreted to its estimated redemption value in accordance with US Imaging's Operating Agreement, is now listed as "Obligation to purchase minority interest" on the Company's consolidated balance sheets as of December 31, 2016.

The following is a reconciliation of the non-controlling interest balance (in thousands):

Balance December 31, 2015	\$	15,747
Accretion of Put Value		(1,145)
Balance reclassification to current liabilities	\$	(14,602)
Balance December 31, 2016	\$	—

Shawna M. Wilson, Clint Roth, DVM, Steven M. Asakowicz, Rodney A. Lippincott, Kevin S. Wilson and Cuattro, LLC own approximately 29.75%, 8.39%, 4.09%, 3.07%, 0.05% and 0.05% of US Imaging, respectively. Kevin S. Wilson is the Chief Executive Officer and President of the Company and the spouse of Shawna M. Wilson. Steven M. Asakowicz serves as Executive Vice President, Companion Animal Health Sales for the Company. Rodney A. Lippincott serves as Executive Vice President, Companion Animal Health Sales for the Company.

Cuattro, LLC charged US Imaging \$3.6 million from January 1, 2016 to May 31, 2016 and has charged Global Imaging \$10.9 million since June 1, 2016, primarily related to digital imaging products, for which there is an underlying supply contract with minimum purchase obligations, software and services as well as other operating expenses; Heska Corporation charged US Imaging \$5.3 million in 2016, primarily related to sales expenses; Heska Corporation has charged Cuattro, LLC \$0.2 million, primarily related to facility usage and other services.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

At December 31, 2016, US Imaging had a \$1.6 million note receivable, including accrued interest, from International Imaging, which is due on June 15, 2019 and which eliminates in consolidation of the Company's financial statements. This note was previously listed as "Note receivable – related party" on the Company's consolidated balance sheets and, as discussed above, was assumed as part of the Company's acquisition of International Imaging. At December 31, 2016, Heska Corporation had accounts receivable from US Imaging of \$5.6 million, including accrued interest, which eliminates in consolidation of the Company's financial statements; US Imaging had a net receivable due from Cuattro, LLC of \$0.1 million, which is included in "Due from – related parties" on the Company's consolidated balance sheets; Global Imaging had net prepaid receivables from US Imaging of \$1.2 million which eliminates in consolidation of the Company's financial statements; all monies owed accrue interest at the same interest rate Heska Corporation pays under its credit and security agreement with Wells Fargo once past due with the exception of the note receivable, which accrues at this rate to its maturity date.

**3. INCOME TAXES**

As of December 31, 2016, the Company had a domestic federal net operating loss carryforward ("NOL"), of approximately \$96.0 million, a domestic alternative minimum tax credit of approximately \$0.5 million and a domestic research and development tax credit carryforward of approximately \$0.4 million for federal tax purposes. The Company's NOL is expected to expire as follows if unused: \$90.0 million in 2018 through 2022, \$5.5 million in 2024 and 2025 and \$0.5 million in 2027 and later. The NOL and tax credit carryforwards are subject to alternative minimum tax limitations and to examination by the tax authorities. In addition, the Company had a "change of ownership" as defined under the provisions of Section 382 of the Internal Revenue Code of 1986, as amended (an "Ownership Change").

The Company does not believe this Ownership Change will place a significant restriction on its ability to utilize its NOL in the future. The Company has established a valuation allowance against those NOL's and credits for which it is estimated to be more likely than not that they will expire unutilized.

We are subject to income taxes in the U.S. federal jurisdiction, and various foreign, state and local jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. The rate in the year ended December 31, 2016 benefited from additional tax benefits related to employee share-based payment awards which are now recorded as income tax benefit or expense in earnings effective with the adoption of ASU 2016-09. We early adopted the ASU during the second quarter of 2016 and are therefore required to report the impacts as though the accounting standard update had been adopted on January 1, 2016. Accordingly, we recognized additional income tax benefits as an increase to earnings of \$0.8 million in the year ended December 31, 2016.

Cash paid for income taxes for the twelve months ended December 31, 2016, 2015, and 2014 was \$357 thousand, \$55 thousand and \$272 thousand, respectively.

The components of income before income taxes were as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Domestic	\$ 16,375	\$ 8,325	\$ 2,837
Foreign	129	102	113
	<u>\$ 16,504</u>	<u>\$ 8,427</u>	<u>\$ 2,950</u>

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

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

	December 31,	
	2016	2015
Inventory	\$ 1,172	\$ 954
Accrued compensation	114	267
Stock Options	811	344
Research and development	438	440
Alternative minimum tax credit	543	367
Deferred revenue	2,934	3,638
Property and equipment	2,750	1,967
Net operating loss carryforwards – domestic	34,706	37,845
Capital Lease	(2,833)	(384)
Other	34	(8)
	<u>40,669</u>	<u>45,430</u>
Valuation allowance	(19,547)	(19,547)
Total net deferred tax assets	<u>\$ 21,122</u>	<u>\$ 25,883</u>

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

	Year Ended December 31,		
	2016	2015	2014
<b>Current income tax expense:</b>			
Federal	\$ 197	\$ 1,492	\$ 11
State	179	65	7
Foreign	31	24	29
Total current expense	<u>\$ 407</u>	<u>\$ 1,581</u>	<u>\$ 47</u>
<b>Deferred income tax expense:</b>			
Federal	\$ 3,545	\$ 1,043	\$ 1,181
State	387	284	123
Foreign	—	—	—
Total deferred expense	<u>3,932</u>	<u>1,327</u>	<u>1,304</u>
Total income tax expense	<u>\$ 4,339</u>	<u>\$ 2,908</u>	<u>\$ 1,351</u>

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

The Company's income tax expense (benefit) relating to income (loss) for the periods presented differs from the amounts that would result from applying the federal statutory rate to that income (loss) as follows:

	Year Ended December 31,		
	2016	2015	2014
Statutory federal tax rate	34 %	34 %	34 %
State income taxes, net of federal benefit	2 %	3 %	5 %
Non-controlling interest in Heska Imaging US, LLC	(3)%	(1)%	12 %
Other permanent differences	(7)%	(1)%	(3)%
Change in tax rate	— %	(1)%	2 %
Change in valuation allowance	— %	(14)%	78 %
Other	— %	15 %	(82)%
Effective income tax rate	26 %	35 %	46 %

ASC 740 provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the financial statements. Tax positions must meet a "more-likely-than-not" recognition threshold before a benefit is recognized in the financial statements. As of December 31, 2016, the Company has not recorded a liability for uncertain tax positions. The Company would recognize interest and penalties related to uncertain tax positions in income tax expense. No interest and penalties related to uncertain tax positions were accrued at December 31, 2016.

**4. EARNINGS PER SHARE**

Basic earnings per share ("EPS") is computed by dividing net income attributable to Heska Corporation by the weighted-average number of common shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS except that the numerator is increased to exclude charges that would not have been incurred, and the denominator is increased to include the number of additional common shares that would have been outstanding (using the if-converted and treasury stock methods), if securities containing potentially dilutive common shares (stock options and restricted stock units but excluding options to purchase fractional shares resulting from the Company's December 2010 1-for-10 reverse stock split) had been converted to common shares, and if such assumed conversion is dilutive.

The following is a reconciliation of the weighted-average shares outstanding used in the calculation of basic and diluted earnings per share for the years ended December 31, 2016, 2015, and 2014 (in thousands, except per share data):

	Years ended December 31,		
	2016	2015	2014
Net income attributable to Heska Corporation	\$ 10,508	\$ 5,239	\$ 2,603
Basic weighted-average common shares outstanding	6,783	6,509	5,951
Assumed exercise of dilutive stock options and restricted stock units	578	565	458
Diluted weighted-average common shares outstanding	7,361	7,074	6,409
Basic earnings per share	\$ 1.55	\$ 0.80	\$ 0.44
Diluted earnings per share	\$ 1.43	\$ 0.74	\$ 0.41



**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

The following stock options and restricted units were excluded from the computation of diluted earnings per share because they would have been anti-dilutive (in thousands):

	Years ended December 31,		
	2016	2015	2014
Stock options	234	144	367

**5. GOODWILL AND OTHER INTANGIBLES**

The following summarizes the changes in goodwill during the years ended December 31, 2016 and 2015 (in thousands):

	Year Ended December 31,	
	2016	2015
Carrying amount, December 31, 2015	\$ 20,910	\$ 20,903
Additions and adjustments	5,737	7
Carrying amount, December 31, 2016	\$ 26,647	\$ 20,910

Other intangibles assets, net consisted of the following as of December 31, 2016 and 2015 (in thousands):

	Year Ended December 31,	
	2016	2015
Gross carrying amount	\$ 2,622	\$ 788
Accumulated amortization	(276)	(732)
Net carrying amount	\$ 2,346	\$ 56

Amortization expense relating to other intangibles is as follows (in thousands):

	Years Ended December 31,		
	2016	2015	2014
Amortization expense	\$ 230	\$ 246	\$ 260

Estimated amortization expense related to intangibles for each of the five years from 2017 through 2021 and thereafter is as follows (in thousands):

Year Ending December 31,	
2017	\$ 388
2018	388
2019	388
2020	388
2021	384
Thereafter	410
	\$ 2,346

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

**6. PROPERTY AND EQUIPMENT**

Detail of property and equipment is as follows (in thousands):

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
Land	\$ 377	\$ 377
Building	2,868	2,868
Machinery and equipment	36,588	35,284
Leasehold and building improvements	7,662	6,673
Construction in progress	1,655	1,496
	<u>49,150</u>	<u>46,698</u>
Less accumulated depreciation	(32,569)	(29,678)
Total property and equipment, net	<u>\$ 16,581</u>	<u>\$ 17,020</u>

The Company has utilized marketing programs whereby its instruments in inventory may be placed in a customer's location on a rental basis. The cost of these instruments is transferred to machinery and equipment or other long-term assets and depreciated, typically over a five to seven-year period depending on the circumstance under which the instrument is placed with the customer. Total costs transferred from inventory were approximately \$1.8 million, \$4.1 million and \$4.6 million for the years ended December 31, 2016, 2015 and 2014, respectively.

The Company has sold certain customer rental contracts and underlying assets to third parties under agreements that once the customer has met the customer obligations under the contract, ownership of the assets underlying the contract would be returned to the Company. The Company enters a debit to cash and a corresponding credit to deferred revenue at the time of these sales. Since the Company anticipates it will regain ownership of the assets underlying these sales, the Company reports these assets as part of property and equipment and depreciates these assets in accordance with its depreciation policies. The Company had \$0.3 million and \$2.2 million of net property and equipment related to these transactions as of December 31, 2016 and December 31, 2015, respectively, all related to the Company's 54.6%-owned subsidiary, US Imaging.

Depreciation expense for property and equipment was \$4.4 million, \$4.0 million and \$3.4 million for the years ended December 31, 2016, 2015 and 2014, respectively.

The Company capitalizes third-party software costs, where appropriate, and reports such costs, net of accumulated amortization, on the "property and equipment, net" line of its consolidated balance sheets. We had \$0.4 million of such capitalized costs, net of accumulated amortization, on the "property and equipment, net" line of each of our consolidated balance sheets as of December 31, 2016 and 2015, respectively. Capitalized software costs in a given year are reported on the "purchases of property and equipment" line item of the Company's consolidated statements of cash flows. We had \$251 thousand, \$51 thousand and \$31 thousand of capitalized software costs reported on the "purchases of property and equipment" line item of our consolidated statements of cash flows for the years ended December 31, 2016, 2015 and 2014, respectively.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

**7. ACCRUED LIABILITIES**

Accrued liabilities consisted of the following as of December 31, 2016 and 2015 (in thousands):

	2016	2015
Accrued payroll and employee benefits	\$ 2,166	\$ 1,626
Accrued property taxes	748	594
Other	3,555	3,196
Total accrued liabilities	<u>\$ 6,469</u>	<u>\$ 5,416</u>

Other accrued liabilities consists of items that are individually less than 5% of total current liabilities.

**8. CAPITAL STOCK**

*Stock Option Plans*

We have two stock option plans which authorize granting of stock options and stock purchase rights to our employees, officers, directors and consultants to purchase shares of common stock. In 1997, the board of directors adopted the 1997 Stock Incentive Plan (the "1997 Plan") and terminated two prior option plans. All shares that remained available for grant under the terminated plans were incorporated into the 1997 Plan, including shares subsequently canceled under prior plans. In May 2012, the stockholders approved an amendment to the 1997 Plan allowing for an increase of 250,000 shares and an annual increase through 2016 based on the number of non-employee directors serving as of our Annual Meeting of Stockholders, subject to a maximum of 45,000 shares per year. In May 2016, the stockholders approved a further amendment to the 1997 Plan to authorize additional 500,000 shares to be available for issuance thereunder. In May 2003, the stockholders approved a new plan, the 2003 Equity Incentive Plan, which allows for the granting of options for up to 239,050 shares of the Company's common stock. The number of shares reserved for issuance under both plans as of December 31, 2016 was 407,339.

The stock options granted by the board of directors may be either incentive stock options ("ISOs") or non-qualified stock options ("NQs"). The exercise price for options under all of the plans may be no less than 100% of the fair value of the underlying common stock for ISOs or 85% of fair 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 we are sold or merged, outstanding options will either be assumed by the surviving corporation or vest immediately.

There are four key inputs to the Black-Scholes model which we use to estimate the fair value for options which it issues: expected term, expected volatility, risk-free interest rate and expected dividends, all of which require us to make estimates. Our estimates for these inputs may not be indicative of actual future performance and changes to any of these inputs can have a material impact on the resulting estimated fair value calculated for the option. Our expected term input was estimated based on our historical experience for time from option grant to option exercise for all employees in 2016, 2015 and 2014. We treated all employees in one grouping in all three years. Our expected volatility input was estimated based on our historical stock price volatility in 2016, 2015 and 2014. Our risk-free interest rate input was determined based on the U.S. Treasury yield curve at the time of option issuance in 2016, 2015 and 2014. Our expected dividends inputs were zero in all periods as we did not anticipate paying dividends in the foreseeable future.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Weighted average assumptions used in 2016, 2015 and 2014 for each of these four key inputs are listed in the following table:

	2016	2015	2014
Risk-free interest rate	1.76%	1.41%	1.21%
Expected lives	4.5 years	3.4 years	3.4 years
Expected volatility	41%	41%	43%
Expected dividend yield	0%	0%	0%

A summary of our stock option plans, excluding options to purchase fractional shares resulting from our December 2010 1-for-10 reverse stock split, is as follows:

	Year Ended December 31,					
	2016		2015		2014	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at beginning of period	940,610	\$ 14.163	1,074,251	\$ 10.110	1,321,232	\$ 10.386
Granted at Market	129,855	\$ 67.706	146,446	\$ 36.904	134,800	\$ 16.398
Canceled	(463)	\$ 14.881	(28,440)	\$ 10.080	(218,926)	\$ 17.786
Exercised	(240,385)	\$ 11.886	(251,647)	\$ 10.559	(162,855)	\$ 7.234
Outstanding at end of period	829,617	\$ 23.203	940,610	\$ 14.163	1,074,251	\$ 10.110
Exercisable at end of period	532,703	\$ 12.140	621,559	\$ 10.269	729,175	\$ 9.800

The total estimated fair value of stock options granted were computed to be approximately \$3.2 million, \$1.6 million and \$0.7 million during the years ended December 31, 2016, 2015 and 2014, respectively. The amounts are amortized ratably over the vesting periods of the options. The weighted average estimated fair value of options granted was computed to be approximately \$24.59, \$11.35 and \$5.28 during the years ended December 31, 2016, 2015 and 2014, respectively. The total intrinsic value of options exercised was \$9.9 million, \$4.7 million and \$0.7 million during the years ended December 31, 2016, 2015 and 2014, respectively. The cash proceeds from options exercised was \$1.9 million, \$1.8 million and \$1.2 million during the years ended December 31, 2016, 2015 and 2014, respectively.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2016, excluding outstanding options to purchase an aggregate of 0.5 fractional shares resulting from our December 2010 1-for-10 reverse stock split with a weighted average remaining contractual life of 0.34 years at an exercise price of \$22.50. We intend to issue whole shares only from option exercises.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Exercise Prices	Options Outstanding			Options Exercisable		
	Number of Options Outstanding at December 31, 2016	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Number of Options Exercisable at December 31, 2016	Weighted Average Exercise Price	
\$ 4.40 - \$ 6.90	164,794	3.94	\$ 5.679	163,663	\$ 5.676	
\$ 6.91 - \$ 7.36	157,323	6.89	\$ 7.360	114,670	\$ 7.360	
\$ 7.37 - \$18.13	214,697	6.68	\$ 12.800	162,451	\$ 11.317	
\$18.14 - \$39.76	182,303	7.93	\$ 34.954	91,878	\$ 31.057	
\$39.77 - \$72.85	110,500	9.99	\$ 72.721	41	\$ 56.587	
\$ 4.40 - \$72.85	<u>829,617</u>	6.89	\$ 23.203	<u>532,703</u>	\$ 12.140	

As of December 31, 2016, there was approximately \$4.5 million of total unrecognized compensation cost related to outstanding stock options. That cost is expected to be recognized over a weighted-average period of 1.9 years with all cost to be recognized by the end of December 2018, assuming all options vest according to the vesting schedules in place at December 31, 2016. As of December 31, 2016, the aggregate intrinsic value of outstanding options was approximately \$40.3 million and the aggregate intrinsic value of exercisable options was approximately \$31.7 million.

*Employee Stock Purchase Plan (the "ESPP")*

Under the 1997 Employee Stock Purchase Plan, we are authorized to issue up to 450,000 shares of common stock to our employees, of which 408,668 had been issued as of December 31, 2016. On May 5, 2015, our shareholders approved the amendment and restatement of the ESPP, including a 75,000 share increase to 450,000 total shares authorized under the ESPP as well as changes discussed below as compared to the ESPP prior to the amendment and restatement. Employees who are expected to work at least 20 hours per week and 5 months per year are eligible to participate and can choose to have up to 10% of their compensation withheld to purchase our stock under the ESPP when they choose to withhold a whole percentage of their compensation.

Beginning on July 1, 2013, our ESPP had a 27-month offering period and three-month accumulation periods ending on each March 31, June 30, September 30 and December 31. The purchase price of stock on March 31, June 30, September 30 and December 31 was the lesser of (1) 85% of the fair market value at the time of purchase and (2) the greater of (i) 95% of the fair market value at the beginning of the applicable offering period or (ii) 65% of the fair market value at the time of purchase. In addition, participating employees may purchase shares under the ESPP at the beginning of an applicable offering period for a purchase price of stock equal to 95% of the fair market value at such time or at 5 pm on a day other than March 31, June 30, September 30 and December 31 during the applicable offering period for a purchase price of stock equal to 95% of the fair market value at purchase.

Beginning April 1, 2015, employees may elect to withhold a positive fixed amount from each compensation payment in addition to the previous approach of withholding a whole percentage of such compensation payment, with all withholding for a given employee subject to a maximum monthly amount of \$2,500 following the amendment and restatement as opposed to a \$25,000 maximum annual amount prior to the amendment and restatement. For offering periods beginning on or after April 1, 2015, the purchase price of stock on March 31, June 30, September 30 and December 31 is to be the lesser of (1) 85% of the fair market value at the time of purchase and (2) the greater of (i) 85% of the fair market value at the beginning of the applicable offering period, (ii) the fair market value at the beginning of the applicable offering period less

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

1 cent and (iii) 65% of the fair market value at the time of purchase. In addition, participating employees may elect to purchase shares under the ESPP at the beginning of an applicable offering period for a purchase price of stock equal to the greater of (1) 85% of the fair market value at the beginning of the applicable offering period and (2) the fair market value at the beginning of the applicable offering period less 1 cent or at 5 pm on a day other than March 31, June 30, September 30 and December 31 during the applicable offering period for a purchase price of stock equal to the greater of (1) 85% of the fair market value at the time of purchase and (2) the fair market value at the time of purchase less 1 cent.

We issued 17,057, 16,673 and 29,847 shares under the ESPP for the years ended December 31, 2016, 2015 and 2014, respectively.

