



2017

ANNUAL  
REPORT





## 2017 Heska Corporation Annual Report

This report was finalized on March 23, 2018 and speaks only as of such date or, with respect to historical information (including the financial data included herein), to such earlier date as may be expressly stated. Information contained herein has not been updated for the passage of time or otherwise from such dates.

This report also contains express or implied forward-looking information about the future plans, financial condition and operating performance of Heska Corporation ("Heska") that are not statements of historical fact. These are forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations, and factors that could cause our actual business and financial results to differ materially from those expressed in Heska's forward-looking statements include the following: risks related to relying on historical results to project future performance; uncertainties related to spending in the veterinary marketplace, including during times of economic difficulty; uncertainties related to Heska's ability to sell and market its products in an economically sustainable fashion; uncertainties related to the reputation of Heska and its offerings with Heska's customers and the reputation of third parties which sell Heska's products, including Heska's ability to benefit from such reputations; uncertainties related to the future technical performance of Heska's products; uncertainties related to product development and commercialization, including the risk that a planned product will not perform as anticipated or a new product will not gain the market acceptance anticipated; uncertainties related to Heska's reliance on third-parties to develop and supply certain of its products, which is substantial; uncertainties related to projects for which Heska is working with third-parties, which may or may not come to fruition; and the risks and uncertainties set forth in Heska's filings and future filings with the Securities and Exchange Commission (the "SEC"), including those articulated in Heska's Annual Report on Form 10-K/A for the twelve month period ended December 31, 2017. Heska does not undertake any obligation to update any forward-looking statement except as may be required by law.



March 23, 2018

Dear Shareholder,

The “humanization” of pets is in full swing and Heska is leading by example. We sleep with our pets, we cuddle with our pets, we read, we joke, we hike, we ride, we run, we drive, and we even ski and surf... with our pets. Certain days, we may begin to look more like our pets! Pets are among our best friends, and we, along with millions around the world, deeply care and take responsibility for the wellbeing of our best friends. As pet owners and animators of the global pet healthcare industry, we at Heska are honored to help veterinarians improve pet healthcare outcomes. Because pet patients cannot “speak” about their symptoms, discomfort, or the challenges of aging, Heska is dedicated to providing veterinarians with the advanced point of care diagnostics they need to answer millions of these unspoken questions rapidly, accurately, non-invasively, and cost effectively. This is our mission and each time a Heska point of care laboratory, imaging, allergy, or infectious disease diagnostic is performed, the lives of pets, families, and veterinarians improve.

Heska helped millions of pets in 2017 and was rewarded with very strong financial results for the year. We continued to increase our market share and the number of Heska Reset Subscribers, while achieving full year \$1.30 of earnings per share and record full year gross margins (45%), operating margins (14.1%) and adjusted non-GAAP earnings per share (\$2.07)<sup>(1)</sup>. Importantly, we achieved these results while also providing veterinarians and pet families with the highest-level combination of diagnostics, value, and savings available, leaving them confident and with more money for other important things. I am proud of these results and the savings we provided and am thankful for each Heska employee who worked hard to deliver them; I hope you are as well.

The substantial value-creating work Heska accomplished from 2013 through 2017 improved our base business and has us well positioned for the next strategic cycle. We enter our “second act” of 2018 through 2022 with the strongest pipeline of product upgrades, new product lines, geographic expansion, and strategic partnerships in our history. Fully aware of the strength and size of our competitors, my confidence in Heska to win in this upcoming cycle is firm and I am encouraged by well-informed industry partners and long-term investors who join me in this view. I am optimistic that we can do our work well into this large and healthy market, and I am extraordinarily excited about our prospects. This is the most exciting time to be a Heska stakeholder; we are honored to have you join us in our mission.

Respectfully,



Kevin S. Wilson  
Chief Executive Officer and President

<sup>(1)</sup> See “Use of Non-GAAP Financial Measure” and related appendix included in Heska’s earnings release dated February 28, 2018 and furnished with the SEC under cover of Form 8-K on February 28, 2018 for a definition and reconciliation to its most directly comparable GAAP financial measure of this non-GAAP financial measure.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

**OPINIONS ON THE CONSOLIDATED FINANCIAL STATEMENTS AND INTERNAL CONTROL OVER FINANCIAL REPORTING**

We have audited the accompanying consolidated balance sheets of Heska Corporation and Subsidiaries (the "Company") as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows, for each year in the three-year period ended December 31, 2017, and the related notes (collectively referred to as the "financial statements"). We have also audited the Company's internal control over financial reporting as of December 31, 2017, based on the criteria established in *Internal Control - Integrated Framework: (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each year in the three-year period ended December 31, 2017, 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, 2017, based on criteria established in *Internal Control - Integrated Framework: (2013)* issued by COSO.

**BASIS FOR OPINIONS**

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. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the US federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. 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.

### **DEFINITION AND LIMITATIONS OF INTERNAL CONTROL OVER FINANCIAL REPORTING**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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.

*EKS+H LLLP*

EKS&H LLLP

March 19, 2018  
Denver, Colorado

We have served as the Company's auditor since 2006.



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

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 9,659	\$ 10,794
Accounts receivable, net of allowance for doubtful accounts of \$215 and \$237, respectively	15,710	20,857
Due from – related parties	1	100
Inventories, net	32,596	20,395
Lease receivable, current	2,069	825
Other current assets	2,877	2,302
Total current assets	<u>62,912</u>	<u>55,273</u>
Property and equipment, net	17,331	16,581
Goodwill	26,687	26,647
Other intangible assets, net	1,958	2,346
Deferred tax asset, net	11,877	21,122
Lease receivable, non-current	9,615	4,833
Other non-current assets	5,407	4,042
Total assets	<u>\$ 135,787</u>	<u>\$ 130,844</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 9,489	\$ 6,343
Due to – related party	1,828	1,578
Accrued liabilities	4,417	5,581
Current portion of deferred revenue	3,992	3,560
Obligation to purchase minority interest	—	14,602
Line of credit and other short-term borrowings	6,000	750
Total current liabilities	<u>25,726</u>	<u>32,414</u>
Deferred revenue, net of current portion, and other	9,621	11,455
Total liabilities	<u>35,347</u>	<u>43,869</u>
Commitments and contingencies (Note 11)		
Stockholders' equity:		
Preferred stock, \$.01 par value, 2,500,000 shares authorized, none issued or outstanding	—	—
Common stock, \$.01 par value, 10,000,000 shares authorized, none issued or outstanding	—	—
Public common stock, \$.01 par value, 10,000,000 shares authorized, 7,302,954 and 7,026,051 shares issued and outstanding, respectively	73	70
Additional paid-in capital	243,598	238,635
Accumulated other comprehensive income	232	97
Accumulated deficit	(143,463)	(151,827)
Total stockholders' equity	<u>100,440</u>	<u>86,975</u>
Total liability and stockholders' equity	<u>\$ 135,787</u>	<u>\$ 130,844</u>

See accompanying notes to consolidated financial statements.

