



# Novanta

***Novanta Inc.***  
2018 Annual Report





*Dear Fellow Shareholders,*

2018 was an excellent year for Novanta with solid execution and good financial results. We delivered on our promises for robust top-line growth and bottom-line profitability. Full year reported revenue was \$614 million, with very strong year-over-year growth of 18%, and Organic Revenue Growth\* of 7%. Full year Adjusted EBITDA\* was \$124 million, up 17% versus 2017, and full year Adjusted Diluted Earnings Per Share\* was \$2.16, up 35%. Operating cash flow was \$90 million, up 41% versus the prior year.

Novanta is executing well on its growth strategy based on multiple growth drivers, organically and through M&A, and we are well on our way to execute on our 2020 Strategic Direction. We continue to feel good about the positioning of our businesses around secular macro growth drivers, with half of our revenue in medical markets that are structurally growing. We see a converging trend and need for motion, vision and photonics capabilities in a large variety of applications on the back of macro trends of Healthcare Productivity, Precision Medicine and Industry 4.0. Particularly, we remain excited about our position in applications such as Robotic Surgery, Minimally Invasive Surgery, DNA Sequencing, Metrology, Advanced Material Processing and Precision Automation & Robotics. We believe that the strength of our team, history of innovation, and focus on diversified niche leadership positions with balanced exposure to medical and industrial markets position us well for long-term profitable growth.

Our teams executed well on Organic Revenue Growth and innovation in 2018, as evidenced by our significant growth in revenue from new products, and our robust growth in design wins versus the prior year. Our leadership positions in secular growth areas are providing a solid foundation for future growth. In 2019 and beyond, we will continue to be focused on delivering growth and investing in our business, by building a larger presence in growth markets, and by investing in innovation and our commercial engine.

Disciplined acquisitions are also an important aspect of our growth and capital allocation strategy. In 2018, we continued to execute on our acquisition strategy with two key transactions. The Zettlex acquisition expands our product offerings in our Precision Motion segment, expanding our reach into medical robotic applications and acting as a strong entry point into industrial robotic applications which our existing technology base could not serve. We also acquired the remaining equity interest in Laser Quantum, which further strengthens our position in DNA sequencing applications; we feel we are now securely positioned on multi-generational platforms in this space and foresee a multi-year growth path in this market.

Our balance sheet is very strong, giving us the flexibility we need to act on future transactions. We continue to see our pipeline of acquisition opportunities grow, as our organization continues to work hard at cultivating and evaluating transactions. We want to remain disciplined around financial returns and only move forward when the strategic fit and financial returns are right. In evaluating acquisitions and growth investments, we apply a rigorous capital allocation process using return on invested capital and cash on cash return metrics, which we believe strongly correlate with shareholder returns.

So, to summarize, 2018 was another great year for Novanta. Our focus on accelerating profitable growth and the resilience of our businesses was evident in our strong financial results. Novanta's diversification and relentless focus on leadership positions across medical and industrial growth markets are providing a solid foundation for sustainable profitable growth in today's global economy. We continue to remain excited about the applications we play in and the positions we have. And, as stated earlier, we are well on our way to execute on our long-term strategy and 2020 Strategic Direction.

In closing, I would like to thank our customers, our employees and our shareholders for their ongoing support. I am honored and proud to work at this company and with its talented employees. I want to express my deepest gratitude for their dedication and hard work to make Novanta a truly unique and successful company.

Yours truly,

Matthijs Glastra

Chief Executive Officer

\*Non-GAAP financial measures. A reconciliation of GAAP to non-GAAP financial measures can be found beginning on page 113.



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

**FORM 10-K**

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

For the fiscal year ended December 31, 2018

or

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

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

Commission File No. 001-35083

**Novanta Inc.**

(Exact name of registrant as specified in its charter)

New Brunswick, Canada  
(State or other jurisdiction  
of incorporation or organization)

125 Middlesex Turnpike  
Bedford, Massachusetts, USA  
(Address of principal executive offices)

98-0110412  
(I.R.S. Employer  
Identification No.)

01730  
(Zip Code)

(781) 266-5700

(Registrant's telephone number, including area code)

**Securities Registered Pursuant to Section 12(b) of the Act:**

Title of Each Class

Name of Exchange on Which Registered

Common Shares, no par value

The Nasdaq Global Select Market

**Securities Registered Pursuant to Section 12(g) of the Act:**

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ☐ No ☒

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

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

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

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

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐

Emerging growth company ☐

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

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

The aggregate market value of the Registrant's outstanding common shares held by non-affiliates of the Registrant, based on the closing price of the common shares on the Nasdaq Global Select Market on the last business day of the Registrant's most recently completed second fiscal quarter (June 29, 2018) was \$1,779,955,516. For purposes of this disclosure, common shares held by officers and directors of the Registrant and by persons who hold more than 10% of the Registrant's outstanding common shares have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily conclusive.

As of February 19, 2019, there were 34,900,599 shares of the Registrant's common shares, no par value, issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Definitive Proxy Statement for the Registrant's Annual Meeting of Shareholders scheduled to be held on May 9, 2019 to be filed with the Securities and Exchange Commission are incorporated by reference in answer to Part III of this Annual Report on Form 10-K.

**NOVANTA INC.**  
**FORM 10-K**  
**YEAR ENDED DECEMBER 31, 2018**

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As used in this report, the terms “we,” “us,” “our,” “Novanta,” “NOVT” and the “Company” mean Novanta Inc. and its subsidiaries, unless the context indicates another meaning.

Unless otherwise noted, all dollar amounts in this report are expressed in United States dollars.

The following brand and trade names of Novanta Inc. are used in this report: Cambridge Technology, Lincoln Laser, ExoTec Precision, Synrad, Laser Quantum, WOM, NDS, NDSSI, Reach Technology, JADAK, ThingMagic, Photo Research, General Scanning, Celera Motion, MicroE, Applimotion, Zettlex and Westwind.

## PART I

### Cautionary Note Regarding Forward Looking Statements

Except for historical information, the matters discussed in this Annual Report on Form 10-K are forward looking statements that involve risks, uncertainties and assumptions that, if they never materialize or if they prove incorrect, could cause our consolidated results to differ materially from those expressed or implied by such forward looking statements. The Company makes such forward looking statements under the provision of the “Safe Harbor” section of the Private Securities Litigation Reform Act of 1995. Actual future results may vary materially from those projected, anticipated, or indicated in any forward-looking statements as a result of various important factors, including those set forth in Item 1A of this Annual Report on Form 10-K under the heading “Risk Factors.” Readers should also carefully review the risk factors described in the other documents that we file with the SEC from time to time. In this Annual Report on Form 10-K, the words “anticipates,” “believes,” “expects,” “intends,” “future,” “could,” “estimates,” “plans,” “would,” “should,” “potential,” “continues” and similar words or expressions (as well as other words or expressions referencing future events, conditions or circumstances) identify forward looking statements. Forward looking statements also include the assumptions underlying or relating to any of the forward-looking statements. The forward looking statements contained in this Annual Report include, but are not limited to, statements related to: our belief that the Purchasing Managers Index (PMI) may provide an indication of the impact of general economic conditions on our sales into the advanced industrial end market; our strategy; anticipated financial performance; expected liquidity and capitalization; drivers of revenue growth and our growth expectations in various markets; management’s plans and objectives for future operations, expenditures and product development, and investments in research and development; business prospects; potential of future product releases and expansion of our product and service offerings; anticipated revenue performance; industry trends; market conditions; our competitive positions; changes in economic and political conditions; changes in accounting principles; changes in actual or assumed tax liabilities; expectations regarding tax exposures; anticipated reinvestment of future earnings and dividend policy; anticipated expenditures in regard to the Company’s benefit plans; future acquisitions, integration and anticipated benefits from acquisitions and dispositions; anticipated economic benefits and expected costs of restructuring programs; ability to repay our indebtedness; our intentions regarding the use of cash; expectations regarding legal and regulatory environmental requirements and our compliance thereto; and other statements that are not historical facts. All forward looking statements included in this document are based on information available to us on the date hereof. We will not undertake and specifically decline any obligation to update any forward-looking statements, except as required under applicable law.

### Item 1. *Business*

#### Overview

Novanta Inc. and its subsidiaries (collectively referred to as the “Company”, “Novanta”, “we”, “us”, “our”) is a leading global supplier of core technology solutions that give medical and advanced industrial original equipment manufacturers (“OEMs”) a competitive advantage. We combine deep proprietary technology expertise and competencies in photonics, vision and precision motion with a proven ability to solve complex technical challenges. This enables us to engineer core components and sub-systems that deliver extreme precision and performance, tailored to customers' demanding applications.

Novanta Inc. was founded and initially incorporated in Massachusetts in 1968 as General Scanning, Inc. (“General Scanning”). In 1999, General Scanning merged with Lumonics Inc. The post-merger entity, GSI Lumonics Inc., continued under the laws of the Province of New Brunswick, Canada. In 2005, the Company changed its name to GSI Group Inc. Through a series of strategic divestitures and acquisitions, the Company transformed from one that was more focused on the semiconductor industry to one that primarily sells components and sub-systems to OEMs in the medical and advanced industrial markets. The Company changed its name to Novanta Inc. in May 2016.

#### Strategy

Our strategy is to drive sustainable, profitable growth through short-term and long-term initiatives, including:

- disciplined focus on our diversified business model of providing functionality to long life-cycle OEM customer platforms in attractive medical and advanced industrial niche markets;
- improving our business mix to increase medical sales as a percentage of total revenue by:
  - introducing new products aimed at attractive medical applications, such as minimally invasive and robotic surgery, ophthalmology, patient monitoring, drug delivery, clinical laboratory testing and life science equipment;
  - deepening our key account management relationships with and driving cross selling of our product offerings to leading medical equipment manufacturers; and
  - pursuing complementary medical technology acquisitions;

- increasing our penetration of high growth advanced industrial applications, such as laser materials processing, robotics, automation and metrology, by working closely with OEM customers to launch application specific products that closely match the requirements of each application;
- broadening our portfolio of enabling proprietary technologies and capabilities through increased investment in new product development, expanded sales and marketing channels to reach target customers, and investments in application development to further penetrate existing customers, while expanding the applicability of our solutions to new markets;
- broadening our product and service offerings through the acquisition of innovative and complementary technologies and solutions in medical and advanced industrial technology applications, including increasing our recurring revenue streams such as services, spare parts and consumables;
- improving our existing operations to expand profit margins and improve customer satisfaction by implementing lean manufacturing principles and strategic sourcing across our major production sites; and
- attracting, retaining, and developing world-class talented and motivated employees.

## Acquisitions

We continuously evaluate our business mix and financial performance. Since 2013, we have executed a series of acquisitions in line with our strategy.

In May 2018, the Company acquired Zettlex Holdings Limited (“Zettlex”), a Cambridge, United Kingdom-based provider of inductive encoder products that provide absolute and accurate positioning, even in extreme operating environments, to OEMs in the medical and advanced industrial markets, for a total purchase price of £23.3 million (\$32.0 million).

In July 2017, the Company acquired W.O.M. World of Medicine GmbH (“WOM”), a Berlin, Germany-based provider of medical insufflators, pumps and related disposables to OEMs in the minimally invasive surgery market, for a total purchase price of €118.1 million (\$134.9 million).

In January 2017, the Company acquired an additional approximately 35% of the outstanding shares of Laser Quantum Limited (“Laser Quantum”), a Manchester, United Kingdom-based provider of solid state continuous wave lasers, ultrafast lasers, and optical light engines to OEMs in the medical market, for a total purchase price of £25.5 million (\$31.1 million). As a result of the acquisition of these additional shares, the Company’s equity ownership percentage increased from approximately 41% to approximately 76%. In September 2018, the Company acquired the remaining approximately 24% of the outstanding shares of Laser Quantum for a total purchase price of \$45.1 million.

In January 2017, the Company acquired ThingMagic, a Woburn, Massachusetts-based provider of ultra-high frequency (“UHF”) radio frequency identification (“RFID”) modules and finished RFID readers to OEMs in the medical and advanced industrial markets, for a total purchase price of \$19.1 million.

In May 2016, the Company acquired Reach Technology Inc., a Fremont, California-based provider of embedded touch screen technology solutions to OEMs in the medical and advanced industrial markets, for a total purchase price of \$9.4 million.

In December 2015, the Company acquired all assets and certain liabilities of Skyetek Inc., a Denver, Colorado-based provider of embedded and standalone RFID solutions for OEM customers in the medical and advanced industrial markets, for a total purchase price of \$2.8 million.

In November 2015, the Company acquired certain assets and liabilities of Lincoln Laser Company, a Phoenix, Arizona-based provider of ultrafast precision polygon scanners and other optical scanning solutions for the medical and advanced industrial markets, for a total purchase price of \$12.1 million.

In February 2015, the Company acquired Applimotion Inc., a Loomis, California-based provider of advanced precision motor and motion control technology to OEM customers in the medical and advanced industrial markets, for a total purchase price of \$14.0 million.

In March 2014, the Company acquired JADAK LLC, JADAK Technologies Inc. and Advance Data Capture Corporation (together, “JADAK”), a North Syracuse, New York-based provider of optical data collection and machine vision technologies to OEM medical device manufacturers, for a total purchase price of \$93.7 million.

In January 2013, the Company acquired NDS Surgical Imaging LLC (“NDS”), a San Jose, California-based company that designs, manufactures, and markets high definition visualization solutions and imaging informatics products for the surgical and radiology market segments, for a total purchase price of \$75.4 million.

### Divestitures and Product Rationalization

As part of our ongoing evaluation of our business mix and financial performance, we also review our business for potential divestitures and product rationalizations. Since 2011, we have executed a series of divestitures and product rationalizations in line with our strategy.

In January 2016, the Company discontinued its radiology products, sold under the Dome brand name and operated within the Company’s Visualization Solutions product line. Total revenue from these products was zero in 2018 and 2017, respectively, and approximately \$1.4 million in 2016.

In June 2015, the Company divested its 50% owned joint venture in India, Excel Laser Technology Private Limited, for net cash proceeds of \$0.2 million.

In April 2015, the Company completed the sale of its fiber laser business, operated under the JK Lasers brand name, for \$29.6 million in cash.

In July 2014, the Company completed the sale of its Scientific Lasers business, operated under the Continuum and Quantronix brand names, for \$6.5 million in cash.

In May 2013, the Company sold its Semiconductor Systems business, operated under the GSI Group brand name, for \$9.7 million in cash.

In October 2012, the Company sold its Laser Systems business, operated under the Control Laser and Baublys brand names, for \$6.6 million in cash.

### Segments

Our Chief Operating Decision Maker (“CODM”) utilizes financial information to make decisions about allocating resources and assessing performance for the entire Company. We evaluate the performance of, and allocate resources to, our segments based on revenue, gross profit and operating profit. Our reportable segments have been identified based on commonality and adjacency of technologies, applications, and customers amongst our individual product lines.

Based upon the information provided to the CODM, we have determined that we have three reportable segments. The following table shows the external revenues, gross profit margin and operating profit for each of the segments for the year ended December 31, 2018 (dollars in thousands):

	Revenue	Gross Profit Margin	Operating Profit
Photonics	\$ 249,339	47.0%	\$ 59,285
Vision	\$ 232,902	37.4%	\$ 8,991
Precision Motion	\$ 132,096	45.0%	\$ 31,674

See Note 19 to Consolidated Financial Statements for additional financial information about our reportable segments.

### Photonics

The Photonics segment designs, manufactures and markets photonics-based solutions, including laser scanning, laser beam delivery, CO2 laser, continuous wave and ultrafast laser, and optical light engine products to customers worldwide. The segment serves highly demanding photonics-based applications for advanced industrial processes, metrology, medical and life science imaging, DNA sequencing, and medical laser procedures. The vast majority of the segment’s product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

The Photonics segment is comprised of four product lines:

Product Line	Key End Market	Brand Names	Description
<i>Laser Beam Delivery Components</i>	Advanced Industrial and Medical	Cambridge Technology	Galvanometer and polygon-based optical scanning components. These products provide precise control and delivery of laser beams through motorized manipulation of mirrors and optical elements and are integrated by OEM manufacturers with their controlling hardware and software. Advanced industrial applications include additive manufacturing, packaging converting, laser marking, micromachining and metrology. Medical applications include optical coherence tomography imaging, microscopy, and laser-based vision correction.
<i>Laser Beam Delivery Solutions</i>	Advanced Industrial and Medical	Cambridge Technology, Synrad, Laser Quantum	Galvanometer and polygon based optical scan heads that provide precise control and delivery of laser beams through motorized manipulation of mirrors and optical elements in two and three-axis scan heads, scanning subsystems, and controlling hardware and software. Optical light engine products that integrate lasers into light engines with full beam parameter control. Advanced industrial applications include additive manufacturing, packaging converting, laser marking, micromachining and metrology. Medical applications include DNA sequencing, optical coherence tomography imaging, microscopy, super-resolution imaging, and laser-based vision correction.
<i>CO<sub>2</sub> Lasers</i>	Advanced Industrial	Synrad	Continuous and pulsed CO <sub>2</sub> lasers with power ranges from 5 to 400 watts. Applications include coding, marking, engraving, cutting and trimming of non-metals, fine materials processing, additive manufacturing, packaging converting, and medical applications in dental and dermatology.
<i>Solid State and Ultrafast Lasers</i>	Medical and Advanced Industrial	Laser Quantum	Diode-pumped solid state lasers and ultrafast lasers in the visible to near-infrared. Applications include DNA sequencing, microscopy, and super-resolution imaging.

## ***Vision***

The Vision segment designs, manufactures and markets a range of medical grade technologies, including medical insufflators, pumps and related disposables; visualization solutions; wireless imaging and operating room integration technologies; optical data collection and machine vision technologies; radio frequency identification (“RFID”) technologies; thermal chart recorders; spectrometry technologies, and embedded touch screen solutions. The vast majority of the segment’s product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

The Vision segment has nine product lines:

<b>Product Line</b>	<b>Key End Market</b>	<b>Brand Names</b>	<b>Description</b>
<i>Medical Insufflators, Pumps and Accessories</i>	Medical	WOM	Insufflators, pumps, light sources and video couplers, gamma probes and related accessories for minimally invasive surgery.
<i>Visualization Solutions</i>	Medical	NDS, NDSsi	High definition visualization solutions for minimally invasive surgery and robotic surgery.
<i>Video Processing and Streaming</i>	Medical	NDS, NDSsi	Imaging management for visual information, including real-time distribution, documentation, control, and streaming for multiple imaging modalities for surgical applications. High definition wireless transmission of video signals to replace video cables in minimally invasive surgical equipment.
<i>Touch Panel Displays</i>	Medical and Advanced Industrial	Reach Technology	Embedded capacitive and resistive touch panel technology that delivers high-performance solutions.
<i>Machine Vision</i>	Medical and Advanced Industrial	JADAK	Camera-based machine vision products and solutions performing image analysis within medical devices.
<i>Radio Frequency Identification (RFID)</i>	Medical and Advanced Industrial	JADAK, ThingMagic	RFID technologies via High-Frequency (HF) and Ultra-High Frequency (UHF) readers, writers and antennas for applications such as surgical part tracking and counterfeit detection.
<i>Barcode Identification</i>	Medical and Advanced Industrial	JADAK	Embedded and handheld data collection products for barcode identification.
<i>Thermal Chart Recorders</i>	Medical	JADAK	Rugged thermal chart recorders for patient monitoring, defibrillator equipment, blood gas analyzers, and pulse oximeters.
<i>Light and Color Measurement</i>	Medical and Advanced Industrial	Photo Research	Light and color measurement devices, including spectroradiometers, photometers, and color characterization software, used in research and development and quality control testing.

### ***Precision Motion***

The Precision Motion segment designs, manufactures and markets optical and inductive encoders, precision motors, motion control sub-assemblies, air bearings, air bearing spindles and precision machined components to customers worldwide. The vast majority of the segment's product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

The Precision Motion segment includes five product lines:

<b>Product Line</b>	<b>Key End Market</b>	<b>Brand Names</b>	<b>Description</b>
<i>Optical Encoders</i>	Advanced Industrial and Medical	Celera Motion, MicroE	Optical encoders from core product brand MicroE. Applications include precision motion control and sensing in semiconductor and electronics manufacturing, industrial and medical robotics, metrology, satellite communications, medical devices, and laboratory and diagnostics equipment.
<i>Inductive Encoders</i>	Advanced Industrial and Medical	Celera Motion, Zettlex	Inductive encoders from core product brand Zettlex. Applications include precision motion control and sensing in satellite communications, surveillance, medical devices, industrial and medical robotics, autonomous vehicles, and laboratory and diagnostics equipment.
<i>Precision Motors</i>	Advanced Industrial and Medical	Celera Motion, Applimotion	Direct drive motor components from core product brand Applimotion. Applications include precision motion control in semiconductor and electronics manufacturing, industrial and medical robotics, autonomous vehicles, metrology, satellite communications, surveillance, medical devices, and laboratory and diagnostics equipment.
<i>Integrated Motion Control Solutions</i>	Advanced Industrial and Medical	Celera Motion	Integrated motion sub-assemblies. Applications include precision motion control in semiconductor and electronics manufacturing, industrial and medical robotics, autonomous vehicles, metrology, satellite communications, surveillance, medical devices, and laboratory and diagnostics equipment.
<i>Air Bearing Spindles</i>	Advanced Industrial	Celera Motion, Westwind	High-speed and precision air bearings and air bearing spindles from core product brand Westwind. Applications include printed circuit board (“PCB”) manufacturing, automotive coating, semiconductor manufacturing equipment, micro machining, and power generation.

## End Markets

We primarily operate in two end markets: the advanced industrial market and the medical market.

### *Advanced Industrial Market*

For the year ended December 31, 2018, the advanced industrial market accounted for approximately 50% of the Company’s revenue. Revenue from our products sold to the advanced industrial market is affected by a number of factors, including changing technology requirements and preferences of our customers, productivity or quality investments in a manufacturing environment, the financial condition of our customers, changes in regulatory requirements and laws, and general economic conditions. We believe that the Purchasing Managers Index (PMI) on manufacturing activities specific to different regions around the world may provide an indication of the impact of general economic conditions on our sales into the advanced industrial market.

## *Medical Market*

For the year ended December 31, 2018, the medical market accounted for approximately 50% of the Company's revenue. Revenue from our products sold to the medical market is generally affected by hospital and other healthcare provider capital spending, changes in regulatory requirements and laws, aggregation of purchasing by healthcare networks, trends in surgical procedures, changes in technology requirements, changes in customer or patient preferences, and general demographic trends.

## **Working Capital Requirements**

There are no special inventory requirements or credit terms extended to customers that would have a material adverse effect on our working capital.

## **Customers**

We have a diverse group of customers that include companies that are global leaders in their industries. Many of our customers participate in several market industries. No customer accounted for greater than 10% of our consolidated revenue during the years ended December 31, 2018, 2017 or 2016.

Customers of our Photonics, Vision, and Precision Motion segments include a large number of OEM customers who integrate our products into their systems for sale to end users. We also sell directly to end users. Our customers include leaders in the medical and advanced industrial markets. A typical OEM customer will usually evaluate our products and our ability to provide application knowledge and expertise, post-sales application support and services, supply chain management over long durations, manufacturing capabilities, product quality, global presence, and product customization before deciding to incorporate our products into their products or systems. Customers generally choose suppliers based on a number of factors, including product performance, reliability, application support, price, breadth of the supplier's product offerings, the financial condition of the supplier, and the geographical coverage offered by the supplier. Once certain of our products have been designed into a given OEM customer's product or system, there are generally significant barriers to subsequent supplier changes until the end of the product or system life cycle, especially in the medical market.

## **Seasonality**

While our revenues are not highly seasonal on a consolidated basis, the revenues of some of our individual product lines, particularly our visualization solutions, imaging informatics, and thermal chart recorder products, are impacted in the first and fourth quarters by seasonality due to hospital budgeting cycles.

## **Backlog**

As of December 31, 2018 and 2017, our consolidated backlog was approximately \$234.4 million and \$187.1 million, respectively. The majority of orders included in backlog represent open orders for products and services that, based on management's projections, have a reasonable probability of being delivered over the subsequent twelve-month period. Orders included in backlog may be canceled or rescheduled by customers without significant penalty. Management believes that backlog is not a meaningful indicator of future business prospects for any of our business segments due to the short lead time required on our products and the ability of customers to reschedule or cancel orders. Therefore, backlog as of any particular date should not be relied upon as indicative of our revenues for any future period.

## **Manufacturing**

Manufacturing functions are performed internally when we choose to maintain control over critical portions of the production process or for cost related reasons while some of the less critical portions are outsourced to third parties. To the extent it makes financial sense, we will consider outsourcing additional portions of the production process.

Products offered by our Photonics segment are manufactured at facilities in Bedford, Massachusetts; Mukilteo, Washington; Phoenix, Arizona; Taunton and Manchester, United Kingdom; and Suzhou, China. Products offered by our Vision segment are manufactured at facilities in Syracuse and Rochester, New York; San Jose, California; and Ludwigsstadt, Germany. Products offered by our Precision Motion segment are primarily manufactured at facilities in Bedford, Massachusetts; Loomis, California; Poole and Cambridge, United Kingdom; and Suzhou, China.

Many of our products are manufactured under ISO 9001 certification, while the majority of our products manufactured for the medical market are manufactured under ISO 13485 certification. Our medical insufflators, pumps, cameras and accessories products are also manufactured under ISO 14001 certification. Certain visualization solutions, thermal chart recorders and imaging informatics products are manufactured under current good manufacturing practices (CGMPs), which is a requirement of their medical device

classification by the U.S. Food and Drug Administration (the “FDA”). In addition, certain visualization solutions, thermal printers, imaging informatics and medical insufflators, pumps, cameras and accessories products are manufactured under section 510(k) of the FDA.

## **Marketing, Sales and Distribution**

We sell our products globally, primarily through our direct sales force. Sales outside of the United States are largely based on a direct sales force, but occasionally are sold through distributors, including manufacturers’ representatives, to either augment our selling effort or serve a local market where we have no direct sales force. Our local sales, applications, and service teams and our distributors work closely with our customers to ensure customer satisfaction with our products. We have sales and service centers located in the United States, Europe and Asia.

To support our sales efforts, we maintain and continue to invest in a number of application centers around the world, where our application experts work closely with customers on integrating and using our solutions in their equipment. We currently maintain several service and application centers in the United States, Europe and Asia.

## **Competition**

The markets in which we compete are dynamic and highly competitive. Due to the wide range of our products, we face many different types of competition and competitors. This affects our ability to sell our products and the prices at which these products are sold. Our competitors range from large foreign and domestic organizations, which produce a comprehensive array of goods and services and may have greater financial and other resources than we do, to small firms producing a limited number of goods or services for specialized market segments.

Competitive factors in our Photonics, Vision, and Precision Motion segments include product performance, price, quality and reliability, features, compatibility of products with existing systems, technical support, product breadth, market presence, on-time delivery and our overall reputation. We believe that our products offer a number of competitive advantages. However, some of our competitors are substantially larger and have greater financial and other resources.

## **Raw Materials, Components and Supplies**

Each of our businesses uses a wide variety of raw materials, key components and parts that are generally available from alternative sources of supply and in adequate quantities from domestic and foreign sources. In some instances, we design and/or re-engineer the parts and components used in our products. For certain critical raw materials, key components and parts used in the production of some of our principal products, we have identified only a limited number of suppliers or, in some instances, a single source of supply. We also rely on a limited number of suppliers to manufacture subassemblies for some of our products.

For a further discussion of the importance and risks associated with our supply chain, see applicable risk factors under Item 1A of this Annual Report on Form 10-K.

## **Patents and Intellectual Property**

We rely upon a combination of copyrights, patents, trademarks, trade secret laws and restrictions on disclosure to protect our intellectual property rights. We hold a number of registered and pending patents in the United States and other countries. In addition, we also have trademarks registered in the United States and other countries. We will continue to actively pursue applications for new patents and trademarks as we deem appropriate. However, there can be no assurance that any other patents will be issued to us or that such patents, if and when issued, will provide any protection or benefit to us.

Although we believe that our patents and pending patent applications are important, we rely upon several additional factors that are essential to our business success, including: market position, technological innovation, know-how, application knowledge and product performance. However, there can be no assurance that we will be able to sustain these advantages. Considering the diversified nature of our businesses, we do not believe that any individual patent is material to our business as a whole.

We also protect our proprietary rights by controlling access to our proprietary information and by maintaining confidentiality agreements with our employees, consultants, and certain customers and suppliers. For a further discussion of the importance of risks associated with our intellectual property rights, see applicable risk factors under Item 1A of this Annual Report on Form 10-K.

## Human Resources

As of December 31, 2018 and 2017, we employed 2,133 and 2,034 employees, respectively. We also utilize temporary and contract personnel that are not included in these headcount numbers.

## Government Regulation

Our current and contemplated activities and the products and processes that will result from such activities are subject to substantial government regulations, both in the United States and internationally. Most of our production facilities are subject to various federal, state, local, and/or foreign environmental regulations related to the use, storage, handling, and disposal of regulated materials, chemicals, and certain waste products. Such rules are subject to changes by the governing agencies and we monitor those changes closely.

We may face increasing complexity in our product designs and procurement operations due to the evolving nature of product compliance standards. Those standards may impact the material composition of our products entering specific markets. Such regulations went into effect in the European Union (“EU”) in 2006 (“The Restriction of Hazardous Substances Directive” (“RoHS”)) and in 2007 (“Registration, Evaluation, Authorisation and Restriction of Chemicals” (“REACH”)), and in China in 2007 (“Management Methods for Controlling Pollution Caused by Electronic Information Products Regulation” (“China-RoHS”)).

Our capital expenditures, earnings, and competitive position have not been, and are not expected to be, materially affected by our compliance with federal, state, and local environmental provisions which have been enacted or adopted to regulate the distribution of materials into the environment.

### *Medical Device Regulation*

Certain products manufactured by us are integrated into systems by our customers that are subject to regulation by the United States Food and Drug Administration (the “FDA”). We must comply with certain quality control measurements in order for our products to be effectively used in our customers’ end products. Non-compliance with quality control measurements could result in fines, penalties, and loss of business with our customers.

We are also subject to certain medical device regulations. Medical devices are subject to extensive and rigorous regulation by the FDA and by other federal, state and local authorities. The Federal Food, Drug and Cosmetic Act (the “FDCA”) and related regulations govern the conditions of safety, efficacy, clearance, approval, manufacturing, quality system requirements, labeling, packaging, distribution, storage, recordkeeping, reporting, marketing, advertising, and promotion of products.