For the years ended December 31, 2016, 2015 and 2014, we estimated the fair values of stock purchase rights granted under the ESPP using the Black-Scholes pricing model and the following weighted average assumptions:

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Risk-free interest rate	0.54%	0.27%	0.23%
Expected lives	1.2 years	1.2 years	1.3 years
Expected volatility	42%	36%	34%
Expected dividend yield	0%	0%	0%

The weighted-average fair value of the purchase rights granted was \$8.23, \$6.25 and \$2.61 per share for the years ended December 31, 2016, 2015 and 2014, respectively.

*Restricted Stock Issuance*

On March 26, 2014, we issued 63,572 shares to Robert B. Grieve, Ph.D., who was our Executive Chair, pursuant to an employment agreement between Dr. Grieve and the Company effective as of March 26, 2014 (the "Grieve Employment Agreement"). The shares were issued in five tranches and are subject to time-based vesting and other provisions outlined in the Grieve Employment Agreement. All shares were to vest in full as of April 30, 2017. Effective on October 1, 2015, the Grieve Employment Agreement was terminated and, in connection therewith, the Company entered into a Separation and Release Agreement dated as of October 1, 2015 (the "Release Agreement") with Dr. Grieve. Pursuant to the Release Agreement, the Company agreed to treat the termination of the Grieve Employment Agreement as a termination without cause, entitling Dr. Grieve to the immediate vesting of 55,715 shares, 14,373 of which were withheld for tax purposes. As a result of the termination of the Grieve Employment Agreement, and as acknowledged in the Release Agreement, effective October 1, 2015, Dr. Grieve began serving as a consultant to the Company pursuant to the Consulting Agreement (Founder Emeritus) dated as of March 26, 2014 (the "Consulting Agreement"). The remaining 7,857 shares issued to Dr. Grieve on March 26, 2014 vested on April 30, 2016, of which 2,525 shares were withheld for tax purposes.

On March 26, 2014, we issued 110,000 shares to Mr. Wilson pursuant to an employment agreement between Mr. Wilson and the Company effective as of March 26, 2014 (the "Wilson Employment Agreement"). The shares were issued in four equal tranches and are subject to time-based vesting and other provisions outlined in the Wilson Employment Agreement. The first tranche vested on September 26, 2014, and each of the three remaining tranches is to vest on the succeeding March 26 until all shares are vested in full as of March 26, 2017. On May 6, 2014, we issued an additional 130,000 shares to Mr. Wilson following a vote of approval on the issuance by our stockholders. The shares were issued in ten equal tranches, five of which were subject to vesting based on the achievement of certain stock price targets as defined and further described in the Wilson Employment Agreement and five of which were subject to vesting based on certain

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

"Adjusted EBITDA" targets as defined and further described in the Wilson Employment Agreement. All shares subject to vesting based on "Adjusted EBITDA" vested based on our 2014 performance. Of the five tranches based on the achievement of certain stock price targets, one vested in 2014 and the remaining four vested in 2015.

On March 17, 2015, the Company issued unvested shares to certain Executive Officers related to performance-based restricted stock grants (the "Performance Grants") and performance-based restricted stock grants related to the Company's 2015 Management Incentive Plan (the "2015 MIP Grants"). The Company issued 52,956 shares under the Performance Grants and 24,649 shares under 2015 MIP Grants. The Performance Grants have met the underlying performance condition based on the Company's 2015 financial performance and are to cliff vest on March 17, 2018, subject to other vesting provisions in the underlying restricted stock grant agreement. The 2015 MIP Grants were subject to the Company's achievement of certain financial goals and other vesting provisions in the underlying restricted stock grant agreement. On March 2, 2016, the Company vested 14,364 shares related to the 2015 MIP Grants based on the respective performance criteria, including 4,788 shares withheld for tax, and canceled the remaining 10,285 shares.

On March 2, 2016, the Company issued 15,000 unvested shares to certain Executive Officers related to performance-based restricted stock grants as part of the Company's 2016 Management Incentive Plan (the "2016 MIP Grants"). The 2016 MIP Grants are scheduled to vest on the date MIP Payouts are to be made under the 2016 Management Incentive Plan and are subject to the Company's achievement of certain financial goals and other vesting provisions in the underlying restricted stock grant agreement.

*Restrictions on the transfer of Company stock*

The Company's Restated Certificate of Incorporation, as amended (the "Certificate of Incorporation"), places restrictions (the "Transfer Restrictions") on the transfer of the Company's stock that could adversely affect the Company's ability to utilize its domestic Federal Net Operating Loss Position. In particular, the Transfer Restrictions prevent the transfer of shares without the approval of the Company's Board of Directors if, as a consequence of such transfer, an individual, entity or groups of individuals or entities would become a 5-percent holder under Section 382 of the Internal Revenue Code of 1986, as amended, and the related Treasury regulations, and also prevents any existing 5-percent holder from increasing his or her ownership position in the Company without the approval of the Company's Board of Directors. Any transfer of shares in violation of the Transfer Restrictions (a "Transfer Violation") shall be void *ab initio* under the Certificate of Incorporation, and the Company's Board of Directors has procedures under the Certificate of Incorporation to remedy a Transfer Violation including requiring the shares causing such Transfer Violation to be sold and any profit resulting from such sale to be transferred to a charitable entity chosen by the Company's Board of Directors in specified circumstances.

**9. ACCUMULATED OTHER COMPREHENSIVE INCOME**

Accumulated other comprehensive income consisted of the following (in thousands):

	<b>Minimum pension liability</b>	<b>Foreign currency translation</b>	<b>Sale of equity investment</b>	<b>Total accumulated other comprehensive income</b>
Balances at December 31, 2015	\$ (576)	\$ 673	\$ 90	\$ 187
Current period other comprehensive income (loss)	75	(75)	(90)	(90)
Balances at December 31, 2016	<u>\$ (501)</u>	<u>\$ 598</u>	<u>\$ —</u>	<u>\$ 97</u>



**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

**10. COMMITMENTS AND CONTINGENCIES**

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. Royalties of \$0.4 million became payable under these agreements in each of the years ended December 31, 2016, 2015 and 2014.

The Company has contracts with suppliers for unconditional annual minimum inventory purchases and milestone obligations to third parties the Company believes are likely to be triggered currently totaling approximately \$0.6 million in 2017 and \$0.3 million in 2018.

The Company has entered into operating leases for its office and research facilities and certain equipment with future minimum payments as of December 31, 2016 as follows (in thousands):

**Year Ending December 31,**

2017	\$	2,090
2018		1,970
2019		1,810
2020		1,696
2021		1,677
Thereafter		3,202
	\$	<u>12,445</u>

The Company had rent expense of \$2.0 million in each of the years ended December 31, 2016 and 2015 and \$1.9 million in the year ended December 31, 2014.

From time to time, the Company may be involved in litigation relating to claims arising out of its operations. On March 12, 2015, a complaint was filed against us by Shaun Fauley in the United States District Court Northern District of Illinois alleging our transmittal of unauthorized faxes in violation of the federal Telephone Consumer Protection Act of 1991, as amended by the Junk Fax Prevention Act of 2005, as a class action seeking stated damages of the greater of actual monetary loss or five hundred dollars per violation. We intend to defend ourselves vigorously in this matter. At December 31, 2016, the Company was not a party to any other legal proceedings that were expected, individually or in the aggregate, to have a material adverse effect on our business, financial condition or operating results.

The Company's current terms and conditions of sale include a limited warranty that its products and services will conform to published specifications at the time of shipment and a more extensive warranty related to certain of its products. The Company also sells a renewal warranty for certain of its products. The typical remedy for breach of warranty is to correct or replace any defective product, and if not possible or practical, the Company will accept the return of the defective product and refund the amount paid. Historically, the Company has incurred minimal warranty costs. The Company's warranty reserve was \$0.4 million as of December 31, 2016 and 2015.



**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

**11. INTEREST AND OTHER EXPENSE (INCOME)**

Interest and other expense (income) consisted of the following (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Interest income	\$ (124)	\$ (172)	\$ (190)
Interest expense	160	200	206
Other expense (income), net	(7)	102	(55)
	<u>\$ 29</u>	<u>\$ 130</u>	<u>\$ (39)</u>

Cash paid for interest was \$78 thousand, \$90 thousand and \$92 thousand for the years ended December 31, 2016, 2015 and 2014, respectively.

**12. CREDIT FACILITY AND LONG-TERM DEBT**

At December 31, 2016, we had a \$15.0 million asset-based revolving line of credit with Wells Fargo which has a maturity date of December 31, 2017 as part of our credit and security agreement with Wells Fargo. At December 31, 2016, we had \$0.7 million of borrowings outstanding on this line of credit. Our ability to borrow under this line of credit varies based upon available cash, eligible accounts receivable and eligible inventory. Any interest on borrowings due is to be charged at a stated rate of three month LIBOR plus 2.25% and payable monthly. There is an annual minimum interest charge of \$75 thousand under the agreement. We are required to comply with various financial and non-financial covenants, and we have made various representations and warranties under our agreement with Wells Fargo. A key financial covenant is based on a fixed charge coverage ratio, as defined in our agreement with Wells Fargo. We were in compliance with all financial covenants as of December 31, 2016 and our available borrowing capacity based upon eligible accounts receivable and eligible inventory under our revolving line of credit was approximately \$12.9 million.

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

	December 31,	
	2016	2015
Term loan with a financial entity due in monthly installments beginning July 2012 with the balance to be paid in full in June 2017 and a stated interest rate of 6.0%.	\$ 78	\$ 228
Less current maturities	78	159
Long-term debt, net of current portion	<u>\$ —</u>	<u>\$ 69</u>

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

**13. SEGMENT REPORTING**

The Company is comprised of two reportable segments, Core Companion Animal Health ("CCA") and Other Vaccines, Pharmaceuticals and Products ("OVP"). The CCA segment includes diagnostic instruments and supplies, as well as single use diagnostic and other tests, pharmaceuticals and vaccines, primarily for canine and feline use. The CCA segment also includes digital radiography and ultrasound products along with embedded software and support, data hosting and other services from Heska Imaging. These products are sold directly by the Company as well as through independent third-party distributors and through other distribution relationships. CCA segment products manufactured at the Des Moines, Iowa production facility included in the OVP segment's assets are transferred at cost and are not recorded as revenue for the OVP segment. The OVP segment includes private label vaccine and pharmaceutical production, primarily for cattle, but also for other species including equine, porcine, avian, feline and canine. All OVP products are sold by third parties under third-party labels.

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Summarized financial information concerning the Company's reportable segments is shown in the following table (in thousands):

Year Ended December 31, 2016	<b>Core Companion Animal Health</b>	<b>Other Vaccines, Pharmaceuticals and Products</b>	<b>Total</b>
Total revenue	\$ 107,398	\$ 22,685	\$ 130,083
Operating Income	13,015	3,518	16,533
Income before income taxes	12,938	3,566	16,504
Total assets	110,995	19,849	130,844
Net assets	68,072	18,903	86,975
Capital expenditures	1,135	2,282	3,417
Depreciation and amortization	3,800	845	4,645

Year Ended December 31, 2015	<b>Core Companion Animal Health</b>	<b>Other Vaccines, Pharmaceuticals and Products</b>	<b>Total</b>
Total revenue	\$ 84,249	\$ 20,348	\$ 104,597
Operating Income	4,911	3,646	8,557
Income before income taxes	4,836	3,591	8,427
Total assets	92,567	17,152	109,719
Net assets	48,175	15,353	63,528
Capital expenditures	1,177	2,596	3,773
Depreciation and amortization	3,478	709	4,187

Year Ended December 31, 2014	<b>Core Companion Animal Health</b>	<b>Other Vaccines, Pharmaceuticals and Products</b>	<b>Total</b>
Total revenue	\$ 72,354	\$ 17,483	\$ 89,837
Operating Income	1,198	1,713	2,911
Income before income taxes	1,290	1,660	2,950
Total assets	85,361	11,483	96,844
Net assets	41,286	11,846	53,132
Capital expenditures	1,864	473	2,337
Depreciation and amortization	2,954	758	3,712

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Revenue is attributed to individual countries based on customer location. Total revenue by principal geographic area was as follows (in thousands):

	For the Years Ended December 31,		
	2016	2015	2014
United States	\$ 120,082	\$ 97,164	\$ 83,584
Canada	2,378	1,833	1,123
Europe	4,781	2,086	2,264
Other International	2,842	3,514	2,866
<b>Total</b>	<b>\$ 130,083</b>	<b>\$ 104,597</b>	<b>\$ 89,837</b>

Total assets by principal geographic areas were as follows (in thousands):

	For the Years Ended December 31,		
	2016	2015	2014
United States	\$ 127,827	\$ 106,780	\$ 93,977
Europe	3,017	2,939	2,867
<b>Total</b>	<b>\$ 130,844</b>	<b>\$ 109,719</b>	<b>\$ 96,844</b>

**14. SUPPLEMENTAL QUARTERLY FINANCIAL DATA (Unaudited)**

The following tables present quarterly unaudited results for each of the two years in the periods ended December 31, 2016 and 2015 (amounts in thousands, except per share data).

	Q1	Q2	Q3	Q4	Total
<b>2016</b>					
Total revenue	\$ 27,146	\$ 29,965	\$ 33,430	\$ 39,542	\$ 130,083
Gross profit	11,442	12,682	13,718	16,050	53,892
Operating income	1,970	3,556	4,492	6,515	16,533
Net income	1,447	2,742	3,343	4,633	12,165
Net income attributable to Heska Corporation	1,186	2,522	3,347	3,453	10,508
Basic earnings per share attributable to Heska Corporation	0.18	0.38	0.49	0.50	1.55
Diluted earnings per share attributable to Heska Corporation	0.17	0.35	0.45	0.46	1.43
<b>2015</b>					
Total revenue	\$ 22,894	\$ 23,910	\$ 28,034	\$ 29,759	\$ 104,597
Gross profit	10,084	10,297	11,597	12,235	44,213
Operating income	1,021	1,829	2,142	3,565	8,557
Net income	583	1,178	1,383	2,375	5,519
Net income attributable to Heska Corporation	598	1,197	1,415	2,029	5,239
Basic earnings per share attributable to Heska Corporation	0.10	0.19	0.22	0.29	0.80
Diluted earnings per share attributable to Heska Corporation	0.09	0.17	0.20	0.28	0.74

**HESKA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

**15. SUBSEQUENT EVENTS**

As discussed in more detail above in Item 1A., Risk Factors, under the caption “*We have significant related party transactions, including the planned purchase of the minority interest in Heska Imaging US, LLC via a put option which has been exercised*”, the Imaging Minority has given us notice of exercise of the put option to sell to us all of the Imaging Minority's position in US Imaging granted to them under the Operating Agreement that was executed in connection with the Acquisition because the targeted US Imaging performance criteria has been met within the requisite period of time. Based on US Imaging's 2016 financial performance, the Put Payment is to be for a value of \$13.8 million if we deliver all cash or up to \$14.6 million if we deliver a combination of cash and stock. We plan to deliver the Put Payment and obtain the Imaging Minority's position in US Imaging on or about May 31, 2017. The additional information concerning the Put Payment and put option exercise discussed under the foregoing Risk Factors caption and elsewhere in this annual report on Form 10-K is incorporated herein by reference thereto.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

None.

**Item 9A. Controls and Procedures.**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our chief executive officer and our chief financial officer, evaluated the effectiveness of our disclosure controls and procedures, as defined by Rule 13a-15 of the Exchange Act, as of December 31, 2016. Based on this evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding disclosure.

**Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, the Company conducted an evaluation of the effectiveness of its internal control over financial reporting based on criteria outlined in the 1992 COSO Internal Control over Financial Reporting Guidance for Smaller Public Companies, a supplemental implementation guide issued in 2007, which modified criteria established in the framework in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, the Company's management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2016.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Accordingly, even an effective system of internal control will provide only reasonable assurance that the objectives of the internal control system are met.

EKS&H LLLP, an independent registered public accounting firm, has audited our Consolidated Financial Statements included in this Form 10-K, and as part of the audit, has issued a report, included herein, on the effectiveness of our internal control over financial reporting as of December 31, 2016.

#### **Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting that occurred during the fourth quarter of 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### **Item 9B. Other Information.**

On March 3, 2017, our Compensation Committee further amended the Company's restricted stock grant agreement forms to be used for grants of awards to its employees, consultants and outside directors, as applicable, under or in connection with the Company's 1997 Stock Incentive Plan, as amended and restated, the Company's 2003 Equity Incentive Plan, as amended and restated, and the Company's Amended and Restated Management Incentive Plan. The amendments added additional performance-based criteria to the vesting provisions and made minor other conforming changes, including to make consistent among the several forms the vesting provisions in the case of a participant's death or disability or a change in control of the Company. The foregoing summary is qualified in its entirety by reference to the full text of each of the form agreements, a copy of each of which is attached hereto as an exhibit and is incorporated herein by reference thereto.

### **PART III**

Certain information required by Part III is incorporated by reference to our definitive Proxy Statement filed with the Securities and Exchange Commission in connection with the solicitation of proxies for our 2017 Annual Meeting of Stockholders.

#### **Item 10. Directors, Executive Officers and Corporate Governance.**

##### **Executive Officers**

The information required by this item with respect to executive officers is incorporated by reference to Item 1 of this report and can be found under the caption "Executive Officers of the Registrant."

##### **Directors**

The information required by this section with respect to our directors will be incorporated by reference to the information in the sections entitled "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement.

##### **Code of Ethics**

Our Board of Directors has adopted a code of ethics for our senior executive and financial officers (including our principal executive officer, principal financial officer and principal accounting officer). The code of ethics is available on our website at [www.heska.com](http://www.heska.com) under the Corporate Governance section under the Investor Relations section under the "Company" tab. We intend to disclose any amendments to or waivers from the code of ethics at that location.

##### **Audit Committee**

The information required by this section with respect to our Audit Committee will be incorporated by reference to the information in the section entitled "Board Structure and Committees" in the Proxy Statement.

## Section 16(a) Beneficial Ownership Reporting Compliance

The information required by this item is incorporated by reference to the information in the section entitled "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement.

### Item 11. Executive Compensation.

The information required by this section will be incorporated by reference to the information in the sections entitled "Director Compensation," "Executive Compensation," "Compensation Committee Report" and "Compensation Committee Interlocks and Insider Participation" in the Proxy Statement.

### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The other information required by this section will be incorporated by reference to the information in the section entitled "Ownership of Securities - Common Stock Ownership of Certain Beneficial Owners and Management" in the Proxy Statement.

### Equity Compensation Plan Information

The following table sets forth information about our common stock that may be issued upon exercise of options and rights under all of our equity compensation plans as of December 31, 2016, including the 1997 Stock Incentive Plan, the 2003 Stock Incentive Plan and the 1997 Employee Stock Purchase Plan. Our stockholders have approved all of these plans.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options and Rights (1)	(b) Weighted-Average Exercise Price of Outstanding Options and Rights (1)	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))
Equity Compensation Plans Approved by Stockholders	829,617	\$23.20	449,950
Equity Compensation Plans Not Approved by Stockholders	None	None	None
Total	829,617	\$23.20	449,950

(1) Excluding outstanding options to purchase an aggregate of 0.5 fractional shares resulting from our December 2010 reverse stock split.

### Item 13. Certain Relationships and Related Transactions and Director Independence.

The information required by this section will be incorporated by reference to the information in the sections entitled "Board Structure and Committees" and "Significant Relationships and Transactions with Directors, Officers or Principal Stockholders" in the Proxy Statement.

### Item 14. Principal Accountant Fees and Services.

The information required by this section will be incorporated by reference to the information in the section entitled "Auditor Fees and Services" in the Proxy Statement.

The information required by Part III to the extent not set forth herein, will be incorporated herein by reference to our definitive Proxy Statement for the 2017 Annual Meeting of Stockholders.

## PART IV

### Item 15. Exhibits and Financial Statement Schedules.

(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:

**NOTE:** All schedules have been omitted because they are either not required or the information is included in the financial statements and notes thereto.