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

(in thousands, except per share amounts)

	<b>Year Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Revenue:			
Core companion animal health	\$ 105,191	\$ 107,398	\$ 84,249
Other vaccines, pharmaceuticals and products	24,150	22,685	20,348
Total revenue, net	<u>129,341</u>	<u>130,083</u>	<u>104,597</u>
Cost of revenue	<u>71,080</u>	<u>76,191</u>	<u>60,384</u>
Gross profit	<u>58,261</u>	<u>53,892</u>	<u>44,213</u>
Operating expenses:			
Selling and marketing	23,225	22,092	21,339
Research and development	2,004	2,147	1,658
General and administrative	14,813	13,120	12,659
Total operating expenses	<u>40,042</u>	<u>37,359</u>	<u>35,656</u>
Operating income	<u>18,219</u>	<u>16,533</u>	<u>8,557</u>
Interest and other (income) expense, net	(150)	29	130
Income before income taxes	<u>18,369</u>	<u>16,504</u>	<u>8,427</u>
Income tax expense:			
Current income tax expense	49	407	1,581
Deferred income tax expense	8,864	3,932	1,327
Total income tax expense	<u>8,913</u>	<u>4,339</u>	<u>2,908</u>
Net income	<u>9,456</u>	<u>12,165</u>	<u>5,519</u>
Net (loss) income attributable to non-controlling interest	(497)	1,657	280
Net income attributable to Heska Corporation	<u>\$ 9,953</u>	<u>\$ 10,508</u>	<u>\$ 5,239</u>
Basic earnings per share attributable to Heska Corporation	<u>\$ 1.42</u>	<u>\$ 1.55</u>	<u>\$ 0.80</u>
Diluted earnings per share attributable to Heska Corporation	<u>\$ 1.30</u>	<u>\$ 1.43</u>	<u>\$ 0.74</u>
Weighted average outstanding shares used to compute basic earnings per share attributable to Heska Corporation	<u>7,026</u>	<u>6,783</u>	<u>6,509</u>
Weighted average outstanding shares used to compute diluted earnings per share attributable to Heska Corporation	<u>7,642</u>	<u>7,361</u>	<u>7,074</u>

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2017	2016	2015
Net income	\$ 9,456	\$ 12,165	\$ 5,519
Other comprehensive income (loss):			
Minimum pension liability	12	75	(129)
Sale of equity investment	—	(90)	44
Foreign currency translation	123	(75)	(11)
Comprehensive income	<u>9,591</u>	<u>12,075</u>	<u>5,423</u>
Comprehensive (loss) income attributable to non-controlling interest	(497)	1,657	280
Comprehensive income attributable to Heska Corporation	<u>\$ 10,088</u>	<u>\$ 10,418</u>	<u>\$ 5,143</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, 2015	6,342	\$ 63	\$ 222,297	\$ 283	\$ (169,511)	\$ 53,132
Net income	—	—	—	—	5,519	5,519
Issuance of common stock, net of shares withheld for employee taxes	283	3	1,255	—	—	1,258
Stock-based compensation	—	—	2,269	—	—	2,269
Excess tax benefit from stock-based compensation	—	—	1,514	—	—	1,514
Accretion of non-controlling interest	—	—	(68)	—	—	(68)
Other comprehensive income (loss)	—	—	—	(96)	—	(96)
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, net of shares withheld for employee taxes	226	2	1,616	—	—	1,618
Stock-based compensation	—	—	2,260	—	—	2,260
Accretion of non-controlling interest	—	—	1,145	—	—	1,145
Other comprehensive income (loss)	—	—	—	(90)	—	(90)
Balances, December 31, 2016	7,026	\$ 70	\$ 238,635	\$ 97	\$ (151,827)	\$ 86,975
Net income	—	—	—	—	9,456	9,456
Issuance of common stock, net of shares withheld for employee taxes	277	3	1,373	—	—	1,376
Stock-based compensation	—	—	2,745	—	—	2,745
Accretion of non-controlling interest	—	—	845	—	—	845
Distribution for Heska Imaging minority	—	—	—	—	(1,092)	(1,092)
Other comprehensive income (loss)	—	—	—	135	—	135
Balances, December 31, 2017	7,303	\$ 73	\$ 243,598	\$ 232	\$ (143,463)	\$ 100,440

See accompanying notes to consolidated financial statements.

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

	<b>Year Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 9,456	\$ 12,165	\$ 5,519
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	4,754	4,645	4,187
Deferred income tax expense	8,864	3,932	1,327
Stock-based compensation	2,745	2,260	2,269
Other (gain) loss	(46)	(3)	36
Changes in operating assets and liabilities:			
Accounts receivable	5,156	(4,700)	(4,216)
Inventories	(13,834)	(4,731)	(7,240)
Due from related parties	99	(59)	851
Lease receivable, current	(1,244)	(736)	(89)
Other current assets	(469)	883	(1,000)
Accounts payable	3,143	(688)	3,059
Due to related parties	250	1,356	(30)
Accrued liabilities and other	(1,293)	(351)	73
Lease receivable, non-current	(4,782)	(3,867)	(967)
Other non-current assets	(989)	(1,951)	(1,463)
Deferred revenue and other	(1,401)	(2,300)	(191)
Net cash provided by operating activities	<u>10,409</u>	<u>5,855</u>	<u>2,125</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from sale of equity investment	—	115	—
Purchase of minority interest	(13,757)	—	—
Purchases of property and equipment	(3,469)	(3,417)	(3,773)
Proceeds from disposition of property and equipment	57	—	—
Net cash used in investing activities	<u>(17,169)</u>	<u>(3,302)</u>	<u>(3,773)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from issuance of common stock	2,452	2,382	2,143
Repurchase of common stock	(1,076)	(762)	(885)
Distributions to non-controlling interest members	(965)	—	—
Proceeds from line of credit borrowings	40,307	34,792	26,809
Repayments of line of credit borrowings	(34,979)	(34,262)	(26,714)
Repayments of other debt	(68)	(747)	(141)
Payment of debt issuance costs	(120)	—	—
Excess tax benefit from stock-based compensation	—	—	1,514
Net cash provided by financing activities	<u>5,551</u>	<u>1,403</u>	<u>2,726</u>
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH	74	(52)	(43)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,135)	3,904	1,035
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	10,794	6,890	5,855
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 9,659</u>	<u>\$ 10,794</u>	<u>\$ 6,890</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 subsidiaries ("Heska", the "Company", "we" or "our") sell veterinary and animal health diagnostic and specialty products. Our offerings include point of care diagnostics laboratory instruments and supplies, digital imaging diagnostics 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 and Consolidation*

Our consolidated financial statements include our accounts and the accounts of our wholly-owned subsidiaries since their respective dates of acquisitions. All intercompany accounts and transactions have been eliminated in consolidation. Where our ownership of a subsidiary was 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 ("US GAAP").

*Reclassification*

To maintain consistency and comparability, certain amounts in the financial statements have been reclassified to conform to current year presentation.

*Use of Estimates*

The preparation of financial statements in conformity with US 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 future costs associated with warranties provided, 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, estimating the useful lives of equipment under leasing arrangements, determining the allocation of purchase price under purchase accounting, estimating the expense associated with the granting of stock options, 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.



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

Henry Schein represented 16% of our consolidated accounts receivable at December 31, 2017 and 2016. Merck entities represented approximately 15% and 11% of our consolidated accounts receivable at December 31, 2017 and 2016, respectively. DLL represented 11% and 18% of our consolidated accounts receivable at December 31, 2017 and 2016, respectively. Eli Lilly entities, including Elanco, represented approximately 3% and 15% of our consolidated accounts receivable at December 31, 2017 and 2016, respectively. No other customer accounted for more than 10% of our consolidated accounts receivable at December 31, 2017 or 2016.

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):

	<b>Years Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Balances at beginning of period	\$ 237	\$ 189	\$ 216
Additions - charged to expense	168	163	83
Deductions - write offs, net of recoveries	(190)	(115)	(110)
Balances at end of period	<u>\$ 215</u>	<u>\$ 237</u>	<u>\$ 189</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 1,077,787 and 2,778,614 Euros at December 31, 2017 and 2016, respectively. We held 0 and 1,252,221 Yen at December 31, 2017 and 2016, respectively. We held 80,459 and 172,743 Swiss Francs at December 31, 2017 and 2016, respectively. We held 0 and 26,477 Canadian Dollars at December 31, 2017 and 2016, respectively. The majority of our cash and cash equivalents are held at US-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

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

similar debt with similar maturities and collateral, and at December 31, 2017 and 2016, 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.