### *FDA Premarket Clearance and Approval Requirements*

Unless an exemption applies, each medical device commercially distributed in the United States requires either FDA clearance of a 510(k) premarket notification or approval of a premarket approval application (“PMA”). Under the FDCA, medical devices are classified into one of three classes—Class I, Class II or Class III—depending on the degree of risk associated with each medical device and the extent of manufacturer and regulatory control needed to ensure its safety and effectiveness. Class I includes devices with the lowest risk to the patient and are those for which safety and effectiveness can be assured by adherence to the FDA’s General Controls for medical devices, which include compliance with the applicable portions of the Quality System Regulation (the “QSR”), facility registration and product listing, reporting of adverse medical events, and truthful and non-misleading labeling, advertising, and promotional materials. Class II devices are subject to the FDA’s General Controls and special controls as deemed necessary by the FDA to ensure the safety and effectiveness of the device. These special controls can include performance standards, postmarket surveillance, patient registries and FDA guidance documents. While most Class I devices are exempt from the 510(k) premarket notification requirement, manufacturers of most Class II devices are required to submit to the FDA a premarket notification under Section 510(k) of the FDCA, requesting permission to commercially distribute the device. The FDA’s permission to commercially distribute a device subject to a 510(k) premarket notification is generally known as 510(k) clearance. Devices deemed by the FDA to pose the greatest risks, such as life-sustaining, life-supporting or some implantable devices, or devices that have a new intended use, or use advanced technology that is not substantially equivalent to that of a legally marketed device are placed in Class III, requiring approval of a PMA. Some pre-amendment devices are unclassified, but are subject to the FDA’s premarket notification and clearance process in order to be commercially distributed. In many cases, our customers are responsible for compliance with the FDA’s requirements applicable to medical devices. However, we also currently market certain Class II medical device products independently that are subject to these requirements.

### *510(k) Marketing Clearance Pathway*

To obtain 510(k) clearance, we must submit to the FDA a premarket notification submission demonstrating that the proposed device is “substantially equivalent” to a predicate device already on the market. A predicate device is a legally marketed device that

is not subject to premarket approval, i.e., a device that was legally marketed prior to May 28, 1976 (pre-amendments device) and for which a PMA is not required, a device that has been reclassified from Class III to Class II or Class I, or a device that was found substantially equivalent through the 510(k) process. The FDA's 510(k) clearance process usually takes from nine to twelve months, but may take significantly longer. The FDA may require additional information, including clinical data, to make a determination regarding substantial equivalence.

If the FDA agrees that the device is substantially equivalent to a predicate device currently on the market, it will grant 510(k) clearance to commercially market the device. If the FDA determines that the device is "not substantially equivalent" to a previously cleared device, the device is automatically designated as a Class III device. The device sponsor must then fulfill more rigorous PMA requirements, or can request a risk-based classification determination for the device in accordance with the "de novo" process, which is a route to market for novel medical devices that are low to moderate risk and are not substantially equivalent to a predicate device.

After a device receives 510(k) marketing clearance, any modification that could significantly affect its safety or effectiveness, or that would constitute a major change or modification in its intended use, will require a new 510(k) marketing clearance or, depending on the modification, a de novo classification or PMA approval. The FDA requires each manufacturer to determine whether the proposed change requires submission of a 510(k) or a PMA in the first instance, but the FDA can review any such decision and disagree with a manufacturer's determination. Many minor modifications today are accomplished by a letter-to-file in which the manufacturer documents the change in an internal letter-to-file. The letter-to-file is in lieu of submitting a new 510(k) to obtain clearance for every change. The FDA can always review these letters-to-file in an inspection. If the FDA disagrees with a manufacturer's determination, the FDA can require the manufacturer to cease marketing and/or request the recall of the modified device until 510(k) marketing clearance or PMA approval is obtained. Also, in these circumstances, we may be subject to significant regulatory fines or penalties.

#### *Post-market Regulation*

After a device is cleared or approved for marketing, numerous and pervasive regulatory requirements continue to apply. These include:

- establishment registration and device listing with the FDA;
- QSR requirements, which require manufacturers, including third-party manufacturers, to follow stringent design, testing, control, documentation and other quality assurance procedures during all aspects of the design and manufacturing process;
- labeling and marketing regulations, which require that promotion is truthful, not misleading and fairly balanced, provides adequate directions for use and that all claims are substantiated, and also prohibit the promotion of products for unapproved or "off-label" uses and impose other restrictions on labeling;
- FDA guidance on off-label dissemination of information and responding to unsolicited requests for information;
- clearance or approval of product modifications to 510(k)-cleared devices that could significantly affect safety or effectiveness or that would constitute a major change in intended use of one of the cleared devices;
- medical device reporting regulations, which require that a manufacturer report to the FDA if a device that it markets may have caused or contributed to a death or serious injury, or has malfunctioned and the device or a similar device that it markets would be likely to cause or contribute to a death or serious injury, if the malfunction were to recur;
- correction, removal and recall reporting regulations, which require that manufacturers report to the FDA field corrections and product recalls or removals if undertaken to reduce a risk to health posed by the device or to remedy a violation of the FDCA that may present a risk to health;
- complying with requirements governing Unique Device Identifiers (UDI) on devices and also requiring the submission of certain information about each device to the FDA's Global Unique Device Identification Database (GUDID);
- the FDA's recall authority, whereby the agency can order device manufacturers to recall from the market a product that is in violation of governing laws and regulations; and
- post-market surveillance activities and regulations, which apply when deemed by the FDA to be necessary to protect the public health or to provide additional safety and effectiveness data on the device.

We may be subject to similar foreign laws that may include applicable post-marketing requirements such as safety surveillance. Our manufacturing processes are required to comply with the applicable portions of the QSR, which cover the methods and the facilities and controls for the design, manufacture, testing, production, processes, controls, quality assurance, labeling, packaging, distribution, installation and servicing of finished devices intended for human use. The QSR also requires, among other things, maintenance of a device master file, device history file, and a complaints file. As a manufacturer, we are subject to periodic scheduled or unscheduled inspections by the FDA. Our failure to maintain compliance with the QSR requirements could result in the shut-down

of, or restrictions on, our manufacturing operations and the recall or seizure of our products, which would have a material adverse effect on our business. The discovery of previously unknown problems with any of our products, including unanticipated adverse events or adverse events of increasing severity or frequency, whether resulting from the use of the device within the scope of its clearance or off-label by a physician in the practice of medicine, could result in restrictions on the device, including the removal of the product from the market or voluntary or mandatory device recalls.

The FDA has broad regulatory compliance and enforcement powers. If the FDA determines that we failed to comply with applicable regulatory requirements, it can take a variety of compliance or enforcement actions, which may result in any of the following sanctions:

- warning letters, untitled letters, fines, injunctions, consent decrees and civil penalties;
- recalls, withdrawals, or administrative detention or seizure of our products;
- operating restrictions or partial suspension or total shutdown of production;
- refusing or delaying requests for 510(k) marketing clearance or PMA approvals of new products or modified products;
- withdrawing 510(k) clearances or PMA approvals that have already been granted;
- refusal to grant export or import approvals for our products; or
- criminal prosecution.

#### *Other Healthcare Laws and Regulations*

In the United States and other jurisdictions where we operate our business, there are healthcare laws and regulations that constrain our business operations, including our sales, marketing and promotional activities, and that limit the kinds of arrangements we may have with customers, physicians, healthcare entities and others in a position to purchase or recommend our products or other products or services we may develop and commercialize. These laws include, without limitation: the federal Anti-Kickback Statute, which prohibits, among other things, persons and entities from knowingly and willfully soliciting, receiving, offering or paying remuneration to induce, or in return for, either the referral of an individual or the purchase or recommendation of an item or service for which payment may be made under any federal healthcare program; federal civil and criminal false claims laws and civil monetary penalty laws, which prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, claims for payment to the federal government, including federal healthcare programs, that are false or fraudulent; the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, which created additional federal criminal statutes that prohibit, among other things, executing a scheme to defraud any healthcare benefit program and making false statements relating to healthcare matters; HIPAA, as amended by the Health Information Technology for Economic and Clinical Health Act of 2009, or HITECH, and their implementing regulations, which imposes certain requirements on certain types of individuals and entities relating to the privacy, security and transmission of individually identifiable health information; the federal Physician Payments Sunshine Act, which requires certain manufacturers of drugs, devices, biologics and medical supplies for which payment is available under Medicare, Medicaid or the Children's Health Insurance Program to annually report to the federal government information related to payments or other transfers of value made to physicians and teaching hospitals, as well as ownership and investment interests held by physicians and their immediate family members; and state and foreign law equivalents of each of the above federal laws, which differ from each other in significant ways and may not have the same effect, thus complicating compliance efforts. Violations of these laws may result in substantial civil penalties, including treble damages, and criminal penalties, including imprisonment, fines, the curtailment or restructuring of our operations, and exclusion from participation in governmental healthcare programs. For further information regarding other healthcare laws and regulations that our operations are subject to, see "Item 1A. Risk Factors—Risks Relating to our Business—Our business is indirectly subject to healthcare industry cost containment and healthcare reform measures that could result in reduced sales of our products."

#### **Other Information**

We maintain a website with the address <https://www.novanta.com>. We are not including the information contained on our website as part of, or incorporating it by reference into, this Annual Report on Form 10-K. We make available, free of charge through our website (<https://investors.novanta.com>), our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports as soon as reasonably practicable after we electronically file these materials with, or otherwise furnish them to, the Securities and Exchange Commission ("SEC"). In addition, our reports and other information are filed with securities commissions or other similar authorities in Canada and are available over the Internet at <https://www.sedar.com>.

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

The following risk factors could have a material adverse effect on our business, financial position, results of operations and cash flows and could cause the market value of our common shares to fluctuate or decline. These risk factors may not include all of the important factors that could affect our business or that could cause our future financial results to differ materially from historical or expected results or cause the market price of our common shares to fluctuate or decline.

### **Risks Relating to our Business**

***Our results of operations could be adversely affected by economic and political conditions and the effects of these conditions on our customers' businesses and levels of business activities.***

A large portion of our product sales are dependent on our customers' need for increased capacity, productivity and cost saving initiatives, improved product quality and performance, and new investments. Weaknesses in our end markets could negatively impact our revenue and gross margin and consequently have a material adverse effect on our business, financial condition and results of operations. A severe and/or prolonged overall economic downturn or a negative or uncertain political climate could lead to weaknesses in our end markets and adversely affect our customers' financial condition and the timing or levels of business activity of our customers and the industries we serve. In particular, diminished growth expectations in China, economic and political uncertainty in Europe as Britain negotiates withdrawal from the European Union, as well as political and economic uncertainty in the U.S. could adversely impact our customers' financial condition and ability to maintain product order levels in the future. This may reduce the demand for our products or depress pricing for our products and have a material adverse effect on our results of operations. Changes in global economic conditions could also shift demand for products or services for which we do not have competitive advantages. This could negatively affect the amount of business that we are able to obtain. In addition, if we are unable to successfully anticipate changes in economic and political conditions, we may be unable to effectively plan for and respond to those changes, and our business could be negatively affected.

***Our business depends significantly upon our customers' capital expenditures, which are subject to cyclical market fluctuations.***

Certain sub-segments of the advanced industrial market that we serve, including the microelectronics and industrial capital equipment markets, are cyclical and have historically experienced periods of oversupply, resulting in downturns in demand for capital equipment in which many of our products are used. The timing, length and severity of these downturns and their impact on our business are difficult to predict. Further, our order levels or results of operations for a given period may not be indicative of order levels or results of operations for subsequent periods. For the foreseeable future, our operations will continue to depend upon industries that are subject to market cycles which, in turn, could adversely affect the market demand for our products.

We experienced significant cyclical end market fluctuations in the past. We cannot predict when slowdowns will recur or that the impact of such slowdowns will be more or less significant compared to historical fluctuations.

***Our business success depends upon our ability to respond to fluctuations in product demand, but doing so may require us to incur costs despite limited visibility toward future business declines.***

During a period of increasing demand and rapid growth, we must be able to increase manufacturing capacity quickly. Our inability to quickly increase production in response to a surge in demand could prompt customers to look for alternative sources of supply or leave our customers without a supply, both of which events could harm our reputation and make it difficult for us to retain our existing customers or to obtain new customers and have a material adverse effect on our business.

In periods of weak demand, we may be required to reduce costs while maintaining the ability to motivate and retain key employees at the same time. Additionally, to remain competitive, we must continually invest in research and development, which may inhibit our ability to reduce costs in a down cycle. Long product lead-times create a risk that we may purchase or manufacture inventories of products that we are unable to sell.

***The success of our business depends on our ability to continuously innovate and to manage transitions to new product innovations.***

Technology requirements in our markets are constantly changing. We must continually introduce new products that meet evolving customer needs. Our ability to grow depends on the successful development, introduction and market acceptance of new or enhanced products that address our customers' requirements. Developing new technology is a complex and uncertain process requiring us to accurately anticipate technological and market trends and meet those trends with the right products. Additionally, this requires that we manage the transition from older products to minimize disruption in customer ordering patterns, avoid excess inventory and ensure adequate supplies of new products. Failure to develop new products, failed market acceptance of new products or problems associated with new product transitions could harm our business.

We cannot predict how the market will react to new products introduced by us or to enhancements made to our existing products. If any of our new or enhanced products contain defects or perceived defects or have reliability, quality or compatibility problems or perceived problems, or if our competitors release similar products or enhancements at the same time that are more widely accepted by our customers, our revenue and results of operations for one or more reporting periods could be adversely affected.

***If we fail to introduce new products in a timely manner, we may lose market share and be unable to achieve revenue growth targets.***

Our research and development efforts may not lead to the successful introduction of products within the time frame that our customers demand. Our competitors may introduce new or improved products, processes or technologies that make our current or proposed products obsolete or less competitive. We may encounter delays or problems in connection with our research and development efforts. Product development delays may result from numerous factors, including:

- changing product specifications and customer requirements;
- inability to manufacture new products cost effectively;
- difficulties in reallocating engineering resources and overcoming resource limitations;
- changing market or competitive product requirements; and
- unanticipated engineering complexities.

New products often take longer to develop, may have fewer features than originally considered desirable, and have higher costs than initially estimated. There may be difficulty in sourcing components for new products and delays in starting volume production. New products may also not be commercially successful. Any of these adverse developments could lead to loss of market share and inability to achieve our anticipated revenue growth targets.

***Customer order timing and other factors beyond our control may cause our operating results to fluctuate from period to period.***

Changes in customer order timing and the existence of certain other factors beyond our control may cause our operating results to fluctuate from period to period. Such factors include:

- fluctuations in our customers' businesses;
- timing and recognition of revenues from customer orders;
- timing and market acceptance of new products or enhancements introduced by us or our competitors;
- availability of parts from our suppliers and the manufacturing capacity of our subcontractors;
- decisions by customers to reduce their purchases of our products;
- changes in the prices of our products or of our competitors' products; and
- fluctuations in foreign currency exchange rates.

We may receive several large orders in one quarter from a customer and then receive no orders from that customer in the next quarter. As a result, the timing of revenue recognition from customer orders can cause significant fluctuations in our operating results from quarter to quarter. In addition, our sales are reactive to changes in our customers' businesses. For instance, a customer that placed a large order in one period could subsequently experience a downturn in business and, as a result, could cancel an order or reduce the amount of products it purchases from us in future periods.

A delay in a shipment near the end of a reporting period due to rescheduling or cancellation by customers or unexpected production delays experienced by us may cause revenue in the period to decline significantly and may have a material adverse effect on our operating results for that period.

In addition, we or our competitors may raise or lower prices of products in response to market demands or competitive pressures. If we lower the prices of our products, or if our competitors lower the prices of their products such that demand for our products weakens, our revenue for one or more quarters may decline and our operating results would be adversely affected.

As a result of these factors, our results of operations for any quarter are not necessarily indicative of results to be expected in future periods.

***If we experience a significant disruption in, or breach in security of, our information technology systems, our business may be adversely affected.***

We rely on information technology systems throughout the Company to manage orders, process shipments to customers, manage inventory levels and maintain financial, customer and employee information. Certain events could result in the disruption of our systems, including power outages, computer attacks by hackers, viruses, catastrophes, hardware and software failures and other unforeseen events. If we were to experience a significant period of disruption in information technology systems that involve our interactions with customers or suppliers, it could result in the loss of revenue and customers as well as significant response and mitigation costs, which would adversely affect our business. In addition, security breaches of our information technology systems could result in the misappropriation or unauthorized disclosure of confidential information belonging to us or to our employees, partners, customers or suppliers, which could result in significant financial or reputational damage to us, as well as litigation, regulatory enforcement action, or other liability risks that could lead to substantial damages, fines, penalties and legal costs. We also expend substantial amounts to protect our information technology systems, and if we were to experience a significant breach in security of our information technology systems, we may need to materially increase such expenditures, which would adversely affect our results of operations. Moreover, our insurance to cover costs in the event of a breach may be insufficient to cover such costs.

***Risks associated with data privacy issues, including evolving laws, regulations and associated compliance efforts, may adversely impact our business and financial results.***

Legislation in various countries around the world with regard to cybersecurity, privacy and data protection is rapidly expanding and creating a complex compliance environment. We are subject to many privacy and data protection laws and regulations in the U.S. and around the world, some of which place restrictions on our ability to process personal data across our business. In particular, the General Data Protection Regulation (the “GDPR”), which became effective in May 2018, has caused more stringent data protection requirements in the European Union. The GDPR imposes onerous accountability obligations requiring data controllers and processors to maintain a record of their data processing and implement policies as part of its mandated privacy governance framework. It also requires data controllers to be transparent and disclose to data subjects how their personal information is to be used; imposes limitations on retention of personal data; introduces mandatory data breach notification requirements; and sets higher standards for data controllers to demonstrate that they have obtained valid consent for certain data processing activities. We are subject to the supervision of local data protection authorities in those E.U. jurisdictions where we are established or otherwise subject to the GDPR. Certain breaches of the GDPR requirements could result in substantial fines, which can be up to four percent of worldwide revenue or 20 million Euros, whichever is greater. In addition to the foregoing, a breach of the GDPR could result in regulatory investigations, reputational damage, orders to cease/change our use of data, enforcement notices, as well potential civil claims including class action type litigation where individuals suffer harm. We have invested, and continue to invest, human and technology resources in our GDPR compliance efforts and our data privacy compliance efforts in general. These compliance efforts may be time-intensive and costly. Despite those efforts, there is a risk that we may be subject to fines and penalties, litigation and reputational harm if we fail to protect the privacy of third party data or comply with the GDPR or other applicable regimes.

***As we transact a portion of our sales, and maintain significant cash balances, in foreign currencies, changes in interest rates, credit ratings or foreign currency rates could have a material adverse effect on our financial position, results of operations, and cash flows.***

A portion of our revenue is derived from our European and Asian operations and includes transactions in Euros, British Pounds and Japanese Yen, while our products are mainly manufactured in the U. S., U.K., Germany and China. In the event of a decline in the value of the Euro, British Pounds or Japanese Yen, we would typically experience a decline in our revenues and profit margins. If we increase the selling prices on our products sold in Europe and Asia in order to maintain profit margins and recover costs, we may lose customer sales to lower cost competitors.

Additionally, balances maintained in foreign currencies create additional financial exposure to changing foreign currency rates. If foreign currency rates were to change significantly, we could incur material losses. While we use foreign currency contracts and other risk management techniques to hedge our foreign currency exposure, we cannot be certain that our efforts will be adequate to protect us against significant foreign currency fluctuations or that such efforts will not expose us to additional exchange rate risks.

***Our reliance on international operations in foreign countries subjects us to risks not typically faced by companies operating exclusively in the U.S.***

During the year ended December 31, 2018, approximately 61% of our revenues were derived from operations and customers outside of the U.S. The scope of our international operations subjects us to risks that could materially impact our results of operations, including:

- foreign exchange rate fluctuations;
- increases in shipping costs;

- longer customer payment cycles;
- greater difficulty in collecting accounts receivable;
- use of incompatible systems and equipment;
- problems with staffing and managing foreign operations in diverse cultures;
- trade tariffs;
- trade barriers and export/import controls;
- transportation delays and interruptions;
- increased vulnerability to the theft of, and reduced protection for, intellectual property rights;
- government currency control and restrictions, delays, penalties or required withholdings on repatriation of earnings;
- compliance with foreign laws and regulations, including those that potentially conflict with other jurisdictions;
- the impact of recessionary foreign economies; and
- natural disasters and acts of terrorism.

We also are subject to risks that our operations outside the U.S. could be conducted by our employees, contractors, service providers, representatives or agents in ways that violate the Foreign Corrupt Practices Act or other similar anti-bribery laws. Any such violations could have a negative impact on our business and could result in government investigations and/or injunctive, monetary or other penalties. Moreover, our anti-bribery policy and procedures may be violated by third-party sales representatives or other agents that help sell our products or provide other services. Such representatives or agents are not our employees and it may be more difficult to oversee their conduct, which may increase the risk of violations of anti-bribery laws.

***Increased outsourcing of components manufacturing to manufacturers outside the U.S. leads to additional risks that could negatively impact our business.***

We are increasingly outsourcing the manufacture of subassemblies to suppliers based in China and elsewhere overseas in order to reduce our manufacturing cost. However, economic, political or trade problems with foreign countries could substantially impact our ability to obtain critical parts needed in the timely manufacture of our products, or could substantially increase the costs of these parts. Additionally, this practice increases our vulnerability to the theft of, and reduced protection for, our intellectual property.

***Increases in tariffs, trade restrictions or taxes on our products could have an adverse impact on our operations.***

During the year ended December 31, 2018, approximately 61% of our revenues were derived from operations and customers outside of the U.S. We also manufacture certain of our products and purchase a portion of our raw materials and components from suppliers in China and other foreign countries. The commerce we conduct in the international marketplace makes us subject to tariffs, trade restrictions and other taxes when the raw materials or components we purchase, and the products we ship, cross international borders. Trade tensions between the U.S. and China, as well as those between the U.S. and Canada, Mexico and other countries have been escalating in recent months. Most notably, three rounds of U.S. tariffs were placed on Chinese goods being exported to the U.S., with such tariffs taking effect in July, August and September 2018. Each of these U.S. tariff impositions against Chinese exports were followed by a round of retaliatory Chinese tariffs on U.S. exports to China. Certain of the raw materials and components we purchase from China are subject to these tariffs, which has increased our manufacturing costs and could make our products less competitive than those of our competitors whose inputs are not subject to these tariffs. Certain of our finished products manufactured in the U.S. have been subject to the retaliatory tariffs in China, which has increased our cost and made our products less competitive than those of our competitors whose products are not subject to such retaliatory tariffs. In addition, the U.S. administration has threatened to impose tariffs on all products imported from China, which would impact all of our products and supplies imported from China to the U.S.; and the Chinese government has threatened to levy additional retaliatory tariffs on U.S. manufactured goods. If these were to occur, we may not be able to mitigate the impacts of these tariffs, and our business, results of operations and financial position would be materially adversely affected. Products we sell into certain foreign markets could also become subject to similar retaliatory tariffs, making the products we sell uncompetitive to similar products not subjected to such import tariffs. Further changes in U.S. trade policies, tariffs, taxes, export restrictions or other trade barriers, or restrictions on raw materials or components may limit our ability to produce products, increase our manufacturing costs, decrease our profit margins, reduce the competitiveness of our products, or inhibit our ability to sell products or purchase raw materials or components, which would have a material adverse effect on our business, results of operations and financial conditions.

***Our global operations are subject to extensive and complex import and export rules that vary among the legal jurisdictions in which we operate. Failure to comply with these rules could result in substantial penalties.***

Due to the international scope of our operations, we are subject to a complex system of import and export related laws and regulations, including U.S. export control and customs regulations and customs regulations of other countries. These regulations are complex and vary among the legal jurisdictions in which we operate. Any alleged or actual failure to comply with such regulations may subject us to government scrutiny, investigation and civil and criminal penalties, and may limit our ability to import or export our products or to provide services outside the U.S. Any of these penalties could have a material adverse effect on our financial position, results of operations and cash flows. Additionally, the U.K. is likely to implement new import and export rules as part of the process of exiting the European Union. There will likely be new costs of compliance associated with such rules, as well as the additional risk of penalties for failure to comply.

***The U.K.'s plan for withdrawal from the European Union and the actions of the current U.S. government may have a negative effect on global economic conditions, financial markets and our business, which could reduce the price of our common shares.***

We are a multinational company with worldwide operations, including business operations and investments in the U. K., Germany and China. In March 2017, Prime Minister Theresa May of the U.K. formally began the process of withdrawing the U. K. from the European Union, following the June 2016 referendum in which a majority of voters in the U. K. supported such withdrawal. The terms of the withdrawal are subject to a negotiation period that could last at least until March 2019. The announcement has created significant uncertainty about the future relationship between the U. K. and the European Union, and has given rise to calls for the governments of other European Union member states to consider withdrawal. If the U. K. and the European Union are unable to negotiate acceptable withdrawal terms or if other European Union member states pursue withdrawal, barrier-free access between the U. K. and other European Union member states or among the European economic area overall could be diminished or eliminated. These developments in turn may inhibit our sales of products, mobility of our personnel, and our access to capital.

The policies of the current U.S. government regarding U.S. trade, tax and health care policies, among other things, have led to substantial uncertainty in global financial markets. The current U.S. government has withdrawn the U.S. from the Trans-Pacific Partnership trade agreement, has re-negotiated the North American Free Trade Agreement (“NAFTA”) and has made various comments suggesting the possible re-negotiation of, or withdrawal from, other trade agreements, has imposed significant tariffs on imports from China and other countries, and has suggested the potential imposition of other significant new import barriers. The current U.S. government has also enacted comprehensive tax law reform, and attempted to repeal the U.S. Patient Protection and Affordable Care Act (the “PPACA”), and may continue to seek repeal of the PPACA. These developments and the lack of clarity regarding future U.S. tax, trade and health care policies have created significant uncertainty that could have a material adverse effect on global economic conditions and the stability of global financial markets. Any major changes in these policies could have a material adverse effect on our business, financial condition and results of operations and reduce the price of our common shares. Because of the global nature of our business, and our strategy to increase our sales to the medical market, our business may be particularly impacted by any major changes in U.S. trade, tax and health care policies.

***Others may violate our intellectual property rights and cause us to incur significant costs to protect our rights.***

Our future success depends in part upon our intellectual property rights, including patents, trade secrets, know-how and continuing technological innovation. We do not have personnel dedicated to the oversight, organization and management of our intellectual property. There can be no assurance that the steps we take to protect our intellectual property rights will be adequate to prevent misappropriation or disclosure. It is possible that, despite our efforts, other parties may use, obtain or try to copy our technology and products. There can be no assurance that other companies are not investigating or developing other technologies similar to ours, that any patents will be issued from any application filed by us, or that, if patents are issued, the claims allowed will be sufficient to deter or prohibit others from marketing similar products. In addition, our patents may be challenged, invalidated or circumvented in a legal or administrative proceeding. Policing unauthorized use of our intellectual property rights is difficult and time consuming and may involve initiating claims or litigation against third parties for infringement of our proprietary rights, which could be costly and divert management resources.

Our efforts to protect our intellectual property rights against infringement may not be effective in some foreign countries where we operate or sell our products. If we fail to adequately protect our intellectual property in these countries, we may lose significant business to our competitors.

***Our operating results would suffer if we are unable to successfully defend against infringement claims by third parties.***

We have received in the past, and could receive in the future, notices from third parties alleging that our products infringe patent or other proprietary rights. These allegations could result in significant costs and diversion of the attention of management. Adverse consequences may also apply if we fail to avoid or successfully defend litigation for infringement or misappropriation of proprietary rights of third parties. If a successful claim were brought against us and we were found to have infringed a third-party's intellectual

property rights, we could be required to pay substantial amounts for damages or be enjoined from using the technology deemed to be infringing, or from using, making or selling products deemed to be infringing, any of which could adversely affect our operating results. If we have supplied infringing products to third parties, we may be obligated to indemnify these third parties for any damages that they may be required to pay to the patent holder and for any losses that they may sustain as a result of the infringement.

***We operate in highly competitive industries and, if we lose competitive advantages, our business would suffer adverse consequences.***

Some of our competition comes from established competitors that have greater financial, engineering, manufacturing and marketing resources than we do. Our competitors will continue to improve the design and performance of their existing products and introduce new products. It is possible that we may not successfully differentiate our current and proposed products from the products of our competitors, or that the marketplace will not consider our products to be superior to competing products. To remain competitive, we will be required to invest heavily in research and development, marketing and customer service and support. However, we may not be able to make the necessary technological advances to maintain our competitive position and our products may not receive market acceptance. These factors would cause us not to be able to compete successfully in the future. Increased competition may also result in price reductions, reduced profit margins, loss of market share and an inability to generate cash flows that are sufficient to maintain or expand our new product development programs.

***Our results of operations will be adversely affected if we fail to successfully integrate future acquisitions or to grow the acquired businesses.***

As part of our business strategy, we expect to broaden our product and service offerings by acquiring businesses, technologies, assets and product lines that, we believe, complement or expand our existing businesses. In recent years, we have made a number of acquisitions, including the acquisitions of W.O.M. World of Medicine GmbH, Laser Quantum Limited and Zettlex Limited, and we expect to continue to make acquisitions in the future. We may fail to successfully identify appropriate acquisition candidates or integrate acquired businesses, products, technologies or personnel into our businesses and, as a result, may fail to realize the synergies, cost savings and other benefits expected from the acquisitions. If we are not able to successfully achieve these objectives, the anticipated benefits of such acquisitions may not be realized fully or at all, and our results of operations could be adversely affected. As a result of the number of recent and expected future acquisitions in a relatively short amount of time, these risks may be heightened due to limited resources available to integrate these new businesses. Our acquisition activities may divert management's attention from our regular operations. Managing a larger and more geographically dispersed operation and product portfolio could also pose challenges for our management team.

Further, our ability to maintain and increase profitability of an acquired business will depend on our ability to manage and control operating expenses and to generate and sustain increased levels of revenue. Our expectations to achieve more consistent and predictable levels of revenue and to increase profitability as a result of any acquisition may not be realized. Such revenues and profitability may even decline as we integrate operations into our businesses. If revenues of acquired businesses decline or grow more slowly than we anticipate, or if their operating expenses are higher than we expect, we may not be able to sustain or increase their profitability, in which case our financial condition will suffer and our stock price could decline. In addition, through our acquisitions, we may assume liabilities, losses or costs for which we are not indemnified or insured or for which our indemnity or insurance is inadequate. Any such liabilities may have a material adverse effect on our financial position or results of operations.

***If we do not attract and retain our key personnel, our ability to execute our business strategy will be limited.***

Our success depends, to a significant extent, upon the continued service of our executive officers, key management and technical personnel, particularly our experienced engineers, and upon our ability to continue to attract, retain, and motivate qualified personnel. The competition for these employees is intense. The loss of the services of one or more of our key personnel could have a material adverse effect on our operating results. In addition, there could be a material adverse effect on us should the turnover rates for engineers and other key personnel increase significantly or if we are unable to continue to attract qualified personnel.

Our success also depends on our ability to execute leadership succession plans. The inability to successfully transition key management roles could have a material adverse effect on our operating results.

***We have undertaken restructuring and realignment activities in the past, and we will continue to assess our operating structure in the future. These actions may not improve our financial position, and may ultimately prove detrimental to our operations and sales.***

We have undertaken restructuring and realignment activities in the past, and we will continue to assess our operating structure in the future. Our ability to reduce operating expenses is dependent upon the nature of the actions we take to reduce expenses and our subsequent ability to implement those actions and realize expected cost savings. We may need to take additional restructuring actions, such as eliminating or consolidating certain of our facilities or operations, reducing our headcount, or eliminating certain positions for

a variety of reasons, including deterioration in global economic conditions or significant declines in demand for our products. Failure to successfully implement such restructuring activities could adversely affect our ability to meet customer demand for our products and could increase the cost of production versus our projections, both of which could adversely impact our operating results. Further, expenses and cost inefficiencies associated with our restructuring activities, including severance costs and the loss of trained employees with knowledge of our business and operations, could exceed our expectations and negatively impact our financial results.