#### (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)	(13)	Restated Certificate of Incorporation of the Registrant.
3(ii)	(13)	Certificate of Amendment to Restated Certificate of Incorporation of Registrant.
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10.74	(27)	Assignment and Assumption Agreement (License Agreement) between Heska Imaging US, LLC, Heska Imaging Global, LLC, Cuattro, LLC, and Heska Imaging International, LLC, dated as of March 14, 2016.
10.75+	(13)	Supply Agreement between Cuattro, LLC and Heska Imaging US, LLC effective as of February 24, 2013.
10.76	(23)	First Amendment to Supply Agreement between Heska Imaging US, LLC and Cuattro, LLC, effective as of August 10, 2015.
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10.78+	(15)	Asset Purchase and License Agreement between Diamond Animal Health, Inc., and Elanco Animal Health, a division of Eli Lilly and Company effective as of June 17, 2013.
10.79+	(22)	Master Supply Agreement between Diamond Animal Health, Inc. and Eli Lilly and Company and its Affiliates, operating through its Elanco Animal Health division, effective as of October 1, 2014.
10.80+	(22)	Supplemental Agreement between Diamond Animal Health, Inc. and Eli Lilly and Company and its Affiliates, operating through its Elanco Animal Health division, effective as of October 1, 2014.
10.81+	(25)	Agreement and Plan of Merger among Heska Corporation, Cuattro Veterinary, LLC, Kevin S. Wilson, Cuattro LLC, Lane Naffziger, Clint Roth, DVM and Doug G. Wilson, III, dated as of March 14, 2016.
10.82	(24)	Letter Agreement between Heska Imaging US, LLC and Cuattro Veterinary, LLC, dated as of March 14, 2016.
21.1		Subsidiaries of the Company.
23.1		Consent of EKS&H LLLP, Independent Registered Public Accounting Firm.
24.1		Power of Attorney (See Signature Page of this Form 10-K).
31.1		Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2		Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1**		Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS		XBRL Instance Document.
101.SCH		XBRL Taxonomy Extension Schema Document.
101.CAL		XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF		XBRL Taxonomy Extension Definition Linkbase Document.
101.PRE		XBRL Taxonomy Extension Presentation Linkbase Document.
101.LAB		XBRL Taxonomy Extension Label Linkbase Document.

## Notes

- \* Indicates management contract or compensatory plan or arrangement.
  - + Portions of the exhibit have been omitted pursuant to a request for confidential treatment.
  - \*\* Furnished herewith but not filed.
- (1) Filed with the Registrant's Form 10-Q for the quarter ended September 30, 1997.
  - (2) Filed with the Registrant's Form 10-K for the year ended December 31, 2001.
  - (3) Filed with the Registrant's Form 10-K for the year ended December 31, 2002.
  - (4) Filed with the Registrant's Form 10-K for the year ended December 31, 2004.
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  - (15) Filed with the Registrant's Form 8-K/A on August 29, 2013.
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  - (25) Filed with the Registrants' Form 10-K for the year ended December 31, 2015.
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**Item 16. Form 10-K Summary**

Registrants may voluntarily include a summary of information required by Form 10-K under this item 16. The Registrant has elected not to include such summary information.

## 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 3, 2017.

### HESKA CORPORATION

By: /s/ KEVIN S. WILSON  
Kevin S. Wilson  
Chief Executive Officer and President

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints John McMahon his or her true and lawful attorneys-in-fact, 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 of said attorney-in-fact or their substitute may do or cause to be done by virtue hereof.

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

<b>Signature</b>	<b>Title</b>	<b>Date</b>
<u>/s/ KEVIN S. WILSON</u> Kevin S. Wilson	Chief Executive Officer, President and Director (Principal Executive Officer)	March 3, 2017
<u>/s/ JOHN MCMAHON</u> John McMahon	Vice President, Chief Financial Officer (Principal Financial and Accounting Officer)	March 3, 2017
<u>/s/ SHARON L. LARSON</u> Sharon L. Larson	Chair	March 3, 2017
<u>/s/ G. IRWIN GORDON</u> G. Irwin Gordon	Director	March 3, 2017
<u>/s/ BONNIE J. TROWBRIDGE</u> Bonnie J. Trowbridge	Director	March 3, 2017
<u>/s/ DAVID E. SVEEN</u> David E. Sveen, Ph.D.	Director	March 3, 2017
<u>/s/ CAROL A. WRENN</u> Carol A. Wrenn	Director	March 3, 2017

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10.78+	(15)	Asset Purchase and License Agreement between Diamond Animal Health, Inc., and Elanco Animal Health, a division of Eli Lilly and Company effective as of June 17, 2013.
10.79+	(22)	Master Supply Agreement between Diamond Animal Health, Inc. and Eli Lilly and Company and its Affiliates, operating through its Elanco Animal Health division, effective as of October 1, 2014.
10.80+	(22)	Supplemental Agreement between Diamond Animal Health, Inc. and Eli Lilly and Company and its Affiliates, operating through its Elanco Animal Health division, effective as of October 1, 2014.
10.81+	(25)	Agreement and Plan of Merger among Heska Corporation, Cuattro Veterinary, LLC, Kevin S. Wilson, Cuattro LLC, Lane Naffziger, Clint Roth, DVM and Doug G. Wilson, III, dated as of March 14, 2016.
10.82	(24)	Letter Agreement between Heska Imaging US, LLC and Cuattro Veterinary, LLC, dated as of March 14, 2016.
21.1		Subsidiaries of the Company.
23.1		Consent of EKS&H LLLP, Independent Registered Public Accounting Firm.
24.1		Power of Attorney (See Signature Page of this Form 10-K).

31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1**	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.

Notes

*	Indicates management contract or compensatory plan or arrangement.
+	Portions of the exhibit have been omitted pursuant to a request for confidential treatment.
**	Furnished herewith but not filed.
(1)	Filed with the Registrant's Form 10-Q for the quarter ended September 30, 1997.
(2)	Filed with the Registrant's Form 10-K for the year ended December 31, 2001.
(3)	Filed with the Registrant's Form 10-K for the year ended December 31, 2002.
(4)	Filed with the Registrant's Form 10-K for the year ended December 31, 2004.
(5)	Filed with the Registrant's Form 10-Q for the quarter ended June 30, 2005.
(6)	Filed with the Registrant's Form 10-K for the year ended December 31, 2006.
(7)	Filed with the Registrant's Form 10-K for the year ended December 31, 2007.
(8)	Filed with the Registrant's Form 10-Q for the quarter ended September 30, 2008.
(9)	Filed with the Registrant's Form 10-K for the year ended December 31, 2008.
(10)	Filed with the Registrant's Form 10-Q for the quarter ended June 30, 2011.
(11)	Filed with the Registrant's Form 10-Q for the quarter ended September 30, 2011.
(12)	Filed with the Registrant's Form 10-K for the year ended December 31, 2011.
(13)	Filed with the Registrant's Form 10-K for the year ended December 31, 2012.
(14)	Filed with the Registrant's Form 10-Q for the quarter ended June 30, 2013.
(15)	Filed with the Registrant's Form 8-K/A on August 29, 2013.
(16)	Filed with the Registrant's Form 10-Q for the quarter ended September 30, 2013.
(17)	Filed with the Registrant's Form 10-K for the year ended December 31, 2013.
(18)	Filed with the Registrants' Form 10-Q for the quarter ended June 30, 2014.
(19)	Filed with the Registrants' Form 10-Q for the quarter ended September 30, 2014.
(20)	Filed with the Registrants' Form 10-K for the year ended December 31, 2014.
(21)	Filed with the Registrants' Form 10-Q for the quarter ended March 31, 2015.
(22)	Filed with the Registrants' Form 10-Q for the quarter ended June 30, 2015.
(23)	Filed with the Registrants' Form 10-Q for the quarter ended September 30, 2015.
(24)	Filed with the Registrants' Form 8-K on March 15, 2016.
(25)	Filed with the Registrants' Form 10-K for the year ended December 31, 2015.
(26)	Filed with the Registrant's Form 10-Q for the quarter ended March 31, 2016.
(27)	Filed with the Registrants' Form 10-Q for the quarter ended June 30, 2016.
(28)	Filed with the Registrants' Form 10-Q for the quarter ended September 30, 2016.

**CERTIFICATE OF AMENDMENT  
TO THE  
RESTATED CERTIFICATE OF INCORPORATION, AS AMENDED,  
OF  
HESKA CORPORATION**

Heska Corporation (the "Corporation"), a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the "DGCL"), does hereby certify:

1. This Certificate of Amendment to the Corporation's Restated Certificate of Incorporation, as amended (the "Certificate"), has been duly adopted in accordance with the provisions of Section 242 of the DGCL.
2. This Certificate of Amendment to the Certificate amends Article IV of the Certificate by deleting the existing Paragraph A of Article IV in its entirety and substituting therefore a new Paragraph A of Article IV, to read in its entirety as follows:
  - A. Authorized Stock. The total authorized stock of the Corporation, which shall be an aggregate of 20,500,000 shares, shall consist of three classes: (i) a first class consisting of 9,000,000 shares of Traditional Common Stock having a par value of \$0.01 per share (the "Original Common Stock"); (ii) a second class consisting of 9,000,000 shares of Public Common Stock having a par value of \$0.01 per share (the "Common Stock" or "NOL Restricted Common Stock" and, together with the Original Common Stock, the "Common Stock Securities"); and (iii) a third class consisting of 2,500,000 shares of Preferred Stock having a par value of \$0.01 per share (the "Preferred Stock").
3. This Certificate of Amendment shall become effective at the time this Certificate of Amendment to the Restated Certificate of Incorporation, as amended, is filed with the Secretary of State of the State of Delaware.

IN WITNESS WHEREOF, the Corporation has caused this Certificate of Amendment to be executed by a duly authorized officer on this 13th day of May, 2016.

Heska Corporation

By: /s/ Jason A. Napolitano  
 Name: Jason A. Napolitano  
 Title: *Chief Operating Officer, Chief Financial Officer, Executive Vice President and Secretary*

AMENDED AND RESTATED 1997 STOCK INCENTIVE PLAN

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**Heska Corporation**  
**1997 Stock Incentive Plan**

**Most Recently Amended and Restated effective March 28, 2016**

**Table of Contents**

<b>ARTICLE 1. INTRODUCTION</b>	4
<b>ARTICLE 2. ADMINISTRATION</b>	4
2.1 Committee Composition	4
2.2 Committee Responsibilities	5
<b>ARTICLE 3. SHARES AVAILABLE FOR GRANTS</b>	5
3.1 Basic Limitation	5
3.2 Additional Shares	5
<b>ARTICLE 4. ELIGIBILITY</b>	5
4.1 Nonstatutory Stock Options and Restricted Shares	5
4.2 Incentive Stock Options	6
<b>ARTICLE 5. OPTIONS</b>	6
5.1 Stock Option Agreement	6
5.2 Number of Shares	6
5.3 Exercise Price	6
5.4 Exercisability and Term	6
5.5 Effect of Change in Control	6
5.6 Modification or Assumption of Options	7
5.7 Buyout Provisions	7
<b>ARTICLE 6. PAYMENT FOR OPTION SHARES</b>	7
6.1 General Rule	7
6.2 Surrender of Stock	7
6.3 Exercise/Sale	7
6.4 [Reserved]	7
6.5 [Reserved]	7
6.6 Other Forms of Payment	8
<b>ARTICLE 7. CLAWBACK</b>	8
<b>ARTICLE 8. RESTRICTED SHARES</b>	8
8.1 Time, Amount and Form of Awards	8
8.2 Payment for Awards	8
8.3 Vesting Conditions	8
8.4 Voting and Dividend Rights	9
8.5 Section 162(m) Performance Restrictions	9
8.6 Minimum Vesting Requirement	11



<b>ARTICLE 9. PROTECTION AGAINST DILUTION</b>	11
9.1 Adjustments	11
9.2 Dissolution or Liquidation	12
9.3 Reorganizations	12
<b>ARTICLE 10. AWARDS UNTER OTHER PLANS</b>	12
<b>ARTICLE 11. LIMITATION ON RIGHTS</b>	12
11.1 Retention Rights	12
11.2 Stockholders' Rights	12
11.3 Regulatory Requirements	13
<b>ARTICLE 12. WITHHOLDING TAXES; PARACHUTE PAYMENTS</b>	13
12.1 General	13
12.2 Section 280G	13
<b>ARTICLE 13. FUTURE OF THE PLAN</b>	14
13.1 Term of the Plan	14
13.2 Performance Awards	14
<b>ARTICLE 14. DEFINITIONS</b>	14
<b>ARTICLE 15. EXECUTION</b>	16

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**HESKA CORPORATION  
1997 STOCK INCENTIVE PLAN**

**Most Recently Amended and Restated Effective March 28, 2016**

**ARTICLE 1.  
INTRODUCTION**

The Plan was originally adopted by the Board effective March 15, 1997, and was subsequently amended and/or restated as of March 6, 2007, May 5, 2009, February 22, 2012, March 25, 2014, and May 6, 2014. The number of Common Shares available for issuance and subject to Awards under the Plan was adjusted in connection with completion of the Company's 1-for-10 Reverse Stock Split on December 30, 2010. Effective March 28, 2016, the Board hereby adopts this amended and restated plan subject to stockholder approval. If stockholder approval is not obtained within 12 months, this amended and restated plan will be of no further effect and the form of the Plan as of May 6, 2014 will be effective in accordance with its terms.

The purpose of the Plan is to promote the long-term success of the Company and the creation of stockholder value by (a) encouraging Employees, Outside Directors and Consultants to focus on critical long-range objectives, (b) encouraging the attraction and retention of Employees, Outside Directors and Consultants with exceptional qualifications and (c) linking Employees, Outside Directors and Consultants directly to stockholder interests through increased stock ownership. The Plan seeks to achieve this purpose by providing for Awards in the form of Restricted Shares or Options (which may constitute incentive stock options or nonstatutory stock options).

The Plan shall be governed by, and construed in accordance with, the laws of the State of Colorado (except its choice-of-law provisions).

**ARTICLE 2.  
ADMINISTRATION.**

2.1 **COMMITTEE COMPOSITION.** The Plan shall be administered by the Committee. The Committee shall consist exclusively of two or more directors of the Company, who shall be appointed by the Board. In addition, the composition of the Committee shall satisfy:

- (a) Such requirements as the Securities and Exchange Commission may establish for administrators acting under plans intended to qualify for exemption under Rule 16b-3 (or its successor) under the Exchange Act; and
- (b) Such requirements as the Internal Revenue Service may establish for outside directors acting under plans intended to qualify for exemption under section 162(m)(4)(C) of the Code.

The Board may also appoint one or more separate committees of the Board, each composed of one or more directors of the Company who need not satisfy the foregoing requirements, who may administer the Plan with respect to Employees and Consultants who are not considered officers or directors of the Company under section 16 of the Exchange Act, may grant Awards under the Plan to such Employees and Consultants and may determine all terms of such Awards.

- 2.2 **COMMITTEE RESPONSIBILITIES.** The Committee shall (a) select the Employees, Outside Directors and Consultants who are to receive Awards under the Plan, (b) determine the type, number, vesting requirements and other features and conditions of such Awards, (c) interpret the Plan and (d) make all other decisions relating to the operation of the Plan. The Committee may adopt such rules or guidelines as it deems appropriate to implement the Plan. The Committee may amend or modify any outstanding Awards in any manner to the extent the Committee would have had the authority under the Plan initially to make such Awards as so amended or modified. The Committee's determinations under the Plan shall be final and binding on all persons.

**ARTICLE 3.  
SHARES AVAILABLE FOR GRANTS.**

- 3.1 **BASIC LIMITATION.** Common Shares issued pursuant to the Plan may be authorized but unissued shares or treasury shares, or shares reacquired by the Company in any manner. The number of shares stated in this Section 3.1 as available for the grant of Awards is subject to adjustment in accordance with Article 9. As of March 27, 2016, the aggregate number of Common Shares cumulatively authorized by the Company's stockholders for issuance as Options and Restricted Shares under the Plan was 2,135,130. Of that total, as of March 27, 2016, Previously Issued Awards have been issued covering 2,103,899 Common Shares, leaving 31,231 Common Shares for the issuance of Options and Restricted Shares. Common Shares underlying Previously Issued Awards as of March 27, 2016 consisted of 316,666 Restricted Shares which were not subject to further vesting conditions, 370,625 Common Shares issued pursuant to the exercise of ISOs, 480,517 Common Shares issued pursuant to the exercise of NQOs, 117,677 Restricted Shares subject to further vesting conditions, 572,234 Common Shares underlying outstanding ISOs and 246,180 Common Shares underlying outstanding NQOs. With this amendment and restatement of the Plan, the Company's Board and stockholders have approved an increase of 500,000 in the aggregate number of Common Shares available for Awards under the Plan, to a new total of 2,635,130. Assuming no Unexercised/Unvested Awards outstanding as of March 27, 2016 are exercised, if applicable, or vest, the total number of Common Shares that may be granted underlying ISOs is 1,467,322. Assuming all Unexercised/Unvested Awards outstanding as of March 27, 2016 vest and are exercised, if applicable, the total number Common Shares that may be granted underlying ISOs is 531,231.
- 3.2 **ADDITIONAL SHARES.** Any shares of Common Stock subject to an Award that is canceled, forfeited or expires prior to exercise or realization, either in full or in part, shall again become available for issuance under the Plan as ISOs or any type of Award. Notwithstanding anything to the contrary contained herein: shares subject to an Award under the Plan shall not again be made available for issuance or delivery under the Plan if such shares are (a) shares tendered in payment of an Option, or (b) shares delivered or withheld by the Company to satisfy any tax withholding obligation.

**ARTICLE 4.  
ELIGIBILITY.**

- 4.1 **NONSTATUTORY STOCK OPTIONS AND RESTRICTED SHARES.** Only Employees, Outside Directors and Consultants shall be eligible for the grant of NQOs and Restricted Shares.

- 4.2 **INCENTIVE STOCK OPTIONS.** Only Employees who are common-law employees of the Company, a Parent or a Subsidiary shall be eligible for the grant of ISOs. In addition, an Employee who owns more than 10% of the total combined voting power of all classes of outstanding stock of the Company or any of its Parents or Subsidiaries shall not be eligible for the grant of an ISO unless the requirements set forth in section 422(c)(6) of the Code are satisfied.

**ARTICLE 5.  
OPTIONS.**

- 5.1 **STOCK OPTION AGREEMENT.** Each grant of an Option under the Plan shall be evidenced by a Stock Option Agreement between the Optionee and the Company. Such Option shall be subject to all applicable terms of the Plan and may be subject to any other terms that are not inconsistent with the Plan. The Stock Option Agreement shall specify whether the Option is an ISO or an NQO. The provisions of the various Stock Option Agreements entered into under the Plan need not be identical. Options may be granted in consideration of a cash payment or in consideration of a reduction in the Optionee's other compensation.
- 5.2 **NUMBER OF SHARES.** Each Stock Option Agreement shall specify the number of Common Shares subject to the Option and shall provide for the adjustment of such number in accordance with Article 9. Options granted to any Optionee in a single fiscal year of the Company shall not cover more than 50,000 Common Shares, except that Options granted to a new Employee in the fiscal year of the Company in which his or her service as an Employee first commences shall not cover more than 100,000 Common Shares. The limitations set forth in the preceding sentence shall be subject to adjustment in accordance with Article 9.
- 5.3 **EXERCISE PRICE.** Each Stock Option Agreement shall specify the Exercise Price; provided that the Exercise Price under an ISO shall in no event be less than 100% of the Fair Market Value of a Common Share on the date of grant and the Exercise Price under an NQO shall in no event be less than 85% of the Fair Market Value of a Common Share on the date of grant. In the case of an NQO, a Stock Option Agreement may specify an Exercise Price that varies in accordance with a predetermined formula while the NQO is outstanding.
- 5.4 **EXERCISABILITY AND TERM.** Each Stock Option Agreement shall specify the date when all or any installment of the Option is to become exercisable. The Stock Option Agreement shall also specify the term of the Option; provided that the term of an ISO shall in no event exceed 10 years from the date of grant. A Stock Option Agreement may provide for accelerated exercisability in the event of the Optionee's death, disability or retirement or other events and may provide for expiration prior to the end of its term in the event of the termination of the Optionee's service. NQOs may also be awarded in combination with Restricted Shares, and such an Award may provide that the NQOs will not be exercisable unless the related Restricted Shares are forfeited.
- 5.5 **EFFECT OF CHANGE IN CONTROL.** The Committee may determine, at the time of granting an Option or thereafter, that such Option shall become exercisable as to all or part of the Common Shares subject to such Option in the event that a Change in Control occurs with respect to the Company, provided, however, that in the case of an ISO, the acceleration of exercisability shall not occur without the Optionee's written consent.