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

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Raw materials	\$ 18,465	\$ 10,807
Work in process	4,296	3,820
Finished goods	11,465	7,087
Allowance for excess or obsolete inventory	(1,630)	(1,319)
	<u>\$ 32,596</u>	<u>\$ 20,395</u>

*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:

<b>Asset Classification</b>	<b>Estimated Useful Life</b>
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, which range from three to five years. Costs incurred during the preliminary project 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 estimated fair value of the reporting unit is less than its carrying amount as a basis for determining whether it

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

is necessary to perform the comparison of the estimated fair value of the reporting unit to the carrying value. 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 it is more likely than not that the estimated fair value of a reporting unit is less than its carrying amount, we would then estimate the fair value of the reporting unit and compare it to the carrying value. If the carrying value exceeds the estimated fair value we would recognize an impairment for the difference; 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 quantitative analysis. Doing so does not preclude us from performing the qualitative assessment in any subsequent period.

In the fourth quarter of 2017, we performed a qualitative assessment of the goodwill residing within the assets of our CCA segment, also determined to be a reporting unit, and determined that no indications of impairment existed.

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, either by outright purchase by our customers or through a subscription agreement whereby our customers receive equipment and pay us a monthly fee for the usage of the equipment as well as, when applicable, the consumables needed to conduct testing. Outright sales to customers is the majority of imaging diagnostics transactions, while subscription placement is the majority of point of care diagnostics laboratory transactions. We also may recognize revenue 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 outright sale of products to customers 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. Distributor rebates are recorded as a reduction to revenue.



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

Revenue from our subscription agreements is recognized based on the length of the agreements that are signed by our customers. Among other factors, the length of the agreement determines whether a subscription is considered an operating lease or capital lease. Our capital leases qualify for sales-type lease treatment. For subscription agreements that are considered operating leases, we recognize revenue of our subscriptions ratably over the term of the agreement. The equipment is transferred from inventory to property, plant and equipment and depreciated into cost of revenue over the term of the agreement, based on the assets' useful life. Revenue from subscription agreements that are sales-type (capital) leases is recognized, along with the associated cost of the equipment, at the time of placement in our customer's location. The amount of revenue recognized at the time of lease inception is based on, along with other factors, observable prior sales prices of similar equipment sold by us over the prior twelve months, relative to total contract value. We record a short and long-term capital lease receivable related to sales-type leases.

Revenue from our rentals of digital imaging equipment is recognized ratably over the term of the rental agreement, which is typically over a 26-month period. The equipment is transferred from inventory to property, plant and equipment and depreciated over the assets' useful life.

Recording revenue from the sale of products involves the use of estimates and management's 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 obligations 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 enter into arrangements that include multiple elements. 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.

*Stock-based Compensation*

Stock-based compensation expense is measured at the grant date based upon the estimated fair value of the portion of the award that is ultimately expected to vest and is recognized as expense over the applicable vesting period of the award generally using the straight-line method.

**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 each of the years ended December 31, 2017 and 2016, and \$0.1 million for the year ended December 31, 2015.

*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, including the current year impact of the enacted 21% US corporate income tax rate under the Tax Cuts and Jobs Act, 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.

*Earnings Per Share*

Basic earnings per share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding during the period increased to include the number of additional shares of common stock that would have been outstanding if the potentially dilutive securities had been issued.

*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 related to shipping and handling are classified as revenue. Shipping and handling costs incurred by us for the delivery of products to customers are classified as cost of revenue.

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

*Warranty Costs*

The Company generally provides for the estimated cost of hardware and software warranties in the period the related revenue is recognized. The Company assesses the adequacy of its accrued warranty liabilities and adjusts the amounts as necessary based on actual experience and changes in future estimates. Should product failure rates differ from our estimates, actual costs could vary significantly from our expectations.

*Adoption of New Accounting Pronouncements*

In May 2017, the Financial Accounting Standards Board ("FASB") issued ASU 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting." ASU 2017-09 was issued to provide clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718 to a change in the terms or conditions of a share-based payment award. ASU 2017-09 provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting under Topic 718. The amendments in ASU 2017-09 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period. The amendments in ASU 2017-09 should be applied prospectively to an award modified on or after the adoption date. Heska adopted the new guidance in its second quarter of fiscal year 2017.

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment," to simplify financial reporting by eliminating the need to determine the fair value of individual assets and liabilities of a reporting unit to measure goodwill impairment. Under ASU 2017-04, an entity should perform its goodwill impairment test by comparing the fair value of the reporting unit with its carrying amount and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, up to the amount of goodwill allocated to that reporting unit. The new guidance effectively eliminates "Step 2" from the previous goodwill impairment test. ASU 2017-04 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. Early adoption is permitted for goodwill impairment tests performed on testing dates after January 1, 2017. Heska adopted the new guidance in its fourth quarter of fiscal year 2017 when it performed its annual goodwill impairment test as of December 15, 2017.

*Accounting Pronouncements Not Yet Adopted*

In February 2018, the FASB issued ASU 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income". The ASU permits companies to elect a reclassification of disproportionate tax effects in accumulated other comprehensive income (AOCI) caused by the Tax Cuts and Jobs Act of 2017 to retained earnings. The ASU also requires additional disclosures. This update is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, with early adoption permitted. We are currently evaluating the effect of this ASU on our consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses (Topic 326)", which require that financial assets measured at amortized cost be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset to present the net carrying value at the amount expected to be collected. The income statement reflects the measurement of credit losses for newly recognized financial assets, as well as the increases or decreases of expected credit losses that have taken place during the period. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The amendments in this update are effective for



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

fiscal years beginning after December 15, 2019 and interim periods within those annual periods. Early adoption for fiscal year beginning after December 15, 2018 is permitted.

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. The accounting for lessors does not fundamentally change except for changes to conform and align guidance to the lessee guidance as well as to the new revenue recognition guidance in ASU 2014-09. This update is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. 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 May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" and has subsequently issued several supplemental and/or clarifying ASUs (collectively "ASC 606"). ASC 606 prescribes a single common revenue standard that replaces most existing US GAAP revenue recognition guidance. ASC 606 outlines a five-step model, under which Heska will recognize revenue as performance obligations within a customer contract are satisfied. ASC 606 is intended to provide more consistent interpretation and application of the principles outlined in the standard across filers in multiple industries and within the same industries compared to current practices, which should improve comparability. Along with the issuance of ASC 606, additional cost guidance was issued and codified under ASC 340-40 that outlines the requirement for capitalizing incremental costs of obtaining a contract and costs to fulfill a contract that meet certain capitalization criteria.

Adoption of ASC 606 is required for annual reporting periods beginning after December 15, 2017, including interim periods within the reporting period. Upon adoption, Heska must elect to adopt either retrospectively to each prior reporting period presented (full retrospective method) or using the cumulative effect transition method with the cumulative effect of initial adoption recognized at the date of initial application (modified retrospective method). Heska has elected to adopt the modified retrospective method and apply this method to contracts not yet completed as of January 1, 2018. The cumulative effect of initially applying the new revenue standard is recognized as an adjustment to the opening balance of our fiscal year 2018 retained earnings. The comparative information will not be recast and will continue to be reported under the accounting standards in effect for those periods.

Heska assessed the impact that the adoption of ASC 606 is expected to have on its Consolidated Financial Statements by analyzing its current portfolio of customer contracts and various revenue streams, including a review of historical accounting policies and practices to identify potential differences in applying the guidance of ASC 606. Heska also performed a comprehensive review of its current processes and systems to determine and implement changes required to support the adoption of ASC 606 on January 1, 2018.