***Product defects or problems with integrating our products with other vendors' products used by our customers may seriously harm our business and reputation.***

We produce complex products that can contain latent defects or performance problems. This could happen to both existing and new products. Such defects or performance problems could result in litigation against us and be detrimental to our business and reputation.

In addition, customers frequently integrate our products with other vendors' products. When problems occur in a combined environment, it may be difficult to identify the source of the problem. These problems may cause us to incur significant warranty and repair costs, divert the attention of our engineering personnel from our product development efforts, and cause significant customer relationship issues, any of which could adversely affect our results of operations and financial condition.

***Disruptions in the supply of certain key components and other goods from our suppliers, including limited or single source suppliers, could have an adverse effect on the results of our business operations, and could damage our relationships with customers.***

The production of our products requires a wide variety of raw materials, key components and other goods that are generally available from alternate sources of supply. However, certain critical raw materials, key components and other goods required for the production of some of our principal products are available from limited or single source of supply. If a single source supplier decides to stop producing a key component for us, or if the receipt of certain limited source or single source materials is otherwise delayed, our relationship with customers may be harmed if such decisions or delays cause us to miss our scheduled shipment deadlines. Our current or alternative sources may not be able to continue to meet all of our demands on a timely basis. If suppliers or subcontractors experience difficulties or fail to meet our manufacturing requirements, our business would be harmed until we are able to secure alternative sources, if any, on commercially reasonable terms. A prolonged inability to obtain certain raw materials, key components or other goods is possible and could have a significant adverse effect on our business operations, damage our relationships with customers, or even lead to permanent loss of customer orders.

In addition, certain of our businesses buy components, including limited or sole source items, from competitors of our other businesses. This dynamic may adversely impact our relationship with these suppliers. For example, these suppliers could increase the price of those components or reduce their supply of those components to us, which could have a significant adverse effect on our business operations or lead to permanent loss of customer orders.

***If we fail to accurately forecast component and raw material requirements for our products, we could incur additional costs and experience significant delays in shipments, which could have an adverse effect on the results of our business operations, and could damage our relationships with customers.***

We use rolling forecasts based on anticipated product orders to determine our production requirements. It is important that we accurately predict both the demand for our products and the lead times required to obtain the necessary components and raw materials to manufacture our products. Lead times for our components and raw materials vary significantly and depend on factors including the specific supplier requirements, the size of the order, contract terms and current market demand. For substantial increases in our sales levels of certain products, some of our suppliers may need significant lead time. If we overestimate our component and raw material requirements, we may have excess inventory, which would increase our costs. If we underestimate our component and raw material requirements, we may have inadequate inventory, which could interrupt and delay delivery of our products to customers. Any of these occurrences could adversely affect our results of operations and damage our relationships with customers.

***Production difficulties and product delivery delays or disruptions could have a material adverse effect on our business.***

We assemble our products at our facilities in the U.S., the U. K., Germany and China. Each of our products is typically manufactured in a single manufacturing location. If production activities at any of our manufacturing facilities were disrupted by a natural disaster or otherwise, our operations would be negatively impacted until we could establish alternative production and service operations. Significant production difficulties could be the result of:

- mistakes made while transferring manufacturing processes between locations;
- changing process technologies;
- ramping production;

- installing new equipment at our manufacturing facilities;
- implementing new information technology systems;
- shortage of key components; and
- loss of electricity or employees' access to the manufacturing facilities due to man-made and natural disasters.

From time to time, we determine to consolidate certain of our manufacturing facilities, or otherwise move our production of certain products to another facility. Moving complicated manufacturing facilities involves various risks, including the inability to commence production within the cost and timeframe estimated, damage to equipment, inability to produce a high-quality product, shipping delays, distraction to management and employees, and the inability to hire and retain a sufficient number of qualified personnel. Failure to successfully move manufacturing facilities due to these and other unforeseen risks could adversely affect our ability to meet customer demand, harm our relationships with customers, and adversely impact our results of operations and financial position.

In addition, we may experience product delivery delays in the future. We ship a significant portion of our products to our customers through independent package delivery and import/export companies. We also ship our products through national trucking firms, overnight carrier services and local delivery practices. If one or more of the package delivery or import/export providers experience significant disruption in services or institutes a significant price increase, the delivery of our products could be disrupted or delayed. Such events could cause us to incur increased shipping costs that could not be passed on to our customers, negatively impacting our profitability and our relationships with customers.

***We are subject to extensive and dynamic medical device regulation, which may impede or hinder the approval or sale of our products and, in some cases, may ultimately result in an inability to obtain approval of certain products or may result in the recall or seizure of previously approved products.***

Some of our products and the related sales and marketing development activities and manufacturing processes are subject to extensive and rigorous regulation by the FDA pursuant to the Federal Food, Drug, and Cosmetic Act (the "FDCA"), by comparable agencies in foreign countries, and by other regulatory agencies and governing bodies. Under the FDCA, medical devices must receive FDA clearance or approval or an exemption from such clearance or approval before they can be commercially marketed in the U.S. In the European Union, we are required to comply with applicable medical device directives (including the Medical Devices Directive) and to obtain CE Mark certification in order to market medical devices. The CE Mark is applied following approval from an independent notified body or declaration of conformity. The process of obtaining marketing approval or clearance from the FDA or by comparable agencies in foreign countries for new products, or with respect to enhancements or modifications to existing products, could:

- take a significant period of time;
- require the expenditure of substantial resources;
- involve rigorous pre-clinical and clinical testing, as well as increased post-market surveillance;
- require changes to products; and
- result in limitations on the indicated uses of products.

In addition, exported devices are subject to the regulatory requirements of each country to which the device is exported. Some countries do not have medical device regulations, but in most foreign countries, medical devices are regulated. Most countries outside of the U.S. require that product approvals be renewed or recertified on a regular basis, generally every four to five years. The renewal or recertification process requires that we evaluate any device changes and any new regulations or standards relevant to the device and conduct appropriate testing to document continued compliance. Where renewal or recertification applications are required, they may need to be renewed and/or approved in order for us to continue selling our products in those countries. There can be no assurance that we will receive the required approvals for new products or modifications to existing products on a timely basis or that any approval will not be subsequently withdrawn or conditioned upon extensive post-market study requirements.

In addition, on April 5, 2017, the European Parliament passed the Medical Devices Regulation (the "MDR") which repeals and replaces the EU Medical Devices Directive. Unlike directives, which must be implemented into the national laws of the European Economic Area (the "EEA") member states, the regulations are directly applicable (i.e., without the need for adoption of EEA member state laws implementing them) in all EEA member states and are intended to eliminate current differences in the regulation of medical devices among EEA member states. The MDR, among other things, is intended to establish a uniform, transparent, predictable and sustainable regulatory framework across the EEA for medical devices and in vitro diagnostic devices and ensure a high level of safety and health while supporting innovation. The MDR will, however, only become applicable three years after publication. Once applicable, the new regulations will, among other things:

- strengthen the rules on placing devices on the market and reinforce surveillance once they are available;

- establish explicit provisions on manufacturers' responsibilities for the follow-up of the quality, performance and safety of devices placed on the market;
- improve the traceability of medical devices throughout the supply chain to the end-user or patient through a unique identification number;
- set up a central database to provide patients, healthcare professionals and the public with comprehensive information on products available in the European Union; and
- strengthen rules for the assessment of certain high-risk devices, such as implants, which may have to undergo an additional check by experts before they are placed on the market.

We face uncertainties as the MDR is rolled out and enforced by the European Commission and EEA competent authorities, creating risks in several areas including the CE Marking process and data transparency in the upcoming years.

The FDA and other worldwide regulatory agencies actively monitor compliance with local laws and regulations through review and inspection of design and manufacturing practices, recordkeeping, reporting of adverse events, labeling and promotional practices. The FDA can ban certain medical devices; detain or seize adulterated or misbranded medical devices; order recall, repair, replacement or refund of these devices; and require notification of healthcare professionals and others with regard to medical devices that present unreasonable risks of substantial harm to the public health. The FDA can take action against a company that promotes "off-label" uses. The FDA may also enjoin and restrain a company for certain violations of the FDCA and regulations pertaining to medical devices, or initiate action for criminal prosecution of such violations. Any adverse regulatory action, depending on its magnitude, may restrict a company from effectively marketing and selling its products, may limit a company's ability to obtain future premarket clearances or approvals, and could result in a substantial modification to the company's business practices and operations. International sales of medical devices manufactured in the U.S. that are not approved by the FDA for use in the U.S., or that are banned or deviate from lawful performance standards, are subject to FDA export requirements.

Regulations regarding the development, manufacture and sale of medical devices are evolving and subject to future change. We cannot predict what impact, if any, those changes might have on our business. Failure to comply with regulatory requirements could have a material adverse effect on our business, financial condition and results of operations. Later discovery of previously unknown problems with a product or manufacturer could result in fines, delays or suspensions of regulatory clearances or approvals, seizures or recalls of products, physician advisories or other field actions, operating restrictions and/or criminal prosecution. We may also initiate field actions as a result of a failure to strictly comply with our internal quality policies. The failure to receive product approval clearance on a timely basis, suspensions of regulatory clearances, seizures or recalls of products, physician advisories or other field actions, or the withdrawal of product approval by the FDA or by comparable agencies in foreign countries could have a material adverse effect on our business, financial condition and results of operations.

***Our products and operations are subject to various foreign, U.S. federal, and state healthcare laws and regulations, which could expose us to penalties.***

Our products and our operations may be directly, or indirectly through our customers, subject to various foreign, U.S. federal and state healthcare laws and regulations, including, without limitation, anti-kickback, false claims and privacy statutes. These laws may restrict, among other things, the development, sales, marketing and distribution of our products. These laws include:

- the federal Anti-Kickback Statute, which prohibits, among other things, persons from knowingly and willfully soliciting, receiving, offering or paying remuneration, directly or indirectly, to induce, or in return for, the purchase or recommendation of an item or service reimbursable under a federal healthcare program, such as the Medicare and Medicaid programs;
- federal civil and criminal false claims laws and civil monetary penalty laws, which prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, false or fraudulent claims for payment from Medicare, Medicaid, or other third-party payors;
- the federal Health Insurance Portability and Accountability Act of 1996, or HIPPA, which created new federal criminal statutes that prohibit executing a scheme to defraud any healthcare benefit program and making false statements relating to healthcare matters;
- HIPAA as amended by the Health Information Technology and Clinical Health Act, or HITECH, and its implementing regulations, which imposes certain requirements relating to the privacy, security, and transmission of individually identifiable health information;

- the federal physician “sunshine” requirements under PPACA, which requires manufacturers of drugs, devices, biologics, and medical supplies to report annually to CMS information related to payments and other transfers of value to physicians, other healthcare providers, and teaching hospitals, and ownership and investment interests held by physicians and other healthcare providers and their immediate family members;
- state and foreign law equivalents of each of the above federal laws, such as anti-kickback and false claims laws that may apply to items or services reimbursed by any third-party payor, including commercial insurers; state laws that require device manufacturers to comply with the industry’s voluntary compliance guidelines and the applicable compliance guidance promulgated by the federal government, or otherwise restrict payments that may be made to healthcare providers and other potential referral sources; state laws that require device manufacturers to report information related to payments and other transfers of value to physicians and other healthcare providers or marketing expenditures; and state laws governing the privacy and security of health information in certain circumstances, many of which differ from each other in significant ways, thus complicating compliance efforts.

Efforts to ensure that our business operations comply with applicable healthcare laws may involve substantial costs. If our operations are found to be in violation of any of these laws or any other governmental regulations that may apply to us, we may be subject to, without limitation, civil, criminal and administrative penalties, damages, monetary fines, disgorgement, possible exclusion from participation in governmental healthcare programs, contractual damages, reputational harm, diminished profits and future earnings and curtailment or restructuring of our operations. Further, defending against any such actions can be costly, time-consuming and may require significant financial and personnel resources. Therefore, even if we are successful in defending against any such actions that may be brought against us, our business may be impaired.

***Our business is indirectly subject to healthcare industry cost containment and healthcare reform measures that could result in reduced sales of our products.***

Several of our customers rely on third party payors, such as government programs and private health insurance plans, to reimburse some or all of the cost of the procedures in which our products are used. The continuing efforts of governments, insurance companies and other payors of healthcare costs to contain or reduce those costs could lead to patients being unable to obtain approval for payment from these third-party payors for procedures in which our products are used. If that occurred, sales of medical devices may decline significantly and our customers may reduce or eliminate purchases of our products, or demand further price reductions. The cost containment measures that healthcare payors are instituting, both in the U.S. and internationally, could reduce our revenues and harm our operating results.

In addition, in the U.S. and other jurisdictions, there have been, and we expect there will continue to be, a number of legislative and regulatory changes and proposed changes to reform healthcare systems. For example, PPACA imposes an annual excise tax of 2.3% on any entity that manufactures or imports medical devices offered for sale in the U.S., with limited exceptions, although the effective rate paid may be lower. Through a series of legislative amendments, the excise tax was suspended through December 31, 2019. On December 14, 2018, a U.S. District Court Judge in the Northern District of Texas ruled that the PPACA was invalid due to the legislative repeal of the individual mandate. While the ruling will have no immediate effect, it is unclear how this decision, subsequent appeals, if any, and other efforts to repeal and replace the PPACA will impact the PPACA and our business. There may be additional challenges and amendments to the PPACA in the future. Other elements of health care reform such as comparative effectiveness research, an independent payment advisory board, payment system reforms including shared savings pilots and other provisions could meaningfully change the way healthcare is developed and delivered, and may materially adversely impact numerous aspects of our business, results of operations and financial condition. Changes in governmental regulations related to our business or our products could reduce demand for our products or increase our expenses.

We are subject to many governmental regulations, including, but not limited to, the laser radiation safety regulations of the Radiation Control for Health and Safety Act administered by the National Center for Devices and Radiological Health, a branch of the FDA, and certain health regulations related to the manufacture of products using beryllium, an element used in some of our products. Among other things, these regulations require us to file annual reports, to maintain quality control and sales records, to perform product testing, to distribute appropriate operating manuals, to conduct safety reviews, to incorporate design and operating features in products sold to end-users, and to certify and label our products. Depending on the class of the product, various warning labels must be affixed and certain protective devices must be installed.

We are also subject to regulatory oversight, including comparable enforcement mechanisms, in the markets we serve. We compete in many markets in which we and our customers must comply with federal, state, local and international regulations, such as environmental, health and safety and food and drug regulations. We develop, configure and market our products to meet customer needs created by those regulations. Any significant changes in these regulations could reduce demand for our products or increase our expenses, which in turn could adversely affect our business, financial condition, results of operations and cash flows.

***Compliance or the failure to comply with current and future environmental regulations could result in significant costs.***

Our operations are subject to a variety of federal, state, local and international environmental regulations relating to the use, storage, discharge and disposal of hazardous chemicals used during our manufacturing process or the recycling of products we manufacture. We are subject to regulations of the Environmental Protection Agency in the U.S. and comparable authorities in other countries. If we fail to comply with any present or future regulations, we could be subject to regulatory fines.

Future developments, administrative actions or liabilities relating to environmental matters could have a material adverse effect on our business, results of operations or financial condition. It is difficult to anticipate how such regulations will be implemented and enforced. We continue to evaluate the necessary steps for compliance with regulations as they are enacted. Certain regulations may require us to redesign our products to ensure compliance with the applicable standards. These redesigns may adversely affect the performance of our products, add greater testing lead-times for product introductions and reduce our profitability.

***If we fail to implement new information technology systems successfully, our business could be adversely affected.***

We rely on centralized information systems throughout the Company to keep financial records, process orders, manage inventory, process shipments to customers, and operate other critical functions. We are in the process of upgrading our information technology infrastructure, including implementing new enterprise resource planning (“ERP”) systems and other complementary information technology systems. We have invested, and will continue to invest, significant capital and human resources in the upgrades and new ERP systems. Any disruptions, delays or deficiencies in the transition, design and implementation of the upgrades and new ERP systems, particularly any disruptions, delays or deficiencies that impact our operations, could have a material adverse effect on our results of operations and cash flows.

We may experience difficulties as we transition to these new upgraded systems and processes, including loss of data and the ability to process customer orders, ship products, provide services and support to our customers, issue sales invoices, collect accounts receivable, fulfill contractual obligations, satisfy internal and external financial reporting requirements in a timely manner, or otherwise run our business. We may also experience decreases in productivity as our personnel implement these systems and become familiar with the new systems. In addition, as we are dependent upon our ability to gather and promptly transmit accurate information to key decision makers, our business, results of operations and financial condition may be materially and adversely affected if our information technology infrastructure does not allow us to transmit accurate information, even for a short period of time. Furthermore, the transition, design and implementation of upgrades and new ERP systems may be much more costly than we anticipated.

***Our results of operations will be adversely affected if we fail to realize the full value of our intangible assets.***

As of December 31, 2018, we had \$360.6 million of net intangible assets, including goodwill, on our consolidated balance sheet. Net intangible assets consist principally of goodwill, customer relationships, patents, trademarks, core technologies and technology licenses. Goodwill and indefinite-lived intangible assets are tested for impairment at least on an annual basis. All other intangible assets are evaluated for impairment should discrete events occur that call into question the recoverability of the intangible assets.

Adverse changes in our business, adverse changes in the assumptions used to determine the fair value of our reporting units, or the failure to grow our businesses may result in an impairment of our intangible assets, which could adversely affect our results of operations.

***We are exposed to the credit risk of some of our customers and to credit exposures in weakened markets, which could adversely affect our results of operations.***

Customers with liquidity issues may lead to additional bad debt expense. There can be no assurance that our open credit customers will pay the amounts they owe to us or that the reserves we maintain will be adequate to cover such credit exposures. In addition, to the extent that turmoil in the credit markets or increases in interest rates make it more difficult for some customers to obtain financing, their ability to pay may be adversely impacted. Our customers’ failure to pay and/or our failure to maintain sufficient reserves could have a material adverse effect on our future cash flows and financial condition.

***Our reliance upon third party distribution channels subjects us to credit, inventory, business concentration, and business failure risks beyond our control.***

We sell many of our products through resellers, distributors, and system integrators. As these third parties tend to have more limited financial resources than OEM and end-user customers, they generally represent sources of increased credit risk. Any downturn in the business of our resellers, distributors, and systems integrators would in turn harm our results of operations and financial condition.

Our sales also depend upon the ability of our OEM customers to develop and sell systems that incorporate our products. Adverse economic conditions, large inventory positions, limited marketing resources and other factors influencing these OEM customers could have a substantial adverse effect on our financial results. We cannot assure investors that our OEM customers will not experience financial or other difficulties that could adversely affect their operations and, in turn, adversely affect our results of operations and financial condition.

## **Risks Relating to Taxes**

***Novanta Inc. may be subject to U.S. federal income taxation even though it is a non-U.S. corporation.***

Novanta, Inc. is a holding company organized in Canada and is subject to Canadian tax laws. However, we are also subject to U.S. tax rules and file U.S. federal income tax returns for our operations in the U.S. In addition, distributions or payments from entities in one jurisdiction to entities in another jurisdiction may be subject to income and/or withholding taxes. We do not intend to operate in a manner that will cause Novanta, Inc. to be treated as engaged in a U.S. trade or business or otherwise be subject to U.S. federal income taxes on its income, but it generally will be subject to U.S. federal withholding tax on certain U.S.-sourced passive income items, such as dividends and certain types of interest.

***Tax audits by tax authorities could adversely affect future results.***

We are subject to regular examination of our income tax returns by the Internal Revenue Service (“IRS”) and other tax authorities. We regularly assess the likelihood of favorable or unfavorable outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. Although we believe our tax estimates are reasonable, there can be no assurance that any final determination will not be materially different than the treatment reflected in our historical income tax provisions and accruals, which could materially and adversely affect our financial condition, net income and earnings per share.

***Our effective tax rate is subject to fluctuation, which could impact our financial position and earnings per share.***

Our effective tax rate is subject to fluctuation as the effective income tax rate for each year is a function of (a) taxable income levels in numerous tax jurisdictions, (b) our ability to utilize recognized deferred tax assets, (c) taxes, interest, or penalties resulting from tax audits and, (d) credits and deductions as a percentage of total taxable income. From time to time, the U.S., foreign and state governments make substantive changes to tax rules where significant judgment is required to determine the impact of such changes on our provision for income taxes, which may result in increased costs. Further, such tax law changes may cause our effective tax rate to fluctuate between periods.

## **Risks Relating to Our Common Shares and Our Capital Structure**

***We may require additional capital to adequately respond to business challenges or opportunities and repay or refinance our existing indebtedness, but this capital may not be available on acceptable terms or at all.***

We may require additional capital to adequately respond to future business challenges or opportunities, including, but not limited to, the need to develop new products or enhance our existing products, maintaining or expanding research and development projects, the need to build inventory or to invest other cash to support business growth, and opportunities to acquire complementary businesses and technologies.

As of December 31, 2018, we had outstanding debt of \$209.6 million under the amended and restated senior secured credit agreement (the “Second Amended and Restated Credit Agreement”) and \$189.9 million available to be drawn under the revolving credit facility. If we are unable to satisfy the conditions in the Second Amended and Restated Credit Agreement or our needs exceed the amounts available under the revolving credit facility, we may need to engage in equity or debt financings to obtain additional funds. If we raise additional funds through further issuances of equity or convertible debt securities, our existing shareholders could suffer significant dilution. Any new equity securities we issue could have rights, preferences and privileges superior to those of the holders of our common shares. Further, our Second Amended and Restated Credit Agreement restricts our ability to obtain additional debt financing from other sources. If we are unable to obtain adequate financing or obtain financing on terms satisfactory to us when we need it, our ability to continue to support our business growth and to respond to business challenges could be significantly limited. In addition, the terms of any additional equity or debt issuances may adversely affect the value and price of our common shares.

Global credit conditions have varied widely over the past decade and could continue to vary significantly in the future. Although these conditions have not affected our current plans, adverse credit conditions in the future could have a material negative impact on our ability to execute on future strategic initiatives.

***Our existing indebtedness could adversely affect our future business, financial condition and results of operations.***

As of December 31, 2018, we had \$209.6 million of outstanding debt. This level of debt could have significant consequences on our future operations, including:

- reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts, acquisitions and other general corporate purposes, and limiting our ability to obtain additional financing for these purposes;
- limiting our flexibility in planning for or reacting to, and increasing our vulnerability to, changes in our business, changes in the general economic environment, and market changes in the industries in which we operate; and
- placing us at a competitive disadvantage compared to our competitors that have less debt or are less leveraged.

Any of these factors could have an adverse effect on our business, financial condition and results of operations.

In addition, as a global corporation, we have significant cash reserves held in foreign countries. Some of these balances may not be immediately available to repay our debt.

Our Second Amended and Restated Credit Agreement contains covenants that limit our ability to engage in activities that may be in our long-term best interests. Our failure to comply with those covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all of our borrowings thereunder.

***The market price for our common shares may be volatile.***

The market price of our common shares could be subject to wide fluctuations. These fluctuations could be caused by:

- quarterly variations in our results of operations;
- changes in earnings estimates by analysts;
- conditions in the markets we serve; or
- general market or economic conditions.

In addition, the stock market has experienced extreme price and volume fluctuations in recent years. These fluctuations have had a substantial effect on the market prices of many companies, often unrelated to the operating performance of the specific companies. These market fluctuations could adversely affect the price of our common shares.

***Certain provisions of our corporate documents may delay or prevent a change in control of the Company.***

Our corporate documents and our existence as a corporation under the laws of New Brunswick subject us to provisions of Canadian law that may enable our Board of Directors to resist a change in control of the Company. These provisions include:

- limitations on persons authorized to call a special meeting of shareholders;
- the ability to issue an unlimited number of common shares; and
- advance notice procedures required for stockholders to nominate candidates for election as directors or to bring matters before an annual meeting of shareholders.

These anti-takeover defenses could discourage, delay or prevent a transaction involving a change in control of the Company. These provisions could also discourage proxy contests and make it more difficult for shareholders to elect directors of their choosing and cause us to take other corporate actions that shareholders desire. In addition, under New Brunswick law, cumulative voting is mandatory in director elections which can result in stockholders holding less than a majority of shares being able to elect persons to the Board of Directors and prevent a majority stockholder from controlling the election of all of the directors.

**Risks Relating to Our Internal Controls**

***If we fail to maintain appropriate internal controls in the future, we may not be able to report our financial results accurately, which may adversely affect our stock price and our business.***

While our management and our independent registered public accounting firm concluded that our internal control over financial reporting was effective as of December 31, 2018, it is possible that material weaknesses may be identified in the future.

If we are unable to maintain effective internal controls, we may not have adequate, accurate or timely financial information, and we may be unable to meet our reporting obligations as a publicly traded company or to comply with the requirements of the SEC or the

Sarbanes-Oxley Act of 2002. This could result in a restatement of our financial statements, the imposition of sanctions, including the inability of registered broker dealers to make a market in our common shares, or investigation by regulatory authorities. Any such action or other negative results caused by our inability to meet our internal control and financial reporting requirements or to comply with legal and regulatory requirements could adversely affect the trading price of our common shares and our business. Material weaknesses in our internal control over financial reporting could also reduce our ability to obtain financing or could increase the cost of any financing we obtain.

As part of our growth strategy, we may make additional acquisitions of privately held businesses. Prior to becoming part of our consolidated company, the acquired businesses would not be required to implement or maintain the disclosure controls and procedures or internal control over financial reporting that are required of public companies. We are required to integrate the acquired businesses into our consolidated company's system of disclosure controls and procedures and internal control over financial reporting, but we cannot provide assurance as to how long the integration process may take for our recently acquired businesses or any businesses that we may acquire in the future. Additionally, we may need to improve our internal control or those of any business we acquire and may be required to design enhanced processes and controls in order to make such improvements. This could result in significant costs to us and could require us to divert substantial resources, including management time and attention, from other activities.

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

None.

## Item 2. *Properties*

Our principal owned and leased properties as of December 31, 2018 are listed in the table below.

<u>Location</u>	<u>Principal Use</u>	<u>Current Segment</u>	<u>Approximate Square Feet</u>	<u>Owned/Leased</u>
Bedford, Massachusetts, United States	Manufacturing, R&D, Marketing, Sales and Administration	Photonics, Precision Motion & Corporate	147,000	Leased; expires in 2031
Ludwigsstadt, Germany	Manufacturing	Vision	105,000	Owned
San Jose, California, United States	Manufacturing, R&D, Marketing, Sales and Administration	Vision	73,000	Leased; expires in 2019
Mukilteo, Washington, United States	Manufacturing, R&D, Marketing, Sales and Administration	Photonics	63,000	Owned
North Syracuse, New York, United States	Manufacturing, R&D, Marketing, Sales and Administration	Vision	55,000	Leased; expires in 2029
Suzhou, People's Republic of China	Manufacturing, R&D, Marketing, Sales and Administration	Photonics, Vision & Precision Motion	55,000	Leased; expires in 2023
Poole, United Kingdom	Manufacturing, R&D, Marketing, Sales and Administration	Precision Motion	51,000	Building owned; land leased through 2078
Berlin, Germany	R&D, Marketing, Sales and Administration	Vision	51,000	Leased; expires in 2026
Manchester, United Kingdom	Manufacturing, R&D, Marketing, Sales and Administration	Photonics	35,000	(1)
Phoenix, Arizona, United States	Manufacturing, R&D, Marketing, Sales and Administration	Photonics	31,000	Owned
Rocklin, California, United States	Manufacturing, R&D, Marketing, Sales and Administration	Precision Motion	28,000	Leased; expires in 2023
Taunton, United Kingdom	Manufacturing, R&D, Marketing and Sales	Photonics	19,000	Leased; expires in 2019

(1) Novanta owns one facility of 9,000 square feet and leases six other facilities of 26,000 square feet in aggregate with lease expiration dates ranging from 2019 to 2026.

A portion of our leased facility in San Jose, California is currently under-utilized. As of December 31, 2018, the Company had exited approximately 22,000 square feet of this facility.

Additional research and development, sales, service and logistics sites are located in Arizona, California, Florida, New York, Oregon and Colorado, United States; Munich, Reichenbach and Konstanz, Germany; Cambridge, United Kingdom; Breda, the Netherlands; Brno, Czech Republic; Tokyo, Japan; Beijing, Shenzhen and Hong Kong, China; and Milan, Italy. These additional offices are leased facilities occupying approximately 120,000 square feet in the aggregate, and are related to our Photonics, Vision and Precision Motion segments.

**Item 3. *Legal Proceedings***

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. The Company does not believe that the outcome of these claims will have a material adverse effect upon its financial condition or results of operations but there can be no assurance that any such claims, or any similar claims, would not have a material adverse effect upon its financial condition or results of operations.

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

Not applicable.

## PART II

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

#### Market Information

The Company's common shares, no par value, are traded on the Nasdaq Global Select Market under the symbol "NOVT".

#### Holders

As of the close of business on February 19, 2019, there were approximately 37 holders of record of the Company's common shares. Since many of the common shares are registered in "nominee" or "street" names, the Company believes that the total number of beneficial owners is considerably higher.

#### Dividend Policy

The Company has never declared or paid cash dividends on its common shares and does not anticipate paying any cash dividends in the foreseeable future.

#### Purchases of Equity Securities by the Issuer and Affiliated Purchaser

In October 2013, the Company's Board of Directors authorized a share repurchase plan (the "2013 Repurchase Plan") for the repurchase of up to an aggregate of \$10.0 million of the Company's common shares. As of December 31, 2018, the Company had completed the 2013 Repurchase Plan and had repurchased an aggregate of 385 thousand common shares.