- 5.6 **MODIFICATION OR ASSUMPTION OF OPTIONS.** The Committee may modify, extend or assume outstanding options or may accept the cancellation of outstanding options (whether granted by the Company or by another issuer) in return for the grant of new options for the same or a different number of shares and at the same or a different exercise price. The foregoing notwithstanding, no modification of an Option shall, without the consent of the Optionee, alter or impair his or her rights or obligations under such Option (except that the Committee has the authority to amend any outstanding Option without the Optionee's consent if the Committee deems it necessary or advisable to comply with Code Section 409A). In addition, to the extent the Committee's modification of the purchase price or the exercise price of any outstanding Award effects a repricing, shareholder approval shall be required before the repricing is effective.
- 5.7 **BUYOUT PROVISIONS.** The Committee may at any time (a) offer to buy out for a payment in cash or cash equivalents an Option previously granted or (b) authorize an Optionee to elect to cash out an Option previously granted, in either case at such time and based upon such terms and conditions as the Committee shall establish.

## **ARTICLE 6. PAYMENT FOR OPTION SHARES.**

- 6.1 **GENERAL RULE.** The entire Exercise Price of Common Shares issued upon exercise of Options shall be payable in cash or cash equivalents at the time when such Common Shares are purchased, except as follows:
- (a) In the case of an ISO granted under the Plan, payment shall be made only pursuant to the express provisions of the applicable Stock Option Agreement. The Stock Option Agreement may specify that payment may be made in any form(s) described in this Article 6.
  - (b) In the case of an NQO, the Committee may at any time accept payment in any form(s) described in this Article 6.
- 6.2 **SURRENDER OF STOCK.** To the extent that this Section 6.2 is applicable, all or any part of the Exercise Price may be paid by surrendering Common Shares that are already owned by the Optionee. Such Common Shares shall be valued at their Fair Market Value on the date when the new Common Shares are purchased under the Plan. The Optionee shall not surrender Common Shares in payment of the Exercise Price if such action could cause the Company to recognize additional compensation expense with respect to the Option for financial reporting purposes under GAAP accounting at the time of such proposed surrender.
- 6.3 **EXERCISE/SALE.** To the extent that this Section 6.3 is applicable, all or any part of the Exercise Price may be paid by delivering (on a form prescribed by the Company) an irrevocable direction to a securities broker approved by the Company to sell all or part of the Common Shares being purchased under the Plan and to deliver all or part of the sales proceeds to the Company.
- 6.4 [RESERVED]
- 6.5 [RESERVED]

- 6.6 **OTHER FORMS OF PAYMENT.** To the extent that this Section 6.6 is applicable, all or any part of the Exercise Price may be paid in any other form that is consistent with applicable laws, regulations and rules.

**ARTICLE 7.  
CLAWBACK.**

Notwithstanding any other provisions in this Plan to the contrary, any Award received by a Subject Participant, and/or any Common Share issued upon exercise of any Award received by a Subject Participant hereunder, and/or any amount received with respect to any sale of any such Award or Common Share, will be subject to potential cancellation, recoupment, rescission, payback or other action to the extent required pursuant to applicable law, government regulation or national securities exchange listing requirement (or any clawback policy adopted by the Company pursuant to any such law, government regulation or national securities exchange listing requirement). Each Subject Participant agrees and consents to the Company's application, implementation and enforcement of any policy established by the Company that may apply to the Subject Participant and any provision of applicable law, government regulation or national securities exchange listing requirement relating to cancellation, rescission, payback or recoupment of compensation, and expressly agrees that the Company may take such actions as are necessary to effectuate any such policy (as applicable to the Subject Participant) or applicable law, government regulation or national securities exchange listing requirement without further consent or action being required by the Subject Participant.

**ARTICLE 8.  
RESTRICTED SHARES.**

- 8.1 **TIME, AMOUNT AND FORM OF AWARDS.** Awards under the Plan may be granted in the form of Restricted Shares. Restricted Shares may also be awarded in combination with NQOs, and such an Award may provide that the Restricted Shares will be forfeited in the event that the related NQOs are exercised. The maximum aggregate number of Common Shares that may be granted in the form of Restricted Shares in any one calendar year to any one Participant is 45,000, except a new Employee may receive a grant of up to 75,000 Restricted Shares in the fiscal year of the Company in which his or her service with the Company begins.
- 8.2 **PAYMENT OF AWARDS.** To the extent that an Award is granted in the form of newly issued Restricted Shares, the Award recipient, as a condition to the grant of such Award, shall be required to pay the Company in cash, cash equivalents or any other form of legal consideration acceptable to the Company, including but not limited to future services, an amount equal to the par value of such Restricted Shares. To the extent that an Award is granted in the form of Restricted Shares from the Company's treasury, no cash consideration shall be required of the Award recipients.
- 8.3 **VESTING CONDITIONS.** Each Award of Restricted Shares shall be subject to vesting. Vesting shall occur, in full or in installments, upon satisfaction of the conditions specified in the Stock Award Agreement. A Stock Award Agreement may provide for accelerated vesting in the event of the Participant's death, disability or retirement or other events. Notwithstanding any other provision of the Plan to the contrary, the Committee may determine, at the time of granting Restricted Shares or thereafter, that all or part of such Restricted Shares shall become vested in the event that a Change in Control occurs with respect to the Company.

8.4 **VOTING AND DIVIDEND RIGHTS**. Unless otherwise provided in the Stock Award Agreement, the holder of Restricted Shares awarded under the Plan shall have the same voting, dividend and other rights as the Company's other stockholders. Without limitation, a Stock Award Agreement may require that the holders of Restricted Shares invest any cash dividends received in additional Restricted Shares (in which case such additional Restricted Shares shall be subject to the same conditions and restrictions as the Award with respect to which the dividends were paid), or may defer payment of any dividends until vesting of the Award.

8.5 **SECTION 162(M) PERFORMANCE RESTRICTIONS**

- (a) ***In General.*** For purposes of qualifying grants of Restricted Shares as "performance-based compensation" under Code Section 162(m), the Committee, in its discretion, may make Restricted Shares subject to vesting based on the achievement of performance goals, in which case the Committee will specify in writing, by resolution or otherwise, the Participants eligible to receive such an Award (which may be expressed in terms of a class of individuals) and the performance goals applicable to such Awards within 90 days after the commencement of the period to which the performance goals relate, or such earlier time as required to comply with Section 162(m) of the Code. No such Award shall be payable unless the Committee certifies in writing, by resolution or otherwise, that the performance goals applicable to the Award were satisfied. In no case may the Committee increase the value of an Award granted under this Section 8.5 above the maximum value determined under the performance formula by the attainment of the applicable performance goals, but the Committee retains the discretion to reduce the value below such maximum.
- (b) ***Performance Goals.*** Unless and until the Committee proposes for stockholder vote and the stockholders approve a change in the general performance measures applicable to Awards, the performance goals upon which the payment or vesting of an Award that is intended to qualify as performance based compensation are limited to the following Performance Measures:
- (1) operating income or operating profit (including but not limited to operating income and any affiliated growth measure);
  - (2) net earnings or net income (before or after taxes, including but not limited to deferred taxes, and any affiliated growth measure);
  - (3) basic or diluted earnings per share (before or after taxes, including but not limited to deferred taxes, and any affiliated growth measure);
  - (4) revenues (including but not limited to revenue, gross revenue, net revenue, and any affiliated growth measure);
  - (5) gross profit or gross profit growth;
  - (6) return on assets, capital, invested capital, equity or sales;
  - (7) cash flow (including, but not limited to, operating cash flow, free cash flow, and cash flow return on capital);

- (8) earnings before or after taxes, interest, depreciation and/or amortization (including but not limited to changes in this measure);
- (9) improvements or changes in capital structure (including but not limited to debt balances or debt issuance);
- (10) budget management;
- (11) productivity targets;
- (12) economic value added or other value added measurements;
- (13) share price (including, but not limited to, growth measures and total shareholder return);
- (14) expense targets;
- (15) margins (including but not limited to gross or operating margins);
- (16) efficiency measurements (including but not limited to availability measurements, call wait times, call, meeting, shipping or other volume measurements, turnaround times and error rates);
- (17) working capital targets (including but not limited to items reported on the Company's balance sheet and time-based or similar measures such as days inventory, days receivable and days payable);
- (18) equity or market value measures;
- (19) enterprise or adjusted market value measures;
- (20) safety record;
- (21) completion of business acquisition, divestment or expansion;
- (22) book value or changes in book value (including but not limited to tangible book value and net asset measures);
- (23) assets or changes in assets;
- (24) cash position or changes in cash position;
- (25) employee retention or recruiting measures;
- (26) milestones related to filings with government entities or related approvals (including but not limited to filings with the Securities and Exchange Commission which may require stockholder approval);
- (27) changes in location or the opening or closing of facilities;



- (28) contract or other development of relationship with identified suppliers, distributors or other business partners; and
- (29) new product development (including but not limited to third-party collaborations or contracts, and with milestones that may include but are not limited to contract execution, proof of concept, regulatory approval, product launch and targets such as unit volume and revenue following product launch).

Any performance measures may be used to measure the performance of the Company as a whole and/or any one or more business segments, regional operations, products and/or Affiliates of the Company or any combination thereof, as the Committee may deem appropriate, and any performance measures may be used in comparison to the performance of a group of peer companies, or a published or special index that the Committee, in its sole discretion, deems appropriate. The Committee also has the authority to provide in an Award for accelerated vesting of an Award based on the achievement of performance goals.

The Committee may provide in any Award that any evaluation of attainment of a performance goal may include or exclude any of the following events that occurs during the relevant period: (a) asset write downs; (b) litigation judgments or settlements; (c) the effect of changes in tax laws, accounting principles, or other laws or regulations affecting reported results; (d) any reorganization and/or restructuring transactions or programs; (e) extraordinary nonrecurring items as described in Accounting Principles Board Opinion No. 30 and/or in management's discussion and analysis of financial condition and results of operations appearing in the Company's Annual Report on Form 10-K for the applicable year; and (f) acquisitions or divestitures and associated costs; (g) any other specific unusual or nonrecurring events, or objectively determinable category thereof; (h) foreign currency gains and losses; and (i) a change in the Company's fiscal year.

In the event that applicable tax and/or securities laws change to permit discretion by the Committee to alter the governing performance measures without obtaining stockholder approval of such changes, the Committee shall have sole discretion to make such changes without obtaining stockholder approval. In addition, in the event that the Committee determines that it is advisable to grant Awards that do not qualify as performance based compensation, the Committee may make such grants without satisfying the requirements of Section 162(m) of the Code.

- 8.6 **MINIMUM VESTING REQUIREMENT.** The minimum period for Restricted Shares granted under the Plan to vest shall be one year.

## **ARTICLE 9. PROTECTION AGAINST DILUTION.**

- 9.1 **ADJUSTMENTS.** In the event of a subdivision of the outstanding Common Shares, a declaration of a dividend payable in Common Shares, a declaration of a dividend payable in a form other than Common Shares in an amount that has a material effect on the price of Common Shares, a combination or consolidation of the outstanding Common Shares (by reclassification or otherwise) into a lesser number of Common Shares, a recapitalization, a spin-off or a similar occurrence, the Committee shall make such adjustments as it, in its sole discretion, deems appropriate in one or more of (a) the number of Options and Restricted Shares available for future Awards under Article 3, (b) the limitations set forth in Section 5.2 and Section 8.1, (c) the number of Common Shares covered by each outstanding Option or (d) the Exercise Price under each outstanding Option. Except as provided in this Article 9, a Participant shall have no rights by reason of any issue by the Company of stock of any class or securities convertible into stock of any class, any subdivision or consolidation of shares of stock of any class, the payment of any stock dividend or any other increase or decrease in the number of shares of stock of any class.

- 9.2 **DISSOLUTION OR LIQUIDATION.** To the extent not previously exercised, Options shall terminate immediately prior to the dissolution or liquidation of the Company.
- 9.3 **REORGANIZATIONS.** In the event that the Company is a party to a merger or other reorganization, outstanding Options and Restricted Shares shall be subject to the agreement of merger or reorganization. Such agreement may provide, without limitation, for the continuation of outstanding Awards by the Company (if the Company is a surviving corporation), for their assumption by the surviving corporation or its parent or subsidiary, for the substitution by the surviving corporation or its parent or subsidiary of its own awards for such Awards, for accelerated vesting and accelerated expiration, or for settlement in cash or cash equivalents.

**ARTICLE 10.  
AWARDS UNDER OTHER PLANS.**

The Company may grant awards under other plans or programs. Such awards may be settled in the form of Common Shares issued under this Plan. Such Common Shares shall be treated for all purposes under the Plan like Restricted Shares and shall, when issued, reduce the number of Common Shares available under Article 3.

**ARTICLE 11.  
LIMITATION ON RIGHTS.**

- 11.1 **RETENTION RIGHTS.** Neither the Plan nor any Award granted under the Plan shall be deemed to give any individual a right to remain an Employee, Outside Director or Consultant. The Company and its Parents, Subsidiaries and Affiliates reserve the right to terminate the service of any Employee, Outside Director or Consultant at any time, with or without cause, subject to applicable laws, the Company's certificate of incorporation and bylaws and a written employment agreement (if any).
- 11.2 **STOCKHOLDERS' RIGHTS.** A Participant shall have no dividend rights, voting rights or other rights as a stockholder with respect to any Common Shares covered by his or her Award prior to the time when a stock certificate for such Common Shares is issued or, in the case of an Option, the time when he or she becomes entitled to receive such Common Shares by filing a notice of exercise and paying the Exercise Price. No adjustment shall be made for cash dividends or other rights for which the record date is prior to such time, except as expressly provided in the Plan.

- 11.3 **REGULATORY REQUIREMENTS.** Any other provision of the Plan notwithstanding, the obligation of the Company to issue Common Shares under the Plan shall be subject to all applicable laws, rules and regulations and such approval by any regulatory body as may be required. The Company reserves the right to restrict, in whole or in part, the delivery of Common Shares pursuant to any Award prior to the satisfaction of all legal requirements relating to the issuance of such Common Shares, to their registration, qualification or listing or to an exemption from registration, qualification or listing.

**ARTICLE 12.**  
**WITHHOLDING TAXES; Parachute payments.**

- 12.1 **GENERAL.** To the extent provided by the terms of an Award Agreement and subject to the discretion of the Committee, the Participant may satisfy any federal, state or local tax withholding obligation relating to the exercise or acquisition of Common Stock under an Award by any of the following means (in addition to the Company's right to withhold from any compensation paid to the Participant by the Company) or by a combination of such means: (a) tendering a cash payment; (b) authorizing the Company to withhold shares of Common Stock from the shares of Common Stock otherwise issuable to the Participant as a result of the exercise or acquisition of Common Stock under the Award, provided, however, that no shares of Common Stock are withheld with a value exceeding the minimum amount of tax required to be withheld by law; or (c) delivering to the Company previously owned and unencumbered shares of Common Stock of the Company. The Company shall not be required to issue any Common Shares or make any cash payment under the Plan until such obligations are satisfied.
- 12.2 **SECTION 280G.** To the extent that any of the payments and benefits provided for under the Plan or any other agreement or arrangement between the Company or its Affiliates and a Participant (collectively, the "Payments") (i) constitute a "parachute payment" within the meaning of Code Section 280G and (ii) but for this paragraph would be subject to the excise tax imposed by Section 4999 of the Code, then the Payments shall be payable either (i) in full or (ii) as to such lesser amount which would result in no portion of such Payments being subject to excise tax under Section 4999 of the Code (determined in accordance with the reduction of payments and benefits paragraph set forth below); whichever of the foregoing amounts, taking into account the applicable federal, state and local income taxes and the excise tax imposed by Section 4999, results in the participant's receipt on an after-tax basis, of the greatest amount of benefits under this Plan, notwithstanding that all or some portion of such benefits may be taxable under Section 4999 of the Code. Any determination required under this provision will be made by accountants chosen by the Company, whose determination shall be conclusive and binding upon the participant and the Company for all purposes.

Except to the extent, if any, otherwise agreed in writing between a participant and the Company, reduction of payments and benefits hereunder, if applicable, will be made by reducing, first, payments or benefits to be paid in cash in the order in which such payment or benefit would be paid or provided (beginning with such payment or benefit that would be made last in time and continuing, to the extent necessary, through to such payment or benefit that would be made first in time) and, then, reducing any benefit to be provided in-kind hereunder in a similar order; provided, however, that any reduction or elimination of accelerated vesting of any equity award will first be accomplished by reducing or eliminating

the vesting of such awards that are valued in full for purposes of Section 280G of the Code, then the reduction or elimination of vesting of other equity awards.

### **ARTICLE 13. FUTURE OF THE PLAN.**

- 13.1 **TERM OF THE PLAN.** The Plan was initially effective on March 14, 1997. The Board may, at any time and for any reason, amend, suspend or terminate the Plan (subject to the approval of the Company's stockholders only to the extent required by applicable law, regulations or rules). The Committee may issue ISOs under the Plan until the tenth anniversary of the date of its most recent amendment or restatement. The Committee may issue any Award other than ISOs at any time prior to the date, if any, that the Board suspends or terminates the Plan. No Award may be granted pursuant to the Plan after such date, but Awards granted before such date may extend beyond that date.
- 13.2 **PERFORMANCE AWARDS.** Unless the Company determines to submit the Plan to the Company's stockholders at the first stockholder meeting that occurs in the fifth year following the year in which the Plan was last approved by stockholders (or any earlier meeting designated by the Board), in accordance with the requirements of Code Section 162(m), and unless such stockholder approval is obtained, then no further Awards made under Section 8.5 will qualify as performance-based compensation for purposes of Code Section 162(m).

### **ARTICLE 14. DEFINITIONS.**

- 14.1 **Affiliate** means any entity other than a Subsidiary, if the Company and/or one or more Subsidiaries own not less than 50% of such entity.
- 14.2 **Award** means any award of an Option or a Restricted Share under the Plan.
- 14.3 **Board** means the Company's Board of Directors, as constituted from time to time.
- 14.4 **Change in Control** shall mean:
- (a) The consummation of a merger or consolidation of the Company with or into another entity of any other corporate reorganization, if more than 50% of the combined voting power of the continuing or surviving entity's securities outstanding immediately after such merger, consolidation or other reorganization is owned by persons who were not stockholders of the Company immediately prior to such merger, consolidation, or other reorganization;
  - (b) The sale, transfer or other disposition of all or substantially all of the Company's assets; or
  - (c) A majority of the members of the Board are replaced during any eighteen month period by directors whose appointment or election is not endorsed by a majority of the Board before the date of appointment or election.
- 14.5 **Code** means the Internal Revenue Code of 1986, as amended.
- 14.6 **Committee** means a committee of the Board, as described in Article 2.

- 14.7 **Common Share** means, as may be applicable, one share of Traditional Common Stock, par value \$0.01 per share, of the Company to the extent any remains outstanding at the time of determination, or one share of Public Common Stock, par value \$0.01 per share, of the Company, to the extent any remains outstanding at the time of determination.
- 14.8 **Company** means Heska Corporation, a Delaware corporation.
- 14.9 **Consultant** means a consultant or adviser who provides bona fide services to the Company, a Parent, a Subsidiary or an Affiliate as an independent contractor. Service as a Consultant shall be considered employment for all purposes of the Plan, except as provided in Section 4.2.
- 14.10 **Employee** means a common-law employee of the Company, a Parent, a Subsidiary or an Affiliate.
- 14.11 **Exchange Act** means the Securities Exchange Act of 1934, as amended.
- 14.12 **Exercise Price** means the amount for which one Common Share may be purchased upon exercise of such Option, as specified in the applicable Stock Option Agreement.
- 14.13 **Fair Market Value** means, for so long as the Common Stock is listed on any established stock exchange or a national market system, the value of the Common Stock as determined by reference to the most recent reported sale price of a share of Common Stock (or if no sales were reported, the most recent closing price) as quoted on such exchange or system at the time of determination. In the absence of an established market for the Common Stock, the Fair Market Value shall be determined in good faith by the Committee and such determination shall be conclusive and binding on all persons.
- 14.14 **ISO** means an incentive stock option described in section 422(b) of the Code.
- 14.15 **NQO** means a stock option not described in sections 422 or 423 of the Code.
- 14.16 **Option** means an ISO or NQO granted under the Plan and entitling the holder to purchase Common Shares.
- 14.17 **Optionee** means an individual or estate who holds an Option.
- 14.18 **Outside Director** shall mean a member of the Board who is not an Employee. Service as an Outside Director shall be considered employment for all purposes of the Plan, except as provided in Section 4.2.
- 14.19 **Parent** means any corporation (other than the Company) in an unbroken chain of corporations ending with the Company, if each of the corporations other than the Company owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain. A corporation that attains the status of a Parent on a date after the adoption of the Plan shall be considered a Parent commencing as of such date.
- 14.20 **Participant** means an individual or estate who holds an Award.