Based on review of customer contracts within our Core Companion Animal ("CCA") segment, Heska has determined the timing of revenue recognition of our product sales, which includes upfront equipment sales and sales of consumables, will continue to be recognized as it is currently, generally upon shipment of products. Also included within CCA are our subscription agreements, which contain a lease of equipment, for which rental income will continue to be recognized under ASC 840, Leases, unless the equipment is considered a sales-type lease, which revenue will be recognized under ASC 606 at the point of sale.

Based on review of customer contracts within our Other Vaccines, Pharmaceuticals, and Products segment, Heska has determined that the timing of revenue recognition of our customer contracts will continue

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

to be recognized as it is currently - generally upon shipment or acceptance by our customer. Heska assessed the over-time criteria within ASC 606 and concluded that because products within this segment have no alternative use to Heska as Heska is contractually prohibited to redirect the product to other customers, Heska does not have right to payment for performance to date and therefore, point in time recognition is appropriate.

Often our contracts contain multiple performance obligations to which the transaction price must be allocated. The objective when allocating the transaction price is to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer. To accomplish this objective, Heska will allocate transaction price on a relative standalone selling price basis (SSP) and where SSP is not readily observable, Heska will generally utilize expected cost-plus-a-margin approach. All of the individual performance obligations, including equipment, consumables, and services are sold separately, and therefore, observable prices are available.

Because a significant number of Heska's customers are under noncancelable contracts for periods extending beyond one year with the delivery of goods and services occurring throughout the duration, Heska anticipates recording an asset related to the prepayment of such contract acquisition costs. In addition, ASC 606 states that "an asset recognized in accordance with the incremental costs of obtaining a contract shall be amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates." Because a significant number of Heska's customers are under noncancelable contracts for periods extending beyond one year with the delivery of goods and services occurring throughout the duration, Heska anticipates recording an asset related to the prepayment of such contract acquisition costs.

We expect the impact of the adoption of the new standard will result in an adjustment to the recognition of software support revenue, which historically has been a separate element however this has been deemed to be an immaterial promise and therefore, previously deferred revenue relating to software support will be recognized at point of sale along with the equipment and embedded software. The adoption of the new standard will also impact the recognition of sales commissions. Previously, sales commissions were expensed when the underlying contract was executed, which will now be recognized as a cost to acquire a contract and amortized over its useful life. Finally, the new standard will impact the recognition of revenue associated with certain bill and hold arrangements. Previously, we deferred revenue recognition until shipment, which will now be recognized upon customer acceptance. We are finalizing the quantitative impact of these changes.

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

### *Cuatro Veterinary, LLC*

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 liabilities assumed at their estimated fair values. Intangible assets were valued based on a report from an independent third party. The goodwill associated with the acquisition is the result of expected synergies and expansion of the technology into additional markets.

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
<b>Total fair value of consideration transferred</b>	<b>\$</b>	<b>7,882</b>

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)
<b>Total fair value of consideration transferred</b>	<b>\$</b>	<b>7,882</b>

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

	<b>Useful Life</b>	<b>Amortization Method</b>	<b>Fair Value</b>
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 point of care laboratory 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 CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

Heska Imaging US, LLC ("US Imaging") was transferred to the Company's wholly-owned subsidiary, Heska Imaging Global, LLC ("Global Imaging").

*Cuatro Veterinary USA, LLC*

On February 24, 2013, the Company acquired a 54.6% interest in Cuatro Veterinary USA, LLC (the "Acquisition"), which was subsequently renamed Heska Imaging US, LLC ("US Imaging"). The remaining minority position (45.4)% in US Imaging was subject to purchase by Heska under performance-based puts and calls following the audit of our financial statements for 2016 and 2017. The required performance criteria were met in 2016, we considered notice given on March 3, 2017 that the put option was being exercised and on May 31, 2017, we delivered \$13.8 million in cash to obtain the remaining minority position in US Imaging.

Prior to the purchase of the minority position (the "Imaging Minority"), Shawna M. Wilson, Clint Roth, DVM, Steven M. Asakowicz, Rodney A. Lippincott, Kevin S. Wilson and Cuatro, LLC owned 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. On April 3, 2017, and in accordance with the terms of its Operating Agreement, US Imaging distributed \$2.1 million based on past operating performance, including \$1.0 million to its minority interest members. As of December 31, 2017, US Imaging accrued an additional \$0.3 million distribution, including \$0.1 million to its minority interest members.

On June 1, 2017, the Company consolidated its assets and liabilities in the US Imaging and International Imaging companies into Global Imaging, which was re-named Heska Imaging, LLC ("Heska Imaging").

*Related Party Activities*

Cuatro, LLC charged Heska Imaging \$17.7 million, \$14.5 million, and \$9.0 million during 2017, 2016, and 2015, respectively, 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 Cuatro, LLC \$0.1 million, \$0.2 million, and \$0.2 million in the years ended December 31, 2017, 2016, and 2015, respectively, primarily related to facility usage and other services.

Heska Corporation had a receivable from Cuatro, LLC of \$1 thousand and \$22 thousand as of December 31, 2017 and 2016, respectively which is included in "Due from - related parties" on the Company's consolidated balance sheet. Heska Imaging had a receivable from Cuatro, LLC of \$0 thousand and \$78 thousand as of December 31, 2017 and 2016, respectively. Heska Imaging owed Cuatro \$1.7 million as of December 31, 2017, and Global Imaging owed Cuatro \$1.6 million as of December 31, 2016, which is included in "Due to- related parties" on the Company's consolidated balance sheets.

Heska Corporation charged US Imaging \$2.9 million from January 1, 2017 to May 31, 2017, prior to the acquisition of the minority interest, and \$5.3 million and \$4.9 million for the years ended December 31, 2016, and 2015, respectively, for sales and other administrative related expenses. At December 31, 2016, US Imaging had a \$1.6 million note receivable, including accrued interest, from International Imaging, which was due on June 15, 2019 and which eliminated in consolidation of the Company's financial statements. As of June 1, 2017, the \$0.3 million remaining balance of the note was eliminated in the consolidation of the imaging companies into Heska Imaging. At December 31, 2016, Heska Corporation had accounts receivable from US Imaging of \$5.6 million, including accrued interest, and Global Imaging had net prepaid receivables

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

from US Imaging of \$1.2 million, all of which eliminated in consolidation of the Company's financial statements.

**3. INCOME TAXES**

*Income Taxes*

As of December 31, 2017, the Company had a domestic federal net operating loss carryforward ("NOL"), of approximately \$94.0 million and a domestic research and development tax credit carryforward of approximately \$0.4 million. Our federal NOL is expected to expire as follows if unused: \$88.0 million in 2018 through 2022, \$5.5 million in 2024 and 2025 and \$0.5 million in 2027 and later. The Tax Cuts and Jobs Act repealed the corporate alternative minimum tax credit and made refundable all carryforward amounts in years 2018-2021. As a result, the alternative minimum tax credit of \$0.5 million has been reclassified from a deferred tax asset to a non-current federal income tax asset.

The Company is subject to income taxes in the US 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. In the United States, the tax years 2014 - 2016 remain open to examination by the Internal Revenue Service and the tax years 2013 - 2016 remain open for various state taxing authorities.

Cash paid for income taxes for the years ended December 31, 2017, 2016, and 2015 was \$213 thousand, \$357 thousand and \$55 thousand, respectively.