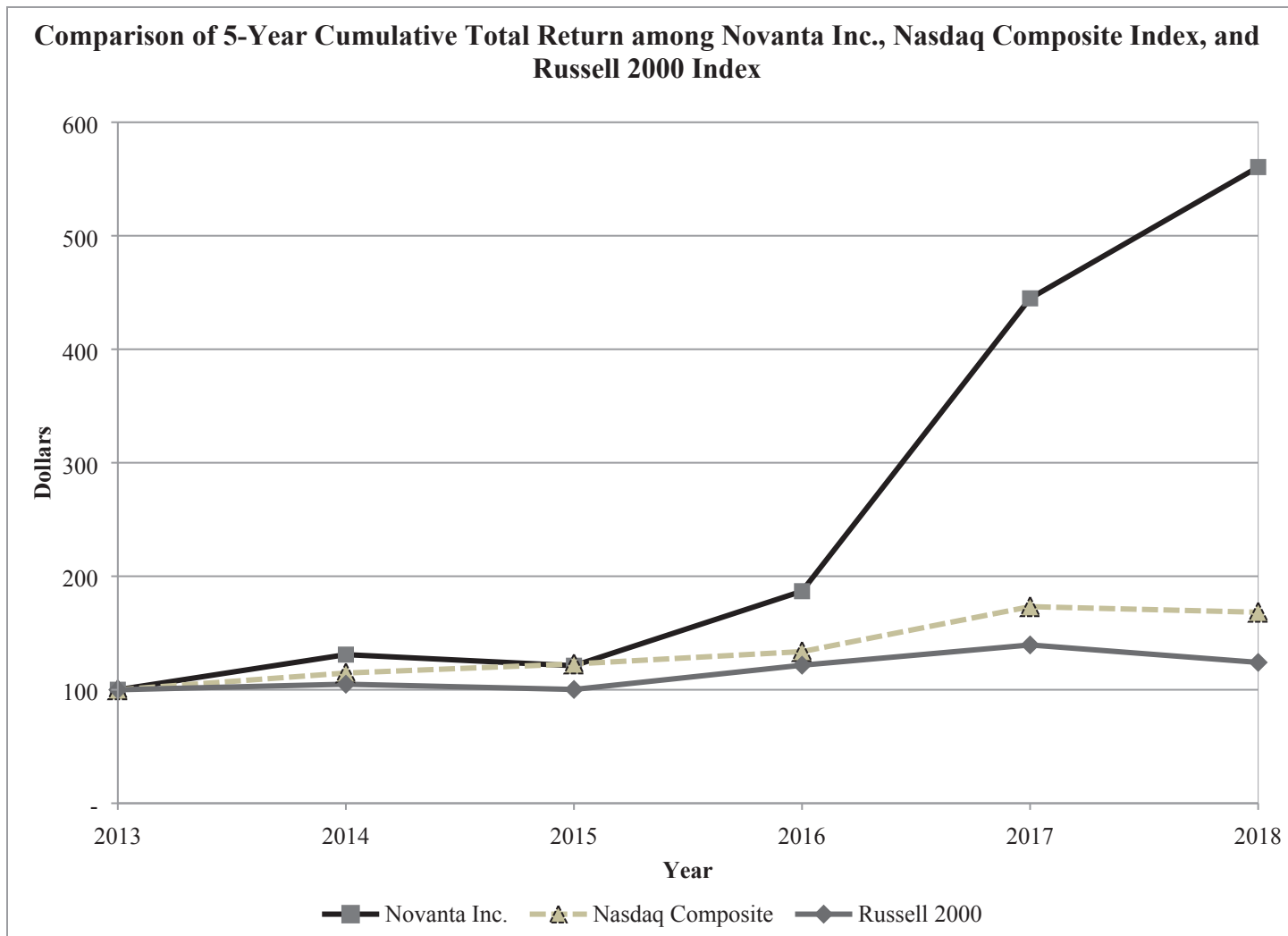
The following table sets forth certain information with respect to repurchases of the Company's common shares under the 2013 Repurchase Plan for the periods indicated.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value that May Yet Be Purchased Under the Plans or Programs
October 1 - November 2, 2018	11,750	\$ 64.15	11,750	\$ 1,325,330
November 3 - November 30, 2018	8,000	\$ 68.92	8,000	\$ 773,963
December 1 - December 31, 2018	12,767	\$ 61.13	12,767	—
Total	<u>32,517</u>		<u>32,517</u>	

In October 2018, the Company's Board of Directors approved a new share repurchase plan (the "2018 Repurchase Plan") authorizing the repurchase of an additional \$25.0 million worth of common shares. The 2018 Repurchase Plan does not obligate the Company to acquire any particular amount of our common shares. No time limit was set for the completion of the 2018 Repurchase Plan, and the plan may be suspended or discontinued at any time. No shares had been repurchased under the 2018 Repurchase Plan as of December 31, 2018.

## Performance Graph

The following graph compares the cumulative total return on the Company's common shares with the cumulative total return on the Nasdaq Composite Index and the Russell 2000 Index for the period from December 31, 2013 through December 31, 2018. The comparison assumes an investment of \$100 is made on December 31, 2013 in the Company's common shares and in each of the indices and, in the case of the indices, it also assumes reinvestment of all dividends. The performance shown is not necessarily indicative of future performance.



	December 31, 2013	December 31, 2014	December 31, 2015	December 31, 2016	December 31, 2017	December 31, 2018
Novanta Inc.	\$ 100.00	\$ 130.96	\$ 121.17	\$ 186.83	\$ 444.84	\$ 560.50
Nasdaq Composite Index	\$ 100.00	\$ 114.75	\$ 122.74	\$ 133.62	\$ 173.22	\$ 168.30
Russell 2000 Index (1)	\$ 100.00	\$ 104.89	\$ 100.26	\$ 121.63	\$ 139.49	\$ 124.09

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## Item 6. Selected Financial Data

The selected financial data set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 7 and the consolidated financial statements and related notes thereto in Item 8 of this Annual Report on Form 10-K to fully understand factors that may affect the comparability of the information presented below. The selected consolidated financial data in this section is not intended to replace the consolidated financial statements.

The consolidated statement of operations data for the years ended December 31, 2018, 2017 and 2016 and the consolidated balance sheet data as of December 31, 2018 and 2017 are derived from our audited consolidated financial statements included in this Annual Report on Form 10-K. The consolidated statement of operations data for the years ended December 31, 2015 and 2014 and the consolidated balance sheet data as of December 31, 2016, 2015 and 2014 are derived from our audited consolidated financial statements that are not included in this Annual Report on Form 10-K.

	Year Ended December 31,				
	2018	2017 (1)	2016	2015	2014
(In thousands, except per share data)					
<b>Consolidated Statement of Operations Data:</b>					
Revenue	\$ 614,337	\$ 521,290	\$ 384,758	\$ 373,598	\$ 364,706
Gross profit	261,528	220,531	162,452	157,890	150,167
Operating expenses (2) (3)	190,515	162,965	129,497	128,586	166,896
Operating income (loss) from continuing operations (2) (3)	71,013	57,566	32,955	29,304	(16,729)
Income (loss) from continuing operations before income taxes (2) (4) (5)	61,302	76,134	32,522	46,022	(17,915)
Income tax provision (benefit)	10,207	13,827	10,519	10,394	(1,006)
Income (loss) from continuing operations	51,095	62,307	22,003	35,628	(16,909)
Loss from discontinued operations, net of tax	—	—	—	(13)	(5,607)
Loss on disposal of discontinued operations, net of tax (6)	—	—	—	—	(1,726)
Consolidated net income (loss)	51,095	62,307	22,003	35,615	(24,242)
Less: Net income attributable to noncontrolling interest	(1,986)	(2,256)	—	—	(10)
Net income (loss) attributable to Novanta Inc.	\$ 49,109	\$ 60,051	\$ 22,003	\$ 35,615	\$ (24,252)
Earnings (loss) per common share from continuing operations. (7):					
Basic	\$ 1.46	\$ 1.14	\$ 0.63	\$ 1.03	\$ (0.49)
Diluted	\$ 1.43	\$ 1.13	\$ 0.63	\$ 1.02	\$ (0.49)
Loss per common share from discontinued operations:					
Basic	\$ —	\$ —	\$ —	\$ (0.00)	\$ (0.21)
Diluted	\$ —	\$ —	\$ —	\$ (0.00)	\$ (0.21)
Earnings (loss) per common share attributable to Novanta Inc. (7):					
Basic	\$ 1.46	\$ 1.14	\$ 0.63	\$ 1.03	\$ (0.70)
Diluted	\$ 1.43	\$ 1.13	\$ 0.63	\$ 1.02	\$ (0.70)
Weighted average common shares outstanding—basic	34,913	34,817	34,694	34,579	34,352
Weighted average common shares outstanding—diluted	35,473	35,280	34,914	34,827	34,352

- (1) In 2017, the Company completed the acquisitions of WOM, Laser Quantum and ThingMagic businesses, which contributed a total of \$102.7 million in revenue for the year ended December 31, 2017. The operating results of these businesses have been included in the consolidated statement of operations since their respective acquisition dates.
- (2) In 2014, the Company recorded an impairment charge of \$41.4 million related to goodwill (\$19.6 million) and identifiable intangible assets (\$21.8 million) of our NDS business acquired in January 2013.
- (3) In May 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2017-07, “Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” ASU 2017-07 requires employers that offer or maintain defined benefit plans to disaggregate the service component from the other components of net periodic benefit cost and provides guidance on the presentation of the service component and the other components of net periodic benefit cost in the statement of operations. The Company retrospectively adopted the provisions of ASU 2017-07 during 2018. Amounts prior to 2018 have been revised to conform with this presentation.
- (4) In 2015, the Company sold its JK Lasers business and recorded a gain on disposal of \$19.6 million.

- (5) In 2017, the Company acquired an additional approximately 35% of the outstanding shares of Laser Quantum and recorded a gain of \$26.4 million, representing the excess of the fair value of the Company's previously-held equity interest in Laser Quantum over its carrying value upon gaining control.
- (6) In 2014, the Company sold its Scientific Lasers business and recorded a loss on disposal, net of tax, of \$1.7 million.
- (7) In the computation of earnings per common share attributable to Novanta Inc., net income attributable to Novanta Inc. included \$1.8 million and (\$20.2) million of redeemable noncontrolling interest redemption value adjustment for the years ended December 31, 2018 and 2017, respectively.

	December 31,				
	2018	2017 <sup>(1)</sup>	2016	2015	2014
	(in thousands)				
<b>Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 82,043	\$ 100,057	\$ 68,108	\$ 59,959	\$ 51,146
Total assets (2)	719,576	726,703	425,637	416,045	396,294
Debt, current (2)	4,535	9,119	7,366	7,385	7,345
Debt, long-term (2)	202,843	225,500	70,554	88,426	105,030
Long-term liabilities, excluding debt	44,282	44,567	25,717	25,965	25,951
Redeemable noncontrolling interest (3)	—	46,923	—	—	—
Total stockholders' equity	368,255	311,545	258,870	244,701	210,825

- (1) In 2017, the Company completed the acquisitions of WOM, Laser Quantum and ThingMagic businesses. Total assets acquired amounted to \$284.4 million as of the acquisition date. The acquisitions were financed with borrowings under the revolving credit facility in the aggregate amount of \$176.8 million.
- (2) In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs." ASU 2015-03 requires debt issuance related costs to be presented in the balance sheet as a direct reduction to the carrying amount of the associated debt liability. The Company adopted the provisions of ASU 2015-03 during 2015. Amounts prior to 2015 have been revised to conform with this presentation.
- (3) In 2017, the Company acquired an additional approximately 35% of the outstanding shares of Laser Quantum, which increased our ownership position in Laser Quantum from approximately 41% to approximately 76%. The noncontrolling interest was considered a redeemable equity instrument and was presented as temporary equity on the consolidated balance sheet at the greater of the carrying value or the estimated redemption value of the noncontrolling interest. In 2018, the Company acquired the remaining approximately 24% of the outstanding shares of Laser Quantum.

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Consolidated Financial Statements and Notes included in Item 8 of this Annual Report on Form 10-K. The MD&A contains certain forward looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. In addition to historical financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. These forward-looking statements include, but are not limited to, our belief that the Purchasing Managers Index ("PMI") may provide an indication of the impact of general economic conditions on our sales into the advanced industrial end market; our strategy; anticipated financial performance; expected liquidity and capitalization; drivers of revenue growth and our growth expectations in various markets; management's plans and objectives for future operations, expenditures and product development, and investments in research and development; business prospects; potential of future product releases and expansion of our product and service offerings; anticipated revenue performance; industry trends; market conditions; our competitive positions; changes in economic and political conditions; changes in accounting principles; changes in actual or assumed tax liabilities; expectations regarding tax exposures; anticipated reinvestment of future earnings and dividend policy; anticipated expenditures in regard to the Company's benefit plans; future acquisitions, integration and anticipated benefits from acquisitions and dispositions; anticipated economic benefits and expected costs of restructuring programs; ability to repay our indebtedness; our intentions regarding the use of cash; expectations regarding legal and regulatory environmental requirements and our compliance thereto; and other statements that are not historical facts. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various important factors, including those set forth in Item 1A of this Annual Report on Form 10-K under the heading "Risk Factors." The words "anticipates," "believes," "expects," "intends," "future," "could," "estimates," "plans," "would," "should," "potential," "continues," and similar words or expressions (as well as other words or expressions referencing future events, conditions or circumstances) identify forward looking statements. Readers should not place undue reliance on any such forward looking statements, which speak only as of the date they are made. Management and the Company disclaim any obligation to publicly update or revise any such statements to reflect any change in its expectations or in events, conditions, or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those contained in the forward looking statements, except as required under applicable law.*

### **Business Overview**

Novanta Inc. and its subsidiaries (collectively referred to as, the "Company", "Novanta", "we", "us", "our") is a leading global supplier of core technology solutions that give medical and advanced industrial original equipment manufacturers ("OEMs") a competitive advantage. We combine deep proprietary technology expertise and competencies in photonics, vision and precision motion with a proven ability to solve complex technical challenges. This enables us to engineer core components and sub-systems that deliver extreme precision and performance, tailored to our customers' demanding applications.

### **End Markets**

We primarily operate in two end markets: the advanced industrial market and the medical market.

#### *Advanced Industrial Market*

For the year ended December 31, 2018, the advanced industrial market accounted for approximately 50% of our revenue. Revenue from our products sold to the advanced industrial market is affected by a number of factors, including changing technology requirements and preferences of our customers, productivity or quality investments in a manufacturing environment, the financial condition of our customers, changes in regulatory requirements and laws, and general economic conditions. We believe that the Purchasing Managers Index (PMI) on manufacturing activities specific to different regions around the world may provide an indication of the impact of general economic conditions on our sales into the advanced industrial market.

#### *Medical Market*

For the year ended December 31, 2018, the medical market accounted for approximately 50% of our revenue. Revenue from our products sold to the medical market is generally affected by hospital and other healthcare provider capital spending, changes in regulatory requirements and laws, aggregation of purchasing by healthcare networks, trends in surgical procedures, changes in technology requirements, changes in customer or patient preferences, and general demographic trends.

### **Strategy**

Our strategy is to drive sustainable, profitable growth through short-term and long-term initiatives, including:

- disciplined focus on our diversified business model of providing functionality to long life-cycle OEM customer platforms in attractive medical and advanced industrial niche markets;

- improving our business mix to increase medical sales as a percentage of total revenue by:
  - introducing new products aimed at attractive medical applications, such as minimally invasive and robotic surgery, ophthalmology, patient monitoring, drug delivery, clinical laboratory testing and life science equipment;
  - deepening our key account management relationships with and driving cross selling of our product offerings to leading medical equipment manufacturers; and
  - pursuing complementary medical technology acquisitions;
- increasing our penetration of high growth advanced industrial applications, such as laser materials processing, robotics, automation and metrology, by working closely with OEM customers to launch application specific products that closely match the requirements of each application;
- broadening our portfolio of enabling proprietary technologies and capabilities through increased investment in new product development, expanded sales and marketing channels to reach target customers, and investments in application development to further penetrate existing customers, while expanding the applicability of our solutions to new markets;
- broadening our product and service offerings through the acquisition of innovative and complementary technologies and solutions in medical and advanced industrial technology applications, including increasing our recurring revenue streams such as services, spare parts and consumables;
- improving our existing operations to expand profit margins and improve customer satisfaction by implementing lean manufacturing principles and strategic sourcing across our major production sites; and
- attracting, retaining, and developing world-class talented and motivated employees.

## Significant Events and Updates

### *Acquisition of Zettlex Holdings Limited*

On May 1, 2018, we acquired 100% of the outstanding stock of Zettlex Holdings Limited (“Zettlex”), a Cambridge, United Kingdom-based provider of inductive encoder products that provide absolute and accurate positioning, even in extreme operating environments, to OEMs in the medical and advanced industrial markets. The purchase price of £23.3 million (\$32.0 million), net of working capital adjustments, was financed with cash on hand and borrowings under our revolving credit facility. We expect that the addition of Zettlex will broaden the range of components and solutions that we can provide our customers by combining our commercial resources and application-specific competencies with Zettlex's technologies and strong team. Zettlex is included in our Precision Motion reportable segment.

### *Acquisition of Remaining Equity Ownership in Laser Quantum*

On September 27, 2018, we acquired the remaining approximately 24% of the outstanding shares of Laser Quantum for an aggregate consideration of \$45.1 million in cash and restricted stock. The acquisition of these noncontrolling interests was accounted for as a transaction among shareholders. No gain or loss was recognized in the consolidated statement of operations. The total purchase price was financed with cash on hand, borrowings under our credit facility, and the issuance of 213,219 shares of restricted stock with a fair market value of \$14.4 million. The restricted stock will become fully vested upon achievement of certain milestones as specified in the restricted stock agreement. Restricted stock not otherwise vested as of December 31, 2025 will be subject to forfeiture.

## Overview of Financial Results

Total revenue for 2018 was \$614.3 million, an increase of \$93.0 million, or 17.8%, versus 2017. The effect of our acquisitions in 2017 and 2018 resulted in an increase in revenue of \$52.9 million, or 10.2%. Foreign exchange rates positively impacted our revenue by \$3.7 million, or 0.6%, in 2018.

Operating income increased \$13.4 million from \$57.6 million in 2017 to \$71.0 million in 2018. This increase was primarily attributable to an increase in gross profit of \$41.0 million as a result of higher revenue, partially offset by an increase in operating expenses of \$27.5 million, primarily due to acquisitions in 2017 and 2018.

Diluted earnings per share (“EPS”) of \$1.43 in 2018 increased \$0.30 from an EPS of \$1.13 in 2017. This increase was primarily attributable to higher operating income and a \$22.0 million decrease in the Laser Quantum nontaxable redeemable noncontrolling interest redemption value adjustment from 2017, partially offset by the \$26.4 million nontaxable gain recognized from the acquisition of the additional approximately 35% of Laser Quantum equity interest in 2017. Diluted EPS for the year ended December 31, 2018 was positively impacted by a \$1.8 million redeemable noncontrolling interest redemption value adjustment, while Diluted EPS for the year ended December 31, 2017 was negatively impacted by a \$20.2 million redeemable noncontrolling interest redemption value adjustment. (See Note 10 to the accompanying Consolidated Financial Statements.)

Specific components of our operating results for 2018, 2017 and 2016 are further discussed below.

## Results of Operations

The following table sets forth our results of operations as a percentage of revenue for the years indicated:

	2018	2017	2016
Revenue	100.0%	100.0%	100.0%
Cost of revenue	57.4	57.7	57.8
Gross profit	42.6	42.3	42.2
Operating expenses:			
Research and development and engineering	8.3	8.0	8.3
Selling, general and administrative	18.9	19.5	21.1
Amortization of purchased intangible assets	2.5	2.3	2.1
Restructuring, acquisition and divestiture related costs	1.3	1.4	2.1
Total operating expenses	31.0	31.3	33.7
Operating income	11.6	11.0	8.6
Interest income (expense), net	(1.6)	(1.4)	(1.2)
Foreign exchange transaction gains (losses), net	0.0	(0.1)	0.6
Other income (expense), net	(0.0)	(0.0)	0.5
Gain on acquisition of business	—	5.1	—
Income before income taxes	10.0	14.6	8.5
Income tax provision	1.7	2.7	2.7
Consolidated net income	8.3	12.0	5.7
Less: Net income attributable to noncontrolling interest	(0.3)	(0.4)	—
Net income attributable to Novanta Inc.	8.0%	11.5%	5.7%

### Revenue

The following table sets forth external revenue by reportable segment for 2018, 2017 and 2016 (dollars in thousands):

	2018	2017	2016	% Change	
				2018 vs. 2017	2017 vs. 2016
Photonics	\$ 249,339	\$ 232,359	\$ 174,158	7.3%	33.4%
Vision	232,902	183,074	122,250	27.2%	49.8%
Precision Motion	132,096	105,857	88,350	24.8%	19.8%
Total	<u>\$ 614,337</u>	<u>\$ 521,290</u>	<u>\$ 384,758</u>	17.8%	35.5%

## Photonics

Photonics segment revenue in 2018 increased by \$17.0 million, or 7.3%, versus 2017, due to an increase in revenue across all of our product lines. Revenue from our laser beam delivery products increased \$13.1 million as a result of increased volumes in the advanced industrial and medical markets.

Photonics segment revenue in 2017 increased by \$58.2 million, or 33.4%, versus 2016, primarily as a result of the Laser Quantum acquisition, which increased segment revenues by \$44.7 million, and an increase in revenue of our laser beam delivery products and our CO2 lasers products as a result of increased volumes in the advanced industrial market.

## Vision

Vision segment revenue in 2018 increased by \$49.8 million, or 27.2%, versus 2017. The increase was primarily due to a \$46.9 million increase in revenue as a result of full-year revenue from WOM being included in 2018 results.

Vision segment revenue in 2017 increased by \$60.8 million, or 49.8%, versus 2016. The increase was primarily due to a \$58.4 million increase in revenue as a result of the WOM, ThingMagic and Reach acquisitions.

## Precision Motion

Precision Motion segment revenue in 2018 increased by \$26.2 million, or 24.8%, versus 2017. The increase was primarily due to an increase in revenue across all of our product lines as a result of increased demand in the advanced industrial and medical markets and the Zettlex acquisition in May 2018.

Precision Motion segment revenue in 2017 increased by \$17.5 million, or 19.8%, versus 2016. The increase was primarily due to an increase in revenue of our Celera Motion products and our air bearing spindles products as a result of increased demand in the advanced industrial and medical markets.

## Gross Profit

The following table sets forth the gross profit and gross profit margin for each of our reportable segments for 2018, 2017 and 2016 (dollars in thousands):

	2018	2017	2016
<b>Gross profit:</b>			
Photonics	\$ 117,109	\$ 106,117	\$ 76,696
Vision	87,198	69,249	47,181
Precision Motion	59,477	46,564	40,044
Unallocated Corporate and Shared Services	(2,256)	(1,399)	(1,469)
Total	<u>\$ 261,528</u>	<u>\$ 220,531</u>	<u>\$ 162,452</u>
<b>Gross profit margin:</b>			
Photonics	47.0%	45.7%	44.0%
Vision	37.4%	37.8%	38.6%
Precision Motion	45.0%	44.0%	45.3%
Total	42.6%	42.3%	42.2%

Gross profit and gross profit margin can be influenced by a number of factors, including product mix, pricing, volume, manufacturing efficiencies and utilization, costs for raw materials and outsourced manufacturing, headcount, inventory obsolescence and warranty expenses.

## Photonics

Photonics segment gross profit for 2018 increased \$11.0 million, or 10.4%, versus 2017, due to an increase in revenue. Photonics segment gross profit margin was 47.0% for 2018, compared with a gross profit margin of 45.7% for 2017. The increase in gross profit margin was primarily attributable to changes in product mix, productivity improvements and reductions in cost of poor quality. Amortization of inventory fair value adjustments and amortization of developed technologies also decreased \$2.0 million, which resulted in a 0.8 percentage point increase in gross profit margin.

Photonics segment gross profit for 2017 increased \$29.4 million, or 38.4%, versus 2016, due to an increase in revenue as a result of the Laser Quantum acquisition and increased volumes in our legacy product lines. Photonics segment gross profit margin was 45.7% for 2017, compared with a gross profit margin of 44.0% for 2016. The increase in gross profit margin was primarily attributable to the Laser Quantum acquisition. Gross profit margin for the year ended December 31, 2017 was negatively impacted by an increase in amortization of inventory fair value adjustments and amortization of developed technology of \$3.2 million.

### **Vision**

Vision segment gross profit for 2018 increased \$17.9 million, or 25.9%, versus 2017, primarily due to full-year gross profit from WOM being included in 2018 results. Vision segment gross profit margin was 37.4% for 2018, compared with a gross profit margin of 37.8% for 2017. The decrease in gross profit margin was primarily attributable to unfavorable product mix, partially offset by a net decrease in amortization of inventory fair value adjustments and amortization of developed technologies of \$1.9 million, which resulted in a 0.8 percentage point increase in gross profit margin.

Vision segment gross profit for 2017 increased \$22.1 million, or 46.8%, versus 2016. The increase was primarily attributable to an increase in revenue from the WOM, ThingMagic and Reach acquisitions, which increased gross profit by \$17.6 million. Vision segment gross profit margin was 37.8% for 2017, compared with a gross profit margin of 38.6% for 2016. The decrease in gross profit margin was primarily attributable to an increase in amortization of inventory fair value adjustments and amortization of developed technology of \$6.1 million, which resulted in a 3.3 percentage point decrease in gross profit margin, partially offset by changes in product mix and cost savings from restructuring activities in 2016.

### **Precision Motion**

Precision Motion segment gross profit for 2018 increased \$12.9 million, or 27.7%, versus 2017, primarily due to an increase in revenue. Precision Motion segment gross profit margin was 45.0% for 2018, compared with a gross profit margin of 44.0% for 2017. The increase in gross profit margin was primarily related to changes in product mix.

Precision Motion segment gross profit for 2017 increased \$6.5 million, or 16.3%, versus 2016, primarily due to an increase in revenue. Precision Motion segment gross profit margin was 44.0% for 2017, compared with a gross profit margin of 45.3% for 2016. The decrease in gross profit margin was attributable to temporary supply chain transition challenges in our Celera Motion business, which led to production inefficiencies and quality impacts.

### *Operating Expenses*

The following table sets forth operating expenses for 2018, 2017 and 2016 (dollars in thousands):

	2018	2017	2016	% Change	
				2018 vs. 2017	2017 vs. 2016
Research and development and engineering	\$ 51,024	\$ 41,673	\$ 32,002	22.4%	30.2%
Selling, general and administrative	115,900	101,654	81,299	14.0%	25.0%
Amortization of purchased intangible assets	15,550	12,096	8,251	28.6%	46.6%
Restructuring, acquisition and divestiture related costs	8,041	7,542	7,945	6.6%	(5.1)%
Total	<u>\$ 190,515</u>	<u>\$ 162,965</u>	<u>\$ 129,497</u>	16.9%	25.8%

### *Research and Development and Engineering Expenses*

Research and development and engineering (“R&D”) expenses are primarily comprised of employee compensation and related expenses and cost of materials for R&D projects.

R&D expenses were \$51.0 million, or 8.3% of revenue, in 2018, versus \$41.7 million, or 8.0% of revenue, in 2017. R&D expenses increased in terms of total dollars and as a percentage of revenue primarily due to higher investments across the majority of our product lines and acquisitions in 2017 and 2018.

R&D expenses were \$41.7 million, or 8.0% of revenue, in 2017, versus \$32.0 million, or 8.3% of revenue, in 2016. R&D expenses increased in terms of total dollars primarily due to R&D expenses from acquisitions in 2016 and 2017.

### *Selling, General and Administrative Expenses*

Selling, general and administrative (“SG&A”) expenses include costs for sales and marketing, sales administration, finance, human resources, legal, information systems and executive management.

SG&A expenses were \$115.9 million, or 18.9% of revenue, in 2018, versus \$101.7 million, or 19.5% of revenue, in 2017. SG&A expenses increased in terms of total dollars primarily due to acquisitions in 2017 and 2018, and an increase in compensation as a result of higher headcount and stock-based compensation expense.

SG&A expenses were \$101.7 million, or 19.5% of revenue, in 2017, versus \$81.3 million, or 21.1% of revenue, in 2016. SG&A expenses increased in terms of total dollars primarily due to acquisitions in 2016 and 2017, investments in sales and marketing resources and higher variable compensation associated with the Company's financial performance.

#### *Amortization of Purchased Intangible Assets*

Amortization of purchased intangible assets is charged to our Photonics, Vision and Precision Motion segments. Amortization of core technologies is included in cost of revenue in the consolidated statement of operations. Amortization of customer relationships, trademarks, backlog and other intangibles are included in operating expenses in the consolidated statement of operations.

Amortization of purchased intangible assets, excluding the amortization of developed technologies that is included in cost of revenue, was \$15.6 million, or 2.5% of revenue, in 2018, versus \$12.1 million, or 2.3% of revenue, in 2017. The increase, in terms of total dollars and as a percentage of revenue, was the result of acquired intangible assets from acquisitions in 2017 and 2018.

Amortization of purchased intangible assets, excluding the amortization of developed technologies that is included in cost of revenue, was \$12.1 million, or 2.3% of revenue, in 2017, versus \$8.3 million, or 2.1% of revenue, in 2016. The increase, in terms of total dollars and as a percentage of revenue, was the result of acquired intangible assets from acquisitions in 2016 and 2017.

#### *Restructuring, Acquisition and Divestiture Related Costs*

Restructuring, acquisition and divestiture related charges primarily relate to our restructuring programs, acquisition related costs incurred for completed acquisitions, acquisition costs related to future potential acquisitions and failed acquisitions, and changes in fair value of contingent considerations.

We recorded restructuring, acquisition and divestiture related costs of \$8.0 million in 2018, versus \$7.5 million in 2017. The increase in restructuring, acquisition and divestiture related costs versus 2017 was primarily due to a \$1.7 million increase in restructuring related charges as a result of the 2018 and 2019 restructuring programs, partially offset by a decrease in acquisition related charges of \$1.2 million mostly attributable to an investment banking success fee related to the acquisition of WOM in 2017.

We recorded restructuring, acquisition and divestiture related costs of \$7.5 million in 2017, versus \$7.9 million in 2016. The decrease in restructuring, acquisition and divestiture related costs versus 2016 was primarily due to a \$2.6 million decrease in restructuring related charges as a result of the 2016 restructuring program which was substantially completed in 2016, partially offset by an increase in acquisition related charges of \$2.2 million mostly attributable to an investment banking success fee related to the WOM acquisition.

#### *Operating Income (Loss) by Segment*

The following table sets forth operating income (loss) by segment for 2018, 2017 and 2016 (in thousands):

	2018	2017	2016
<b>Operating Income (Loss)</b>			
Photonics	\$ 59,285	\$ 51,660	\$ 35,217
Vision	8,991	7,883	(1,277)
Precision Motion	31,674	27,146	21,101
Unallocated Corporate and Shared Services	(28,937)	(29,123)	(22,086)
<b>Total</b>	<u>\$ 71,013</u>	<u>\$ 57,566</u>	<u>\$ 32,955</u>

#### **Photonics**

Photonics segment operating income was \$59.3 million, or 23.8% of revenue, in 2018, versus \$51.7 million, or 22.2% of revenue, in 2017. The increase in operating income was primarily due to an increase in gross profit of \$11.0 million, partially offset by an increase in R&D expenses and SG&A expenses of \$3.7 million. Photonics segment operating income was favorably affected by a \$2.3 million decrease in amortization of inventory fair value adjustments and amortization of intangible assets.

Photonics segment operating income was \$51.7 million, or 22.2% of revenue, in 2017, versus \$35.2 million, or 20.2% of revenue, in 2016. The increase in operating income was primarily due to an increase in gross profit of \$29.4 million, partially offset by

increases in operating expenses, primarily related to the Laser Quantum acquisition and increased volumes in our legacy product lines. Photonics segment operating income for the year ended December 31, 2017 was negatively affected by a \$7.1 million increase in amortization of inventory fair value adjustments and amortization of intangible assets.

### **Vision**

Vision segment operating income was \$9.0 million, or 3.9% of revenue, in 2018, versus \$7.9 million, or 4.3% of revenue, in 2017. The increase in operating income in terms of total dollars was primarily due to an increase in gross profit, partially offset by the inclusion of full-year operating expenses from WOM in 2018. Vision segment operating income was negatively affected by a \$1.1 million net increase in amortization of inventory fair value adjustments and amortization of intangible assets.