- 14.21 **Plan** means this Heska Corporation 1997 Stock Incentive Plan, as amended from time to time.
- 14.22 **Previously Issued Awards** means Restricted Shares which were not subject to further vesting conditions, Common Shares issued pursuant to the exercise of ISOs, Common Shares issued pursuant to the exercise of NQOs, Restricted Shares subject to further vesting conditions, outstanding ISOs and outstanding NQOs.
- 14.23 **Restricted Share** means a Common Share awarded under the Plan.
- 14.24 **Stock Award Agreement** means the agreement between the Company and the recipient of a Restricted Share that contains the terms, conditions and restrictions pertaining to such Restricted Share.
- 14.25 **Stock Option Agreement** means the agreement between the Company and an Optionee that contains the terms, conditions and restrictions pertaining to his or her Option.
- 14.26 **Subsidiary** means any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company, if each of the corporations other than the last corporation in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in such chain. A corporation that attains the status of a Subsidiary on a date after the adoption of the Plan shall be considered a Subsidiary commencing as of such date.
- 14.27 **Subject Participant** means a Participant who is designated by the Board as an "executive officer" under the Exchange Act.
- 14.28 **Unexercised/Unvested Awards** means Restricted Shares subject to further vesting conditions, as well as outstanding ISOs and outstanding NQOs.

**ARTICLE 15.  
EXECUTION.**

To record the adoption of the Plan by the Board, the Company has caused its duly authorized officer to execute this document in the name of the Company.

**HESKA CORPORATION**

By: /s/ Jason A. Napolitano  
Chief Operating Officer, Chief  
Financial Officer, Executive Vice  
President and Secretary

-17-

**HESKA CORPORATION**  
**1997 STOCK INCENTIVE PLAN**  
**RESTRICTED STOCK GRANT AGREEMENT**

THIS AGREEMENT is made as of the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_ (the “Grant Date”) by and between Heska Corporation (the “Company”) and \_\_\_\_\_ (the “Executive”).

In consideration of the mutual covenants and representations herein set forth, the Company and Executive agree as follows:

**SECTION 1. GRANT OF STOCK.**

1.1 Precedence of Plan. This Agreement is subject to and shall be construed in accordance with the terms and conditions of the Heska Corporation 1997 Stock Incentive Plan (the “Plan”), as now or hereinafter in effect. Any capitalized terms that are used in this Agreement without being defined and that are defined in the Plan shall have the meaning specified in the Plan.

1.2 Grant of Stock. The Company hereby grants to Executive an aggregate of \_\_\_\_\_ shares of Restricted Stock (the “Shares”), subject to vesting as provided in Section 2.

**SECTION 2. UNVESTED SHARES SUBJECT TO FORFEITURE.**

2.1 Shares Subject to Forfeiture. The Shares are subject to time-based and performance-based vesting requirements.

a. The Shares will vest in accordance with the Vesting Schedule attached as Attachment 1, with the performance-based vesting to be tied to one or more of the Company’s annual operating cash flow, annual operating income, annual revenue, stock price level and stock price performance as compared to the S&P 500 Index over a specified time period. The shares will vest or be forfeited in a maximum of seven (7) years.

b. In the event of a Change of Control prior to the vesting of all Shares, any remaining unvested Shares will vest. For this purpose, “Change of Control” means (i) a sale of all or substantially all of the Company’s assets, (ii) any merger, consolidation, or other business combination transaction of the Company with or into another corporation, entity, or person, other than a transaction in which the holders of at least a majority of the shares of voting capital stock of the Company outstanding immediately prior to such transaction continue to hold (either by such shares remaining outstanding or by their being converted into shares of voting capital stock of the surviving entity) a majority of the total voting power represented by the shares of voting capital stock of the Company (or the surviving entity) outstanding immediately after such transaction, (iii) the direct or indirect acquisition (including by way of a tender or exchange offer) by any person, or persons acting as a group, of beneficial ownership or a right to acquire beneficial ownership of shares representing a majority of the voting power of the then outstanding shares of capital stock of the Company, (iv) a contested election of Directors, as a result of which or in connection with which the persons who were Directors before such election



or their nominees cease to constitute a majority of the Board, or (v) a dissolution or liquidation of the Company.

c. In the event that Executive's employment with the Company is terminated at least one (1) year following the Grant Date because of either (i) Executive's death or (ii) Executive's total and permanent disability, any remaining unvested Shares will vest. For this purpose, "total and permanent disability" means that Executive is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted, or can be expected to last, for a continuous period of not less than one year.

d. In the event that Executive's employment with the Company is terminated prior to the vesting of all Shares for any reason other than death or total and permanent disability, Executive will forfeit all right to any unvested Shares. In the event that Executive's employment with the Company is terminated prior to one (1) year following the Grant Date because of either (i) Executive's death or (ii) Executive's total and permanent disability, Executive will forfeit all right to any unvested Shares.

2.2 Restriction on Transfer. Until the Shares are vested, the Shares may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated.

### **SECTION 3. STOCKHOLDER RIGHTS**

3.1 Stock Register and Certificates. The Shares will be recorded in the stock register of the Company in the name of Executive. If applicable, a stock certificate or certificates representing the Shares will be registered in the name of Executive, but such certificates shall remain in the custody of the Company. Executive shall deposit with the Company a Stock Assignment Separate from Certificate in the form attached below as Attachment 2, endorsed in blank, so as to permit retransfer to the Company of all or a portion of the Shares that are forfeited or otherwise do not become vested in accordance with the Plan and this Agreement.

3.2 Exercise of Stockholder Rights. Executive shall have the right to vote the Shares (to the extent of the voting rights of said Shares, if any), to receive and retain all regular cash dividends and such other distributions, as the Board of Directors of the Company may, in its discretion, designate, pay or distribute on such Shares, and to exercise all other rights, powers and privileges of a holder of Common Stock with respect to such Shares, except as set forth in this Agreement and the Plan.

3.3 Legends. Certificates, if any, representing the Shares will contain the following or other legends in the Company's discretion:

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS UPON AND OBLIGATIONS WITH RESPECT TO TRANSFER AND RIGHTS OF REPURCHASE AS SET FORTH IN AN AGREEMENT BETWEEN THE COMPANY AND THE ORIGINAL REGISTERED HOLDER, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THE COMPANY.

#### **SECTION 4. RESPONSIBILITY FOR TAXES.**

4.1 Section 83(b) Election. Executive may complete and file with the Internal Revenue Service an election pursuant to Section 83(b) of the Internal Revenue Code to be taxed currently on the fair market value of the Shares without regard to the vesting restrictions set forth in this Agreement. Executive shall be responsible for all taxes associated with the acceptance of the transfer of the Shares, including any tax liability associated with the representation of fair market value if the election is made pursuant to Code Section 83(b).

4.2 Withholding. In accordance with Section 12 of the Plan, Executive agrees to make arrangements satisfactory to the Company for the satisfaction of any withholding tax obligations that arise in connection with the Plan under applicable federal, state, local or foreign law. The Company in its discretion may permit Executive to satisfy all or part of Executive's withholding or income tax obligations by having the Company withhold all or a portion of the Shares that otherwise would be issued to Executive on vesting.

#### **SECTION 5. MISCELLANEOUS.**

5.1 Not an Employment Contract. This Agreement is not an employment contract and nothing in this Agreement shall be deemed to create in any way whatsoever any obligation on the part of Executive to remain in the service of the Company in any capacity, or of the Company to continue Executive's service in any capacity.

5.2 Effect on Employee Benefits. Executive agrees that the Award will constitute special incentive compensation that will not be taken into account as "salary" or "compensation" or "bonus" in determining the amount of any payment under any pension, retirement, profit sharing or other remuneration plan of the Company unless so provided in such plan.

5.3 Further Assurances. The parties agree to execute such further instruments and to take such further action as may reasonably be necessary to carry out the intent of this Agreement.

5.4 Entire Agreement. This Agreement, including any exhibits, is the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior oral and written understandings of the parties.

5.5 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Colorado as applied to contracts between Colorado residents to be wholly performed within the State of Colorado.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

**EXECUTIVE**

**HESKA CORPORATION**

a Delaware corporation

\_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Address \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

# Attachment 1

## VESTING SCHEDULE

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## Attachment 2

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**ASSIGNMENT SEPARATE FROM CERTIFICATE**

FOR VALUE RECEIVED, I, \_\_\_\_\_, hereby sell, assign and transfer unto \_\_\_\_\_  
( ) shares of the Common Stock of Heska Corporation, standing in my name on the books of said corporation represented by  
Certificate No. herewith and do hereby irrevocably constitute and appoint \_\_\_\_\_ to transfer said stock on the books of the  
within-named corporation with full power of substitution in the premises.

Dated: , 20\_.

Signature: \_\_\_\_\_

This Assignment Separate from Certificate was executed in conjunction with the terms of a Restricted Stock Grant Agreement  
between the above assignor and Heska Corporation, dated \_\_\_\_\_, 20\_\_.

**Instruction:**      **Please do not fill in any blanks other than the signature line.**

**HESKA CORPORATION**  
**1997 STOCK INCENTIVE PLAN**  
**RESTRICTED STOCK GRANT AGREEMENT**

*(Management Incentive Plan Award)*

THIS AGREEMENT is made as of the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_ (the “Grant Date”) by and between Heska Corporation (the “Company”) and \_\_\_\_\_ (the “Executive”), in connection with the Executive’s election to receive a portion of Executive’s \_\_\_\_\_ award under the Management Incentive Plan in the form of Restricted Stock.

In consideration of the mutual covenants and representations herein set forth, the Company and Executive agree as follows:

**SECTION 1. GRANT OF STOCK.**

1.1 Precedence of Plan. This Agreement is subject to and shall be construed in accordance with the terms and conditions of the Heska Corporation 1997 Stock Incentive Plan (the “Plan”), as now or hereinafter in effect. Any capitalized terms that are used in this Agreement without being defined and that are defined in the Plan shall have the meaning specified in the Plan.

1.2 Grant of Stock. The Company hereby grants to Executive an aggregate of \_\_\_\_\_ shares of Restricted Stock (the “Shares”), subject to vesting as provided in Section 2.

**SECTION 2. UNVESTED SHARES SUBJECT TO FORFEITURE.**

2.1 Shares Subject to Forfeiture.

a. The Shares are subject to vesting requirements as established in connection with the Management Incentive Plan, including the terms and conditions for awards made under the \_\_\_\_\_ Management Incentive Plan (the “MIP”). As described in more detail in the MIP, up to 100% of the Shares will vest at the later of the time payments are made under the MIP (the “Payout Time”) or one (1) year from the Grant Date, and will vest as determined by dividing \_\_\_% of the Executive’s MIP Payout (as defined in the MIP) by \$\_\_\_\_\_, and rounding to the nearest whole share. Executive will forfeit all Shares that do not vest at that time.

b. In the event that the Executive is an active employee through December 31, \_\_\_\_\_ and at least one (1) year from the Grant Date and Executive’s employment with the Company is subsequently terminated because of either (i) Executive’s death or (ii) Executive being unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted, or can be expected to last, for a continuous period of not less than one (1) year, up to 100% of the Shares will vest at the Payout Time as determined by dividing \_\_\_% of the Executive’s MIP Payout (as defined in the MIP) by \$\_\_\_\_\_, and rounding to the nearest whole share. Executive will forfeit all Shares that do not vest at that time.

c. Except in the cases of (i) either a Change in Control of the Company, the effect of which is governed by the MIP, or (ii) the circumstances described in subsection b. above, which is governed by subsection b. above, in the event that Executive's employment with the Company is terminated prior to vesting, Executive will forfeit all right to the Shares. For the avoidance of doubt, in the event Executive's employment is terminated due to Executive's death on or before December 31, \_\_\_\_, Executive will forfeit all right to the Shares but this forfeiture is not intended to diminish any MIP Payout to which Executive's designated beneficiary is entitled, as governed by the MIP.

2.2 Restriction on Transfer. Until the Shares are vested, the Shares may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated.

### **SECTION 3. STOCKHOLDER RIGHTS**

3.1 Stock Register and Certificates. The Shares will be recorded in the stock register of the Company in the name of Executive. If applicable, a stock certificate or certificates representing the Shares will be registered in the name of Executive, but such certificates shall remain in the custody of the Company. Executive shall deposit with the Company a Stock Assignment Separate from Certificate in the form attached below as Attachment 1, endorsed in blank, so as to permit retransfer to the Company of all or a portion of the Shares that are forfeited or otherwise do not become vested in accordance with the Plan and this Agreement.

3.2 Exercise of Stockholder Rights. Executive shall have the right to vote the Shares (to the extent of the voting rights of said Shares, if any), to receive and retain all regular cash dividends and such other distributions, as the Board of Directors of the Company may, in its discretion, designate, pay or distribute on such Shares, and to exercise all other rights, powers and privileges of a holder of Common Stock with respect to such Shares, except as set forth in this Agreement and the Plan.

3.3 Legends. Certificates, if any, representing the Shares will contain the following or other legends in the Company's discretion:

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS UPON AND OBLIGATIONS WITH RESPECT TO TRANSFER AND RIGHTS OF REPURCHASE AS SET FORTH IN AN AGREEMENT BETWEEN THE COMPANY AND THE ORIGINAL REGISTERED HOLDER, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THE COMPANY.

### **SECTION 4. RESPONSIBILITY FOR TAXES.**

4.1 Section 83(b) Election. Executive may complete and file with the Internal Revenue Service an election pursuant to Section 83(b) of the Internal Revenue Code to be taxed currently on the fair market value of the Shares without regard to the vesting restrictions set forth in this Agreement. Executive shall be responsible for all taxes associated with the acceptance of the transfer of the Shares, including any tax liability associated with the representation of fair market value if the election is made pursuant to Code Section 83(b).



4.2 Withholding. In accordance with Section 12 of the Plan, Executive agrees to make arrangements satisfactory to the Company for the satisfaction of any withholding tax obligations that arise in connection with the Plan under applicable federal, state, local or foreign law. The Company in its discretion may permit Executive to satisfy all or part of his withholding or income tax obligations by having the Company withhold all or a portion of the Shares that otherwise would be issued to him on vesting.

**SECTION 5. MISCELLANEOUS.**

5.1 Not an Employment Contract. This Agreement is not an employment contract and nothing in this Agreement shall be deemed to create in any way whatsoever any obligation on the part of Executive to remain in the service of the Company in any capacity, or of the Company to continue Executive's service in any capacity.

5.2 Effect on Employee Benefits. Executive agrees that the Award will constitute special incentive compensation that will not be taken into account as "salary" or "compensation" or "bonus" in determining the amount of any payment under any pension, retirement, profit sharing or other remuneration plan of the Company unless so provided in such plan.

5.3 Further Assurances. The parties agree to execute such further instruments and to take such further action as may reasonably be necessary to carry out the intent of this Agreement.

5.4 Entire Agreement. This Agreement, including any exhibits, is the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior oral and written understandings of the parties.

5.5 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Colorado as applied to contracts between Colorado residents to be wholly performed within the State of Colorado.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

**EXECUTIVE**

**HESKA CORPORATION**

a Delaware corporation

\_\_\_\_\_  
Address \_\_\_\_\_  
\_\_\_\_\_

By: \_\_\_\_\_  
Title: \_\_\_\_\_

# Attachment 1

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**ASSIGNMENT SEPARATE FROM CERTIFICATE**

FOR VALUE RECEIVED, I, \_\_\_\_\_, hereby sell, assign and transfer unto \_\_\_\_\_ (\_\_\_\_\_) shares of the Common Stock of Heska Corporation, standing in my name on the books of said corporation represented by Certificate No. \_\_\_\_\_ herewith and do hereby irrevocably constitute and appoint \_\_\_\_\_ to transfer said stock on the books of the within-named corporation with full power of substitution in the premises.

Dated: , 20\_.

Signature: \_\_\_\_\_

This Assignment Separate from Certificate was executed in conjunction with the terms of a Restricted Stock Grant Agreement between the above assignor and Heska Corporation, dated \_\_\_\_\_, 20\_\_.

**Instruction:**     **Please do not fill in any blanks other than the signature line.**

**HESKA CORPORATION**  
**1997 STOCK INCENTIVE PLAN**  
**RESTRICTED STOCK GRANT AGREEMENT**

*(Outside Director Award)*

THIS AGREEMENT is made as of the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_ (the “Grant Date”) by and between Heska Corporation (the “Company”) and \_\_\_\_\_ (the “Director”).

In consideration of the mutual covenants and representations herein set forth, the Company and Director agree as follows:

**SECTION 1 GRANT OF STOCK.**

1.1 Precedence of Plan. This Agreement is subject to and shall be construed in accordance with the terms and conditions of the Heska Corporation 1997 Stock Incentive Plan (the “Plan”), as now or hereinafter in effect. Any capitalized terms that are used in this Agreement without being defined and that are defined in the Plan shall have the meaning specified in the Plan.

1.2 Grant of Stock. The Company hereby grants to Director an aggregate of \_\_\_ shares of Restricted Stock (the “Shares”), subject to vesting as provided in Section 2.

**SECTION 2. UNVESTED SHARES SUBJECT TO FORFEITURE.**

2.1 Shares Subject to Forfeiture.

A. The Shares will vest (the “Vesting Time”) at the latter of (i) the Company’s next Annual Meeting of Stockholders (the “Meeting”) and (ii) the one year anniversary of the Grant Date. In addition, vesting is subject to (i) the Director’s service as a member of the Company’s Board of Directors (the “Board”) through the Vesting Time, unless that Director’s current Board term expires at the Meeting, in which case vesting is subject to the Director’s service as a member of the Company’s Board to the Meeting, and (ii) the Director not engaging in “Competition” prior to the Vesting Time. For purposes of this Agreement, Director will be deemed to have engaged in “Competition” if Director, without the written consent of the Board, directly or indirectly (i) provides services or assistance in any form to any individual, entity, or company providing veterinary products for the companion animal health industry or imaging products or services for the veterinary market (a “Restricted Company”), whether such services or assistance is provided as an employee, consultant, agent, corporate officer, director, or otherwise or (ii) participates in the financing, operation, management, or control of, a Restricted Company. A Restricted Company includes, without limitation, Abaxis, Inc., IDEXX Laboratories, Inc., scil animal health company GmbH (currently a wholly-owned subsidiary of Henry Schein, Inc.), Sound Technologies, Inc. (currently a wholly-owned subsidiary of VCA Inc.), and Synbiotics Corporation (currently a wholly owned subsidiary of Zoetis Inc.). Notwithstanding the foregoing, Director shall not be deemed to be in Competition if Director is employed or engaged in a corporate function or senior management position (and holding

commensurate equity interests) in a division of a Restricted Company, so long as such division is not in any way engaged in providing veterinary products for the companion animal health industry or imaging products or services for the veterinary market and Director does not directly or indirectly provide services or assistance to any division that does provide veterinary products for the companion animal health industry or imaging products or services for the veterinary market.

b. In the event that the Director serves as a member of the Company's Board for at least one (1) year from the Grant Date and Director's service as a member of the Board is subsequently terminated because of either (i) Director's death or (ii) Director being unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted, or can be expected to last, for a continuous period of not less than one (1) year, the Shares will vest at the time the Director's service as a member of the Board terminates. Furthermore, if Director completes his or her Board term at the Meeting and prior to the Vesting Time and does not engage in Competition prior to the Vesting Time, the Shares shall vest at the Vesting Time.

c. Except in the cases of (i) either a Change in Control of the Company, in which case the Shares shall vest, or (ii) the circumstances described in subsection b. above, which is governed by subsection b. above, in the event that Director's service as a member of the Company's Board is terminated prior to vesting, Director will forfeit all right to the Shares.

2.2 Restriction on Transfer. Until the Shares are vested, the Shares may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated.

### **SECTION 3. STOCKHOLDER RIGHTS**

3.1 Stock Register and Certificates. The Shares will be recorded in the stock register of the Company in the name of Director. If applicable, a stock certificate or certificates representing the Shares will be registered in the name of Director, but such certificates shall remain in the custody of the Company. Director shall deposit with the Company a Stock Assignment Separate from Certificate in the form attached below as Attachment 1, endorsed in blank, so as to permit retransfer to the Company of all or a portion of the Shares that are forfeited or otherwise do not become vested in accordance with the Plan and this Agreement.