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

	<b>Year Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Domestic	\$ 18,188	\$ 16,375	\$ 8,325
Foreign	181	129	102
	<u>\$ 18,369</u>	<u>\$ 16,504</u>	<u>\$ 8,427</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):

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Inventory	\$ 1,321	\$ 1,172
Accrued compensation	103	114
Stock options	914	811
Research and development	442	438
Alternative minimum tax credit	—	543
Deferred revenue	2,002	2,934
Property and equipment	2,531	2,750
Net operating loss carryforwards – domestic	22,627	34,706
Foreign tax credit carryforward	54	—
Capital leases	(3,757)	(2,833)
Unremitted earnings for controlled foreign corporations	(50)	—
Other	194	34
	<u>26,381</u>	<u>40,669</u>
Valuation allowance	(14,504)	(19,547)
Total net deferred tax assets	<u>\$ 11,877</u>	<u>\$ 21,122</u>

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

	<b>Year Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
<b>Current income tax expense:</b>			
Federal	\$ —	\$ 197	\$ 1,492
State	6	179	65
Foreign	43	31	24
Total current expense	<u>\$ 49</u>	<u>\$ 407</u>	<u>\$ 1,581</u>
<b>Deferred income tax expense (benefit):</b>			
Federal	\$ 9,736	\$ 3,545	\$ 1,043
State	(872)	387	284
Foreign	—	—	—
Total deferred expense	<u>8,864</u>	<u>3,932</u>	<u>1,327</u>
Total income tax expense	<u>\$ 8,913</u>	<u>\$ 4,339</u>	<u>\$ 2,908</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:

	<b>Year Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Statutory federal tax rate	34 %	34 %	34 %
State income taxes, net of federal benefit	(5)%	2 %	3 %
Non-controlling interest in Heska Imaging US, LLC	1 %	(3)%	(1)%
Non-temporary stock option benefit	(30)%	(7)%	(1)%
Other permanent differences	1 %	(1)%	— %
Change in tax rate	32 %	— %	(1)%
Change in valuation allowance	16 %	— %	(14)%
Other	— %	1 %	15 %
Effective income tax rate	<u>49 %</u>	<u>26 %</u>	<u>35 %</u>

In 2017, we had total income tax expense of \$8.91 million, including \$8.86 million in domestic deferred income tax expense, a non-cash expense, and \$0.05 million in current 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 expense, 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 expense, and \$1.6 million in current income tax expense. The overall increase in tax expense in 2017 from 2016 was due to the re-measurement of our deferred tax assets (including the valuation allowance) due to the US Tax Cuts and Jobs Act, offset by the reduction of tax expense from stock based compensation deductions. Income tax expense increased in 2016 from 2015 as a result of higher income before taxes in 2016.

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, 2017, 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 (benefit)/expense. No interest and penalties related to uncertain tax positions were accrued at December 31, 2017.

*US Tax Reform*

On December 22, 2017, the tax legislation commonly known as the US Tax Cuts and Jobs Act was signed into law (the "Act"). This enactment resulted in a number of significant changes to US federal income tax law for US corporations. Most notably, the statutory US federal corporate income tax rate was changed from 35% to 21% for corporations. In addition to the change in the corporate income tax rate, the Act further introduced a number of other changes including a one-time transition tax via a mandatory deemed repatriation of post-1986 undistributed foreign earnings and profits; the introduction of a tax on global intangible low-taxed income ("GILTI") for tax years beginning after December 31, 2017; the further limitation of the deductibility of share-based compensation of certain highly compensated employees; and the repeal of the corporate alternative minimum tax; amongst other things.

Shortly after enactment, the Security and Exchange Commission ("SEC") issued SAB 118, which provides guidance on accounting for the new legislation. Under SAB 118, an entity should recognize amounts for which accounting can be completed. Where accounting under ASC 740 is incomplete relative to



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certain income tax effects of tax reform, the entity should recognize provisional amounts and adjust such amounts as more information becomes available and disclose this information in its financial statements. The measurement period under SAB 118 is one year from date of enactment (with the approach being similar to business combinations).

Heska has determined the estimated tax impact of the Act by using the most reliable data available in accordance with SAB 118. Specifically, at the time the estimated tax reform impact was performed, only the Final Bill itself and Notice 2018-07 had been released to provide guidance. Therefore, reasonable approaches and considerations were performed in estimating the overall tax reform impact. Further refinement will be made to this estimation as the IRS provides further guidance prior to the filing of the Company's 2017 income tax returns. The ultimate impact of the Act may differ from this year-end estimate due to changes in interpretations and assumptions, guidance that may be issued by various US authorities and standard setting bodies, and actions the Company may take as a result of the new provisions. The Company will refine these estimates during the one year measurement period in accordance with SAB 118.

The items below outline the 2017 financial statement considerations associated with the most material provisions of the Act impacting the Company. This list is not intended to be inclusive of all provisions included in the Act nor all impacts to the Company as a result of the Act.

- The Act reduces the US corporate income tax rate to 21% for tax years beginning after December 31, 2017. The Company's deferred tax balances were re-measured at 21% as of December 31, 2017. The total impact of the US tax rate decrease resulted in a one-time tax expense of \$5.9 million (i.e., the write down of deferred tax asset balances and the valuation allowance.). The large amount of federal NOLs, offset against the valuation allowance thereon, were included in this re-measurement, acting as a significant driver in the large adjustment.
- The Act imposes a one-time transition tax associated with the deemed mandatory repatriation of accumulated, and previously undistributed, foreign earnings. The Company has considered estimates of earnings and profits (E&P) as prepared and maintained for US income tax reporting and performed other procedures consistent with current guidance, in arriving at the current transition tax estimate of \$38 thousand. The Company will pay this tax liability in the year it is initially assessed and will not elect to pay over the optional eight-year period.
- GILTI (Global Intangible and Low Taxed Income) is not expected to apply to the Company as it has been historically subject to full inclusions of Subpart F income, which is excluded from "tested income" for GILTI purposes. This will be monitored going forward to ensure proper inclusion if necessary. If indeed levied, the Company will likely elect to treat such GILTI inclusion as a period expense, not a deferred tax liability.
- Corporate AMT is repealed for tax years beginning after December 31, 2017. For this reason, the remaining AMT credit carryforward has been re-classified in the tax provision from a deferred tax asset to a long term receivable. This change reflects the Act's provision that AMT credits become refundable over time beginning in 2018.

We previously considered the earnings in our non-US subsidiaries to be indefinitely reinvested and, accordingly, recorded no deferred income taxes for the year ended December 31, 2016. As of December 31, 2017, Heska is no longer asserting indefinite reinvestment under the exception noted in ASC 740-30-25-3, which states that the presumption that all undistributed earnings will be transferred to the parent entity may be overcome, and no income taxes shall be accrued by the parent entity. Prior to the Transition Tax, we had an excess of the amount for financial reporting over the tax basis in our foreign subsidiaries. While the Transition Tax resulted in the reduction of the excess of the amount for financial reporting over the tax basis

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in our foreign subsidiaries and subjected undistributed foreign earnings to an estimated \$.02 million of tax which has been provisionally recorded, an actual repatriation from our non-US subsidiaries could still be subject to additional foreign withholding taxes and US state taxes. As such, for those investments from which we were able to make a reasonable estimate of the tax effects of such repatriation, we have recorded a provisional estimate for withholding and state taxes as a deferred tax liability of \$.05 million. We will record the tax effects of any change in our prior assertion with respect to these investments, and disclose any unrecognized deferred tax liability for temporary differences related to our foreign investments, if practicable, in the period that we are first able to make a reasonable estimate, no later than December 2018.