Vision segment operating income was \$7.9 million, or 4.3% of revenue, in 2017, versus an operating loss of \$1.3 million, or (1.0%) of revenue, in 2016. The increase in operating income was primarily due to an increase in gross profit of \$22.1 million and a decrease in spending primarily related to our 2016 restructuring program, which was substantially completed in 2016, partially offset by an increase in R&D and SG&A expenses related to acquisitions in 2017. Vision segment operating income for the year ended December 31, 2017 was negatively affected by a \$6.0 million increase in amortization of inventory fair value adjustments and amortization of intangible assets.

### **Precision Motion**

Precision Motion segment operating income was \$31.7 million, or 24.0% of revenue, in 2018, versus \$27.1 million, or 25.6% of revenue, in 2017. The increase in operating income in terms of total dollars was primarily due to an increase in gross profit of \$12.9 million, partially offset by an increase in R&D and SG&A expenses of \$3.5 million and an increase in acquisition earn-out costs of \$4.0 million associated with the Zettlex acquisition.

Precision Motion segment operating income was \$27.1 million, or 25.6% of revenue, in 2017, versus \$21.1 million, or 23.9% of revenue, in 2016. The increase in operating income was primarily due to an increase in gross profit of \$6.5 million.

### **Unallocated Corporate and Shared Services**

Unallocated corporate and shared services costs primarily represent costs of corporate and shared service functions and other public company costs that are not allocated to the operating segments, including certain restructuring and most acquisition related costs.

Unallocated corporate and shared services costs for 2018 decreased by \$0.2 million, or 0.6%, from 2017.

Unallocated corporate and shared services costs for 2017 increased by \$7.0 million, or 31.9%, from 2016 primarily due to an increase in acquisition related costs of \$2.3 million mostly attributable to an investment banking success fee related to the WOM acquisition, and an increase in SG&A expenses of \$5.4 million as a result of higher headcount and higher variable compensation associated with the Company's financial performance.

### *Interest Income (Expense), Foreign Exchange Transaction Gains (Losses), and Other Income (Expense), Net*

The following table sets forth interest income (expense), foreign exchange transaction gains (losses), and other income (expense) for 2018, 2017 and 2016 (in thousands):

	2018	2017	2016
Interest income (expense), net	\$ (9,814)	\$ (7,165)	\$ (4,559)
Foreign exchange transaction gains (losses), net	147	(447)	2,317
Other income (expense), net	(44)	(229)	1,809
Gain on acquisition of business	—	26,409	—

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

Net interest expense was \$9.8 million in 2018 versus \$7.2 million in 2017. The increase in net interest expense was primarily due to an increase in average debt levels as a result of acquisitions in 2017 and 2018 and an increase in the weighted average interest rate on our senior credit facilities. The weighted average interest rate on our Senior Credit Facilities was 3.53% and 3.32% during 2018 and 2017, respectively. Included in net interest expense was non-cash interest expense of approximately \$1.0 million and \$0.8 million in 2018 and 2017, respectively, related to the amortization of deferred financing costs on our debt.

Net interest expense was \$7.2 million in 2017 versus \$4.6 million in 2016. The increase in net interest expense was primarily due to an increase in average debt levels as a result of acquisitions in 2017, partially offset by a decrease in the weighted average interest rate on our senior credit facilities. The weighted average interest rate on our Senior Credit Facilities was 3.32% and 3.52% during 2017 and 2016, respectively. Included in net interest expense was non-cash interest expense of approximately \$0.8 million and \$0.9 million in 2017 and 2016, respectively, related to the amortization of deferred financing costs on our debt.

#### *Foreign Exchange Transaction Gains (Losses), Net*

Foreign exchange transaction gains (losses), net, were \$0.1 million net gains in 2018 versus \$0.4 million net losses in 2017 primarily due to changes in the value of the U.S. Dollar against the British Pound, Euro and Japanese Yen, and net realized gains from foreign currency contracts.

Foreign exchange transaction gains (losses), net, were \$0.4 million net losses in 2017 versus \$2.3 million net gains in 2016 primarily due to changes in the value of the U.S. Dollar against the British Pound, Euro and Japanese Yen.

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

Net other expense was nominal in 2018 versus \$0.2 million in 2017. The decrease in net other expense was primarily due to a decrease in net periodic pension costs of our frozen U.K. defined benefit pension plan covering employees of a divested business.

Other income (expense) was \$0.2 million net other expense in 2017 versus \$1.8 million net other income in 2016 primarily due to earnings from our equity-method investment in Laser Quantum reported in other income (expense) prior to 2017. In January 2017, we acquired an additional approximately 35% of the outstanding shares of Laser Quantum. As a result of this acquisition, earnings from Laser Quantum have been consolidated in the Company's consolidated financial statements since the acquisition date.

#### *Gain on Acquisition of Business*

The gain on acquisition of business in 2017 was related to a nontaxable gain of \$26.4 million recognized upon gaining control of Laser Quantum in January 2017 as a result of acquiring an additional approximately 35% of its outstanding shares.

#### *Income Taxes*

We recorded a tax provision of \$10.2 million in 2018, as compared to a tax provision of \$13.8 million in 2017. The effective tax rate for 2018 was 16.7% of income before taxes, compared to an effective tax rate of 18.2% of income before taxes for 2017. Our effective tax rate in 2018 differs from the Canadian statutory rate of 29.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, including the benefit of the new 21% U.S. corporate income tax rate and \$1.6 million of estimated deductions for Foreign Derived Intangible Income under the U.S. Tax Cuts and Jobs Act (the "Tax Reform Act"), a \$0.9 million benefit from share-based compensation, a \$1.9 million U.K. patent box deduction and \$1.3 million of other tax credits; offset by \$0.8 million of non-deductible expenses recognized under an earn-out agreement in connection with the Zettlex acquisition.

We recorded a tax provision of \$13.8 million in 2017, as compared to a tax provision of \$10.5 million in 2016. The effective tax rate for 2017 was 18.2% of income before taxes, compared to an effective tax rate of 32.3% of income before taxes for 2016. Our effective tax rate in 2017 differs from the Canadian statutory rate of 29.0% primarily due to a \$1.2 million tax effect of non-deductible acquisition related expenses and a \$2.8 million provision for the revaluation of deferred tax assets and liabilities as of December 31, 2017 as a result of the Tax Reform Act, which reduced the U.S. federal statutory corporate income tax rate from 35% to 21%. These increases were offset by a \$2.0 million benefit from international tax rate differences, a \$1.1 million benefit due to the Section 199 Domestic Production Activity deduction in the U.S., a \$1.0 million benefit associated with R&D and foreign tax credits generated in 2017, recognition of \$1.6 million net tax benefits from uncertain tax positions upon expiration of statute of limitations and conclusion of income tax audits, and a \$1.6 million benefit from the patent box deduction in the U.K. In addition, in 2017, we reported a nontaxable gain of \$26.4 million on our previously-held Laser Quantum equity interest and wrote off \$1.5 million of Laser Quantum related deferred tax liability, which had a combined 8.7% favorable impact on our effective tax rate for the year ended December 31, 2017.

#### **Liquidity and Capital Resources**

We assess our liquidity in terms of our ability to generate cash to fund our operating, investing, and financing activities. Our primary ongoing cash requirements are funding operations, capital expenditures, investments in businesses, and repayment of our debt and related interest expense. Our primary sources of liquidity are cash flows from operations and borrowings under our revolving credit facility. We believe our future operating cash flows will be sufficient to meet our future operating and capital expenditure cash needs for the foreseeable future, including at least the next 12 months. The availability of borrowing capacity under our revolving credit facility provides another potential source of liquidity for acquisitions. We may seek to raise additional capital, which could be in

the form of bonds, convertible debt or equity, to fund business development activities or other future investing cash requirements, subject to approval by the lenders in the Second Amended and Restated Credit Agreement.

Significant factors affecting the management of our ongoing cash requirements are the adequacy of available bank lines of credit and our ability to attract long term capital with satisfactory terms. The sources of our liquidity are subject to all of the risks of our business and could be adversely affected by, among other factors, a decrease in demand for our products, our ability to integrate current and future acquisitions, deterioration in certain financial ratios, availability of borrowings under our revolving credit facility, and market changes in general. See “Risks Relating to Our Common Shares and Our Capital Structure” included in Item 1A of this Annual Report on Form 10-K.

Our ability to make payments on our indebtedness and to fund our operations may be dependent upon the earnings and the distribution of funds from our subsidiaries. Local laws and regulations and/or the terms of our indebtedness restrict certain of our subsidiaries from paying dividends and transferring assets to us. We cannot assure you that applicable laws and regulations and/or the terms of our indebtedness will permit our subsidiaries to provide us with sufficient dividends, distributions or loans when necessary.

As of December 31, 2018, \$49.2 million of our \$82.0 million cash and cash equivalents was held by our subsidiaries outside of Canada and the United States. Generally, our intent is to use cash held in these foreign subsidiaries to fund our local operations or acquisitions by those local subsidiaries and to pay down borrowings under our revolving credit facility. Approximately 64.4% of our outstanding borrowings under our Senior Credit Facilities (defined below) were held in our subsidiaries outside of Canada and the United States. Additionally, we may use intercompany loans to address short-term cash flow needs for various subsidiaries. In certain instances, we have identified excess cash for which we may repatriate and have established liabilities for the expected tax cost. Because of the ownership structure of the Company, our foreign entities outside the U.S. are not considered controlled foreign corporations of the U.S. company, as defined under U.S. tax principles, and accordingly, the accumulated earnings of these foreign subsidiaries are not subject to the one-time tax on the repatriation of foreign earnings (the “Toll Charge”) under the Tax Reform Act.

### ***Share Repurchase Plans***

In October 2013, our Board of Directors authorized a share repurchase plan (the “2013 Repurchase Plan”) under which we could repurchase outstanding shares of our common stock up to an aggregate amount of \$10.0 million. During 2018, we repurchased 89 thousand shares for an aggregate purchase price of \$5.9 million at an average price of \$65.43 per share under the 2013 Repurchase Plan. As of December 31, 2018, we had repurchased a cumulative total of 385 thousand shares under the 2013 Repurchase Plan for an aggregate purchase price of \$10.0 million at an average price of \$25.97 per share. As of December 31, 2018, we had completed the 2013 Repurchase Plan.

In October 2018, our Board of Directors approved a new share repurchase plan (the “2018 Repurchase Plan”) authorizing the repurchase of an additional \$25.0 million worth of common shares. We expect that share repurchases will be made under the 2018 Repurchase Plan pursuant to Rule 10b-18 under the Securities Exchange Act of 1934. We had \$25.0 million available for share repurchases under the 2018 Repurchase Plan as of December 31, 2018.

Under the 2018 Repurchase Plan, shares may be repurchased from time to time, at our discretion, based on its ongoing assessment of the capital needs of the business, the market price of our common stock, and general market conditions. Shares may also be repurchased through an accelerated stock purchase agreement, on the open market or in privately negotiated transactions in accordance with applicable federal securities laws. Repurchases may be made under certain SEC regulations, which would permit common stock to be purchased when we would otherwise be prohibited from doing so under insider trading laws. The 2018 Repurchase Plan does not obligate us to acquire any particular amount of common stock. No time limit was set for the completion of the 2018 Repurchase Plan, and the plan may be suspended or discontinued at any time. We expect to fund the share repurchases through cash on hand and future cash generated from operations.

### ***Second Amended and Restated Credit Agreement***

In May 2016, we entered into the second amended and restated senior secured credit agreement (the “Second Amended and Restated Credit Agreement”), consisting of a \$75.0 million, 5-year term loan facility and a \$225.0 million, 5-year revolving credit facility (collectively, the “Senior Credit Facilities”). The Senior Credit Facilities mature in May 2021. In August 2017, we entered into a third amendment (the “Third Amendment”) to the Second Amended and Restated Credit Agreement. The Third Amendment increased the borrowing limit under the revolving credit facility commitment from \$225 million to \$325 million and reset the accordion feature to \$125 million for future expansion. Additionally, the Third Amendment increased the term loan balance from \$65.6 million to \$90.6 million. The term loan is payable in quarterly installments of \$2.3 million beginning in October 2017, with the remaining amount due upon maturity. We may make payments to pay down our revolving credit facility with cash on hand and cash generated from future operations.

On February 26, 2018, we entered into a fourth amendment (the “Fourth Amendment”) to the Second Amended and Restated Credit Agreement. The Fourth Amendment increased the maximum permitted consolidated leverage ratio from 3.00 to 3.50, increased the maximum consolidated leverage ratio for permitted acquisitions and stock repurchases from 2.50 to 3.00, increased the maximum permitted consolidated leverage ratio for a designated acquisition from 3.00 to 3.50, and increased the maximum leverage ratio for four consecutive quarters following a designated acquisition from 3.50 to 4.00. Certain other technical changes were made to the Second Amended and Restated Credit Agreement as a result of the Fourth Amendment and are not considered material.

As of December 31, 2018, we had a term loan of \$74.5 million and revolving loans of \$135.1 million outstanding under the Second Amended and Restated Credit Agreement.

The Second Amended and Restated Credit Agreement contains various covenants that we believe are usual and customary for this type of agreement, including a maximum allowed leverage ratio and a minimum required fixed charge coverage ratio (as defined in the Second Amended and Restated Credit Agreement). The following table summarizes these financial covenants and our compliance therewith as of December 31, 2018:

	Requirement	Actual December 31, 2018
Maximum consolidated leverage ratio	3.50	1.66
Minimum consolidated fixed charge coverage ratio	1.50	5.11

In addition, the Second Amended and Restated Credit Agreement contains various other customary representations, warranties and covenants applicable to the Company and its subsidiaries, including: (i) limitations on certain payments; (ii) limitations on fundamental changes involving the Company; (iii) limitations on the disposition of assets; and (iv) limitations on indebtedness, investments, and liens.

#### *Cash Flows*

Cash and cash equivalents totaled \$82.0 million at December 31, 2018, versus \$100.1 million at December 31, 2017. The net decrease in cash and cash equivalents is primarily attributable to debt repayments of \$74.6 million, acquisition of the remaining equity interest in Laser Quantum of \$30.8 million, current year business acquisitions of \$29.6 million, and capital expenditures of \$14.7 million. These cash outflows were offset by cash provided by operating activities of \$89.6 million and borrowings under our revolving credit facility of \$55.3 million.

The following table summarizes our cash and cash equivalent balances, cash flows and unused borrowing capacity available under our revolving credit facility for the years indicated (in thousands):

	2018	2017	2016
Cash and cash equivalents, end of year	\$ 82,043	\$ 100,057	\$ 68,108
Net cash provided by operating activities	\$ 89,647	\$ 63,378	\$ 47,788
Net cash used in investing activities	\$ (45,590)	\$ (177,380)	\$ (12,865)
Net cash provided by (used in) financing activities	\$ (60,164)	\$ 143,330	\$ (23,189)
Unused borrowing capacity available under revolving credit facility, end of year	\$ 189,942	\$ 175,547	\$ 215,000

#### *Operating Cash Flows*

Cash provided by operating activities was \$89.6 million in 2018, versus \$63.4 million in 2017. Cash provided by operating activities in 2018 increased from 2017 primarily due to the increase in operating income.

Cash provided by operating activities for 2018 was positively impacted by an increase in our days payables outstanding and an increase in accrued expenses. The Company’s growth in revenue of \$93.0 million and gross profit of \$41.0 million increased our outstanding trade receivables and inventories, which negatively impacted our cash provided by operating activities.

Cash provided by operating activities for 2017 was positively impacted by an increase in our outstanding payables and accrued expenses. Cash provided by operating activities was negatively impacted by an increase in outstanding trade receivables and an increase in inventories, excluding trade receivables and inventories acquired from acquisitions in 2017, and an increase in income tax payments.

Cash provided by operating activities for 2016 was positively impacted by an increase in our days payables outstanding from 41 days at December 31, 2015 to 53 days at December 31, 2016 and improvement in our inventory turnover ratio from 3.6 at December

31, 2015 to 3.7 at December 31, 2016. Cash provided by operating activities was negatively impacted by an increase in our days sales outstanding from 57 days at December 31, 2015 to 59 days at December 31, 2016.

In January 2019, we paid £3.0 million (\$3.9 million) as the first installment under our earn-out obligations in connection with the Zettlex acquisition, which will be reported as cash used in operating activities in the first quarter of 2019.

### ***Investing Cash Flows***

Cash used in investing activities was \$45.6 million during 2018, primarily related to \$29.6 million in cash outflows (net of cash acquired of \$3.8 million) related to acquisitions in 2018 and \$14.7 million in capital expenditures.

Cash used in investing activities was \$177.4 million during 2017, primarily driven by our acquisitions of WOM, ThingMagic and Laser Quantum. In connection with these acquisitions, we paid \$185.0 million in cash considerations, which is reported in the consolidated statement of cash flows as \$168.3 million cash outflows from investing activities (net of cash acquired of \$16.7 million and working capital adjustments). We also paid \$9.1 million for capital expenditures during 2017.

Cash used in investing activities was \$12.9 million during 2016, primarily due to \$13.4 million in cash consideration paid for the Reach acquisition and the acquisition of certain developed technology assets, and \$8.5 million in cash paid for capital expenditures, partially offset by \$3.6 million in net cash consideration received from the sale of our Orlando, Florida facility in March 2016, \$3.4 million in net cash consideration received from the sale of our Chatsworth, California facility in August 2016, \$0.4 million received from the finalization of the Lincoln Laser acquisition working capital adjustments, and \$1.5 million received from the release of escrow funds from our 2014 Scientific Lasers divestiture.

We have no material commitments to purchase property, plant and equipment. We expect to use approximately \$14 million to \$16 million in 2019 for capital expenditures related to investments in new property, plant and equipment for our existing businesses.

### ***Financing Cash Flows***

Cash used in financing activities was \$60.2 million during 2018, primarily due to \$30.8 million of cash consideration paid for the acquisition of the remaining equity interest in Laser Quantum, \$9.2 million of contractual term loan payments, \$65.4 million of optional repayments of borrowings under our revolving credit facility, \$3.6 million of payroll tax payments on stock-based compensation awards, and \$5.9 million of repurchases of common stock, partially offset by \$55.3 million of borrowings under our revolving credit facility used to fund a portion of the cash consideration paid for the acquisition of Zettlex and the remaining equity interest in Laser Quantum.

Cash provided by financing activities was \$143.3 million during 2017, primarily due to \$176.8 million of borrowings under our revolving credit facility used to fund a portion of the cash considerations paid for the WOM, ThingMagic and Laser Quantum acquisitions, partially offset by \$7.9 million of contractual term loan payments, \$19.0 million of optional repayments of borrowings under our revolving credit facility, \$2.5 million of contingent consideration payments, \$2.1 million of payroll withholding tax payments on stock-based compensation awards, \$0.4 million of repurchases of our common shares and \$0.9 million of principal payments under our capital lease obligations. We also paid \$0.7 million for debt issuance costs as a result of the Third Amendment to the Second Amended and Restated Credit Agreement entered into in August 2017.

Cash used in financing activities was \$23.2 million during 2016, primarily due to \$7.5 million of contractual term loan payments, \$8.8 million of optional repayments of borrowings under our revolving credit facility, \$1.8 million of payroll withholding tax payments on stock-based compensation awards, \$1.6 million of repurchases of our common shares, and \$1.2 million of principal payments under our capital lease obligations. We also paid \$2.5 million for debt issuance costs as a result of the Second Amended and Restated Credit Agreement signed in May 2016.

In 2019, we are contractually required to pay \$4.6 million (comprised of two quarterly payments of \$2.3 million) on our term loan facility and \$0.6 million in principal payments under our capital lease obligations. In addition, we may pay down our term loan and revolving credit facility from time to time with available cash generated from future operating activities.

### ***Other Liquidity Matters***

#### ***Pension Plans***

We maintain a defined benefit pension plan in the U.K. (the “U.K. Plan”). Our U.K. Plan was closed to new members in 1997 and stopped accruing additional pension benefits for existing members in 2003, thereby limiting our obligation to benefits earned through that date. Benefits under this plan were based on the employees’ years of service and compensation as of the date the plan was frozen, adjusted for inflation. On July 1, 2013, the Company provided a Guarantee (the “Guarantee”) in favor of the trustees of the U.K. Plan

with respect to all present and future obligations and liabilities (whether actual or contingent and whether owed jointly or severally and in any capacity whatsoever) under the U.K. Plan of Novanta Technologies UK Limited, a wholly owned subsidiary of Novanta Inc.

Our funding policy is to fund pensions based on actuarial methods as permitted by regulatory authorities. The results of funding valuations depend on both the funding deficit and the assumptions used (such as asset returns, discount rates, mortality, retail price inflation and other market driven changes). The assumptions used represent one estimate of many possible future outcomes. The final cost to us will be determined by events as they actually become known. Due to the underfunded position that our U.K. Plan currently has and potential changes in the actual outcomes relative to the assumptions used in funding valuations, we may have to increase payments to fund this plan in the future. As of December 31, 2018, the projected benefit obligation under the U.K. Plan exceeded the fair value of plan assets by \$3.8 million.

Based on the results of the most recent funding valuation, the Company's annual contributions are expected to be approximately \$0.9 million in 2019 and will increase by 2.9% per year thereafter.

As a result of the covenant that exists between our U.K. subsidiary and the Plan Trustees regarding the funding of the U.K. Plan, our ability to transfer assets outside our U.K. subsidiary, and its wholly owned subsidiary in China, may be limited.

## Off-Balance Sheet Arrangements, Contractual Obligations

### Contractual Obligations

The following table summarizes our contractual obligations at December 31, 2018 and the effect that such obligations are expected to have on our liquidity and cash flows in future years. We have excluded the future cash payments for unrecognized tax benefits of \$4.5 million, including interest and penalties, because we are uncertain if and when such amounts may be settled. These unrecognized tax benefits are further explained in Note 15 to our Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K.

Contractual Obligations	Total	2019	2020 - 2021	2022 - 2023	Thereafter
			(In thousands)		
Senior Credit Facilities (1)	\$ 209,583	\$ 4,600	\$ 204,983	\$ —	\$ —
Interest on Senior Credit Facilities (2)	15,591	6,970	8,621	—	—
Capital leases	10,108	990	1,887	1,837	5,394
Operating leases (3)	55,949	7,797	12,020	9,983	26,149
Purchase commitments (4)	98,951	93,810	5,141	—	—
U.K. pension plan (5)	3,758	928	1,937	893	—
Contingent consideration and earn-outs (6)	7,733	3,823	2,967	943	—
Total contractual cash obligations	<u>\$ 401,673</u>	<u>\$ 118,918</u>	<u>\$ 237,556</u>	<u>\$ 13,656</u>	<u>\$ 31,543</u>

- (1) As of December 31, 2018, a total of \$74.5 million of borrowings under our term loan and \$135.1 million of borrowings under our revolving credit facility were outstanding under the Senior Credit Facilities. The term loan is payable in quarterly installments of \$2.3 million with the final installment of \$56.1 million due upon maturity in May 2021. As of December 31, 2018, the contractually required quarterly payments for the first two quarters of 2019 had been prepaid. Borrowings under the revolving credit facility are due at maturity in May 2021.
- (2) For the purpose of this calculation, current interest rates on floating rate obligation (LIBOR plus applicable margin, as defined in the Second Amended and Restated Credit Agreement) were used for the remainder contractual life of both the term loan and outstanding borrowings under the revolving credit facility.
- (3) These amounts primarily represent the gross amounts due for facilities that are leased. The amounts include payments due with respect to both active operating facilities and idle facilities that have been vacated.
- (4) Purchase commitments represent purchase obligations as of December 31, 2018.
- (5) Amounts shown represent funding obligations equivalent to \$0.9 million per year, increasing 2.9% through 2022 based on annual funding contributions in effect as of December 31, 2018. Future funding requirements will be subject to change as a result of future changes in various actuarial assumptions and actual investment returns on plan assets.
- (6) These amounts represent the estimated contingent consideration and earn-out payments accrued in the consolidated balance sheet as of December 31, 2018 that are expected to be paid between 2019 and 2022. The undiscounted range of the possible contingent consideration and earn-out payments is zero to \$17.5 million.

## *Off-Balance Sheet Arrangements*

Through December 31, 2018, we have not entered into any off-balance sheet arrangements or material transactions with unconsolidated entities or other persons.

## **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the financial statements and the reported amounts of revenues and expenses for the reporting periods. On an ongoing basis, we evaluate our estimates, assumptions and judgments, including those related to revenue recognition, inventory valuation, assessment of the valuation of goodwill, intangible assets and tangible long-lived assets, contingent consideration obligations, employee benefit plans, restructuring charges, accounting for income taxes, and accounting for loss contingencies. Actual results in the future could differ significantly from our estimates.

We believe that the following critical accounting policies and estimates most significantly affect the portrayal of our financial condition and results of operations and require the most difficult and subjective judgments.

**Revenue Recognition.** Beginning January 1, 2018, we adopted Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09” or “Topic 606”) using the modified retrospective method. Under Topic 606, an entity recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. To determine revenue recognition for arrangements within the scope of Topic 606, the entity performs the following five steps: (i) identifying the contract(s) with a customer; (ii) identifying the performance obligations in the contract; (iii) determining the transaction price; (iv) allocating the transaction price to the performance obligations in the contract; and (v) recognizing revenue when (or as) the entity satisfies a performance obligation.

We recognize revenue when control of promised goods or services is transferred to customers. This generally occurs upon shipment when the title and risk of loss pass to the customer. The vast majority of our revenue is generated from the sale of distinct products. Revenue is measured as the amount of consideration we expect to receive in exchange for such products, which is generally at contractually stated prices. Sales taxes and value added taxes collected concurrently with revenue generating activities are excluded from revenue.

Substantially all of our revenue is recognized at a point in time, upon shipment, rather than over time. At the request of our customers, we may perform professional services, generally for the maintenance and repair of products previously sold to those customers and for engineering services. Professional services are typically short in duration, mostly less than one month, and total less than 3% of our consolidated revenue. Revenue is typically recognized at a point in time when control transfers to the customer upon completion of professional services. These services generally involve a single distinct performance obligation. The consideration expected to be received in exchange for such services is normally the contractually stated amount.

We occasionally sell separately priced non-standard/extended warranty services or preventative maintenance plans with the sale of products. The transfer of control over the service plans is over time. We recognize the related revenue ratably over the terms of the service plans. The transaction price of a contract is allocated to each performance obligation based on its relative standalone selling price. Standalone selling prices are generally determined based on the prices charged to customers or using the expected cost plus a margin.

We account for shipping and handling activities that occur after the transfer of control over the related goods as fulfillment activities rather than performance obligations. The shipping and handling fees charged to customers are recognized as revenue and the related costs are recorded in cost of revenue at the time of transfer of control.

We generally provide warranties for our products. The standard warranty period is typically 12 months to 24 months for our Photonics and Precision Motion segments and 12 months to 36 months for the Vision segment. The standard warranty period for product sales is accounted for under the provisions of ASC 450, “Contingencies,” as we have the ability to ascertain the likelihood of the liability and can reasonably estimate the amount of the liability. A provision for the estimated cost related to warranty is recorded to cost of revenue at the time revenue is recognized. Our estimate of costs to service the warranty obligations is based on historical experience and expectations of future conditions. To the extent our experience in warranty claims or costs associated with servicing those claims differ from the original estimates, revisions to the estimated warranty liability are recorded at that time, with an offsetting entry recorded to cost of revenue.

We expense incremental direct costs of obtaining a contract when incurred if the expected amortization period is one year or less. These costs are recorded within selling, general and administrative expenses in the consolidated statement of operations. We do not

adjust the promised amount of consideration for the effects of a financing component because the transfer of a promised good to a customer and the customer's payment for that good are typically one year or less.

**Inventories.** Inventories, which include materials and conversion costs, are stated at the lower of cost or net realizable value, using the first-in, first-out method. Cost includes the cost of purchased materials, inbound freight charges, external and internal processing and applicable labor and overhead costs. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation.

We regularly review inventory quantities on hand and, when necessary, record provisions for excess and obsolete inventory based on either our forecasted product demand and production requirements or historical trailing usage of the product. If our sales do not materialize as planned or at historical levels, we may have to increase our reserve for excess and obsolete inventory, which would reduce our earnings. If actual market conditions are more favorable than anticipated, inventory previously written down may be sold, resulting in lower cost of revenue and higher income from operations than expected in that period.

**Share-Based Compensation.** We record expenses associated with share-based compensation awards to employees and directors based on the fair value of awards as of the grant date. For share-based compensation awards that vest over time based on employment, the associated expenses are recognized in the consolidated statements of operations ratably over the vesting period of the award, net of estimated forfeitures.

We grant two types of performance-based awards to certain members of the executive management team: non-GAAP EPS performance-based restricted stock units ("EPS-PSUs") and relative total shareholder return performance-based restricted stock units ("TSR-PSUs"). For EPS-PSUs, share-based compensation expense is recognized ratably over the vesting period when it is probable that specified performance targets are expected to be achieved based on management's projections. Management's projections are revised, if necessary, in subsequent periods when underlying factors change the evaluation of the probability of achieving the performance targets. Accordingly, share-based compensation expense associated with EPS-PSUs may differ significantly from period to period based on changes to the probability of achieving performance targets. For TSR-PSUs, we recognize the related compensation expense based on the fair value of the TSR-PSUs, which is determined using the Monte-Carlo simulation valuation model as of the date of grant. The expense related to TSR-PSUs is recognized on a straight-line basis from the grant date to the end of the performance period, which is generally three years.

The Monte Carlo simulation model utilizes multiple input variables that determine the probability of satisfying the performance conditions stipulated in the grant agreement and calculates the fair market value for the market-based restricted stock units granted. The Monte Carlo simulation model also uses stock price volatility and other variables to estimate the probability of satisfying the performance conditions, including the possibility that the market condition may not be satisfied, and the resulting fair value of the award.

**Valuation of Long-lived Assets.** The purchase price we pay for acquired companies is allocated first to the identifiable assets acquired and liabilities assumed at their fair value. Any excess purchase price is then allocated to goodwill. We make various assumptions and estimates in order to assign fair value to acquired tangible and intangible assets and liabilities. These assumptions typically include cash flow forecasts, discount rates, technology royalty rates, and customer attrition rates, among others. Actual cash flows may vary from forecasts used to value these assets at the time of the business combination.

Our most significant identifiable intangible assets are customer relationships, acquired technologies, trademarks and trade names. In addition to our review of the carrying value of each asset, the useful life assumption for each asset, including the classification of certain intangible assets as "indefinite-lived," are reviewed on a periodic basis to determine if changes in circumstances warrant revisions to them. All definite-lived intangible assets are amortized over the periods in which their economic benefits are expected to be realized.

Impairment analyses of goodwill and indefinite-lived intangible assets are conducted in accordance with ASC 350, "Intangibles—Goodwill and Other." During the second quarter of 2018, we adopted ASU 2017-14, "Simplifying the Test for Goodwill Impairment" ("ASU 2017-04" or "Topic 350"), which eliminates Step 2 of the goodwill impairment test. We test our goodwill balances annually as of the beginning of the second quarter or more frequently if indicators are present or changes in circumstances suggest that an impairment may exist. Should the fair value of our goodwill or indefinite-lived intangible assets decline because of reduced operating performance, market declines, or other indicators of impairment, or as a result of changes in the discount rate, charges for impairment loss may be necessary.