3.2 Exercise of Stockholder Rights. Director shall have the right to vote the Shares (to the extent of the voting rights of said Shares, if any), to receive and retain all regular cash dividends and such other distributions, as the Board of the Company may, in its discretion, designate, pay or distribute on such Shares, and to exercise all other rights, powers and privileges of a holder of Common Stock with respect to such Shares, except as set forth in this Agreement and the Plan.

3.3 Legends. Certificates, if any, representing the Shares will contain the following or other legends in the Company's discretion:

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS UPON AND OBLIGATIONS WITH RESPECT TO TRANSFER AND RIGHTS OF REPURCHASE AS SET FORTH IN AN

AGREEMENT BETWEEN THE COMPANY AND THE ORIGINAL REGISTERED HOLDER, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THE COMPANY.

**SECTION 4. RESPONSIBILITY FOR TAXES.**

4.1 Section 83(b) Election. Director may complete and file with the Internal Revenue Service an election pursuant to Section 83(b) of the Internal Revenue Code to be taxed currently on the fair market value of the Shares without regard to the vesting restrictions set forth in this Agreement. Director shall be responsible for all taxes associated with the acceptance of the transfer of the Shares, including any tax liability associated with the representation of fair market value if the election is made pursuant to Code Section 83(b).

4.2 Withholding. In accordance with Section 12 of the Plan, Director agrees to make arrangements satisfactory to the Company for the satisfaction of any withholding tax obligations that arise in connection with the Plan under applicable federal, state, local or foreign law.

**SECTION 5. MISCELLANEOUS.**

5.1 Not an Employment Contract. This Agreement is not an employment contract and nothing in this Agreement shall be deemed to create in any way whatsoever any obligation on the part of Director to remain in the service of the Company in any capacity, or of the Company to continue Director's service in any capacity.

5.2 Further Assurances. The parties agree to execute such further instruments and to take such further action as may reasonably be necessary to carry out the intent of this Agreement.

5.3 Entire Agreement. This Agreement, including any exhibits, is the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior oral and written understandings of the parties.

5.4 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Colorado as applied to contracts between Colorado residents to be wholly performed within the State of Colorado.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

**DIRECTOR**

**HESKA CORPORATION**

a Delaware corporation

\_\_\_\_\_

By: \_\_\_\_\_

Address \_\_\_\_\_

Title: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

# Attachment 1

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**ASSIGNMENT SEPARATE FROM CERTIFICATE**

FOR VALUE RECEIVED, I, \_\_\_\_\_, hereby sell, assign and transfer unto \_\_\_\_\_( ) shares of the Common Stock of Heska Corporation, standing in my name on the books of said corporation represented by Certificate No. herewith and do hereby irrevocably constitute and appoint \_\_\_\_\_ to transfer said stock on the books of the within-named corporation with full power of substitution in the premises.

Dated: , 20\_.

Signature: \_\_\_\_\_

This Assignment Separate from Certificate was executed in conjunction with the terms of a Restricted Stock Grant Agreement between the above assignor and Heska Corporation, dated \_\_\_\_\_, 20\_\_.

**Instruction:**      **Please do not fill in any blanks other than the signature line.**



**Heska Corporation 1997 Stock Incentive Plan****Stock Option Agreement  
(employees and consultants)****Tax Treatment**

This option is intended to be an incentive stock option under section 422 of the Internal Revenue Code or a nonstatutory option, as provided in the Notice of Stock Option Grant.

**Vesting/  
Exercisability**

This option vests and becomes exercisable in installments, as shown in the Notice of Stock Option Grant. In addition, this option shall vest and become exercisable in full if one of the following events occurs:

- Your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary terminates because of death or total and permanent disability, or
- The Company is a party to a merger or other reorganization while you are an Employee, Consultant or Outside Director of the Company or a Subsidiary, this option is not continued by the Company and is not assumed by the surviving corporation or its parent, and the surviving corporation or its parent does not substitute its own option for this option, or
- The Company is subject to a “Change in Control” while you are an Employee, Consultant or Outside Director of the Company or a Subsidiary and, your service is terminated either (i) without Cause as part of an agreement which contemplated such Change in Control or (ii) without your consent and without Cause, as defined below. If the surviving entity demotes you to a lower position, materially reduces your authority or responsibilities, materially reduces your total compensation or announces its intention to relocate your principal place of work by more than 20 miles, then that action will be treated as a termination of your service.
- “Cause” shall mean (i) your failure to perform your assigned duties or responsibilities as an Employee, Consultant or Outside Director of the Company or a Subsidiary (other than a failure resulting from total and permanent disability, as discussed below) after notice thereof from the Company describing your failure to perform such duties or responsibilities; (ii) your material breach of any confidentiality agreement or invention assignment agreement between you and the Company or a Subsidiary; (iii) your engaging in any act of dishonesty, fraud, misrepresentation, moral turpitude or misappropriation of material property that was or is materially injurious to the Company or its affiliates; (iv) your violation of any federal or state law or regulation applicable to the Company’s business; or (v) your being convicted of, or entering a plea of nolo contendere to, any crime.

No additional shares become vested after your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary has terminated for any reason other than those outlined herein.

<b>Term</b>	This option expires in any event at the close of business at Company headquarters on the day before the 10th anniversary of the Date of Grant, as shown in the Notice of Stock Option Grant. (It will expire earlier if your service terminates, as described below.)
<b>Regular Termination</b>	If your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary terminates for any reason except death or total and permanent disability, then this option will expire at the close of business at Company headquarters on the date three months after your termination date. The Company determines when your service terminates for this purpose.
<b>Death</b>	If your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary terminates because of your death, then this option will expire at the close of business at Company headquarters on the date 12 months after the date of death.
<b>Disability</b>	<p>If your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary terminates because of your total and permanent disability, then this option will expire at the close of business at Company headquarters on the date 12 months after your termination date.</p> <p>For all purposes under this Agreement, “total and permanent disability” means that you are unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted, or can be expected to last, for a continuous period of not less than one year.</p>
<b>Leaves of Absence</b>	<p>Vesting of this option shall be suspended during any unpaid leave of absence unless continued vesting is required by the terms of the leave or by applicable law.</p> <p>For purposes of this option, your service does not terminate when you go on a military leave, a sick leave or another <i>bona fide</i> leave of absence, if the Company approved your leave in writing and if continued crediting of service is required by the terms of the leave or by applicable law.</p> <p>For purposes of incentive stock options, no such leave may exceed 90 days, unless reemployment upon expiration of such leave is guaranteed by the terms of the leave or by applicable law. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, then three months following the 91<sup>st</sup> day of such leave, an incentive stock option shall cease to be treated as an incentive stock option and shall be treated for tax purposes as a nonstatutory option.</p> <p>Unless you immediately return to active work when the approved leave ends, your service will terminate.</p>
<b>Restrictions on Exercise</b>	The Company will not permit you to exercise this option if the issuance of shares at that time would violate any law or regulation.

## **Notice of Exercise**

When you wish to exercise this option, you must notify the Company by filing the proper “Notice of Exercise” form at the address given on the form. Your notice must specify how many shares you wish to purchase. The exercise will be effective when the Company receives the Notice of Exercise with the option exercise payment described herein.

If someone else wants to exercise this option after your death, that person must prove to the Company's satisfaction that he or she is entitled to do so.

## **Form of Payment**

When you submit your notice of exercise, you must include payment of the option exercise price for the shares you are purchasing. Payment may be made in one (or a combination of two or more) of the following forms:

- Your personal check, a cashier's check or a money order.
- Certificates for shares of Company stock that you own, along with any forms needed to affect a transfer of those shares to the Company. The value of the shares, determined as of the effective date of the option exercise, will be applied to the option exercise price. However, you may not surrender shares of Company stock in payment of the exercise price if your action would cause the Company to recognize compensation expense (or additional compensation expense) with respect to this option for financial reporting purposes.
- Irrevocable directions to a securities broker approved by the Company to sell all or part of your option shares and to deliver to the Company proceeds from the sale in an amount sufficient to pay the option exercise price and any withholding taxes. (The balance of the sale proceeds, if any, will be delivered to you.) The directions must be given by signing a special “Notice of Exercise” form provided by the Company.

## **Withholding Taxes and Stock Withholding**

You will not be allowed to exercise this option unless you make arrangements acceptable to the Company to pay any withholding taxes that may be due as a result of the option exercise. These arrangements may include (with the Company's approval) withholding shares of Company stock that otherwise would be issued to you when you exercise this option. The value of these shares, determined as of the effective date of the option exercise, will be applied to the withholding taxes.

## **Restrictions on Resale**

By signing this Agreement, you agree not to sell any option shares at a time when applicable laws, Company policies or an agreement between the Company and its underwriters prohibit a sale. This restriction will apply as long as you are an Employee, Consultant or Outside Director of the Company or a Subsidiary.

**Transfer of Option**

Prior to your death, only you may exercise this option. You cannot transfer or assign this option. For instance, you may not sell this option or use it as security for a loan. You may, however, dispose of this option in your will, by the laws of descent and distribution or through a beneficiary designation.

Regardless of any marital property settlement agreement, the Company is not obligated to honor a notice of exercise from your former spouse, nor is the Company obligated to recognize your former spouse's interest in your option in any other way.

**Retention Rights**

Neither your option nor this Agreement gives you the right to be employed or otherwise retained by the Company or a Subsidiary in any capacity. The Company or a Subsidiary reserves the right to terminate your service at any time, with or without cause.

**Stockholder Rights**

You, or your estate or heirs, have no rights as a stockholder of the Company until you have exercised this option by giving the required notice to the Company and paying the exercise price.

**Applicable Law**

This Agreement will be interpreted and enforced under the laws of the State of Colorado (without giving effect to its conflict of laws provisions).

**The Plan and Other Agreements**

The 1997 Stock Incentive Plan is incorporated in this Agreement by reference. Unless otherwise defined herein, all capitalized terms herein have the same defined meanings as in the 1997 Stock Incentive Plan.

This Agreement and the Plan constitute the entire understanding between you and the Company regarding this option. Any prior agreements, commitments or negotiations concerning this option are superseded. This Agreement may be amended only by another written agreement, signed by both parties.

**By signing the notice of stock option grant of this Agreement, you agree to all of the terms and conditions described above and in the 1997 Stock Incentive Plan.**

## Heska Corporation 1997 Stock Incentive Plan

### Stock Option Agreement (Outside Directors)

#### Tax Treatment

This option is intended to be a nonstatutory option.

#### Vesting/ Exercisability

This option is immediately exercisable, but subject to vesting as indicated in the Notice of Stock Option Grant. In the event of termination of your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary, any unvested shares issued upon exercise are subject to repurchase by the Company at the same price as the original Exercise Price Per Share. The Company's right to repurchase such shares shall lapse as the shares become vested as indicated in the Notice of Stock Option Grant.

In addition, this option becomes vested in full if one of the following events occurs:

- Your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary terminates because of death, total and permanent disability, or retirement at or after age 65, or
- The Company is a party to a merger or other reorganization while you are an Employee, Consultant or Outside Director of the Company or a Subsidiary, this option is not continued by the Company and is not assumed by the surviving corporation or its parent, and the surviving corporation or its parent does not substitute its own option for this option, or
- The Company is subject to a "Change in Control" while you are an Employee, Consultant or Outside Director of the Company or a Subsidiary and, your service is terminated either (i) without Cause as part of an agreement which contemplated such Change in Control or (ii) without your consent and without Cause, as defined below. If the surviving entity demotes you to a lower position, materially reduces your authority or responsibilities, materially reduces your total compensation or announces its intention to relocate your principal place of work by more than 20 miles, then that action will be treated as a termination of your service.

"Cause" shall mean (i) your failure to perform your assigned duties or responsibilities as an Employee, Consultant or Outside Director of the Company or a Subsidiary (other than a failure resulting from total and permanent disability, as discussed below) after notice thereof from the Company describing your failure to perform such duties or responsibilities; (ii) your material breach of any confidentiality agreement or invention assignment agreement between you and the Company or a Subsidiary; (iii) your engaging in any act of dishonesty, fraud, misrepresentation, moral turpitude or misappropriation of material

property that was or is materially injurious to the Company or its affiliates; (iv) your violation of any federal or state law or regulation applicable to the Company's business; or (v) your being convicted of, or entering a plea of nolo contendere to, any crime. No additional shares become vested after your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary has terminated for any reason other than those outlined herein.

**Term** This option expires in any event at the close of business at Company headquarters on the day before the 10th anniversary of the Date of Grant, as shown in the Notice of Stock Option Grant. (It will expire earlier if your service terminates, as described below.)

**Regular Termination** If your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary terminates for any reason except death or total and permanent disability, then this option will expire at the close of business at Company headquarters on the date three months after your termination date. The Company determines when your service terminates for this purpose.

**Death** If your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary terminates because of your death, then this option will expire at the close of business at Company headquarters on the date 12 months after the date of death.

**Disability** If your service as an Employee, Consultant or Outside Director of the Company or a Subsidiary terminates because of your total and permanent disability, then this option will expire at the close of business at Company headquarters on the date 12 months after your termination date.

For all purposes under this Agreement, "total and permanent disability" means that you are unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted, or can be expected to last, for a continuous period of not less than one year.

**Restrictions on Exercise** The Company will not permit you to exercise this option if the issuance of shares at that time would violate any law or regulation.

**Notice of Exercise** When you wish to exercise this option, you must notify the Company by filing the proper “Notice of Exercise” form at the address given on the form. Your notice must specify how many shares you wish to purchase. The exercise will be effective when the Company receives the Notice of Exercise with the option exercise payment described herein.

If someone else wants to exercise this option after your death, that person must prove to the Company's satisfaction that he or she is entitled to do so.

**Exercise of Unvested Shares** Exercise of unvested shares is allowed under the Plan. If you would like to exercise your option before it is vested, you must complete a Stock Repurchase Agreement, which provides for the repurchase of that portion of the shares that remain unvested at the time of your termination.

**Form of Payment** When you submit your notice of exercise, you must include payment of the option exercise price for the shares you are purchasing. Payment may be made in one (or a combination of two or more) of the following forms:

- Your personal check, a cashier's check or a money order.
- Certificates for shares of Company stock that you own, along with any forms needed to affect a transfer of those shares to the Company. The value of the shares, determined as of the effective date of the option exercise, will be applied to the option exercise price. However, you may not surrender shares of Company stock in payment of the exercise price if your action would cause the Company to recognize compensation expense (or additional compensation expense) with respect to this option for financial reporting purposes.
- Irrevocable directions to a securities broker approved by the Company to sell all or part of your option shares and to deliver to the Company proceeds from the sale in an amount sufficient to pay the option exercise price and any withholding taxes. (The balance of the sale proceeds, if any, will be delivered to you.) The directions must be given by signing a special “Notice of Exercise” form provided by the Company.

**Withholding Taxes and Stock Withholding** You will not be allowed to exercise this option unless you make arrangements acceptable to the Company to pay any withholding taxes that may be due as a result of the option exercise. These arrangements may include (with the Company's approval) withholding shares of Company stock that otherwise would be issued to you when you exercise this option. The value of these shares, determined as of the effective date of the option exercise, will be applied to the withholding taxes.

**Repurchase Rights** In the event that you exercise unvested shares through the execution of a Stock Repurchase Agreement, the Company will have 90 days to repurchase any shares that remain unvested at the time of your termination. The terms of any such repurchase will be set forth in the Stock Repurchase Agreement.

**Restrictions on Resale** By signing this Agreement, you agree not to sell any option shares at a time when applicable laws, Company policies or an agreement between the Company and its underwriters prohibit a sale. This restriction will apply as long as you are an Employee, Consultant or Outside Director of the Company or a Subsidiary.

**Transfer of Option** Prior to your death, only you may exercise this option. You cannot transfer or assign this option. For instance, you may not sell this option or use it as security for a loan. You may, however, dispose of this option in your will, by the laws of descent and distribution or through a beneficiary designation.

Regardless of any marital property settlement agreement, the Company is not obligated to honor a notice of exercise from your former spouse, nor is the Company obligated to recognize your former spouse's interest in your option in any other way.

**Retention Rights** Neither your option nor this Agreement give you the right to be employed or otherwise retained by the Company or a Subsidiary in any capacity.

**Stockholder Rights** You, or your estate or heirs, have no rights as a stockholder of the Company until you have exercised this option by giving the required notice to the Company and paying the exercise price.



**Applicable Law**

This Agreement will be interpreted and enforced under the laws of the State of Colorado (without giving effect to its conflict of laws provisions).

**The Plan and Other Agreements**

The 1997 Stock Incentive Plan is incorporated in this Agreement by reference. Unless otherwise defined herein, all capitalized terms herein have the same defined meanings as in the 1997 Stock Incentive Plan.

This Agreement and the Plan constitute the entire understanding between you and the Company regarding this option. Any prior agreements, commitments or negotiations concerning this option are superseded. This Agreement may be amended only by another written agreement, signed by both parties.

**By signing the Notice of Stock option Grant of this Agreement, you agree to all of the terms and conditions described above and in the 1997 Stock Incentive Plan.**

**HESKA CORPORATION**  
**2003 EQUITY INCENTIVE PLAN**  
**RESTRICTED STOCK GRANT AGREEMENT**

THIS AGREEMENT is made as of the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_ (the “Grant Date”) by and between Heska Corporation (the “Company”) and \_\_\_\_\_ (the “Executive”).

In consideration of the mutual covenants and representations herein set forth, the Company and Executive agree as follows:

**SECTION 1. GRANT OF STOCK**

1.1 Precedence of Plan. This Agreement is subject to and shall be construed in accordance with the terms and conditions of the Heska Corporation 2003 Equity Incentive Plan (the “Plan”), as now or hereinafter in effect. Any capitalized terms that are used in this Agreement without being defined and that are defined in the Plan shall have the meaning specified in the Plan.

1.2 Grant of Stock. The Company hereby grants to Executive an aggregate of \_\_\_\_\_ shares of Restricted Stock (the “Shares”), subject to vesting as provided in Section 2.

**SECTION 2. UNVESTED SHARES SUBJECT TO FORFEITURE.**

2.1 Shares Subject to Forfeiture. The Shares are subject to time-based and performance-based vesting requirements.

a. The Shares will vest in accordance with the Vesting Schedule attached as Attachment 1, with the performance-based vesting to be tied to one or more of the Company’s annual operating cash flow, annual operating income, annual revenue, stock price level and stock price performance as compared to the S&P 500 Index over a specified time period. The shares will vest or be forfeited in a maximum of seven (7) years.

b. In the event of a Change of Control prior to the vesting of all Shares, any remaining unvested Shares will vest. For this purpose, “Change of Control” means (i) a sale of all or substantially all of the Company's assets, (ii) any merger, consolidation, or other business combination transaction of the Company with or into another corporation, entity, or person, other than a transaction in which the holders of at least a majority of the shares of voting capital stock of the Company outstanding immediately prior to such transaction continue to hold (either by such shares remaining outstanding or by their being converted into shares of voting capital stock of the surviving entity) a majority of the total voting power represented by the shares of voting capital stock of the Company (or the surviving entity) outstanding immediately after such transaction, (iii) the direct or indirect acquisition (including by way of a tender or exchange offer) by any person, or persons acting as a group, of beneficial ownership or a right to acquire beneficial ownership of shares representing a majority of the voting power of the then outstanding shares of capital stock of the Company, (iv) a contested election of Directors, as a result of which or in connection with which the persons who were Directors before such election

or their nominees cease to constitute a majority of the Board, or (v) a dissolution or liquidation of the Company.

c. In the event that Executive's employment with the Company is terminated at least one (1) year following the Grant Date because of either (i) Executive's death or (ii) Executive's Disability, any remaining unvested Shares will vest.

d. In the event that Executive's employment with the Company is terminated prior to the vesting of all Shares for any reason other than death or Disability, Executive will forfeit all right to any unvested Shares. In the event that Executive's employment with the Company is terminated prior to one (1) year following the Grant Date because of either (i) Executive's death or (ii) Executive's Disability, Executive will forfeit all right to any unvested Shares.

2.2 Restriction on Transfer. Until the Shares are vested, the Shares may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated.