**4. LEASES**

In our CCA segment, primarily related to our point of care laboratory products, the Company enters into sales-type (capital) and operating leases as part of our subscription agreements. Detail of scheduled minimum lease receipts are as follows in the years ended December 31, (in thousands):

Year	2018	2019	2020	2021	2022	Thereafter
Sales-type leases	\$2,119	\$2,288	\$2,281	\$2,198	\$1,794	\$1,004
Operating leases	1,159	933	605	148	9	—

Our cost of equipment under operating leases at December 31, 2017 and December 31, 2016, was \$10.8 million and \$10.5 million, before accumulated depreciation of \$5.0 million and \$3.7 million, and the net book value was \$5.7 million and \$6.8 million, respectively.

**5. 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.

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

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, 2017, 2016, and 2015 (in thousands, except per share data):

	<b>Years ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Net income attributable to Heska Corporation	\$ 9,953	\$ 10,508	\$ 5,239
Basic weighted-average common shares outstanding	7,026	6,783	6,509
Assumed exercise of dilutive stock options and restricted stock units	616	578	565
Diluted weighted-average common shares outstanding	7,642	7,361	7,074
Basic earnings per share	\$ 1.42	\$ 1.55	\$ 0.80
Diluted earnings per share	\$ 1.30	\$ 1.43	\$ 0.74

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):

	<b>Years ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Stock options	123	234	144

**6. GOODWILL AND OTHER INTANGIBLES**

The following summarizes the changes in goodwill during the years ended December 31, 2017 and 2016 (in thousands):

Carrying amount, December 31, 2015	\$ 20,910
Additions and adjustments	5,761
Foreign currency adjustments	(24)
Carrying amount, December 31, 2016	\$ 26,647
Foreign currency adjustments	40
Carrying amount, December 31, 2017	\$ 26,687

Other intangibles assets, net consisted of the following as of December 31, 2017 and 2016 (in thousands):

	<b>Year Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
Gross carrying amount	\$ 3,309	\$ 3,309
Accumulated amortization	(1,351)	(963)
Net carrying amount	\$ 1,958	\$ 2,346

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

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

	<b>Years Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Amortization expense	\$ 388	\$ 230	\$ 246

Estimated amortization expense related to intangibles for each of the five years from 2018 through 2022 and thereafter is as follows (in thousands):

<b>Year Ending December 31,</b>	
2018	\$ 388
2019	388
2020	388
2021	384
2022	378
Thereafter	32
	<u>\$ 1,958</u>

**7. PROPERTY AND EQUIPMENT**

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

	<b>December 31,</b>	
	<b>2017</b>	<b>2016</b>
Land	\$ 377	\$ 377
Building	2,868	2,868
Machinery and equipment	38,432	36,588
Leasehold and building improvements	8,156	7,662
Construction in progress	3,531	1,655
	<u>53,364</u>	<u>49,150</u>
Less accumulated depreciation	(36,033)	(32,569)
Total property and equipment, net	<u>\$ 17,331</u>	<u>\$ 16,581</u>

The Company has subscription agreements 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 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 \$1.1 million, \$1.8 million and \$4.1 million for the years ended December 31, 2017, 2016 and 2015, 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 \$0.2 million and \$0.3 million of net property and equipment related to these transactions as of December 31, 2017 and December 31, 2016, respectively, all related to Heska Imaging.

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Depreciation expense for property and equipment was \$4.3 million, \$4.4 million and \$4.0 million for the years ended December 31, 2017, 2016 and 2015, respectively.

**8. ACCRUED LIABILITIES**

Accrued liabilities consisted of the following as of December 31, 2017 and 2016 (in thousands):

	2017	2016
Accrued payroll and employee benefits	\$ 1,209	\$ 2,166
Accrued property taxes	661	748
Other	2,547	2,667
Total accrued liabilities	<u>\$ 4,417</u>	<u>\$ 5,581</u>

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

**9. CAPITAL STOCK**

*Stock Plans*

We have two stock option plans which authorize granting of stock options, restricted, and stock purchase rights to our employees, officers, directors and consultants. In 1997, the board of directors adopted the 1997 Stock Incentive Plan (the "1997 Plan") and terminated two prior stock 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 an additional 500,000 shares to be available for issuance thereunder. In May 2003, the stockholders approved a new plan, the 2003 Equity Incentive Plan (the "2003 Plan"), which allows for the granting of stock options/restricted stock 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, 2017 was 320,039.

*Stock Options*

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 we issue: 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 2017, 2016 and 2015. 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 2017, 2016 and 2015. Our risk-free interest rate input was determined based on the US



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Treasury yield curve at the time of option issuance in 2017, 2016 and 2015. Our expected dividends inputs were zero in all periods as we did not anticipate paying dividends in the foreseeable future.

Weighted average assumptions used in 2017, 2016 and 2015 for each of these four key inputs are listed in the following table:

	<b>2017</b>	<b>2016</b>	<b>2015</b>
Risk-free interest rate	1.76%	1.76%	1.41%
Expected lives	4.8 years	4.5 years	3.4 years
Expected volatility	41%	41%	41%
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:

	<b>Year Ended December 31,</b>					
	<b>2017</b>		<b>2016</b>		<b>2015</b>	
	<b>Options</b>	<b>Weighted Average Exercise Price</b>	<b>Options</b>	<b>Weighted Average Exercise Price</b>	<b>Options</b>	<b>Weighted Average Exercise Price</b>
Outstanding at beginning of period	829,617	\$ 23.203	940,610	\$ 14.163	1,074,251	\$ 10.110
Granted at Market	27,050	\$ 99.087	129,855	\$ 67.706	146,446	\$ 36.904
Canceled	(18,331)	\$ 57.197	(463)	\$ 14.881	(28,440)	\$ 10.080
Exercised	(207,489)	\$ 11.520	(240,385)	\$ 11.886	(251,647)	\$ 10.559
Outstanding at end of period	<u>630,847</u>	<u>\$ 29.312</u>	<u>829,617</u>	<u>\$ 23.203</u>	<u>940,610</u>	<u>\$ 14.163</u>
Exercisable at end of period	<u>456,802</u>	<u>\$ 18.316</u>	<u>532,703</u>	<u>\$ 12.140</u>	<u>621,559</u>	<u>\$ 10.269</u>

The total estimated fair value of stock options granted were computed to be approximately \$1.0 million, \$3.2 million and \$1.6 million during the years ended December 31, 2017, 2016 and 2015, 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 \$37.35, \$24.59 and \$11.35 during the years ended December 31, 2017, 2016 and 2015, respectively. The total intrinsic value of options exercised was \$17.7 million, \$9.9 million and \$4.7 million during the years ended December 31, 2017, 2016 and 2015, respectively. The cash proceeds from options exercised was \$1.8 million, \$1.9 million and \$1.8 million during the years ended December 31, 2017, 2016 and 2015, respectively.

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The following table summarizes information about stock options outstanding and exercisable at December 31, 2017.

Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Options Outstanding at December 31, 2017	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Number of Options Exercisable at December 31, 2017	Weighted Average Exercise Price
\$ 4.40 - \$ 6.90	97,743	2.68	\$ 5.404	97,743	\$ 5.404
\$ 6.91 - \$ 8.35	132,096	5.77	\$ 7.548	132,096	\$ 7.548
\$ 8.36 - \$18.13	132,976	6.18	\$ 14.456	108,852	\$ 13.680
\$18.14 - \$39.76	144,683	7.85	\$ 37.055	90,388	\$ 35.785
\$39.77 - \$108.25	123,349	9.02	\$ 78.497	27,723	\$ 76.389
\$ 4.40 - \$108.25	<u>630,847</u>	6.52	\$ 29.312	<u>456,802</u>	\$ 18.316

As of December 31, 2017, there was approximately \$3.5 million of total unrecognized compensation cost related to outstanding stock options. That cost is expected to be recognized over a weighted-average period of 2.1 years with all cost to be recognized by the end of December 2019, assuming all options vest according to the vesting schedules in place at December 31, 2017. As of December 31, 2017, the aggregate intrinsic value of outstanding options was approximately \$32.6 million and the aggregate intrinsic value of exercisable options was approximately \$28.3 million.