We evaluate our goodwill, intangible assets and other long-lived assets for impairment at the reporting unit level which is generally at least one level below our reportable segments. We have the option of first performing a qualitative assessment to determine whether it is necessary to perform the quantitative impairment test. In performing the qualitative assessment, we review factors both specific to the reporting unit and to the Company as a whole, such as financial performance, macroeconomic conditions, industry and market considerations, and the fair value of each reporting unit at the last valuation date. If we elect this option and believe, as a result of the

qualitative assessment, that it is more likely than not that the carrying value of goodwill is not recoverable, the quantitative impairment test is required; otherwise, no further testing is required.

Alternatively, we may elect to bypass the qualitative assessment and perform the quantitative impairment test. This approach requires a comparison of the carrying value of each of our reporting units to the fair value of these reporting units. If the carrying value of a reporting unit exceeds its fair value, an impairment charge is recorded for the difference. The fair value of a reporting unit is estimated primarily using a discounted cash flow (“DCF”) method. The DCF approach requires that we forecast future cash flows for each of the reporting units and discount the cash flow streams based on a weighted average cost of capital (“WACC”) that is derived, in part, from comparable companies within similar industries. The DCF calculations also include a terminal value calculation that is based upon an expected long-term growth rate for the applicable reporting unit. The carrying values of each reporting unit include assets and liabilities which relate to the reporting unit’s operations. Additionally, reporting units that benefit from corporate assets or liabilities are allocated a portion of those corporate assets and liabilities on a proportional basis.

We assess indefinite-lived intangible assets for impairment on an annual basis, and more frequently if impairment indicators are identified. We also periodically reassess their continuing classification as indefinite-lived intangible assets. Impairment exists if the fair value of the intangible asset is less than its carrying value. An impairment charge equal to the difference is recorded to reduce the carrying value to its fair value.

We evaluate amortizable intangible assets and other long-lived assets for impairment in accordance with ASC 360-10-35-15, “Impairment or Disposal of Long-Lived Assets,” whenever changes in events or circumstances indicate that the carrying values of the reporting units may exceed the undiscounted cash flow forecasts attributable to the reporting units. If undiscounted cash flow forecasts indicate that the carrying value of definite-lived intangible assets or other long-lived assets may not be recoverable, a fair value assessment is performed. For intangible assets, fair value estimates are derived from discounted cash flow forecasts. For other long-lived assets (primarily property, plant and equipment), fair value estimates are derived from the sources most appropriate for the particular asset and have historically included such approaches as sales comparison approach and replacement cost approach. If fair value is less than carrying value, an impairment charge equal to the difference is recorded. We also review the useful life and residual value assumptions for definite-lived intangible assets and other long-lived assets on a periodic basis to determine if changes in circumstances warrant revisions to them.

Factors which may trigger an impairment of our goodwill, intangible assets and other long-lived assets include the following:

- significant underperformance relative to historical or projected future operating results;
- changes in our use of the acquired assets or the strategy for our overall business;
- long-term negative industry or economic trends;
- technological changes or developments;
- changes in competition;
- loss of key customers or personnel;
- adverse judicial or legislative outcomes or political developments;
- significant declines in our stock price for a sustained period of time; and
- the decline of our market capitalization below net book value as of the end of any reporting period.

The occurrence of any of these events or any other unforeseeable events or circumstances that materially affect future operating results or cash flows may cause an impairment that is material to our results of operations or financial position in the reporting period in which it occurs or is identified.

The most recent annual goodwill and indefinite-lived intangible asset impairment test was performed as of the beginning of the second quarter of 2018, using a qualitative assessment, noting no impairment. As of December 31, 2018, there were no indicators of impairment of our long-lived assets.

We have a significant amount of goodwill, intangible assets and other long-lived assets. The following table shows the breakdown of goodwill, intangible assets and property, plant and equipment by reportable segment as of December 31, 2018 (in thousands):

	Goodwill	Intangible Assets, net	Property, Plant & Equipment, net
Photonics	\$ 66,494	\$ 45,689	\$ 17,850
Vision	123,295	82,829	33,003
Precision Motion	27,873	14,402	10,131
Unallocated Corporate and Shared Services	—	—	4,480
Total	<u>\$ 217,662</u>	<u>\$ 142,920</u>	<u>\$ 65,464</u>

**Pension Plans.** Our subsidiary located in the U.K. maintains a defined benefit pension plan (the “U.K. Plan”). The U.K. Plan was closed to new membership in 1997 and stopped accruing for additional pension benefits for existing members in 2003, limiting our obligation to benefits earned through that date. Benefits under this plan were based on the employees’ years of service and compensation as of the date the plan was frozen, adjusted for inflation. At December 31, 2018, the fair market value of the plan assets was \$33.1 million, which was \$3.8 million, or 10.2%, less than the projected benefit obligation of \$36.9 million.

The cost and obligations of our U.K. Plan are calculated using many assumptions. Major assumptions used in the accounting for this pension plan include the discount rate, rate of inflation, mortality rate and expected return on plan assets. Assumptions are determined each year based on data and appropriate market indicators in consultation with a third-party actuary. Should any of these assumptions change, they would have an effect on net periodic pension cost and the unfunded benefit obligation as of the end of the year. The most sensitive assumption affecting the determination of our U.K. Plan pension obligation is the discount rate. A 50 basis point decrease in the discount rate as of December 31, 2018 would change the pension obligation by \$3.2 million.

**Accounting for Income Taxes.** As part of the process of preparing our consolidated financial statements, we are required to calculate our income tax provision (benefit) in each of the jurisdictions in which we operate. This process involves estimating our current income tax provision (benefit) together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are reported on our consolidated balance sheet.

Judgment is required in determining our worldwide income tax provision. In the ordinary course of a global business, there are many transactions and calculations where the ultimate outcome is uncertain. Although we believe our estimates are reasonable, no assurance can be given that the final outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. Such differences could have a material impact on our income tax provision and net income in the period in which such determination is made.

We record a valuation allowance on our deferred tax assets when it is more likely than not that they will not be realized. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. In the event we determine that we are able to realize our deferred tax assets in the future in excess of their net recorded amount, an adjustment to the valuation allowance for the deferred tax assets would be recorded and would increase our net income in the period such determination is made. Likewise, should we determine that we will not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the valuation allowance for the deferred tax assets will be recorded and will reduce our net income in the period such determination is made.

In conjunction with our ongoing review of our actual results and anticipated future earnings, we continuously reassess the adequacy of the valuation allowance currently in place on our deferred tax assets. In 2018, we released valuation allowance of \$0.3 million recorded on net operating losses and other timing items in certain tax jurisdictions. The decrease of our valuation allowance was determined in accordance with the provisions of ASC 740, “Income Taxes,” which requires an assessment of both positive and negative evidence when determining whether it is more likely than not that deferred tax assets are recoverable. Such assessment is required on a jurisdiction by jurisdiction basis.

The amount of income taxes we pay is subject to audits by federal, state and foreign tax authorities, which may result in proposed assessments. We believe that we have adequately provided for any reasonably foreseeable outcome related to these matters. However, our future results may include favorable or unfavorable adjustments to our tax liabilities in the period that the assessments are made or resolved, or when the statute of limitations for certain periods expires. As of December 31, 2018, the total amount of gross unrecognized tax benefits was \$4.7 million, of which \$3.6 million would favorably affect our effective tax rate, if recognized. Over the next twelve months, we may need to record up to \$0.5 million of previously unrecognized tax benefits in the event of statute of limitations closures.

Income and foreign withholding taxes have not been recognized on the excess of the amount for financial reporting purposes over the tax basis of investments in foreign subsidiaries that are essentially permanent in nature. This amount becomes taxable upon a repatriation of assets from a subsidiary or a sale or liquidation of a subsidiary. The amount of undistributed earnings of foreign subsidiaries totaled \$135.6 million as of December 31, 2018. The estimated unrecognized income and foreign withholding tax liability on this temporary difference is approximately \$0.3 million.

On December 22, 2017, the President of the United States signed into law the Tax Reform Act. The Tax Reform Act significantly changed U.S. tax law by, among other things, lowering corporate income tax rates, implementing a territorial tax system, providing a one-time transition Toll Charge on foreign earnings, creating a new limitation on deductible interest expense and modifying the officer's compensation limitation. The Tax Reform Act permanently reduced the U.S. corporate income tax rate from a maximum of 35% to a flat 21% rate, effective January 1, 2018.

As a result of the Tax Reform Act, we revalued our deferred tax assets and liabilities at the newly enacted 21% U.S. corporate income tax rate. Because of the ownership structure of the Company, our foreign entities outside the U.S. are not considered controlled foreign corporations of the U.S. company, as defined under U.S. tax principles, and accordingly, the accumulated earnings of these foreign subsidiaries are not subject to the one-time transition Toll Charge under the Tax Reform Act.

During the year ended December 31, 2018, there were no changes made to the provisional amounts recognized in 2017 in connection with the enactment of the Tax Reform Act. The accounting for the income tax effects of the Tax Reform Act is complete as of December 31, 2018.

**Loss Contingencies.** We are subject to legal proceedings, lawsuits and other claims relating to labor, service and other matters arising in the ordinary course of business. We review the status of each significant matter and assess our potential financial exposure on a quarterly basis. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure is reasonably estimable. Because of uncertainties related to these matters, accruals are based only on the best information available as of the date of the financial statement. As additional information becomes available, we will reassess the potential liability related to our pending claims and litigation and may revise our estimates. Such revisions in the estimates of the potential liabilities could have a material impact on our results of operations and financial position. We expense legal fees as incurred.

## **Recent Accounting Pronouncements**

See Note 2 to Consolidated Financial Statements for recent accounting pronouncements that could have an effect on us.

## **Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to market risk from changes in foreign currency exchange rates and interest rates, which could affect our operating results, financial position and cash flows. We manage our exposure to these market risks through our regular operating and financing activities. We address market risks from changes in foreign currency exchange rates through a risk management program that includes the use of derivative financial instruments to mitigate certain foreign currency transaction exposures from future settlement of non-functional currency monetary assets and liabilities as of the end of a period.

### *Foreign Currency Exchange Rate Risk and Sensitivity*

We are exposed to changes in foreign currency exchange rates which could affect our operating results as well as our financial position and cash flows. The foreign currencies to which we have the most significant exchange rate exposure are the Euro, British Pound and Japanese Yen. The Company manages its foreign currency exposures on a consolidated basis, which allows the Company to analyze exposures globally and take into account offsetting exposures in certain balances. The primary foreign currency denominated transactions include revenue and expenses and the resulting accounts receivable and accounts payable balances reflected on our consolidated balance sheet and with intercompany trading partners that are eliminated in consolidation.

In the ordinary course of business, we enter into foreign currency contracts for periods consistent with our committed exposures to mitigate the effect of foreign currency movements on transactions denominated in foreign currencies. We do not enter into or hold foreign currency derivative financial instruments for trading or speculative purposes, nor do we enter into derivative financial instruments to hedge future cash flows or forecasted transactions. The intent of these economic hedges is to offset gains and losses on the underlying exposures from these currencies with gains and losses resulting from the foreign currency contracts that hedge these exposures.

We had foreign currency contracts with notional amounts totaling \$31.2 million and a fair value of \$0.2 million as of December 31, 2018. A hypothetical 10% strengthening of the U.S. dollar against other currencies would result in an approximately \$2.5 million increase in the fair value of our foreign currency contracts as of December 31, 2018. By contrast, a hypothetical 10% weakening of the U.S. dollar against other currencies would result in an approximately \$2.5 million decrease in the fair value of our foreign currency contracts as of December 31, 2018.

#### *Interest Rates*

Our exposure to market risk associated with changes in interest rates relates primarily to our debt obligations. We have \$209.6 million of outstanding variable rate debt as of December 31, 2018. A 100 basis point increase in interest rates at December 31, 2018 would increase our annual pre-tax interest expense by approximately \$2.1 million.

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

**NOVANTA INC.**

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## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of Novanta Inc.:

### ***Opinions on the Financial Statements and Internal Control over Financial Reporting***

We have audited the accompanying consolidated balance sheets of Novanta Inc. and its subsidiaries (the “Company”) as of December 31, 2018 and 2017, and the related consolidated statements of operations, comprehensive income, stockholders’ equity and cash flows for each of the three years in the period ended December 31, 2018, including the related notes (collectively referred to as the “consolidated financial statements”). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018 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, 2018, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

### ***Change in Accounting Principle***

As discussed in Note 3 to the consolidated financial statements, the Company changed the manner in which it accounts for revenues from contracts with customers in 2018.

### ***Basis for Opinions***

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Annual Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company's consolidated financial statements and 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 U.S. 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 consolidated 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 consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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.

/s/ PricewaterhouseCoopers LLP

Boston, Massachusetts  
February 27, 2019

We have served as the Company's auditor since 2013.

**NOVANTA INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands of U.S. dollars or shares)

	December 31, 2018	December 31, 2017
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 82,043	\$ 100,057
Accounts receivable, net of allowance of \$321 and \$554, respectively	83,955	81,482
Inventories	104,764	91,278
Prepaid income taxes and income taxes receivable	1,852	4,387
Prepaid expenses and other current assets	9,155	10,675
Total current assets	281,769	287,879
Property, plant and equipment, net	65,464	61,718
Deferred tax assets	9,492	7,052
Other assets	2,269	4,018
Intangible assets, net	142,920	155,048
Goodwill	217,662	210,988
Total assets	<u>\$ 719,576</u>	<u>\$ 726,703</u>
<b>LIABILITIES, NONCONTROLLING INTEREST AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities		
Current portion of long-term debt	\$ 4,535	\$ 9,119
Accounts payable	50,733	39,793
Income taxes payable	2,633	5,942
Accrued expenses and other current liabilities	46,295	43,314
Total current liabilities	104,196	98,168
Long-term debt	202,843	225,500
Deferred tax liabilities	22,632	25,672
Income taxes payable	4,463	3,754
Other liabilities	17,187	15,141
Total liabilities	351,321	368,235
Commitments and Contingencies (Note 17)		
Redeemable noncontrolling interest	—	46,923
Stockholders' Equity:		
Common shares, no par value; Authorized shares: unlimited; Issued and outstanding: 34,886 and 34,595, respectively	423,856	423,856
Additional paid-in capital	46,018	33,309
Accumulated deficit	(79,092)	(127,740)
Accumulated other comprehensive loss	(22,527)	(17,880)
Total stockholders' equity	368,255	311,545
Total liabilities, noncontrolling interest and stockholders' equity	<u>\$ 719,576</u>	<u>\$ 726,703</u>

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

NOVANTA INC.

**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands of U.S. dollars or shares, except per share amounts)

	Year Ended December 31,		
	2018	2017	2016
Revenue	\$ 614,337	\$ 521,290	\$ 384,758
Cost of revenue	352,809	300,759	222,306
Gross profit	261,528	220,531	162,452
Operating expenses:			
Research and development and engineering	51,024	41,673	32,002
Selling, general and administrative	115,900	101,654	81,299
Amortization of purchased intangible assets	15,550	12,096	8,251
Restructuring, acquisition and divestiture related costs	8,041	7,542	7,945
Total operating expenses	190,515	162,965	129,497
Operating income	71,013	57,566	32,955
Interest income (expense), net	(9,814)	(7,165)	(4,559)
Foreign exchange transaction gains (losses), net	147	(447)	2,317
Other income (expense), net	(44)	(229)	1,809
Gain on acquisition of business	—	26,409	—
Income before income taxes	61,302	76,134	32,522
Income tax provision	10,207	13,827	10,519
Consolidated net income	51,095	62,307	22,003
Less: Net income attributable to noncontrolling interest	(1,986)	(2,256)	—
Net income attributable to Novanta Inc.	\$ 49,109	\$ 60,051	\$ 22,003
Earnings per common share attributable to Novanta Inc. (Note 10):			
Basic	\$ 1.46	\$ 1.14	\$ 0.63
Diluted	\$ 1.43	\$ 1.13	\$ 0.63
Weighted average common shares outstanding—basic	34,913	34,817	34,694
Weighted average common shares outstanding—diluted	35,473	35,280	34,914

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

**NOVANTA INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands of U.S. dollars)

	Year Ended December 31,		
	2018	2017	2016
Consolidated net income	\$ 51,095	\$ 62,307	\$ 22,003
Other comprehensive income (loss):			
Foreign currency translation adjustments, net of tax (1)	(4,172)	8,909	(7,524)
Pension liability adjustments, net of tax (2)	(475)	926	(1,361)
Total other comprehensive income (loss)	(4,647)	9,835	(8,885)
Total consolidated comprehensive income	46,448	72,142	13,118
Less: Comprehensive income attributable to noncontrolling interest	(1,986)	(2,256)	—
Comprehensive income attributable to Novanta Inc.	<u>\$ 44,462</u>	<u>\$ 69,886</u>	<u>\$ 13,118</u>

- (1) The tax effect on this component of comprehensive income was (\$93), (\$94) and \$36 in 2018, 2017 and 2016, respectively.
- (2) The tax effect on this component of comprehensive income was (\$153), \$277 and (\$462) in 2018, 2017 and 2016, respectively.

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

**NOVANTA INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(In thousands of U.S. dollars or shares)

	Novanta Inc. Stockholders					
	Common Shares		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
	# of Shares	Amount				
<b>Balance at December 31, 2015</b>	34,345	\$ 423,856	\$ 29,225	\$ (18,830)	\$ (189,550)	\$ 244,701
Net income	—	—	—	—	22,003	22,003
Common stock issued under stock plans	351	—	181	—	—	181
Shares withheld for taxes on vested stock awards	(129)	—	(1,789)	—	—	(1,789)
Repurchases of common stock	(109)	—	(1,634)	—	—	(1,634)
Share-based compensation	—	—	4,293	—	—	4,293
Other comprehensive loss, net of tax	—	—	—	(8,885)	—	(8,885)
<b>Balance at December 31, 2016</b>	34,458	423,856	30,276	(27,715)	(167,547)	258,870
Net income	—	—	—	—	60,051	60,051
Redeemable noncontrolling interest redemption value adjustment (Note 5)	—	—	—	—	(20,244)	(20,244)
Common stock issued under stock plans	228	—	—	—	—	—
Shares withheld for taxes on vested stock awards	(77)	—	(2,090)	—	—	(2,090)
Repurchases of common stock	(14)	—	(370)	—	—	(370)
Share-based compensation	—	—	5,493	—	—	5,493
Other comprehensive loss, net of tax	—	—	—	9,835	—	9,835
<b>Balance at December 31, 2017</b>	34,595	423,856	33,309	(17,880)	(127,740)	311,545
Net income	—	—	—	—	49,109	49,109
Redeemable noncontrolling interest redemption value adjustment (Note 5)	—	—	—	—	1,781	1,781
Acquisition of noncontrolling interest	213	—	14,401	—	—	14,401
Common stock issued under stock plans	231	—	—	—	—	—
Shares withheld for taxes on vested stock awards	(64)	—	(3,556)	—	—	(3,556)
Repurchases of common stock	(89)	—	(5,850)	—	—	(5,850)
Share-based compensation	—	—	7,714	—	—	7,714
Adoption of ASU 2016-16 (Note 2)	—	—	—	—	(2,242)	(2,242)
Other comprehensive income, net of tax	—	—	—	(4,647)	—	(4,647)
<b>Balance at December 31, 2018</b>	<u>34,886</u>	<u>\$ 423,856</u>	<u>\$ 46,018</u>	<u>\$ (22,527)</u>	<u>\$ (79,092)</u>	<u>\$ 368,255</u>

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

NOVANTA INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands of U.S. dollars)

	Year Ended December 31,		
	2018	2017	2016
<b>Cash flows from operating activities:</b>			
Consolidated net income	\$ 51,095	\$ 62,307	\$ 22,003
Adjustments to reconcile consolidated net income to net cash provided by operating activities:			
Depreciation and amortization	37,052	30,758	20,357
Provision for inventory excess and obsolescence	1,898	1,421	3,091
Share-based compensation	7,714	5,493	4,293
Deferred income taxes	(6,076)	(2,560)	(1,766)
Earnings from equity-method investment	—	(104)	(2,191)
Dividend from equity-method investment	—	—	2,341
Gain on acquisition of business	—	(26,409)	—
(Gain) loss on sale of fixed assets	106	36	(1,707)
Contingent consideration adjustments	—	425	1,267
Inventory acquisition fair value adjustment	—	4,754	173
Non-cash interest expense	955	825	882
Other non-cash items	(165)	283	813
Changes in assets and liabilities which provided/(used) cash, excluding effects from businesses acquisitions:			
Accounts receivable	(1,156)	(2,077)	(6,394)
Inventories	(15,603)	(13,587)	(2,917)
Prepaid expenses and other current assets	1,350	(2,169)	(1,729)
Prepaid income taxes and income taxes receivable	2,165	(2,282)	462
Accounts payable, income taxes payable, accrued expenses and other current liabilities	11,238	8,993	10,590
Other non-current assets and liabilities	(926)	(2,729)	(1,780)
Cash provided by operating activities	89,647	63,378	47,788
<b>Cash flows from investing activities:</b>			
Purchases of property, plant and equipment	(14,658)	(9,094)	(8,462)
Acquisition of businesses, net of cash acquired and working capital adjustments	(29,600)	(168,332)	(8,958)
Acquisition of assets	(1,599)	—	(3,980)
Release of escrow from sale of business	—	—	1,498
Proceeds from sale of property, plant and equipment	267	46	7,037
Cash used in investing activities	(45,590)	(177,380)	(12,865)
<b>Cash flows from financing activities:</b>			
Borrowings under revolving credit facility	55,253	176,769	—
Repayments of term loan and revolving credit facility	(74,648)	(26,925)	(16,250)
Payments of debt issuance costs	—	(655)	(2,523)
Payments of withholding taxes from stock-based awards	(3,556)	(2,090)	(1,789)
Payments of contingent considerations	—	(2,546)	—
Repurchases of common stock	(5,850)	(370)	(1,634)
Acquisition of noncontrolling interest	(30,800)	—	—
Other financing activities	(563)	(853)	(993)
Cash provided by (used in) financing activities	(60,164)	143,330	(23,189)
Effect of exchange rates on cash and cash equivalents	(1,907)	2,621	(3,585)
Increase (decrease) in cash and cash equivalents	(18,014)	31,949	8,149
Cash and cash equivalents, beginning of year	100,057	68,108	59,959
Cash and cash equivalents, end of year	\$ 82,043	\$ 100,057	\$ 68,108
<b>Supplemental disclosure of cash flow information:</b>			
Cash paid for interest	\$ 8,924	\$ 5,832	\$ 2,917
Cash paid for income taxes	\$ 20,323	\$ 21,121	\$ 14,058
Income tax refunds received	\$ 3,011	\$ 337	\$ 932
<b>Supplemental disclosure of non-cash investing activity:</b>			
Accrual for capital expenditures	\$ 1,187	\$ 1,601	\$ 1,253

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

# NOVANTA INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2018

### 1. Organization and Presentation

Novanta Inc. and its subsidiaries (collectively referred to as “Novanta”, the “Company”, “we”, “us”, “our”) is a leading global supplier of core technology solutions that give medical and advanced industrial original equipment manufacturers (“OEMs”) a competitive advantage. Novanta combines deep proprietary technology expertise and competencies in photonics, vision and precision motion with a proven ability to solve complex technical challenges. This enables Novanta to engineer core components and sub-systems that deliver extreme precision and performance, tailored to the customers’ demanding applications.

#### *Basis of Presentation*

These consolidated financial statements have been prepared by the Company in United States (“U.S.”) dollars and in accordance with accounting principles generally accepted in the U.S., applied on a consistent basis.

The consolidated financial statements include the accounts of Novanta Inc. and its subsidiaries. Intercompany accounts and transactions have been eliminated.

Prior to January 10, 2017, the Company had an approximately 41% ownership interest in Laser Quantum Limited (“Laser Quantum”), a privately held company located in the United Kingdom, which was accounted for under the equity method of accounting. During the years ended December 31, 2017 and 2016, the Company recognized income from its equity method investment amounting to \$0.1 million and \$2.2 million, respectively, which was included in other income (expense) in the accompanying consolidated statements of operations.

On January 10, 2017, the Company acquired an additional approximately 35% of the outstanding shares of Laser Quantum. As a result of this transaction, the Company’s ownership position in Laser Quantum increased from approximately 41% to approximately 76%. Since January 10, 2017, Laser Quantum has been consolidated in the Company’s consolidated financial statements. On September 27, 2018, the Company acquired the remaining approximately 24% of the outstanding shares of Laser Quantum for an aggregate consideration of \$45.1 million in cash and restricted stock.

### 2. Summary of Significant Accounting Policies

#### *Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting periods. Estimates and assumptions are reviewed on an on-going basis and the effects of revisions are reflected in the period in which they are deemed to be necessary. The Company evaluates its estimates based on historical experience, current conditions and various other assumptions that it believes are reasonable under the circumstances. Actual results could differ significantly from those estimates.

#### *Foreign Currency Translation*

The financial statements of the Company and its subsidiaries outside the U.S. have been translated into U.S. dollars. Assets and liabilities of foreign operations are translated from foreign currencies into U.S. dollars at the exchange rates in effect as of the balance sheet date. Revenue and expenses are translated at the weighted average exchange rates for the period. Accordingly, gains and losses resulting from translating foreign currency financial statements are reported as cumulative translation adjustments, a separate component of other comprehensive income (loss) in stockholders’ equity. Foreign currency transaction gains and losses, from transactions denominated in currencies other than the functional currencies, are included in the accompanying consolidated statements of operations.

#### *Cash Equivalents*

Cash equivalents are highly liquid investments with original maturities of three months or less. These investments are carried at cost, which approximates fair value.

**NOVANTA INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**  
**AS OF DECEMBER 31, 2018**

***Accounts Receivable and Allowance for Doubtful Accounts***

Accounts receivable are recorded at the invoiced amounts, net of an allowance for doubtful accounts based on the Company's best estimate of probable credit losses resulting from the inability of the Company's customers to make required payments. The Company determines the allowance based on a variety of factors, including the age of amounts outstanding relative to their contractual due date, specific customer factors, and other known risks and economic trends. Charges related to the allowance for doubtful accounts are included as selling, general and administrative expenses and are recorded in the period that the outstanding receivables are determined to be uncollectible. Account balances are charged off against the allowance when the Company believes it is certain that the receivable will not be recovered.

For the years ended December 31, 2018, 2017 and 2016, changes in the allowance for doubtful accounts were as follows (in thousands):

	2018	2017	2016
Balance at beginning of year	\$ 554	\$ 565	\$ 500
Provision charged to selling, general and administrative expenses	66	283	135
Allowance resulting from acquisitions	—	52	15
Write-offs, net of recoveries of amounts previously reserved	(295)	(358)	(82)
Exchange rate changes	(4)	12	(3)
Balance at end of year	<u>\$ 321</u>	<u>\$ 554</u>	<u>\$ 565</u>

***Inventories***

Inventories, which include materials and conversion costs, are stated at the lower of cost or net realizable value, using the first-in, first-out method. Cost includes the cost of purchased materials, inbound freight charges, external and internal processing and applicable labor and overhead costs. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The Company periodically reviews quantities of inventories on hand and compares these amounts to the expected use of each product. The Company records a charge to cost of revenue for the amount required to reduce the carrying value of inventory to the net realizable value.

***Property, Plant and Equipment***

Property, plant and equipment are recorded at cost, adjusted for any impairment, less accumulated depreciation. The Company uses the straight-line method to calculate the depreciation of its property, plant and equipment over their estimated useful lives. Estimated useful lives range from 3 to 30 years for buildings and building improvements and 3 to 10 years for machinery and equipment. Leasehold improvements are depreciated over the lesser of their useful lives or the lease terms, including any renewal period options that are reasonably assured of being exercised. Repairs and maintenance costs are expensed as incurred. Certain costs to develop software for internal use are capitalized when the criteria under Accounting Standards Codification ("ASC") 350-40, "Internal-Use Software," are met. Lease arrangements meeting the criteria of ASC 840-30, "Leases – Capital Leases," are capitalized based on the present value of future minimum lease payments and depreciated over the term of the lease.

***Goodwill, Intangible Assets and Long-Lived Assets***

Goodwill represents the excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities acquired in a business combination. Allocations of the purchase price are based upon a valuation of the fair value of assets acquired and liabilities assumed as of the acquisition date. Goodwill and indefinite-lived intangibles are not amortized but are assessed for impairment at least annually to ensure their current fair values exceed their carrying values.

The Company's most significant intangible assets are customer relationships, patents and developed technologies, trademarks and trade names. The fair values of intangible assets are based on valuations using an income approach, with estimates and assumptions provided by management of the acquired companies and the Company. The process for estimating the fair values of identifiable intangible assets requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. All definite-lived intangible assets are amortized over the periods in which their economic benefits are expected to be realized. The Company reviews the useful life assumptions, including the classification of certain intangible assets as "indefinite-lived", on a periodic basis to determine if changes in circumstances warrant revisions to them. Costs associated with patent and intellectual property applications, renewals or extensions are expensed as incurred.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**  
**AS OF DECEMBER 31, 2018**

The Company evaluates its goodwill, intangible assets and other long-lived assets for impairment at the reporting unit level which is at least one level below our reportable segments.

***Impairment Charges***

Impairment analyses of goodwill and indefinite-lived intangible assets are conducted in accordance with ASC 350, “Intangibles — Goodwill and Other.” During the second quarter of 2018, the Company adopted Accounting Standards Update (“ASU”) 2017-14, “Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”), which eliminates Step Two of the goodwill impairment test. The Company performs its goodwill impairment test annually as of the beginning of the second quarter or more frequently if indicators are present, or changes in circumstances suggest, that an impairment may exist.

The Company has the option of first performing a qualitative assessment to determine whether it is necessary to perform the quantitative impairment test. In performing the qualitative assessment, the Company reviews factors both specific to the reporting unit and to the Company as a whole, such as financial performance, macroeconomic conditions, industry and market considerations, and the fair value of each reporting unit at the last valuation date. If the Company elects this option and believes, as a result of the qualitative assessment, that it is more likely than not that the carrying value of the reporting unit exceeds its fair value, the quantitative impairment test is required; otherwise, no further testing is required.

Alternatively, the Company may elect to bypass the qualitative assessment and perform the quantitative impairment test. This approach requires a comparison of the carrying value of each of the Company’s reporting units to the estimated fair value of these reporting units. The fair value of a reporting unit is estimated primarily using a discounted cash flow (“DCF”) method with a weighted average cost of capital. If the carrying value of a reporting unit exceeds its fair value, an impairment charge is recorded for the difference.

The Company assesses indefinite-lived intangible assets for impairment on an annual basis as of the beginning of the second quarter, and more frequently if indicators are present, or changes in circumstances suggest, that an impairment may exist. The Company will also reassess the continuing classification of these indefinite-lived intangible assets as indefinite-lived when circumstances change such that the useful life may no longer be considered indefinite. The fair values of the Company’s indefinite-lived intangible assets are determined using the relief from royalty method, based on forecasted revenues. If the fair value of an indefinite-lived intangible asset is less than its carrying value, an impairment charge is recorded for the difference between the carrying value and the fair value of the impaired asset.