### **SECTION 3. STOCKHOLDER RIGHTS**

3.1 Stock Register and Certificates. The Shares will be recorded in the stock register of the Company in the name of Executive. If applicable, a stock certificate or certificates representing the Shares will be registered in the name of Executive, but such certificates shall remain in the custody of the Company. Executive shall deposit with the Company a Stock Assignment Separate from Certificate in the form attached below as Attachment 2, endorsed in blank, so as to permit retransfer to the Company of all or a portion of the Shares that are forfeited or otherwise do not become vested in accordance with the Plan and this Agreement.

3.2 Exercise of Stockholder Rights. Executive shall have the right to vote the Shares (to the extent of the voting rights of said Shares, if any), to receive and retain all regular cash dividends and such other distributions, as the Board of Directors of the Company may, in its discretion, designate, pay or distribute on such Shares, and to exercise all other rights, powers and privileges of a holder of Common Stock with respect to such Shares, except as set forth in this Agreement and the Plan.

3.3 Legends. Certificates, if any, representing the Shares will contain the following or other legends in the Company's discretion:

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS UPON AND OBLIGATIONS WITH RESPECT TO TRANSFER AND RIGHTS OF REPURCHASE AS SET FORTH IN AN AGREEMENT BETWEEN THE COMPANY AND THE ORIGINAL REGISTERED HOLDER, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THE COMPANY.

### **SECTION 4. RESPONSIBILITY FOR TAXES.**

4.1 Section 83(b) Election. Executive may complete and file with the Internal Revenue Service an election pursuant to Section 83(b) of the Internal Revenue Code to be taxed

currently on the fair market value of the Shares without regard to the vesting restrictions set forth in this Agreement. Executive shall be responsible for all taxes associated with the acceptance of the transfer of the Shares, including any tax liability associated with the representation of fair market value if the election is made pursuant to Code Section 83(b).

4.2 Withholding. In accordance with Section 11 of the Plan, Executive agrees to remit to the Company an amount sufficient to satisfy federal, state and local taxes (including the Executive's FICA obligation) required to be withheld with respect to the vesting of the Shares, or otherwise to satisfy such obligation as permitted under the Plan. The Company has the right to deduct from any salary or other payments to be made to Executive any federal, state or local taxes required by law to be so withheld.

**SECTION 5. MISCELLANEOUS.**

5.1 Not an Employment Contract. This Agreement is not an employment contract and nothing in this Agreement shall be deemed to create in any way whatsoever any obligation on the part of Executive to remain in the service of the Company in any capacity, or of the Company to continue Executive's service in any capacity.

5.2 Effect on Employee Benefits. Executive agrees that the Award will constitute special incentive compensation that will not be taken into account as "salary" or "compensation" or "bonus" in determining the amount of any payment under any pension, retirement, profit sharing or other remuneration plan of the Company unless so provided in such plan.

5.3 Further Assurances. The parties agree to execute such further instruments and to take such further action as may reasonably be necessary to carry out the intent of this Agreement.

5.4 Entire Agreement. This Agreement, including any exhibits, is the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior oral and written understandings of the parties.

5.5 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware as applied to contracts between Delaware residents to be wholly performed within the State of Delaware.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

**EXECUTIVE**

**HESKA CORPORATION**

a Delaware corporation

\_\_\_\_\_  
Address \_\_\_\_\_  
\_\_\_\_\_

By: \_\_\_\_\_  
Title: \_\_\_\_\_

# Attachment 1

## VESTING SCHEDULE

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## **Attachment 2**

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**ASSIGNMENT SEPARATE FROM CERTIFICATE**

FOR VALUE RECEIVED, I, \_\_\_\_\_, hereby sell, assign and transfer unto \_\_\_\_\_ (\_\_\_\_\_) shares of the Common Stock of Heska Corporation, standing in my name on the books of said corporation represented by Certificate No. herewith and do hereby irrevocably constitute and appoint \_\_\_\_\_ to transfer said stock on the books of the within-named corporation with full power of substitution in the premises.

Dated: , 20\_.

Signature: \_\_\_\_\_

This Assignment Separate from Certificate was executed in conjunction with the terms of a Restricted Stock Grant Agreement between the above assignor and Heska Corporation, dated \_\_\_\_\_, 20\_\_.

**Instruction:**      **Please do not fill in any blanks other than the signature line.**

**HESKA CORPORATION**  
**2003 EQUITY INCENTIVE PLAN**  
**RESTRICTED STOCK GRANT AGREEMENT**

*(Management Incentive Plan Award)*

THIS AGREEMENT is made as of the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_ (the "Grant Date") by and between Heska Corporation (the "Company") and \_\_\_\_\_ (the "Executive"), in connection with the Executive's election to receive a portion of Executive's award under the \_\_\_\_\_ Management Incentive Plan in the form of Restricted Stock.

In consideration of the mutual covenants and representations herein set forth, the Company and Executive agree as follows:

**SECTION 1. GRANT OF STOCK.**

1.1 Precedence of Plan. This Agreement is subject to and shall be construed in accordance with the terms and conditions of the Heska Corporation 2003 Equity Incentive Plan (the "Plan"), as now or hereinafter in effect. Any capitalized terms that are used in this Agreement without being defined and that are defined in the Plan shall have the meaning specified in the Plan.

1.2 Grant of Stock. The Company hereby grants to Executive an aggregate of \_\_\_\_\_ shares of Restricted Stock (the "Shares"), subject to vesting as provided in Section 2.

**SECTION 2. UNVESTED SHARES SUBJECT TO FORFEITURE.**

2.1 Shares Subject to Forfeiture.

a. The Shares are subject to vesting requirements as established in connection with the Management Incentive Plan, including the terms and conditions for awards made under the \_\_\_\_\_ Management Incentive Plan (the "MIP"). As described in more detail in the MIP, up to 100% of the Shares will vest at the later of the time payments are made under the MIP (the "Payout Time") or one (1) year from the Grant Date, and will vest as determined by dividing \_\_\_% of the Executive's MIP Payout (as defined in the MIP) by \$\_\_\_\_\_, and rounding to the nearest whole Share. Executive will forfeit all Shares that do not vest at that time.

b. In the event that the Executive is an active employee through December 31, \_\_\_\_\_ and at least one (1) year from the Grant Date and Executive's employment with the Company is terminated because of either (i) Executive's death or (ii) Executive's Disability, up to 100% of the Shares will vest at the Payout Time as determined by dividing \_\_\_% of the Executive's MIP Payout (as defined in the MIP) by \$\_\_\_\_\_, and rounding to the nearest whole Share. Executive will forfeit all Shares that do not vest at that time.

c. Except in the cases of (i) either a Change in Control of the Company, the effect of which is governed by the MIP, or (ii) the circumstances described in subsection b. above, which is governed by subsection b. above, in the event that Executive's employment with



the Company is terminated prior to vesting, Executive will forfeit all right to the Shares. For the avoidance of doubt, in the event Executive's employment is terminated due to Executive's death on or before December 31, \_\_\_\_, Executive will forfeit all right to the Shares but this forfeiture is not intended to diminish any MIP Payout to which Executive's designated beneficiary is entitled, as governed by the MIP.

2.2 Restriction on Transfer. Until the Shares are vested, the Shares may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated.

### **SECTION 3. STOCKHOLDER RIGHTS**

3.1 Stock Register and Certificates. The Shares will be recorded in the stock register of the Company in the name of Executive. If applicable, a stock certificate or certificates representing the Shares will be registered in the name of Executive, but such certificates shall remain in the custody of the Company. Executive shall deposit with the Company a Stock Assignment Separate from Certificate in the form attached below as Attachment 1, endorsed in blank, so as to permit retransfer to the Company of all or a portion of the Shares that are forfeited or otherwise do not become vested in accordance with the Plan and this Agreement.

3.2 Exercise of Stockholder Rights. Executive shall have the right to vote the Shares (to the extent of the voting rights of said Shares, if any), to receive and retain all regular cash dividends and such other distributions, as the Board of Directors of the Company may, in its discretion, designate, pay or distribute on such Shares, and to exercise all other rights, powers and privileges of a holder of Common Stock with respect to such Shares, except as set forth in this Agreement and the Plan.

3.3 Legends. Certificates, if any, representing the Shares will contain the following or other legends in the Company's discretion:

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS UPON AND OBLIGATIONS WITH RESPECT TO TRANSFER AND RIGHTS OF REPURCHASE AS SET FORTH IN AN AGREEMENT BETWEEN THE COMPANY AND THE ORIGINAL REGISTERED HOLDER, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THE COMPANY.

### **SECTION 4. RESPONSIBILITY FOR TAXES.**

4.1 Section 83(b) Election. Executive may complete and file with the Internal Revenue Service an election pursuant to Section 83(b) of the Internal Revenue Code to be taxed currently on the fair market value of the Shares without regard to the vesting restrictions set forth in this Agreement. Executive shall be responsible for all taxes associated with the acceptance of the transfer of the Shares, including any tax liability associated with the representation of fair market value if the election is made pursuant to Code Section 83(b).

4.2 Withholding. In accordance with Section 11 of the Plan, Executive agrees to remit to the Company an amount sufficient to satisfy federal, state and local taxes (including the Executive's FICA obligation) required to be withheld with respect to the vesting of the Shares, or

otherwise to satisfy such obligation as permitted under the Plan. The Company has the right to deduct from any salary or other payments to be made to Executive any federal, state or local taxes required by law to be so withheld.

**SECTION 5. MISCELLANEOUS.**

5.1 Not an Employment Contract. This Agreement is not an employment contract and nothing in this Agreement shall be deemed to create in any way whatsoever any obligation on the part of Executive to remain in the service of the Company in any capacity, or of the Company to continue Executive’s service in any capacity.

5.2 Effect on Employee Benefits. Executive agrees that the Award will constitute special incentive compensation that will not be taken into account as “salary” or “compensation” or “bonus” in determining the amount of any payment under any pension, retirement, profit sharing or other remuneration plan of the Company unless so provided in such plan.

5.3 Further Assurances. The parties agree to execute such further instruments and to take such further action as may reasonably be necessary to carry out the intent of this Agreement.

5.4 Entire Agreement. This Agreement, including any exhibits, is the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior oral and written understandings of the parties.

5.5 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware as applied to contracts between Delaware residents to be wholly performed within the State of Delaware.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

**EXECUTIVE**

**HESKA CORPORATION**

a Delaware corporation

\_\_\_\_\_  
Address \_\_\_\_\_  
\_\_\_\_\_

By: \_\_\_\_\_  
Title: \_\_\_\_\_

# Attachment 1

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**ASSIGNMENT SEPARATE FROM CERTIFICATE**

FOR VALUE RECEIVED, I, \_\_\_\_\_, hereby sell, assign and transfer unto \_\_\_\_\_ ( ) shares of the Common Stock of Heska Corporation, standing in my name on the books of said corporation represented by Certificate No. \_\_\_\_\_ herewith and do hereby irrevocably constitute and appoint \_\_\_\_\_ to transfer said stock on the books of the within-named corporation with full power of substitution in the premises.

Dated: , 20\_.

Signature: \_\_\_\_\_

This Assignment Separate from Certificate was executed in conjunction with the terms of a Restricted Stock Grant Agreement between the above assignor and Heska Corporation, dated \_\_\_\_\_, 20\_\_.

**Instruction:**      **Please do not fill in any blanks other than the signature line.**

**HESKA CORPORATION**  
**2003 EQUITY INCENTIVE PLAN**  
**RESTRICTED STOCK GRANT AGREEMENT**

*(Outside Director Award)*

THIS AGREEMENT is made as of the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_ (the “Grant Date”) by and between Heska Corporation (the “Company”) and \_\_\_\_\_ (the “Director”).

In consideration of the mutual covenants and representations herein set forth, the Company and Director agree as follows:

**SECTION 1. GRANT OF STOCK.**

1.1 Precedence of Plan. This Agreement is subject to and shall be construed in accordance with the terms and conditions of the Heska Corporation 2003 Equity Incentive Plan (the “Plan”), as now or hereinafter in effect. Any capitalized terms that are used in this Agreement without being defined and that are defined in the Plan shall have the meaning specified in the Plan.

1.2 Grant of Stock. The Company hereby grants to Director an aggregate of \_\_\_\_\_ shares of Restricted Stock (the “Shares”), subject to vesting as provided in Section 2.

**SECTION 2. UNVESTED SHARES SUBJECT TO FORFEITURE.**

2.1 Shares Subject to Forfeiture.

a. The Shares will vest (the “Vesting Time”) at the latter of (i) the Company’s next Annual Meeting of Stockholders (the “Meeting”) and (ii) the one year anniversary of the Grant Date. In addition, vesting is subject to (i) the Director’s service as a member of the Company’s Board of Directors (the “Board”) through the Vesting Time, unless that Director’s current Board term expires at the Meeting, in which case vesting is subject to the Director’s service as a member of the Company’s Board to the Meeting, and (ii) the Director not engaging in “Competition” prior to the Vesting Time. For purposes of this Agreement, Director will be deemed to have engaged in “Competition” if Director, without the written consent of the Board, directly or indirectly (i) provides services or assistance in any form to any individual, entity, or company providing veterinary products for the companion animal health industry or imaging products or services for the veterinary market (a “Restricted Company”), whether such services or assistance is provided as an employee, consultant, agent, corporate officer, director, or otherwise or (ii) participates in the financing, operation, management, or control of, a Restricted Company. A Restricted Company includes, without limitation, Abaxis, Inc., IDEXX Laboratories, Inc., scil animal health company GmbH (currently a wholly-owned subsidiary of Henry Schein, Inc.), Sound Technologies, Inc. (currently a wholly-owned subsidiary of VCA Inc.), and Synbiotics Corporation (currently a wholly owned subsidiary of Zoetis Inc.). Notwithstanding the foregoing, Director shall not be deemed to be in Competition if Director is

employed or engaged in a corporate function or senior management position (and holding commensurate equity interests) in a division of a Restricted Company, so long as such division is not in any way engaged in providing veterinary products for the companion animal health industry or imaging products or services for the veterinary market and Director does not directly or indirectly provide services or assistance to any division that does provide veterinary products for the companion animal health industry or imaging products or services for the veterinary market.

b. In the event that the Director serves as a member of the Company's Board for at least one (1) year from the Grant Date and Director's service as a member of the Board is subsequently terminated because of either (i) Director's death or (ii) Director's Disability, the Shares will vest at the time the Director's service as a member of the Board terminates. Furthermore, if Director completes his or her Board term at the Meeting and prior to the Vesting Time and does not engage in Competition prior to the Vesting Time, the Shares shall vest at the Vesting Time.

c. Except in the cases of (i) either a Change in Control of the Company, in which case the Shares shall vest, or (ii) the circumstances described in subsection b. above, which is governed by subsection b. above, in the event that Director's service as a member of the Company's Board is terminated prior to vesting, Director will forfeit all right to the Shares.

2.2 Restriction on Transfer. Until the Shares are vested, the Shares may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated.

### **SECTION 3. STOCKHOLDER RIGHTS**

3.1 Stock Register and Certificates. The Shares will be recorded in the stock register of the Company in the name of Director. If applicable, a stock certificate or certificates representing the Shares will be registered in the name of Director, but such certificates shall remain in the custody of the Company. Director shall deposit with the Company a Stock Assignment Separate from Certificate in the form attached below as Attachment 1, endorsed in blank, so as to permit retransfer to the Company of all or a portion of the Shares that are forfeited or otherwise do not become vested in accordance with the Plan and this Agreement.

3.2 Exercise of Stockholder Rights. Director shall have the right to vote the Shares (to the extent of the voting rights of said Shares, if any), to receive and retain all regular cash dividends and such other distributions, as the Board of the Company may, in its discretion, designate, pay or distribute on such Shares, and to exercise all other rights, powers and privileges of a holder of Common Stock with respect to such Shares, except as set forth in this Agreement and the Plan.

3.3 Legends. Certificates, if any, representing the Shares will contain the following or other legends in the Company's discretion:

THE SHARES REPRESENTED BY THIS CERTIFICATE ARE SUBJECT TO CERTAIN RESTRICTIONS UPON AND OBLIGATIONS WITH RESPECT TO TRANSFER AND RIGHTS OF REPURCHASE AS SET FORTH IN AN AGREEMENT BETWEEN THE COMPANY AND THE ORIGINAL

REGISTERED HOLDER, A COPY OF WHICH IS ON FILE AT THE PRINCIPAL OFFICE OF THE COMPANY.

**SECTION 4. RESPONSIBILITY FOR TAXES.**

4.1 Section 83(b) Election. Director may complete and file with the Internal Revenue Service an election pursuant to Section 83(b) of the Internal Revenue Code to be taxed currently on the fair market value of the Shares without regard to the vesting restrictions set forth in this Agreement. Director shall be responsible for all taxes associated with the acceptance of the transfer of the Shares, including any tax liability associated with the representation of fair market value if the election is made pursuant to Code Section 83(b).

4.2 Withholding. In accordance with Section 11 of the Plan, Director agrees to remit to the Company an amount sufficient to satisfy federal, state and local taxes (including the Executive's FICA obligation) required to be withheld with respect to the vesting of the Shares, or otherwise to satisfy such obligation as permitted under the Plan.

**SECTION 5. MISCELLANEOUS.**

5.1 Not an Employment Contract. This Agreement is not an employment contract and nothing in this Agreement shall be deemed to create in any way whatsoever any obligation on the part of Director to remain in the service of the Company in any capacity, or of the Company to continue Director's service in any capacity.

5.2 Further Assurances. The parties agree to execute such further instruments and to take such further action as may reasonably be necessary to carry out the intent of this Agreement.

5.3 Entire Agreement. This Agreement, including any exhibits, is the entire agreement of the parties with respect to the subject matter hereof and supersedes all prior oral and written understandings of the parties.

5.4 Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware as applied to contracts between Delaware residents to be wholly performed within the State of Delaware.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

**DIRECTOR**

**HESKA CORPORATION**

a Delaware corporation

\_\_\_\_\_  
Address \_\_\_\_\_  
\_\_\_\_\_

By: \_\_\_\_\_  
Title: \_\_\_\_\_

# Attachment 1

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**ASSIGNMENT SEPARATE FROM CERTIFICATE**

FOR VALUE RECEIVED, I, \_\_\_\_\_, hereby sell, assign and transfer unto  
\_\_\_\_\_ (\_\_\_\_\_) shares of the Common Stock of Heska Corporation, standing in my name on  
the books of said corporation represented by Certificate No. herewith and do hereby irrevocably constitute and appoint  
\_\_\_\_\_ to transfer said stock on the books of the within-named corporation with full power of substitution in the premises.

Dated: , 20\_.

Signature: \_\_\_\_\_

This Assignment Separate from Certificate was executed in conjunction with the terms of a Restricted Stock Grant Agreement between the above assignor and Heska Corporation, dated \_\_\_\_\_, 20\_\_.

**Instruction:**     **Please do not fill in any blanks other than the signature line.**

## Heska Corporation 2003 Equity Incentive Plan

**Stock Option Agreement  
(employees and consultants)**

<b>Tax Treatment</b>	This option is intended to be an incentive stock option under section 422 of the Internal Revenue Code or a nonstatutory option, as provided in the Notice of Stock Option Grant. To the extent this option is designated an incentive stock option and it does not qualify as an incentive stock option and it does not qualify as an incentive stock option under applicable laws, it will be treated as a nonstatutory option.
<b>Vesting/ Exercisability</b>	<p>This option vests and becomes exercisable in installments, as shown in the Notice of Stock Option Grant. In addition, in the event your service as an Employee, Director or Consultant terminates because of your death or Disability, your option shall become fully vested and exercisable as to the total number of shares subject thereto immediately upon the date of your death or your Termination of Service, as applicable.</p> <p>Except as otherwise provided below following a Change in Control, no additional shares become vested after your Termination of Service and the option shall terminate as to any shares that are unvested as of the end of business on the date of your Termination of Service.</p>
<b>Term</b>	This option expires in any event at the close of business at Company headquarters on the day before the 10th anniversary of the Date of Grant, as shown in the Notice of Stock Option Grant. (It will expire earlier if your service terminates, as described below.)
<b>Regular Termination</b>	In the event of your Termination of Service for any reason except death or Disability, then this option will expire as to unexercised vested option shares at the close of business at Company headquarters on the date three months after your termination date. The Company determines when your service terminates for this purpose.
<b>Death</b>	In the event of your Termination of Service because of your death or your death within three months after your Termination of Service, then this option will expire as to unexercised vested option shares at the close of business at Company headquarters on the date one year after your date of death.
<b>Disability</b>	In the event of your Termination of Service because of your Disability, then this option will expire as to unexercised vested option shares at the close of business at Company headquarters on the date one year after your termination date.
<b>Leaves of Absence</b>	Vesting of this option shall be suspended during any unpaid leave of absence unless continued vesting is required by the terms of the leave or by applicable law.