*Employee Stock Purchase Plan*

Under the 1997 Employee Stock Purchase Plan (the "ESPP"), we are authorized to issue up to 450,000 shares of common stock to our employees, of which 419,651 had been issued as of December 31, 2017. 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

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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 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 10,983, 17,826 and 16,673 shares under the ESPP for the years ended December 31, 2017, 2016 and 2015, respectively.

For the years ended December 31, 2017, 2016 and 2015, 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>2017</b>	<b>2016</b>	<b>2015</b>
Risk-free interest rate	0.74%	0.54%	0.27%
Expected lives	1.2 years	1.2 years	1.2 years
Expected volatility	45%	42%	36%
Expected dividend yield	0%	0%	0%

The weighted-average fair value of the purchase rights granted was \$15.72, \$8.23 and \$6.25 per share for the years ended December 31, 2017, 2016 and 2015, respectively.

*Restricted Stock*

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"). Of the 63,572 shares, 39,217 shares were issued from the 1997 Plan and 24,355 shares were issued from the 2003 Plan. The shares were issued in five tranches and were 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 from the 1997 Plan 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 were to vest on the succeeding March 26 until all shares were vested in full as of March 26, 2017. On May 6, 2014, we issued an additional 130,000 shares

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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 "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 the 2015 MIP Grants from the 1997 Plan. 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. The compensation expense is based on the closing market price on the date of the grant.

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") from the 1997 Plan. Of these, 14,629 vested, 371 were forfeited, and 4,133 were withheld for tax. The 2016 MIP Grants vested during the three months ended March 31, 2017. The compensation expense is based on the closing market price on the date of the grant.

On May 1, 2017, the Company issued 2,720 shares of our Common Stock to the Company's non-employee directors from the 2003 Plan, with a subsequent grant of 567 shares to a new non-employee director on June 12, 2017 from the 2003 Plan. These grants are to 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 grant agreement executed by the non-employee director, to the Vesting Time. The compensation expense is based on the closing market price on the date of the grant.

On May 31, 2017, the Company issued 23,700 unvested performance-based restricted stock shares to certain key employees from the 1997 Plan. The vesting of these shares is subject to the achievement of certain Company performance and market conditions and, in some instances, a service period requirement, that must be met on or before May 30, 2024. For the four tranches related to performance conditions, the compensation expense is based on the closing market price on the date of the grant, \$98.66. The award is expensed when the performance condition is considered probable and taken ratably over the period in which the performance metrics are expected to be achieved. For the six tranches related to market conditions, which include stock price targets and outperformance of the S&P, the compensation expense is based on a fair value assigned to the market metric upon grant using a Monte Carlo model, weighted average value of \$69.06, which remains constant throughout the vesting period, also determined within the model.

On June 15, 2017, the Company issued 6,594 unvested shares to certain Executive Officers related to performance-based restricted stock grants as part of the Company's 2017 Management Incentive Plan from

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the 1997 Plan. As of December 31, 2017, all shares were forfeited and no compensation expense was recorded for the period ended December 31, 2017.

On December 1, 2017, the Company issued 45,000 unvested performance-based restricted stock shares from the 1997 Plan to Mr. Wilson. The vesting of these shares is subject to the achievement of certain Company performance and market conditions and, in some instances, a service period requirement, that must be met on or before March 31, 2025. For the three tranches (equal tranches of 9,375 restricted shares) related to performance conditions, the compensation expense is based on the closing market price on the date of the grant, \$86.32. The award is expensed when the performance condition is considered probable and taken ratably over the period in which the performance metrics are expected to be achieved. For the three tranches (equal tranches of 5,625 restricted shares) related to market conditions, which include stock price targets, the compensation expense is based on a fair value assigned to the market metric upon grant using a Monte Carlo model, weighted average value of \$72.95, which remains constant throughout the vesting period, which is also determined within the model.

As of December 31, 2017, there was approximately \$3.2 million of total unrecognized compensation cost related to restricted stock. The Company expects to recognize this expense over a weighted average period of 1.4 years.

*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.

**10. 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
Other comprehensive income (loss)	75	(75)	(90)	(90)
Balances at December 31, 2016	(501)	598	—	97
Other comprehensive income (loss)	12	123	—	135
Balances at December 31, 2017	<u>\$ (489)</u>	<u>\$ 721</u>	<u>\$ —</u>	<u>\$ 232</u>



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

**11. 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 \$0.3 million became payable under these agreements in the year ended December 31, 2017, and \$0.4 million in each of the years ended December 31, 2016 and 2015.

The Company has entered into operating leases for its office and research facilities and certain equipment with future minimum payments as of December 31, 2017 as follows (in thousands):

<b>Year Ending December 31,</b>	
2018	\$ 2,156
2019	2,035
2020	1,835
2021	1,747
2022	1,714
Thereafter	1,617
	\$ 11,104

The Company had rent expense of \$1.6 million in each of the years ended December 31, 2017, 2016, and 2015.

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 ("Fauley Complaint"). The Company does not have insurance coverage for the Fauley Complaint. The Company intends to defend itself vigorously in this matter and at this time is unable to estimate a possible loss or a range of loss. At December 31, 2017, 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 \$0.2 million and \$0.4 million as of December 31, 2017 and 2016, respectively.

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

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

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

	Year Ended December 31,		
	2017	2016	2015
Interest income	\$ (167)	\$ (124)	\$ (172)
Interest expense	245	160	200
Other expense (income), net	(228)	(7)	102
	\$ (150)	\$ 29	\$ 130

Cash paid for interest was \$206 thousand, \$78 thousand and \$90 thousand for the years ended December 31, 2017, 2016 and 2015, respectively.

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

On July 27, 2017, we entered into a Credit Agreement (the "Credit Agreement") with JPMorgan Chase Bank, N.A. ("Chase"), which provides for a revolving credit facility of up to \$30.0 million (the "Credit Facility"). The Credit Facility provides us with the ability to borrow up to \$30.0 million, although the amount of the Credit Facility may be increased by an additional \$20.0 million up to a total of \$50.0 million subject to receipt of additional lender commitments and other conditions. Any interest on borrowings due is to be charged at either the (i) rate of interest per annum publicly announced from time to time by Chase at its prime rate in effect at its principal offices in New York City, subject to a floor, minus 1.65%, or (ii) the interest rate per annum equal to (a) LIBOR for the interest period in effect multiplied by (b) Chase's Statutory Reserve Rate (as defined in the Credit Agreement), plus 1.10% and payable monthly. There is an annual minimum interest charge of \$60 thousand under the Credit Agreement. Borrowings under the Credit Facility are subject to certain financial and non-financial covenants and are available for various corporate purposes, including general working capital, capital investments, and certain permitted acquisitions. The Credit Agreement also permits us to issue letters of credit. The maturity date of the Credit Facility is July 27, 2020. The foregoing discussion of the Credit Facility is a summary only and is qualified in its entirety by reference to the full text of the Credit Agreement, a copy of which has been filed as an exhibit to the Company's Current Report on Form 8-K filed with the SEC on August 2, 2017. At December 31, 2017, we had \$6.0 million of borrowings outstanding on this line of credit and we were in compliance with all financial covenants. In connection with the Credit Agreement, the Company incurred debt issuance costs of \$120 thousand. These costs are included in other non-current assets on the Company's consolidated balance sheet, and will be amortized to interest expense ratably over the term of the agreement.