The carrying amounts of definite-lived long-lived assets are reviewed for impairment whenever changes in events or circumstances indicate that their carrying values may not be recoverable. The recoverability of the carrying value is generally determined by comparison of the asset group’s carrying value to its undiscounted future cash flows. When this test indicates a potential for impairment, a fair value assessment is performed. Once an impairment is determined and measured, an impairment charge is recorded for the difference between the carrying value and the fair value of the impaired asset.

***Revenue Recognition***

See Note 3 for the Company’s revenue recognition policy.

***Research and Development and Engineering Costs***

Research and development and engineering (“R&D”) expenses are primarily comprised of employee related expenses and cost of materials for R&D projects. These costs are expensed as incurred.

***Share-Based Compensation***

The Company records the expense associated with share-based compensation awards to employees and directors based on the fair value of awards as of the grant date. For share-based compensation awards that vest over time based on employment, the associated expenses are recognized in the consolidated statements of operations ratably over the vesting period, net of estimated forfeitures. The Company also grants two types of performance-based awards to certain members of the executive management team: non-GAAP

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**  
**AS OF DECEMBER 31, 2018**

earnings per share performance-based restricted stock units (“EPS-PSUs”) and relative total shareholder return performance-based restricted stock units (“TSR-PSUs”).

Share-based compensation expense associated with EPS-PSUs is recognized ratably over the vesting period when it is probable that the performance targets are expected to be achieved based on management’s projections. Management’s projections are revised, if necessary, in subsequent periods when underlying factors change the evaluation of the probability of achieving the performance targets. When the estimated achievement levels are adjusted at a later date, a cumulative adjustment to the share-based compensation expense previously recognized would be required. Accordingly, share-based compensation expense associated with EPS-PSUs may differ significantly from period to period based on changes to the probability of achieving performance targets. Share-based compensation expense associated with TSR-PSUs is based on the fair value of the TSR-PSUs, determined using the Monte-Carlo valuation model, as of the grant date and is recognized on a straight-line basis from the grant date to the end of the performance period. Compensation expense will not be affected by the number of TSR-PSUs that will actually vest at the end of the performance period.

***Advertising Costs***

Advertising costs are expensed to selling, general and administrative expenses as incurred and were not material for 2018, 2017 and 2016.

***Restructuring, Acquisition and Divestiture Related Costs***

The Company accounts for its restructuring activities in accordance with the provisions of ASC 420, “Exit or Disposal Cost Obligations.” The Company makes assumptions related to the amounts of employee severance benefits and related costs, time period over which facilities will remain vacant, useful lives and residual value of long-lived assets, sublease terms, sublease rental rates and discount rates. Estimates and assumptions are based on the best information available at the time the obligation is recognized. These estimates are reviewed and revised as facts and circumstances dictate.

Acquisition related costs incurred to effect a business combination, including finders’ fees, legal, valuation and other professional or consulting fees, are expensed as incurred. Acquisition related costs also include expenses recognized under earn-out agreements in connection with acquisitions. Expenses associated with divestiture activities, including legal and professional fees directly related to the completion of a business divestiture, are expensed as incurred.

***Accounting for Income Taxes***

The asset and liability method is used to account for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. This method also requires the recognition of future tax benefits, such as net operating loss carryforwards, to the extent that it is more likely than not that such benefits will be realized. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. A valuation allowance is established to reduce the deferred tax assets if it is more likely than not that some or all of the related tax benefits will not be realized in the future. Valuation allowances are reassessed periodically to determine whether it is more likely than not that the tax benefits will be realized in the future and that any valuation allowance should be released.

The majority of the Company’s business activities are conducted through its subsidiaries outside of Canada. Earnings from these subsidiaries are generally indefinitely reinvested in the local businesses. Further, local laws and regulations may also restrict certain subsidiaries from paying dividends to their parents. As such, the Company generally does not accrue income taxes for the repatriation of such earnings in accordance with ASC 740, “Income Taxes.” To the extent that there are excess accumulated earnings that the Company intends to repatriate from any such subsidiaries, the Company recognizes deferred tax liabilities on such foreign earnings.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
AS OF DECEMBER 31, 2018

The Company assesses its income tax positions and records tax benefits for all years subject to examination based on the evaluation of the facts, circumstances, and information available at each reporting date. For those tax positions with a greater than 50 percent likelihood of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information, the Company records a tax benefit. For those income tax positions that are not likely to be sustained, no tax benefit is recognized in the consolidated financial statements. The Company recognizes interest and penalties related to uncertain tax positions as part of the provision for income taxes.

***Foreign Currency Contracts***

The Company uses foreign currency contracts as a part of its strategy to limit its exposures related to foreign currency denominated monetary assets and liabilities. The time duration of these foreign currency contracts approximates the underlying foreign currency transaction exposures, generally less than three months. These contracts are not designated as cash flow, fair value or net investment hedges. Changes in the fair value of these foreign currency contracts are recognized in income before income taxes.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**  
**AS OF DECEMBER 31, 2018**

**Recent Accounting Pronouncements**

<b>Standard</b>	<b>Description</b>	<b>Effective Date</b>	<b>Effect on the Financial Statements or Other Significant Matters</b>
In March 2018, the FASB issued ASU 2018-05, “Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118.”	ASU 2018-05 allows SEC registrants to record provisional amounts in earnings for the year ended December 31, 2017 due to the complexities involved in accounting for the income tax effects of the U.S. Tax Cuts and Jobs Act (the “Tax Reform Act”). Companies have up to one year from the enactment of the Tax Reform Act (the “measurement period”) to obtain, prepare, and analyze the information that is needed in order to complete the accounting under ASC Topic 740. Any provisional amounts or adjustments to provisional amounts during the measurement period should be included in income from operations as an adjustment to tax provision (benefit) in the reporting period in which the amounts are determined.	January 1, 2018.	The Company adopted ASU 2018-05 during the first quarter of 2018. The adoption of ASU 2018-05 did not have a material impact on the Company’s consolidated financial statements. See Note 15.
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.”	ASU 2018-02 allows an entity to reclassify the income tax effects of the Tax Reform Act on items within accumulated other comprehensive income to retained earnings. ASU 2018-02 shall be applied either in the period of adoption or retrospectively to each period (or periods) in which the effects of the change in the U.S. federal corporate income tax rate in the Tax Reform Act is recognized.	January 1, 2019. Early adoption is permitted.	The Company does not expect the adoption of ASU 2018-02 to have a material impact on its consolidated financial statements.
In May 2017, the FASB issued ASU 2017-09, “Compensation – Stock Compensation (Topic 718).”	ASU 2017-09 requires that an entity account for the effects of a modification unless (i) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; (ii) the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and (iii) the classification of the modified award as	January 1, 2018.	The Company adopted ASU 2017-09 during the first quarter of 2018. The adoption of ASU 2017-09 did not have a material impact on the Company’s consolidated financial statements.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
AS OF DECEMBER 31, 2018

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
	an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. ASU 2017-09 should be applied prospectively to an award modified on or after the adoption date.		
In March 2017, the FASB issued ASU 2017-07, “Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.”	ASU 2017-07 requires employers that offer or maintain defined benefit plans to disaggregate the service component from the other components of net periodic benefit cost and provides guidance on the presentation of the service component and the other components of net periodic benefit cost in the statement of operations. ASU 2017-07 should be applied retrospectively for the presentation of net periodic benefit cost in the statement of operations.	January 1, 2018.	The Company retrospectively adopted ASU 2017-07 during the first quarter of 2018. The adoption of ASU 2017-07 resulted in the reclassification of \$0.4 million of the Company’s net periodic benefit costs related to its frozen U.K. pension plan from Selling, general and administrative expenses into Other income (expense) in the consolidated statement of operations for both 2017 and 2016.
In October 2016, the FASB issued ASU 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory.”	ASU 2016-16 requires that an entity recognize the income tax consequences of an intra-entity transfer of an asset other than inventory in the period in which the transfer occurs. ASU 2016-16 shall be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption.	January 1, 2018.	The Company adopted ASU 2016-16 during the first quarter of 2018 using the modified retrospective approach. The adoption resulted in the reclassification of \$2.5 million of prepaid income taxes and income taxes receivable, of which \$2.2 million was recorded to Accumulated deficit and \$0.3 million was recognized as net deferred tax assets, for the year ended December 31, 2018. The Company will recognize incremental deferred income tax expense thereafter as these net deferred tax assets are utilized.
In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).” In August 2015, the FASB issued ASU 2015-14, “Revenue from Contracts with Customers – Deferral of the Effective Date.”	ASU 2014-09 supersedes the revenue recognition requirements in ASC Topic 605, “Revenue Recognition,” and requires entities to recognize revenue in a way that depicts the transfer of goods or services to customers at an amount that reflects the consideration to which the entity	January 1, 2018.	The Company adopted ASU 2014-09 during the first quarter of 2018 using the modified retrospective method. ASU 2014-09 has been applied to those contracts which had not been completed as of January 1, 2018 and all new contracts entered into by the Company subsequent to

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
AS OF DECEMBER 31, 2018

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
	expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgements, and changes in judgements and assets recognized from costs incurred to fulfill a contract.		January 1, 2018. All prior period financial statements and disclosures are presented in accordance with Topic 605. The adoption of ASU 2014-09 did not have an impact on the Company's Accumulated deficit. See Note 3.
In January 2017, the FASB issued ASU 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment."	ASU 2017-04 simplifies the accounting for goodwill impairment by removing Step Two of the goodwill impairment test, which requires a hypothetical purchase price allocation. ASU 2017-04 should be applied on a prospective basis.	January 1, 2020. Early adoption is permitted.	The Company adopted ASU 2017-04 during the second quarter of 2018. The adoption of ASU 2017-04 had no impact on the Company's consolidated financial statements.
In August 2017, the FASB issued ASU 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities."	ASU 2017-12 amends and simplifies existing guidance in order to better align a company's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results in the financial statements. ASU 2017-12 should be applied to hedging relationships existing on the date of adoption. The effect of the adoption should be reflected as of the beginning of the fiscal year of adoption.	January 1, 2019. Early adoption is permitted.	The Company does not expect the adoption of ASU 2017-12 to have a material impact on its consolidated financial statements.
In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." In July 2018, the FASB issued ASU 2018-11, "Leases (Topic 842) – Targeted Improvements."	ASU 2016-02 requires a lessee to recognize on the balance sheet a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term for both finance and operating leases and to disclose key information about leasing arrangements. ASU 2016-02 should be applied as of the beginning of the earliest period presented in the financial statements using a modified	January 1, 2019. Early adoption is permitted.	The Company will adopt the new standard in the first quarter of 2019, using the modified retrospective method. The Company expects this standard will have a material effect on its consolidated balance sheets with the recognition of new right-of-use assets and lease liabilities for all operating leases longer than one year in duration. Upon adoption, the Company estimates both assets and liabilities on the consolidated

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Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
	retrospective approach. ASU 2018-11 provides an additional (and optional) transition method which allows entities to apply ASU 2016-02 as of the adoption date and recognize a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption.		balance sheet will increase by approximately \$32.0 million to \$37.0 million. The Company does not expect the adoption to have a significant impact upon its consolidated statements of operations and cash flows. Changes in lease population or changes in incremental borrowing rates may alter this estimate. The Company will expand the consolidated financial statement disclosures upon adoption of this standard.

### 3. Revenue

The Company recognizes revenue when control of promised goods or services is transferred to customers. The transfer of control generally occurs upon shipment when title and risk of loss pass to the customer. The vast majority of the Company's revenue is generated from the sale of distinct products. Revenue is measured as the amount of consideration the Company expects to receive in exchange for such products, which is generally at contractually stated prices. Sales taxes and value added taxes collected concurrently with revenue generating activities are excluded from revenue.

#### *Performance Obligations*

Substantially all of the Company's revenue is recognized at a point in time, upon shipment, rather than over time.

At the request of its customers, the Company may perform professional services, generally for the maintenance and repair of products previously sold to those customers and for engineering services. Professional services are typically short in duration, mostly less than one month, and aggregate to less than 3% of the Company's consolidated revenue. Revenue is typically recognized at a point in time when control transfers to the customer upon completion of professional services. These services generally involve a single distinct performance obligation. The consideration expected to be received in exchange for such services is normally the contractually stated amount.

The Company occasionally sells separately priced non-standard/extended warranty services or preventative maintenance plans with the sale of products. The transfer of control over the service plans is over time. The Company recognizes the related revenue ratably over the terms of the service plans. The transaction price of a contract is allocated to each performance obligation based on its relative standalone selling price. Standalone selling prices are generally determined based on the prices charged to customers or using the expected cost plus a margin.

#### *Shipping & Handling Costs*

The Company accounts for shipping and handling activities that occur after the transfer of control over the related goods as fulfillment activities rather than performance obligations. The shipping and handling fees charged to customers are recognized as revenue and the related costs are recorded in cost of revenue at the time of transfer of control.

#### *Warranties*

The Company generally provides warranties for its products. The standard warranty period is typically 12 months to 24 months for the Photonics and Precision Motion segments and 12 months to 36 months for the Vision segment. The standard warranty period for product sales is accounted for under the provisions of ASC 450, "Contingencies," as the Company has the ability to ascertain the likelihood of the liability and can reasonably estimate the amount of the liability. A provision for the estimated cost related to warranty

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)**  
**AS OF DECEMBER 31, 2018**

is recorded to cost of revenue at the time revenue is recognized. The Company's estimate of costs to service the warranty obligations is based on historical experience and expectations of future conditions. To the extent that the Company's experience in warranty claims or costs associated with servicing those claims differ from the original estimates, revisions to the estimated warranty liability are recorded at that time, with an offsetting adjustment to cost of revenue.

***Practical Expedients and Exemptions***

The Company expenses incremental direct costs of obtaining a contract when incurred if the expected amortization period is one year or less. These costs are recorded within selling, general and administrative expenses in the consolidated statement of operations.

The Company does not adjust the promised amount of consideration for the effects of a financing component because the transfer of a promised good to a customer and the customer's payment for that good are typically one year or less. The Company does not disclose the value of the remaining performance obligation for contracts with an original expected length of one year or less.

***Contract Liabilities***

Contract liabilities consist of deferred revenue and advance payments from customers, including amounts that are refundable. These contract liabilities are classified as either current or long-term liabilities in the consolidated balance sheet based on the timing of when the Company expects to recognize the related revenue. As of December 31, 2018 and January 1, 2018 (the date of adoption of Topic 606), contract liabilities were \$4.7 million and \$5.4 million, respectively, and are included in accrued expenses and other current liabilities and other liabilities in the accompanying consolidated balance sheets. The decrease in the contract liability balance during the year ended December 31, 2018 is primarily due to \$3.2 million of revenue recognized during the period that was included in the contract liability balance at the date of adoption, partially offset by cash payments received in advance of satisfying performance obligations.

***Disaggregated Revenue***

See Note 19 for the Company's disaggregation of revenue by segment, geography and end market.

**4. Business Combinations**

**2018 Acquisitions**

During the year ended December 31, 2018, the Company acquired two businesses for total cash considerations of \$33.5 million, including the acquisition of Zettlex Holdings Limited ("Zettlex"). The consolidated statement of operations includes the operating results of the businesses from the dates of acquisition.

*Zettlex*

On May 1, 2018, the Company acquired 100% of the outstanding stock of Zettlex, a Cambridge, United Kingdom-based provider of inductive encoder products that provide absolute and accurate positioning, even in extreme operating environments, to OEMs in the medical and advanced industrial markets. The purchase price of £23.3 million (\$32.0 million), net of working capital adjustments, was financed with cash on hand and borrowings under the Company's revolving credit facility. The addition of Zettlex broadens the range of components and solutions that the Company can provide to customers by combining its commercial resources and application-specific competencies with Zettlex's technologies and strong team. Zettlex is included in the Company's Precision Motion reportable segment.

The acquisition of Zettlex has been accounted for as a business combination. The allocation of the purchase price is based upon a valuation of assets acquired and liabilities assumed. Assets acquired and liabilities assumed have been recorded at their estimated fair values as of the acquisition date. The fair values of intangible assets were based on valuations using an income approach, with estimates and assumptions provided by management of Zettlex and the Company. The process for estimating the fair values of identifiable intangible assets requires the use of significant estimates and assumptions, including estimating future cash flows and developing appropriate discount rates. The excess of the purchase price over the tangible assets, identifiable intangible assets and assumed liabilities was recorded as goodwill.

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The final purchase price allocation is as follows (in thousands):

	Amount
Cash	\$ 3,776
Accounts receivable	2,237
Inventories	928
Property, plant and equipment	2,590
Intangible assets	14,585
Goodwill	11,790
Other assets	145
Total assets acquired	36,051
Accounts payable	509
Accrued expenses and other liabilities	1,035
Deferred tax liabilities	2,481
Total liabilities assumed	4,025
Total assets acquired, net of liabilities assumed	32,026
Less: cash acquired	3,776
Total purchase price, net of cash acquired	\$ 28,250

The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Developed technologies	\$ 3,027	10 years
Customer relationships	9,494	15 years
Trademarks and trade names	550	10 years
Backlog	1,514	1 year
Total	\$ 14,585	

The purchase price allocation resulted in \$14.6 million of identifiable intangible assets and \$11.8 million of goodwill. As the Zettlex acquisition is an acquisition of outstanding common shares, none of the resulting goodwill is deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flows potentially attributable to: (i) Zettlex's ability to grow its business with existing and new customers, including leveraging the Company's customer base; and (ii) cost improvements due to the integration of Zettlex operations into the Company's existing infrastructure.

The operating results of Zettlex were included in the Company's results of operations beginning on May 1, 2018. Zettlex contributed revenues of \$8.3 million and a loss before income taxes of \$1.8 million for the year ended December 31, 2018. Loss before income taxes for the year ended December 31, 2018 included amortization of purchased intangible assets of \$1.3 million and compensation expense of \$4.4 million recognized under earn-out agreements.

The pro forma financial information reflecting the operating results of Zettlex, as if it had been acquired as of January 1, 2017, would not differ materially from the operating results of the Company as reported for the year ended December 31, 2017.

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2017 Acquisitions

*WOM*

On July 3, 2017, the Company acquired 100% of the outstanding shares of W.O.M. World of Medicine GmbH (“WOM”), a Berlin, Germany-based provider of medical insufflators, pumps, and related disposables for OEMs in the minimally invasive surgery market, for a total purchase price of €118.1 million (\$134.9 million). The acquisition was financed with a €118.0 million (\$134.8 million) draw-down on the Company’s revolving credit facility.

The final purchase price allocation is as follows (in thousands):

	Amount
Cash	\$ 1,400
Accounts receivable	11,807
Inventories	14,549
Property, plant and equipment	21,940
Intangible assets	59,732
Goodwill	55,632
Other assets	2,660
Total assets acquired	167,720
Accounts payable	4,398
Other liabilities	8,681
Deferred tax liabilities	19,707
Total liabilities assumed	32,786
Total assets acquired, net of liabilities assumed	134,934
Less: cash acquired	1,400
Total purchase price, net of cash acquired	\$ 133,534

The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Developed technologies	\$ 21,586	10 years
Customer relationships	35,634	12 years
Trademarks and trade names	2,284	10 years
Backlog	228	1 year
Total	\$ 59,732	

The purchase price allocation resulted in \$59.7 million of identifiable intangible assets and \$55.6 million of goodwill. As the WOM acquisition was an acquisition of outstanding common shares, none of the resulting goodwill was deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flows attributable to: (i) WOM’s ability to grow its business with existing and new customers, including leveraging the Company’s customer base; and (ii) cost improvements due to expansion in scale.

The operating results of WOM were included in the Company’s results of operations beginning on July 3, 2017. WOM is included in the Company’s Vision reportable segment.

*Laser Quantum*

On January 10, 2017, the Company acquired an additional approximately 35% of the outstanding shares of Laser Quantum, a Manchester, United Kingdom-based provider of solid state continuous wave lasers, ultrafast lasers, and optical light engines to OEMs in the medical market, for £25.5 million (\$31.1 million) in cash consideration. The purchase price was financed with cash on hand and

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a \$30.0 million draw-down on the Company's revolving credit facility. As a result of this transaction, the Company's ownership position in Laser Quantum increased from approximately 41% to approximately 76%.

As part of this transaction, the Company and the remaining shareholders of Laser Quantum entered into a call and put option agreement for the purchase and sale, in 2020, of all the remaining Laser Quantum shares held by the remaining shareholders, subject to certain conditions. The purchase price for the remaining shares would have been based on the proportionate share of the noncontrolling interest in Laser Quantum's cash on hand as of December 31, 2019 and a multiple of Laser Quantum's EBITDA for the twelve months ending December 31, 2019, as defined in the call and put option agreement.

In connection with the purchase price allocation, upon gaining control over Laser Quantum, the Company recognized a nontaxable gain of \$26.4 million in the consolidated statement of operations for the twelve months ended December 31, 2017. The gain represented the excess of the fair value of the Company's previously-held equity interest in Laser Quantum over its carrying value upon gaining control.

The fair value of the approximately 41% equity interest previously held by the Company before the acquisition and the fair value of the approximately 24% noncontrolling interest held by the remaining shareholders of Laser Quantum after the acquisition were determined using a combination of the discounted cash flow method (an income approach), the guideline public company method (a market approach), and the subject company transaction method (a market approach). The subject company transaction method was based on the purchase price paid by the Company for the acquisition of the additional approximately 35% of the outstanding shares, while giving consideration to the control and/or minority nature of the subject equity interests.

The final purchase price allocation is as follows (in thousands):

	Amount
Cash	\$ 15,343
Accounts receivable	2,739
Inventories	6,264
Property, plant and equipment	2,286
Intangible assets	38,955
Goodwill	31,168
Other assets	717
Total fair value of assets	97,472
Accounts payable	796
Other liabilities	2,068
Deferred tax liabilities	7,337
Total fair value of liabilities	10,201
Total fair value of assets, net of fair value of liabilities	87,271
Less: fair value of equity interest previously held by Novanta	34,637
Less: fair value of noncontrolling interest	21,582
Total purchase price paid by Novanta	31,052
Less: cash acquired	15,343
Purchase price, net of cash acquired	\$ 15,709

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The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Developed technologies	\$ 15,501	15 years
Customer relationships	19,990	15 years
Trademarks and trade names	1,964	15 years
Backlog	1,500	9 months
Total	<u>\$ 38,955</u>	

The purchase price allocation resulted in \$39.0 million of identifiable intangible assets and \$31.2 million of goodwill. As the Laser Quantum acquisition was an acquisition of outstanding common shares, none of the resulting goodwill was deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flow potential attributable to: (i) Laser Quantum's ability to grow its business with existing and new customers, including leveraging the Company's broader customer base; and (ii) cost improvements due to expansion in scale.

The operating results of Laser Quantum were included in the Company's results of operations beginning on January 10, 2017. Laser Quantum is included in the Company's Photonics reportable segment.

*ThingMagic*

On January 10, 2017, the Company acquired from Trimble Inc. certain assets and liabilities that constituted the business of ThingMagic, a Woburn, Massachusetts-based provider of ultra-high frequency ("UHF") radio frequency identification ("RFID") modules and finished RFID readers to OEMs in the medical and advanced industrial markets, for a total purchase price of \$19.1 million. The acquisition was financed with cash on hand and a \$12.0 million draw-down on the Company's revolving credit facility.

The final purchase price allocation is as follows (in thousands):

	Amount
Inventories	\$ 1,832
Intangible assets	7,423
Goodwill	9,929
Total assets acquired	19,184
Other liabilities	95
Total liabilities assumed	95
Total purchase price	<u>\$ 19,089</u>

The fair value of intangible assets is comprised of the following (dollar amounts in thousands):

	Estimated Fair Value	Weighted Average Amortization Period
Developed technologies	\$ 4,600	10 years
Customer relationships	2,520	10 years
Trademarks and trade names	303	5 years
Total	<u>\$ 7,423</u>	

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The purchase price allocation resulted in \$7.4 million of identifiable intangible assets and \$9.9 million of goodwill. As the ThingMagic acquisition was treated as an acquisition of assets for income tax purposes, the goodwill acquired is expected to be fully deductible for tax purposes. Intangible assets are being amortized over their weighted average useful lives primarily based upon the pattern in which anticipated economic benefits from such assets are expected to be realized. The goodwill recorded represents the anticipated incremental value of future cash flows potentially attributable to: (i) ThingMagic's ability to grow its business with existing and new customers, including leveraging the Company's customer base; (ii) cost synergies in combining the research and development capabilities from ThingMagic with the existing RFID capabilities within Novanta; and (iii) cost improvements due to the integration of ThingMagic operations into the Company's existing infrastructure.

The operating results of ThingMagic were included in the Company's results of operations beginning on January 10, 2017. ThingMagic is included in the Company's Vision reportable segment.

The pro forma financial information reflecting the operating results of ThingMagic, as if it had been acquired as of January 1, 2016, would not differ materially from the operating results of the Company as reported for the year ended December 31, 2016.

*Unaudited Pro Forma Information*

The unaudited pro forma information presented below includes the effects of business combination accounting resulting from the acquisitions of WOM and Laser Quantum, including amortization of intangible assets, interest expense on borrowings in connection with the acquisitions, and elimination of the gain from the Laser Quantum acquisition and income from the Company's previous equity method investment in Laser Quantum, and the related tax effects, as though the acquisitions had been consummated as of January 1, 2016. The unaudited pro forma financial information is presented for comparative purposes only and is not necessarily indicative of the results of operations that actually would have been achieved if the acquisitions had taken place on January 1, 2016.

	Year Ended December 31,	
	2017	2016
Revenue	\$ 562,818	\$ 487,960
Consolidated net income	\$ 39,630	\$ 21,020
Earnings per share attributable to Novanta Inc. - Basic (1)	\$ 0.49	\$ 0.62
Earnings per share attributable to Novanta Inc. - Diluted (1)	\$ 0.49	\$ 0.61

- (1) The computation of pro forma earnings per share attributable to Novanta Inc. included \$20.2 million and zero adjustment of redeemable noncontrolling interest to estimated redemption value for the years ended December 31, 2017 and 2016, respectively.

Pro forma earnings for the year ended December 31, 2017 were adjusted to exclude non-recurring items such as amortization of inventory fair value adjustments of \$4.4 million, acquisition related costs of \$4.3 million, the gain on business acquisition of \$26.4 million and income from equity method investment of \$0.1 million. Pro forma earnings for the year ended December 31, 2017 were adjusted to include an increase in amortization of intangible assets of \$5.3 million and an increase in interest expense of \$1.4 million associated with borrowings under the Company's revolving credit facility used to fund the acquisitions.

Pro forma earnings for the year ended December 31, 2016 were adjusted to exclude non-recurring items such as acquisition related costs of \$1.2 million and income from equity method investment of \$2.2 million. Pro forma earnings for the year ended December 31, 2016 were adjusted to include an increase in amortization of intangible assets of \$12.5 million and an increase in interest expense of \$3.9 million associated with borrowings under the Company's revolving credit facility used to fund the acquisitions.

**2016 Acquisitions**

*Reach*

On May 24, 2016, the Company acquired 100% of the outstanding stock of Reach Technology Inc. ("Reach"), a Fremont, California-based provider of embedded touch screen technology solutions for OEMs in the medical and advanced industrial markets, for a total purchase price of \$9.4 million. The operating results of Reach were included in the Company's results of operations beginning on May 24, 2016. Reach is included in the Company's Vision reportable segment.

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### Acquisition Costs

The Company recognized acquisition costs of \$1.1 million, \$4.4 million and \$0.2 million in the years ended December 31, 2018, 2017 and 2016, respectively, related to the acquisitions that occurred during those years. These costs consisted of finders' fees, legal, valuation and other professional or consulting fees. These amounts were included in restructuring, acquisition and divestiture related costs in the consolidated statements of operations.

### 5. Redeemable Noncontrolling Interest

As a result of the Company's acquisition of additional outstanding shares of Laser Quantum from the remaining shareholders on January 10, 2017, the Company increased its ownership position in Laser Quantum from approximately 41% to approximately 76% and began to consolidate Laser Quantum in the consolidated financial statements. As part of the purchase agreement, the Company and the remaining shareholders entered into a call and put option agreement for the purchase and sale, in 2020, of all remaining Laser Quantum shares held by the remaining shareholders, subject to certain conditions. As a result of the put option held by the remaining shareholders, the noncontrolling interest was considered a redeemable equity instrument and was presented as temporary equity on the consolidated balance sheet. The proportionate share of the net income from Laser Quantum attributable to the noncontrolling interest was reported as a reduction to the consolidated net income in the Company's consolidated statement of operations and an increase to the carrying value of the redeemable noncontrolling interest.

The initial value of the noncontrolling interest was measured at a fair value of £17.7 million (\$21.6 million) as of January 10, 2017. On the consolidated balance sheet, the Company reported the redeemable noncontrolling interest at the higher of (i) the carrying value without any redemption value adjustments or (ii) the estimated redemption value as of the end of the reporting period. The estimated redemption value was determined as of the end of the reporting period as if it were also the redemption date for the instrument. The resulting adjustments were recorded in retained earnings in shareholders' equity and did not affect net income attributable to Novanta Inc. However, these adjustments were included in the determination of earnings per common share (See Note 10).

On September 27, 2018, the Company acquired the remaining approximately 24% of the outstanding shares of Laser Quantum for an aggregate consideration of \$45.1 million, consisting of \$30.7 million of cash and 213,219 shares of the Company's restricted stock. The restricted stock will become fully vested upon achievement of certain milestones included in the restricted stock agreement. Restricted stock not otherwise vested as of December 31, 2025 will be subject to forfeiture. The acquisition was accounted for as a transaction among shareholders. No gain or loss was recognized in the consolidated statements of operations for the year ended December 31, 2018. The difference between the carrying amount on the balance sheet prior to the acquisition of the redeemable noncontrolling interest and the purchase price was recorded as an adjustment to retained earnings in stockholders' equity. The following table summarizes the changes in the Company's redeemable noncontrolling interest in the twelve months ended December 31, 2018 (in thousands):

	<b>Redeemable Noncontrolling Interest</b>
Balance as of December 31, 2017	\$ 46,923
Net income attributable to noncontrolling interest	1,986
Redeemable noncontrolling interest redemption value adjustment	(1,781)
Foreign currency translation	(1,926)
Acquisition of noncontrolling interest	(45,202)
Balance as of December 31, 2018	\$ —

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6. Accumulated Other Comprehensive Income (Loss)

Comprehensive income (loss) is defined as net income (loss) and other changes in stockholders' equity that do not represent transactions with stockholders or in the Company's stock. Changes in accumulated other comprehensive income (loss) is as follows (in thousands):

	Total Accumulated Other Comprehensive Income (Loss)	Cumulative Translation Adjustments	Pension Liability Adjustments
Balance at December 31, 2015	\$ (18,830)	\$ (9,698)	\$ (9,132)
Other comprehensive loss	(9,611)	(7,524)	(2,087)
Amounts reclassified from accumulated other comprehensive income (loss) (1)	726	—	726
Balance at December 31, 2016	(27,715)	(17,222)	(10,493)
Other comprehensive income (loss)	8,790	8,909	(119)
Amounts reclassified from accumulated other comprehensive income (loss) (1)	1,045	—	1,045
Balance at December 31, 2017	(17,880)	(8,313)	(9,567)
Other comprehensive loss	(5,473)	(4,172)	(1,301)
Amounts reclassified from accumulated other comprehensive income (loss) (1)	826	—	826
Balance at December 31, 2018	<u>\$ (22,527)</u>	<u>\$ (12,485)</u>	<u>\$ (10,042)</u>

- (1) The amounts reclassified from accumulated other comprehensive income (loss) were included in other income (expense) in the consolidated statements of operations.