## **Change in Control**

This option shall vest and become exercisable in full if (i) the Company is subject to a Change in Control, (ii) this option is not continued by the Company and (iii) this option is not either assumed by the surviving corporation or its parent or substituted for by the surviving corporation's or its parent's issuing its own option in replacement of this option. This option shall vest and become exercisable in full if (i) the Company is subject to a Change in Control and (ii) a Termination of Service for you is triggered either (i) without Cause as part of an agreement which contemplated such Change in Control or (ii) without your consent and without Cause. If the surviving corporation or its parent demotes you to a lower position, materially reduces your authority or responsibilities, materially reduces your total compensation or announces its intention to relocate your principal place of work by more than 20 miles, then that action shall be treated as triggering a Termination of Service under this Agreement. For the avoidance of doubt, a refusal by the surviving corporation or its parent to extend a consulting engagement beyond its current term shall not be deemed to trigger any option to vest and become immediately exercisable under this Agreement.

“Cause” shall mean (i) your failure to perform your assigned duties or responsibilities as an Employee, Director or Consultant (other than a failure resulting from death or Disability) after notice thereof from the surviving corporation or its parent describing your failure to perform such duties or responsibilities; (ii) your material breach of any confidentiality agreement or invention assignment between you and the Company or a Subsidiary; (iii) your engaging in any act of dishonesty, fraud, misrepresentation, moral turpitude, or misappropriation of material property that was or is materially injurious to the Company or its Affiliates; (iv) your violation of any federal or state regulation applicable to the Company’s business; or (v) your being convicted of, or entering a plea of nolo contendere to, any crime.

## **Restrictions on Exercise**

The Company will not permit you to exercise this option if the issuance of shares at that time would violate any law or regulation, and the Company will have no liability for failure to issue or deliver any shares upon exercise of this option if the issuance or delivery would violate any law or regulation as determined by the Company in consultation with its legal counsel. This option may not be exercised for a fraction of a share.

## **Notice of Exercise**

When you wish to exercise this option, you must notify the Company by filing the proper “Notice of Exercise” form at the address given on the form. Your notice must specify how many shares you wish to purchase. The exercise will be effective when the Company receives the Notice of Exercise with the option exercise payment described herein.

If someone else wants to exercise this option after your death, that person must prove to the Company's satisfaction that he or she is entitled to do so.

## **Form of Payment**

When you submit your notice of exercise, you must include payment of the option exercise price for the shares you are purchasing. Payment may be made in one (or a combination of two or more) of the following forms:

- Cash, check or wire transfer.
- Certificates for shares of Company stock that you own, along with any forms needed to affect a transfer of those shares to the Company. The value of the shares, determined as of the effective date of the option exercise, will be applied to the option exercise price. However, the Company may restrict your ability to surrender shares of Company stock (including your ability to surrender any particular shares of Company Stock held by you) in payment of the exercise price if your doing so would result in the Company's recognizing additional compensation expense with respect to this option for financial reporting purposes.
- Irrevocable directions to a securities broker approved by the Company to sell all or part of your option shares and to deliver to the Company proceeds from the sale in an amount sufficient to pay the option exercise price and any withholding taxes. (The balance of the sale proceeds, if any, will be delivered to you.) The directions must be given by signing a special "Notice of Exercise" form provided by the Company.

## **Withholding**

### **Taxes and Stock Withholding**

You will not be allowed to exercise this option unless you make arrangements acceptable to the Company to pay any withholding taxes that may be due as a result of the option exercise. These arrangements may include (with the Company's approval) withholding shares of Company stock that otherwise would be issued to you when you exercise this option. The value of these shares, determined as of the effective date of the option exercise, will be applied to the withholding taxes.

## **Restrictions on Resale**

By signing this Agreement, you agree not to sell any option shares at a time when applicable laws, Company policies or an agreement between the Company and its underwriters prohibit a sale. This restriction will apply as long as you are an Employee, Consultant or Director.

## **Transfer of Option**

Prior to your death, only you may exercise this option. You cannot sell, transfer, pledge or assign this option. For instance, you may not sell this option or use it as security for a loan. You may, however, dispose of this option in your will, by the laws of descent and distribution or through a beneficiary designation.

Regardless of any marital property settlement agreement, the Company is not obligated to honor a notice of exercise from your former spouse, nor is the Company obligated to recognize your former spouse's interest in your option in any other way.

**Retention Rights**

Neither your option nor this Agreement gives you the right to be employed or otherwise retained by the Company in any capacity. The Company reserves the right to terminate your service at any time, with or without cause.

**Stockholder Rights**

You, or your estate or heirs, have no rights as a stockholder of the Company until you have exercised this option by giving the required notice to the Company and paying the exercise price.

**Applicable Law**

This Agreement will be interpreted and enforced under the laws of the State of Delaware (without giving effect to its conflict of laws provisions).

**The Plan and Other Agreements**

The Amended and Restated 2003 Equity Incentive Plan (the "Plan") is incorporated in this Agreement by reference. Unless otherwise defined herein, all capitalized terms herein have the same defined meanings as in the Plan. In the event of any conflict between the terms and provisions of the Plan and this Agreement, the Plan terms and provisions shall govern.

This Agreement and the Plan constitute the entire understanding between you and the Company regarding this option. Any prior agreements, commitments or negotiations concerning this option are superseded. This Agreement may be amended only by another written agreement, signed by both parties.

**By signing the notice of stock option grant of this Agreement, you agree to all of the terms and conditions described above and in the Plan.**

**Heska Corporation 2003 Equity Incentive Plan****Non-Qualified Stock Option Agreement  
(Outside Directors)**

<b>Tax Treatment</b>	This option is intended to be a Non-qualified Stock Option and not an Incentive Stock Option under section 422 of the Internal Revenue Code.
<b>Vesting/ Exercisability</b>	<p>This option vests and becomes exercisable in installments, as shown in the Notice of Stock Option Grant. In addition, in the event your service as an Employee, Director or Consultant terminates because of your death, or Disability, this option shall become fully vested and exercisable as to the total number of shares subject thereto immediately upon the date of your death or your Termination of Service, as applicable.</p> <p>Except as otherwise provided below following a Change in Control, no additional shares become vested after your Termination of Service and the option shall terminate as to any shares that are unvested as of the end of business on the date of your Termination of Service.</p>
<b>Term</b>	This option expires in any event at the close of business at Company headquarters on the day before the 10th anniversary of the Date of Grant, as shown in the Notice of Stock Option Grant or as provided in this Agreement or the Amended and Restated 2003 Equity Incentive Plan (the "Plan").
<b>Regular Termination</b>	In the event of your Termination of Service for any reason other than death or Disability, then this option will expire as to unexercised vested option shares at the close of business at Company headquarters on the date three months after your termination date. The Company determines when your service terminates for this purpose.
<b>Death</b>	In the event of your Termination of Service because of your death or your death within three months after your Termination of Service, then this option will expire as to unexercised vested option shares at the close of business at Company headquarters on the date one year after your date of death.
<b>Disability</b>	In the event of your Termination of Service because of your Disability, then this option will expire as to unexercised vested option shares at the close of business at Company headquarters on the date one year after your termination date.
<b>Leaves of Absence</b>	Vesting of this option shall be suspended during any unpaid leave of absence unless continued vesting is required by the terms of the leave or by applicable law.

## Change in Control

This option shall vest and become exercisable in full if (i) the Company is subject to a Change in Control, (ii) this option is not continued by the Company and (iii) this option is not either assumed by the surviving corporation or its parent or substituted for by the surviving corporation's or its parent's issuing its own option in replacement of this option. This option shall vest and become exercisable in full if (i) the Company is subject to a Change in Control and (ii) a Termination of Service for you is triggered either (i) without Cause as part of an agreement which contemplated such Change in Control or (ii) without your consent and without Cause. If the surviving corporation or its parent demotes you to a lower position, materially reduces your authority or responsibilities, materially reduces your total compensation or announces its intention to relocate your principal place of work by more than 20 miles, then that action shall be treated as triggering a Termination of Service under this Agreement. For the avoidance of doubt, a refusal by the surviving corporation or its parent to extend a consulting engagement beyond its current term shall not be deemed to trigger any option to vest and become immediately exercisable under this Agreement.

“Cause” shall mean (i) your failure to perform your assigned duties or responsibilities as an Employee, Director or Consultant (other than a failure resulting from death or Disability) after notice thereof from the surviving corporation or its parent describing your failure to perform such duties or responsibilities; (ii) your material breach of any confidentiality agreement or invention assignment agreement between you and the Company or a Subsidiary; (iii) your engaging in any act of dishonesty, fraud, misrepresentation, moral turpitude, or misappropriation of material property that was or is materially injurious to the Company or its Affiliates; (iv) your violation of any federal or state regulation applicable to the Company's business; of (v) your being convicted of, or entering a plea of nolo contendere to, any crime.

**Restrictions on Exercise**

The Company will not permit you to exercise this option if the issuance of shares at that time would violate any law or regulation, and the Company will have no liability for failure to issue or deliver any shares upon exercise of this option if the issuance or delivery would violate any law or regulation as determined by the Company in consultation with its legal counsel. No shares shall be issued pursuant to this option unless and until any then applicable requirements of state or federal laws and regulatory agencies have been fully complied with to the satisfaction of the Company and its counsel. This option may not be exercised for a fraction of a share.

**Notice of Exercise**

When you wish to exercise this option, you must notify the Company by filing the proper “Notice of Exercise” form at the address given on the form. Your Notice of Exercise must specify how many shares you wish to purchase. The exercise will be effective when the Company receives the Notice of Exercise with the option exercise payment described herein.

If someone else wants to exercise this option after your death, that person must prove to the Company's satisfaction that he or she is entitled to do so.

**Form of Payment**

When you submit your Notice of Exercise, you must include payment of the option exercise price for the shares you are purchasing. Payment may be made in one (or a combination of two or more) of the following forms:

- Cash, check or wire transfer.
- Certificates for shares of Company stock that you own, along with any forms needed to affect a transfer of those shares to the Company. The value of the shares, determined as of the effective date of the option exercise, will be applied to the option exercise price. However, the Company may restrict your ability to surrender shares of Company stock (including your ability to surrender any particular shares of Company Stock held by you) in payment of the exercise price if your doing so would result in the Company's recognizing additional compensation expense with respect to this option for financial reporting purposes.
- Irrevocable directions to a securities broker approved by the Company to sell all or part of your option shares and to deliver to the Company proceeds from the sale in an amount sufficient to pay the option exercise price and any withholding taxes. (The balance of the sale proceeds, if any, will be delivered to you.) The directions must be given by signing a special “Notice of Exercise” form provided by the Company.

**Withholding Taxes and Stock**

You will not be allowed to exercise this option unless you make arrangements acceptable to the Company to pay any withholding taxes that may be due as a result of the option exercise. These arrangements



<b>Withholding</b>	may include (with the Company's approval) withholding shares of Company stock that otherwise would be issued to you when you exercise this option. The value of these shares, determined as of the effective date of the option exercise, will be applied to the withholding taxes.
<b>Restrictions on Resale</b>	By signing this Agreement, you agree not to sell any option shares at a time when applicable laws, Company policies or an agreement between the Company and its underwriters prohibit a sale. This restriction will apply as long as you are an Employee, Consultant or Director.
<b>Transfer of Option</b>	<p>Prior to your death, only you may exercise this option. You cannot sell, transfer, pledge or assign this option. For instance, you may not sell this option or use it as security for a loan. You may, however, dispose of this option in your will, by the laws of descent and distribution or through a beneficiary designation.</p> <p>Regardless of any marital property settlement agreement, the Company is not obligated to honor a notice of exercise from your former spouse, nor is the Company obligated to recognize your former spouse's interest in your option in any other way.</p>
<b>Retention Rights</b>	Neither your option nor this Agreement gives you the right to be employed or otherwise retained by the Company in any capacity. The Company reserves the right to terminate your service at any time, with or without cause.
<b>Stockholder Rights</b>	You, or your estate or heirs, have no rights as a stockholder of the Company until you have exercised this option by giving the required notice to the Company and paying the exercise price.
<b>Applicable Law</b>	This Agreement will be interpreted and enforced under the laws of the State of Delaware (without giving effect to its conflict of laws provisions).
<b>The Plan and Other Agreements</b>	<p>The Plan is incorporated in this Agreement by reference. Unless otherwise defined herein, all capitalized terms herein have the same defined meanings as in the Plan. In the event of any conflict between the terms and provisions of the Plan and this Agreement, the Plan terms and provisions shall govern.</p> <p>This Agreement and the Plan constitute the entire understanding between you and the Company regarding this option. Any prior agreements, commitments or negotiations concerning this option are superseded. This Agreement may be amended only by another written agreement, signed by both parties.</p>

**Acceptance**

You hereby acknowledge receipt of a copy of the Plan and this Agreement. You have read and understand the terms and provisions thereof, and accept this option subject to all the terms and conditions of the Plan and this Agreement. You acknowledge that there may be adverse tax consequences upon exercise of this option or disposition of the underlying shares and that you should consult a tax advisor prior to such exercise or disposition.

**By signing the Notice of Stock Option Grant, you agree to all of the terms and conditions described above and in the Plan.**

## HESKA CORPORATION

### DIRECTOR COMPENSATION POLICY

Non-employee directors of Heska Corporation, a Delaware corporation (the "Company") shall receive the following compensation for their service as a member of the Board of Directors (the "Board") of the Company:

#### **Cash Compensation**

##### *Annual Retainer for General Board Service*

Effective January 1, 2013, each non-employee director shall be entitled to an annual cash retainer in the amount of \$40,000 (the "Annual Retainer"). The Company shall pay the Annual Retainer on a quarterly basis in advance on the first day of the calendar quarter, subject to the non-employee director's continued service to the Company as a non-employee director on such date.

##### *Annual Retainer for Specific Role Service*

Commencing January 1, 2016, any non-employee director who serves in a specified role shall be entitled to an annual cash retainer in an amount specified in the table below (the "Service Retainer"). The Company shall pay each Service Retainer on a quarterly basis in advance on the first day of the calendar quarter, subject to the applicable non-employee director's continued service to the Company in the corresponding role on such date.

<u>Role</u>	<u>Service Retainer</u>
Chair of the Board	\$12,000
Lead Director	\$10,000
Audit Chair	\$20,000
Compensation Chair	\$12,000
Corporate Governance Chair	\$7,500
Audit Member	\$10,000
Compensation Member	\$6,000
Corporate Governance Member	\$3,000

Note: Non-employee directors are not to be paid a Chair and Member fee for service on the same committee.

#### **Equity Compensation**

##### *Annual Award*

Commencing with the 2017 Annual Meeting of Stockholders, each non-employee director elected to the Board and each other continuing non-employee director shall automatically receive an annual grant (the "Annual Grant") of stock valued at \$60,000 (the "Equity Value") based on the fair market value of the Company's common stock at the end of the day of grant which shall be the date of each Company Annual Meeting of Stockholders, subject to such grant covering a maximum of 5,000 shares (the "Share Cap"). Each Annual Grant shall vest (the "Vesting Time") in full on the latter of (i) the one year anniversary of the date of grant and (ii) the Company's Annual Meeting of Stockholders for the year following the

year of grant for the award (the "Vesting Meeting"), subject to (i) the non-employee director's continued service to the Company through the Vesting Time, unless the non-employee director's current term expires at the Vesting Meeting in which case vesting is subject to the non-employee director's service to the Vesting Meeting and (ii) the non-employee director not engaging in "competition", as defined in a restricted stock agreement to be executed by the non-employee director, to the Vesting Time. An Annual Grant may vest early in certain circumstances related to the death or disability of a non-employee director.

#### Initial Award

Beginning on February 23, 2017, any new non-employee directors appointed or elected to our Board between Annual Meetings of Stockholders shall automatically receive a grant of stock (the "Initial Grant") valued at the Equity Value based on the fair market value of the Company's common stock at the end of the day of grant, adjusted pro rata for the time until the next Annual Meeting of Stockholders, subject to the Share Cap adjusted pro rata for the time until the next Annual Meeting of Stockholders. The Initial Grant shall vest (the "Initial Time") in full on the latter of (i) the one year anniversary of the date of grant and (ii) the Company's next Annual Meeting of Stockholders (the "Initial Meeting"), subject to (i) the non-employee director's continued service to the Company through the Initial Time, unless the non-employee director's current term expires at the Initial Meeting in which case vesting is subject to the non-employee director's service to the Initial Meeting and (ii) the non-employee director not engaging in "competition", as defined in a restricted stock agreement to be executed by the non-employee director, to the Initial Time. An Initial Grant may vest early in certain circumstances related to the death or disability of a non-employee director.

#### Provisions Applicable to All Non-Employee Director Option Grants

All grants shall be subject to the terms and conditions of the Company's 1997 Stock Incentive Plan or 2003 Equity Incentive Plan, as applicable, and the terms of the Stock Option Agreement issued thereunder.

For purposes of this Director Compensation Policy, the "value" for Initial Grants and Annual Grants to non-employee directors shall be determined in accordance with the Company's option valuation policy in place at the time of grant for financial reporting purposes.

#### Expense Reimbursement

All non-employee directors shall be entitled to reimbursement from the Company for their reasonable travel (including airfare and ground transportation), lodging and meal expenses incident to meetings of the Board or committees thereof or in connection with other Board related business. The Company shall also reimburse directors for attendance at director continuing education programs that are relevant to their service on the Board and which attendance is pre-approved by the Chair of the Corporate Governance Committee and Chairman of the Board. The Company shall make reimbursement to a non-employee director within a reasonable amount of time following submission by the non-employee director of reasonable written substantiation for the expenses.

*Amended and Restated February 23, 2017*

**SUBSIDIARIES OF COMPANY**

Diamond Animal Health, Inc., an Iowa corporation

Heska Imaging US, LLC, a Delaware Limited Liability Company (54.6% owned)

Heska Imaging International, LLC, a Delaware Limited Liability Company

Heska Imaging Global, LLC, a Delaware Limited Liability Company

Heska AG, a corporation incorporated under the laws of Switzerland

Sensor Devices, Inc., a Wisconsin Corporation (inactive)

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in Heska Corporation's Registration Statements on Form S-8 (File Nos. 333-30951, 333-34111, 333-47129, 333-72155, 333-38138, 333-39448, 333-55112, 333-82096, 333-89738, 333-102871, 333-106679, 333-112701, 333-115995, 333-123196, 333-132916, 333-141737, 333-194120, 333-194122, 333-195734, 333-204036 and 333-211567) of our report dated March 3, 2017, relating to the consolidated financial statements and the effectiveness of internal control over financial reporting of Heska Corporation, which appears in this Annual Report on Form 10-K.

EKS&H LLLP

March 3, 2017  
Denver, Colorado

**CERTIFICATION**

I, Kevin S. Wilson, certify that:

1. I have reviewed this annual report on Form 10-K of Heska Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 3, 2017

/s/ Kevin S. Wilson  
KEVIN S. WILSON  
Chief Executive Officer and President  
(Principal Executive Officer)

**CERTIFICATION**

I, John McMahon, certify that:

1. I have reviewed this annual report on Form 10-K of Heska Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 3, 2017

/s/ John McMahon

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JOHN MCMAHON

Vice President, Chief Financial Officer  
(Principal Financial Officer)



CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Kevin S. Wilson, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of Heska Corporation on Form 10-K for the year ended December 31, 2016 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-K fairly presents in all material respects the financial condition and results of operations of Heska Corporation.

Dated: March 3, 2017

By: /s/ Kevin S. Wilson  
Name: KEVIN S. WILSON  
Title: Chief Executive Officer and President

I, John McMahon, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of Heska Corporation on Form 10-K for the year ended December 31, 2016 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-K fairly presents in all material respects the financial condition and results of operations of Heska Corporation.

Dated: March 3, 2017

By: /s/ John McMahon  
Name: JOHN MCMAHON  
Title: Vice President, Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Heska Corporation and will be retained by Heska Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