Concurrent with the Credit Agreement, we repaid all outstanding balances and closed our \$15.0 million asset-based revolving line of credit with Wells Fargo, which had a maturity date of December 31, 2017. Our outstanding balance under this arrangement at December 31, 2016 was \$0.7 million. Our ability to borrow under this line of credit varied 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. Under this agreement, we were 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 was 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.

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

**14. 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 point of care diagnostic laboratory instruments and supplies, and imaging instruments and software and services as well as single use diagnostic and other tests, pharmaceuticals and vaccines, primarily for canine and feline use. 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.

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

<b>Year Ended December 31, 2017</b>	<b>Core Companion Animal Health</b>	<b>Other Vaccines, Pharmaceuticals and Products</b>	<b>Total</b>
Total revenue	\$ 105,191	\$ 24,150	\$ 129,341
Operating Income	12,656	5,563	18,219
Income before income taxes	12,828	5,541	18,369
Total assets	111,968	23,819	135,787
Net assets	75,984	24,456	100,440
Capital expenditures	209	3,260	3,469
Depreciation and amortization	3,736	1,018	4,754

<b>Year Ended December 31, 2016</b>	<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

<b>Year Ended December 31, 2015</b>	<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

**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):

	<b>For the Years Ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
United States	\$ 116,823	\$ 120,082	\$ 97,164
Canada	2,924	2,378	1,833
Europe	4,780	4,781	2,086
Other International	4,814	2,842	3,514
<b>Total</b>	<b>\$ 129,341</b>	<b>\$ 130,083</b>	<b>\$ 104,597</b>

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

	<b>As of December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
United States	\$ 132,413	\$ 127,827	\$ 106,780
Europe	3,374	3,017	2,939
<b>Total</b>	<b>\$ 135,787</b>	<b>\$ 130,844</b>	<b>\$ 109,719</b>

In our CCA segment, revenue from Butler Animal Health Supply, LLC d/b/a Henry Schein Animal Health ("Henry Schein") represented approximately 13%, 13%, and 10% of our consolidated revenue for the years ended December 31, 2017, 2016, and 2015, respectively. Revenue from Merck entities, including Merck Animal Health, represented approximately 12% for the year ended December 31, 2017, and 11% each for the years ended December 31, 2016 and 2015. Revenue from De Lage Landen Financial Services, Inc. ("DLL"), represented approximately 7%, 11%, and 10% of our consolidated revenue for the years ended December 31, 2017, 2016, and 2015, respectively; DLL is a third-party that provides financing and leasing for our customers, primarily for our imaging products. In our OVP segment, revenue from Eli Lilly entities, including Elanco, represented approximately 11%, 12% and 12% for the years ended December 31, 2017, 2016, and 2015, respectively. No other customer accounted for more than 10% of our consolidated revenue for the years ended December 31, 2017, 2016, or 2015.

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

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

The following tables present quarterly unaudited results for the two years ended December 31, 2017 and 2016 (amounts in thousands, except per share data).

	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Total</u>
<b>2017</b>					
Total revenue (revised)	\$ 29,559	\$ 33,405	\$ 30,336	\$ 36,041	\$ 129,341
Gross profit	13,209	14,929	13,553	16,570	58,261
Operating income	2,788	4,560	3,778	7,093	18,219
Net income	4,303	3,139	3,083	(1,069)	9,456
Net income attributable to Heska Corporation	4,606	3,333	3,083	(1,069)	9,953
Basic earnings (loss) per share attributable to Heska Corporation	0.67	0.47	0.43	(0.15)	1.42
Diluted earnings (loss) per share attributable to Heska Corporation	0.60	0.44	0.40	(0.14)	1.30
<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

For each of the quarters included in the Company's Form 10-Qs for the year ended December 31, 2017, revenue and cost of revenue related to CCA distributor sales were overstated by \$0.8 million, \$0.9 million, and \$1.1 million for the first, second, and third quarters, respectively. On December 31, 2017, an adjustment was made to reduce cost of revenue and full year revenue by \$2.8 million, resulting in no impact on gross profit or net income and an increase to gross profit percentage of 1.3% for the full year and 1.2%, 1.2%, and 1.6% for the first, second, and third quarters, respectively. Management considered the impact to current and past financial statements under the SEC's authoritative guidance on materiality and determined that the issue was not material, and therefore, the prior quarters' Form 10-Qs were not amended. Impacts to all periods in 2017, 2016 and 2015 were immaterial.

The following table illustrates the correction shown in the statements of income in Form 10-Q:

	<u>Three Months Ended March 31, 2017</u>			<u>Three Months Ended June 30, 2017</u>			<u>Three Months Ended September 30, 2017</u>		
	As Reported	Adjustment	As Revised	As Reported	Adjustment	As Revised	As Reported	Adjustment	As Revised
Revenue	\$ 30,382	\$ (823)	\$ 29,559	\$ 34,336	\$ (931)	\$ 33,405	\$ 31,428	\$ (1,092)	\$ 30,336
Cost of Revenue	(17,173)	823	(16,350)	(19,407)	931	(18,476)	(17,875)	1,092	(16,783)
Gross Profit	13,209	—	13,209	14,929	—	14,929	13,553	—	13,553
Gross Margin	43.5%		44.7%	43.5%		44.7%	43.1%		44.7%

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

**16. SUBSEQUENT EVENTS**

On March 7, 2018, the Compensation Committee of the Company's Board of Directors authorized the issuance of 128,500 shares of performance-based restricted common stock and stock options with 130,000 underlying shares of common stock under the 1997 Plan, including 118,500 shares of performance-based restricted common stock and stock options with 120,000 underlying shares of common stock granted to Company Executive Officers. The vesting of the performance-based restricted shares is subject to the achievement of certain Company performance and market conditions and, in some instances, a service period requirement. The shares are to be forfeited if the applicable performance or market condition is not met by the date in each fiscal year that the Company's independent registered public accountants issue their financial report on the Company's prior fiscal year financial statements in 2025 or March 31, 2025, respectively, with the exception of 27,539 shares of restricted common stock with vesting tied to the Company's stock outperforming the S&P 500 Index over a two or four year time period, which will be forfeited if not achieved at the specified time. The stock options are to vest annually in three approximately equal tranches. No other material recognized or non-recognizable subsequent events were identified.











## ONGOING OFFICERS

Kevin S. Wilson, Chief Executive Officer and President

Jason A. Napolitano, Chief Operating Officer, Chief Strategist and Secretary

Nancy Wisniewski, Ph.D., Executive Vice President, Diagnostic Operations and Product Development

Steven M. Eyl, Executive Vice President, Global Sales and Marketing

Steven M. Asakowicz, Executive Vice President, Companion Animal Health Sales

Rodney A. Lippincott, Executive Vice President, Companion Animal Health Sales

Catherine I. Grassman, Vice President, Chief Accounting Officer and Controller

Laurie E. Peterson, Vice President, Heska Des Moines\*

Daniel J. Pollack, Vice President, Financial Planning and Business Analytics\*

## BOARD OF DIRECTORS

Sharon J. Larson, Chair of the Board; Principal and CEO of SLR Associates, LLC

G. Irwin Gordon, Former Executive Vice President and Chief Revenue Officer of Invitation Homes

Scott W. Humphrey, Former President and Chief Executive Officer of One Hope United

David E. Sveen, Ph.D., President, Cedarstone Partners, Inc.

Bonnie J. Trowbridge, Retired Partner, PricewaterhouseCoopers LLP

Kevin S. Wilson, Chief Executive Officer and President, Heska Corporation

Carol A. Wrenn, Owner and President of Whitewater Advisors, LLC

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