7. Goodwill, Intangible Assets and Impairment Charges

*Goodwill*

The following table summarizes changes in goodwill during the year ended December 31, 2018 (in thousands):

	December 31, 2018
Balance at beginning of year	\$ 210,988
Goodwill acquired from acquisitions	12,011
Effect of foreign exchange rate changes	(5,337)
Balance at end of year	<u>\$ 217,662</u>

Goodwill by reportable segment as of December 31, 2018 is as follows (in thousands):

	Reportable Segment			
	Photonics	Vision	Precision Motion	Total
Goodwill	\$ 168,955	\$ 155,017	\$ 44,919	\$ 368,891
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)	(151,229)
Total	<u>\$ 66,494</u>	<u>\$ 123,295</u>	<u>\$ 27,873</u>	<u>\$ 217,662</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
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Goodwill by reportable segment as of December 31, 2017 is as follows (in thousands):

	Reportable Segment			Total
	Photonics	Vision	Precision Motion	
Goodwill	\$ 170,818	\$ 157,436	\$ 33,963	\$ 362,217
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)	(151,229)
Total	<u>\$ 68,357</u>	<u>\$ 125,714</u>	<u>\$ 16,917</u>	<u>\$ 210,988</u>

**Intangible Assets**

Intangible assets as of December 31, 2018 and 2017, respectively, are summarized as follows (dollar amounts in thousands):

	December 31, 2018			Weighted Average Remaining Life (Years)
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	
Amortizable intangible assets:				
Patents and developed technologies	\$ 134,034	\$ (86,623)	\$ 47,411	9.0
Customer relationships	139,097	(64,174)	74,923	11.7
Customer backlog	1,738	(1,191)	547	0.4
Non-compete covenant	2,514	(2,493)	21	0.1
Trademarks and trade names	15,915	(8,924)	6,991	9.1
Amortizable intangible assets	<u>293,298</u>	<u>(163,405)</u>	<u>129,893</u>	10.5
Non-amortizable intangible assets:				
Trade names	13,027	—	13,027	
Total	<u>\$ 306,325</u>	<u>\$ (163,405)</u>	<u>\$ 142,920</u>	

	December 31, 2017			Weighted Average Remaining Life (Years)
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	
Amortizable intangible assets:				
Patents and developed technologies	\$ 130,890	\$ (77,295)	\$ 53,595	10.2
Customer relationships	131,809	(52,015)	79,794	12.3
Customer backlog	2,524	(2,284)	240	0.8
Non-compete covenant	2,514	(1,956)	558	0.9
Trademarks and trade names	15,708	(7,874)	7,834	9.7
Amortizable intangible assets	<u>283,445</u>	<u>(141,424)</u>	<u>142,021</u>	11.3
Non-amortizable intangible assets:				
Trade names	13,027	—	13,027	
Total	<u>\$ 296,472</u>	<u>\$ (141,424)</u>	<u>\$ 155,048</u>	

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Amortizable intangible assets as of December 31, 2018 included intangible assets of \$1.2 million recognized in conjunction with the acquisition of certain customer relationships in September 2018.

All definite-lived intangible assets are amortized either on a straight-line basis or an economic benefit basis over their remaining estimated useful life. Amortization expense for patents and developed technologies is included in cost of revenue in the accompanying consolidated statements of operations. Amortization expense for customer relationships and definite-lived trademarks, trade names and other intangibles is included in operating expenses in the accompanying consolidated statements of operations. Amortization expense is as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Amortization expense – cost of revenue	\$ 10,060	\$ 8,824	\$ 4,164
Amortization expense – operating expenses	15,550	12,096	8,251
Total amortization expense	<u>\$ 25,610</u>	<u>\$ 20,920</u>	<u>\$ 12,415</u>

Estimated future amortization expense for each of the five succeeding years and thereafter is as follows (in thousands):

Year Ending December 31,	Cost of Revenue	Operating Expenses	Total
2019	\$ 9,222	\$ 14,733	\$ 23,955
2020	8,321	12,395	20,716
2021	7,406	11,489	18,895
2022	6,308	9,666	15,974
2023	5,409	8,153	13,562
Thereafter	10,745	26,046	36,791
Total	<u>\$ 47,411</u>	<u>\$ 82,482</u>	<u>\$ 129,893</u>

### Impairment Charges

The Company did not have any goodwill or indefinite-lived intangible asset impairment charges during 2018, 2017 or 2016.

## 8. Fair Value Measurements

ASC 820, “Fair Value Measurement,” establishes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the third is considered unobservable:

Level 1: Quoted prices for identical assets or liabilities in active markets which the Company can access

Level 2: Observable inputs other than those described in Level 1

Level 3: Unobservable inputs

### Cash Equivalents

The Company’s cash equivalents are highly liquid investments with original maturities of three months or less, which represent an asset the Company measures at fair value on a recurring basis. The Company determines the fair value of cash equivalents using a market approach based on quoted prices in active markets. The fair values of cash, accounts receivable, income taxes receivable, accounts payable, income taxes payable and accrued expenses and other current liabilities approximate their carrying values because of their short-term nature.

### Foreign Currency Contracts

The Company addresses market risks from changes in foreign currency exchange rates through a risk management program that includes the use of derivative financial instruments to mitigate certain balance sheet foreign currency transaction exposures. The Company uses foreign currency forward contracts as a part of its strategy to manage exposures related to foreign currency denominated monetary assets and liabilities.

NOVANTA INC.

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**Contingent Consideration**

On December 14, 2016, the Company acquired certain video signal processing and management technologies used in medical visualization solutions. Under the purchase and sale agreement, the owners are eligible to receive contingent consideration based on the achievement of certain revenue targets from 2018 to 2021. The undiscounted range of possible contingent consideration is zero to €5.5 million (\$6.6 million). If such targets are achieved, the contingent consideration would be payable in cash in four installments from 2019 to 2022. As the acquired assets did not meet the definition of a business, the fair value of the contingent consideration is recognized when probable and estimable and is capitalized as part of the cost of the acquired assets. Subsequent changes in the estimated fair value of this contingent liability are recorded as adjustments to the carrying value of the asset acquired and amortized over the remaining useful life of the underlying asset. In December 2017, the Company recorded an estimated fair value of \$1.3 million in contingent consideration, which was reported as a long-term liability in other liabilities on the consolidated balance sheet as of December 31, 2017. Based on 2018 revenue performance and the most recent revenue projections for fiscal years 2019 to 2021, the fair value of the contingent consideration was adjusted to \$3.4 million, which is reported as a long-term liability in other liabilities on the consolidated balance sheet as of December 31, 2018.

On February 19, 2015, the Company acquired Applimotion Inc. (“Applimotion”). Under the purchase and sale agreement for the Applimotion acquisition, the shareholders of Applimotion were eligible to receive contingent consideration based on the achievement of certain revenue targets for fiscal years 2015 to 2017. If such targets were achieved, the contingent consideration would be payable in cash in two installments in 2017 and 2018, respectively. The estimated initial fair value of the contingent consideration of \$1.0 million was determined based on the Monte Carlo valuation method and was recorded as part of the purchase price as of the acquisition date. As a result of Applimotion’s fiscal year 2015 and 2016 revenue results, contingent consideration of \$1.2 million was paid in the first quarter of 2017. Based on Applimotion’s fiscal year 2016 and 2017 revenue results, the fair value for the remaining contingent consideration was adjusted to \$2.8 million as of December 31, 2017. The Company paid \$2.8 million as the final Applimotion contingent consideration payment in January 2018.

The following table summarizes the fair values of the Company’s assets and liabilities measured at fair value on a recurring basis as of December 31, 2018 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
<b>Assets</b>				
Cash equivalents	\$ 4,288	\$ 4,288	\$ —	\$ —
Prepaid expenses and other current assets:				
Foreign currency forward contracts	15	—	15	—
	<u>\$ 4,303</u>	<u>\$ 4,288</u>	<u>\$ 15</u>	<u>\$ —</u>
<b>Liabilities</b>				
Accrued expenses and other current liabilities:				
Foreign currency forward contracts	\$ 182	\$ —	\$ 182	\$ —
Other liabilities:				
Contingent consideration - Long-term	3,376	—	—	3,376
	<u>\$ 3,558</u>	<u>\$ —</u>	<u>\$ 182</u>	<u>\$ 3,376</u>

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The following table summarizes the fair values of the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2017 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
<b>Assets</b>				
Cash equivalents	\$ 2,665	\$ 2,665	\$ —	\$ —
Prepaid expenses and other current assets:				
Foreign currency forward contracts	150	—	150	—
	<u>\$ 2,815</u>	<u>\$ 2,665</u>	<u>\$ 150</u>	<u>\$ —</u>
<b>Liabilities</b>				
Accrued expenses and other current liabilities:				
Contingent consideration - Current	\$ 2,800	\$ —	\$ —	\$ 2,800
Foreign currency forward contracts (1)	—	—	—	—
Other liabilities:				
Contingent consideration - Long-term	1,304	—	—	1,304
	<u>\$ 4,104</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,104</u>

(1) The unrealized loss from foreign currency forward contracts was nominal as of December 31, 2017.

During the years ended December 31, 2018 and 2017, there were no transfers between fair value levels.

Changes in the fair value of Level 3 contingent consideration for the year ended December 31, 2018 were as follows (in thousands):

	Contingent Consideration
Balance at December 31, 2017	\$ 4,104
Payments	(2,800)
Fair value adjustments	2,072
Balance at December 31, 2018	<u>\$ 3,376</u>

As of December 31, 2018, the significant unobservable inputs used in the fair value measurement of the Company's contingent consideration were historical revenues, projected revenues and a discount rate. Increases or decreases in the unobservable inputs would result in a higher or lower fair value measurement.

See Note 12 for discussion of the estimated fair value of the Company's outstanding debt and Note 14 for discussion of the estimated fair value of the Company's pension plan assets.

## 9. Foreign Currency Contracts

The Company addresses market risks from changes in foreign currency exchange rates through a risk management program that includes the use of derivative financial instruments to mitigate certain foreign currency transaction exposures from future settlement of non-functional currency monetary assets and liabilities as of the end of a period. The Company does not enter into derivative transactions for speculative purposes. Gains and losses on derivative financial instruments substantially offset losses and gains on the underlying hedged exposures. Furthermore, the Company manages its exposure to counterparty risks on derivative instruments by entering into contracts with a diversified group of major financial institutions and by actively monitoring outstanding positions.

Beginning in September 2017, the Company commenced a foreign currency hedging program through the use of forward contracts as a part of its strategy to limit its exposures related to monetary assets and liabilities denominated in currencies other than the

NOVANTA INC.

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functional currency of the Company and its subsidiaries. These forward contracts are not designated as cash flow, fair value or net investment hedges. All changes in the fair value of these forward contracts are recognized in income before income taxes.

As of December 31, 2018, the notional amount and fair value of the Company's foreign currency forward contracts was \$31.2 million and a net loss of \$0.2 million, respectively. As of December 31, 2017, the notional amount and fair value of the Company's foreign currency forward contracts was \$17.9 million and a net gain of \$0.2 million, respectively.

For the years ended December 31, 2018 and 2017, the Company recognized aggregate net gains of \$1.5 million and \$0.2 million, respectively, which were included in foreign exchange transaction gains (losses) in the consolidated statements of operations.

# 10. Earnings per Common Share

Basic earnings per common share is computed by dividing net income attributable to Novanta Inc., after redeemable noncontrolling interest redemption value adjustment, by the weighted average number of common shares outstanding during the year. The Company recognizes changes in the redeemable noncontrolling interest redemption value by adjusting the carrying amount of the redeemable noncontrolling interest as of the end of the period to the higher of: (i) the estimated redemption value assuming the end of the period is also the redemption date or (ii) the carrying value without any redemption value adjustments. Such adjustments are recorded in retained earnings in stockholders' equity instead of net income attributable to Novanta Inc. For both basic and diluted earnings per common share, such redemption value adjustments are included in the calculation of the numerator. For diluted earnings per common share, the denominator also includes the dilutive effect of outstanding restricted stock units, stock options, non-GAAP EPS performance-based restricted stock units and total shareholder return performance-based restricted stock units determined using the treasury stock method. Dilutive effects of attainment-based contingently issuable shares granted to the former Laser Quantum noncontrolling interest shareholders and the non-GAAP EPS performance-based restricted stock units will be included in the weighted average dilutive share calculation when the performance targets have been achieved. The dilutive effects of market-based contingently issuable shares are included in the weighted average dilutive share calculation based on the number of shares, if any, that would be issuable as of the end of the reporting period. For years in which net losses are generated, the dilutive potential common shares are excluded from the calculation of diluted earnings per share as the effect would be anti-dilutive.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share amounts):

	Year Ended December 31,		
	2018	2017	2016
<b>Numerators:</b>			
Consolidated net income	\$ 51,095	\$ 62,307	\$ 22,003
Less: Net income attributable to noncontrolling interest	(1,986)	(2,256)	—
Net income attributable to Novanta Inc.	49,109	60,051	22,003
Redeemable noncontrolling interest redemption value adjustment (see Note 5)	1,781	(20,244)	—
Net income attributable to Novanta Inc. after adjustment for redeemable noncontrolling interest redemption value	<u>\$ 50,890</u>	<u>\$ 39,807</u>	<u>\$ 22,003</u>
<b>Denominators:</b>			
Weighted average common shares outstanding— basic	34,913	34,817	34,694
Dilutive potential common shares	560	463	220
Weighted average common shares outstanding— diluted	<u>35,473</u>	<u>35,280</u>	<u>34,914</u>
Antidilutive common shares excluded from above	4	—	85
<b>Earnings per Common Share Attributable to Novanta Inc.:</b>			
Basic	\$ 1.46	\$ 1.14	\$ 0.63
Diluted	\$ 1.43	\$ 1.13	\$ 0.63

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**11. Supplementary Balance Sheet Information**

The following tables provide the details of selected balance sheet items as of the dates indicated (in thousands):

*Inventories*

	December 31,	
	2018	2017
Raw materials	\$ 69,008	\$ 57,277
Work-in-process	15,982	14,847
Finished goods	17,337	16,443
Demo and consigned inventory	2,437	2,711
Total inventories	<u>\$ 104,764</u>	<u>\$ 91,278</u>

*Property, Plant and Equipment, Net*

	December 31,	
	2018	2017
Cost:		
Land, buildings and improvements	\$ 56,068	\$ 53,055
Machinery and equipment	77,918	74,122
Total cost	133,986	127,177
Accumulated depreciation	(68,522)	(65,459)
Property, plant and equipment, net	<u>\$ 65,464</u>	<u>\$ 61,718</u>

As of December 31, 2018 and 2017, the Company had gross assets under capital lease of \$13.5 million and \$13.6 million, respectively. The assets acquired under capital leases are included in land, buildings and improvements and machinery and equipment and the related amortization expense is included in depreciation expense. The Company also capitalized software development costs of \$1.1 million, \$2.0 million and \$2.3 million in 2018, 2017 and 2016, respectively, in accordance with the guidance in ASC 350-40, "Internal-Use Software."

The following table summarizes depreciation expense on property, plant and equipment, including demo units and assets under capital leases (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Depreciation expense	<u>\$ 11,442</u>	<u>\$ 9,838</u>	<u>\$ 8,558</u>

The following table summarizes total accumulated depreciation on assets under capital leases as of the dates indicated (in thousands):

	December 31,	
	2018	2017
Accumulated depreciation on assets under capital leases	<u>\$ 6,901</u>	<u>\$ 6,097</u>

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*Accrued Expenses and Other Current Liabilities*

The following table summarizes accrued expenses and other current liabilities as of the dates indicated (in thousands):

	December 31,	
	2018	2017
Accrued compensation and benefits	\$ 24,545	\$ 17,348
Accrued warranty	4,510	4,835
Contract liabilities, current portion	4,165	4,790
Other	13,075	16,341
Total	<u>\$ 46,295</u>	<u>\$ 43,314</u>

*Accrued Warranty*

The following table summarizes changes in accrued warranty for the periods indicated (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Balance at beginning of year	\$ 4,835	\$ 3,142	\$ 3,335
Provision charged to cost of revenue	3,111	3,169	1,673
Warranty liabilities acquired from acquisitions	—	1,307	23
Use of provision	(3,341)	(2,857)	(1,849)
Foreign currency exchange rate changes	(95)	74	(40)
Balance at end of year	<u>\$ 4,510</u>	<u>\$ 4,835</u>	<u>\$ 3,142</u>

**12. Debt**

Debt consisted of the following (in thousands):

	December 31,	
	2018	2017
Senior Credit Facilities – term loan	\$ 4,600	\$ 9,200
Less: unamortized debt issuance costs	(65)	(81)
Total current portion of long-term debt	<u>4,535</u>	<u>9,119</u>
Senior Credit Facilities – term loan	69,925	79,125
Senior Credit Facilities – revolving credit facility	135,058	149,453
Less: unamortized debt issuance costs	(2,140)	(3,078)
Total long-term debt	<u>202,843</u>	<u>225,500</u>
Total Senior Credit Facilities	<u>\$ 207,378</u>	<u>\$ 234,619</u>

*Senior Credit Facilities*

On May 19, 2016, the Company entered into the second amended and restated credit agreement (the “Second Amended and Restated Credit Agreement”) with new and existing lenders for an aggregate credit facility of \$300.0 million, consisting of a \$75.0 million, 5-year term loan facility and a \$225.0 million, 5-year revolving credit facility (collectively, the “Senior Credit Facilities”). The Senior Credit Facilities mature in May 2021. The Second Amended and Restated Credit Agreement amended and restated the amended and restated credit agreement dated December 27, 2012.

The borrowings outstanding under the Senior Credit Facilities bear interest at rates based on (a) the Eurocurrency Rate, as defined in the Second Amended and Restated Credit Agreement, plus a rate ranging from 1.75% to 2.75% per annum or (b) the Base Rate, as defined in the Second Amended and Restated Credit Agreement, plus a rate ranging from 0.75% to 1.75% per annum, in each case based upon the Company’s consolidated leverage ratio. The Company is also required to pay a commitment fee on unused

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commitments under the revolving credit facility ranging between 0.25% and 0.45% per annum, which is based upon the Company's consolidated leverage ratio.

The Second Amended and Restated Credit Agreement contains various customary representations, warranties and covenants applicable to the Company and its subsidiaries, including: (i) limitations on restricted payments, including dividend payments and stock repurchases, provided that the Company and its subsidiaries may repurchase their equity interests, so long as immediately after giving effect to the repurchase, the Company's consolidated leverage ratio is no more than 2.50; (ii) limitations on fundamental changes involving the Company and its subsidiaries; (iii) limitations on the disposition of assets; and (iv) limitations on indebtedness, investments, and liens. The Second Amended and Restated Credit Agreement also requires the Company to satisfy certain financial covenants, such as maintaining a minimum consolidated fixed charge coverage ratio of 1.50 and a maximum consolidated leverage ratio of 3.00. The maximum consolidated leverage ratio will increase to 3.50 for four consecutive quarters following an acquisition with an aggregate consideration greater than or equal to \$50.0 million.

On August 1, 2017, the Company entered into an amendment (the "Third Amendment") to the Second Amended and Restated Credit Agreement. The Third Amendment increased the borrowing limit under the revolving credit facility from \$225 million to \$325 million and reset the uncommitted accordion feature to \$125 million for potential future expansion. Additionally, the Third Amendment increased the term loan balance from \$65.6 million to \$90.6 million. Under the Third Amendment, the Company is required to pay quarterly scheduled principal repayments of \$2.3 million beginning in October 2017, with the final installment of \$56.1 million due upon maturity in May 2021. Borrowings under the revolving credit facility may be repaid at any time through May 2021, the date of maturity of the Senior Credit Facilities. The Company may voluntarily prepay loans or reduce commitments under the Senior Credit Facilities, in whole or in part, without premium or penalty, subject to certain minimum principal amounts.

On February 26, 2018, the Company entered into a fourth amendment (the "Fourth Amendment") to the Second Amended and Restated Credit Agreement. The Fourth Amendment increased the maximum permitted consolidated leverage ratio from 3.00 to 3.50, increased the maximum consolidated leverage ratio for permitted acquisitions and stock repurchases from 2.50 to 3.00, increased the maximum permitted consolidated leverage ratio for a designated acquisition from 3.00 to 3.50, and increased the maximum permitted leverage ratio for four consecutive quarters following a designated acquisition from 3.50 to 4.00. The Fourth Amendment also made certain other technical changes to the Second Amended and Restated Credit Agreement.

As of December 31, 2018, the outstanding principal under the Company's term loan facility is scheduled to be repaid as follows (in thousands):

	<u>Principal Amount</u>
2019	\$ 4,600
2020	9,200
2021	60,725
Total debt repayments	<u>\$ 74,525</u>

The Company may be required to prepay outstanding loans under the Second Amended and Restated Credit Agreement with the net proceeds of certain asset dispositions and incurrences of certain debt. At the election of the Company, and so long as no default shall have occurred, the Company may reinvest all, or any portion of, the net proceeds from such asset dispositions or incurrences of debt within a year.

As of December 31, 2018, the Company had \$189.9 million available to be drawn under the revolving credit facility. Excluding commitment fees, the weighted average interest rate for the Senior Credit Facilities was approximately 3.37% as of December 31, 2018. The commitment fee rate for the unused commitments under the revolving credit facility was approximately 0.4% as of December 31, 2018.

*Guarantees*

The Senior Credit Facilities is guaranteed by Novanta Inc., Novanta Corporation, NDS Surgical Imaging LLC, Novanta Europe GmbH, Novanta UK Investments Holding Limited and Novanta Technologies UK Limited (collectively, "Guarantors"). Each Guarantor, jointly and severally, unconditionally guarantees the due and punctual payment of the principal, interest and fees under the Senior Credit Facilities, when due and payable, whether at maturity, by required prepayment, by acceleration or otherwise. In addition, Guarantors guarantee the due and punctual payment, fees and interest on the overdue principal of the Senior Credit Facilities and the

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due and punctual performance of all obligations of the Company in accordance with the terms of the Second Amended and Restated Credit Agreement. Furthermore, each Guarantor, jointly and severally, unconditionally guarantees that in the event of any extension, renewal, amendment, refinancing or modification of any of the Senior Credit Facilities, amounts due will be promptly paid in full when due in accordance with the terms of the extension or renewal, at stated maturity, by acceleration or otherwise.

The obligations of each Guarantor are limited to the maximum amount, after giving effect to all other contingent and fixed liabilities or any collections from, or payments made by or on behalf of, any other Guarantor. Each Guarantor that makes a payment or distribution under a Guarantee is entitled to a contribution from each other Guarantor of its pro rata share based on the adjusted net assets of each Guarantor. If at any time any payment of any of the obligations of the Guarantors is rescinded or must otherwise be returned upon the insolvency, bankruptcy or reorganization of the Company, a Guarantor or otherwise, the Guarantees will continue to be effective or be reinstated, as the case may be, as though such payment had not been made.

Each Guarantor may be released from its obligations under its respective Guarantee and its obligations under the Second Amended and Restated Credit Agreement upon the occurrence of certain events, including, but not limited to: (i) the Guarantor ceasing to be a subsidiary; and (ii) payment in full of the principal and accrued and unpaid interest on the Senior Credit Facilities and all other obligations.

The maximum potential amount of future payments the Guarantors could be required to make under the Guarantee is the principal amount of the Senior Credit Facilities plus all accrued and unpaid interest thereon. However, as of December 31, 2018, the Guarantors were not expected to be required to perform under the Guarantee.

#### *Liens*

The Company's obligations under the Senior Credit Facilities are secured, on a senior basis, by a lien on substantially all of the assets of Novanta Inc., Novanta Corporation, NDS Surgical Imaging LLC, Novanta Europe GmbH, Novanta UK Investments Holding Limited and Novanta Technologies UK Limited. The Second Amended and Restated Credit Agreement also contains customary events of default.

#### *Deferred Financing Costs*

The Company capitalized deferred financing costs related to the execution of the Third Amendment dated August 1, 2017, the Second Amended and Restated Credit Agreement dated May 19, 2016 and the amended and restated credit agreement dated December 27, 2012. The Company allocated the deferred financing costs between the term loan and the revolving credit facility based on the maximum borrowing capacity and amortizes the costs on a straight-line basis over the term of the Senior Credit Facilities. Non-cash interest expense related to the amortization of the deferred financing costs was \$1.0 million, \$0.8 million and \$0.9 million in 2018, 2017 and 2016, respectively. Unamortized deferred financing costs are presented as a reduction to the debt balances on the consolidated balance sheets.

#### *Fair Value of Debt*

As of December 31, 2018 and 2017, the outstanding balance of the Company's debt approximated its fair value based on current rates available to the Company for debt of the same maturities. The fair value of the Company's debt is classified as Level 2 under the fair value hierarchy.

### **13. Capital Stock and Share-Based Compensation**

#### *Capital Stock*

The authorized capital of the Company consists of an unlimited number of common shares without nominal or par value. Holders of common shares are entitled to one vote per share. Holders of common shares are entitled to receive dividends, if and when declared by the Board of Directors, and to share ratably in its assets legally available for distribution to the stockholders in the event of liquidation. Holders of common shares have no redemption or conversion rights.

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***Common Stock Repurchases***

In October 2013, the Company's Board of Directors authorized a share repurchase plan (the "2013 Repurchase Plan") under which the Company could repurchase outstanding shares of the Company's common stock up to an aggregate amount of \$10.0 million. During 2018, the Company repurchased 89 thousand shares in the open market for an aggregate purchase price of \$5.9 million at an average price of \$65.43 per share. As of December 31, 2018, the Company had repurchased an aggregate of 385 thousand shares for an aggregate purchase price of \$10.0 million at an average price of \$25.97 per share. As of December 31, 2018, the Company had completed the 2013 Repurchase Plan.

In October 2018, the Company's Board of Directors approved a new share repurchase plan (the "2018 Repurchase Plan") authorizing the repurchase of an additional \$25.0 million worth of common shares. Under the 2018 Repurchase Plan, shares may be repurchased from time to time, at the Company's discretion, based on ongoing assessment of the capital needs of the business, the market price of the Company's common stock, and general market conditions. Shares may also be repurchased through an accelerated stock purchase agreement, on the open market or in privately negotiated transactions in accordance with applicable federal securities laws. Repurchases may be made under certain SEC regulations, which would permit common stock to be repurchased when the Company would otherwise be prohibited from doing so under insider trading laws. The 2018 Repurchase Plan does not obligate the Company to acquire any particular amount of common stock. No time limit was set for the completion of the 2018 Repurchase Plan, and the plan may be suspended or discontinued at any time. The Company expects to fund the share repurchases through cash on hand and future cash generated from operations. As of December 31, 2018, no shares had been repurchased under the 2018 Repurchase Plan.

***2010 Incentive Award Plan***

In November 2010, the Company's stockholders approved the 2010 Incentive Award Plan (the "2010 Incentive Plan") under which the Company may grant share-based compensation awards to employees, consultants and directors. In May 2014, the Company's stockholders approved the amended and restated 2010 Incentive Award Plan and, in July 2016, the Company approved a further amended and restated 2010 Incentive Award Plan (as amended, the "Amended and Restated 2010 Incentive Plan"). The maximum number of shares which can be issued pursuant to the Amended and Restated 2010 Incentive Plan is 4,398,613, subject to adjustment as set forth in the Amended and Restated 2010 Incentive Plan. The Amended and Restated 2010 Incentive Plan provides for the grant of incentive stock options, non-qualified stock options, restricted stock, restricted stock units, stock appreciation rights, deferred stock, deferred stock units, dividend equivalents, performance awards and stock payments (collectively referred to as "Awards"). The Amended and Restated 2010 Incentive Plan provides for specific limits on the number of shares with respect to Awards that may be granted to any person during any calendar year and the amount of cash that can be paid with respect to Awards to any one person during any calendar year. The Amended and Restated 2010 Incentive Plan will expire and no further Awards may be granted after April 9, 2024. As of December 31, 2018, there were 950,865 shares available for future awards under the Amended and Restated 2010 Incentive Plan.

Shares subject to Awards that have expired, forfeited or settled in cash, or repurchased by the Company at the same price paid by the awardee may be added back to the number of shares available for grant under the Amended and Restated 2010 Incentive Plan and may be granted as new Awards. Notwithstanding the foregoing, the following shares will not be added back to the number of shares available for grant: (a) shares that are used to pay the exercise price for an option, (b) shares tendered or withheld to pay taxes with respect to any Award (other than options and stock appreciation rights) to the extent they exceed the number of shares with a fair market value equal to the tax liability based on minimum withholding rates, (c) shares tendered or withheld to pay taxes with respect to options and stock appreciation rights, (d) shares subject to a stock appreciation right that are not issued in connection with the stock settlement of the stock appreciation right on exercise thereof, and (e) shares purchased on the open market with the cash proceeds from the exercise of options. Shares issued to satisfy Awards under the Amended and Restated 2010 Incentive Plan may be previously authorized but unissued shares, treasury shares or shares repurchased on the open market.

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**Share-Based Compensation Expense**

The table below summarizes share-based compensation expense recorded in operating income (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Selling, general and administrative	\$ 6,997	\$ 5,065	\$ 3,920
Research and development and engineering	438	221	117
Cost of revenue	211	207	256
Restructuring, acquisition and divestiture related costs	68	—	—
Total share-based compensation expense	<u>\$ 7,714</u>	<u>\$ 5,493</u>	<u>\$ 4,293</u>

The expense recorded during each of the years ended December 31, 2018, 2017 and 2016 included \$0.5 million related to deferred stock units granted to the members of the Company's Board of Directors pursuant to the Company's Amended and Restated 2010 Incentive Plan.

As of December 31, 2018, the Company's outstanding equity awards for which compensation expense will be recognized in the future consist of time-based restricted stock units, performance stock units, and stock options granted under the Amended and Restated 2010 Incentive Plan. The Company expects to record an aggregate share-based compensation expense of \$13.1 million, net of estimated forfeitures, over a weighted average period of 2.24 years subsequent to December 31, 2018, for all outstanding equity awards as of December 31, 2018.

**Restricted Stock Units and Deferred Stock Units**

The Company's restricted stock units ("RSUs") have generally been issued with vesting periods ranging from three years to five years and vest based solely on service conditions. Accordingly, the Company recognizes compensation expense on a straight-line basis over the requisite service period. The Company reduces the compensation expense by an estimated forfeiture rate which is based on anticipated forfeitures and actual experience.

Deferred stock units ("DSUs") are granted to the members of the Company's Board of Directors. The compensation expense associated with the DSUs is recognized in full on the respective date of grant, as DSUs are fully vested and non-forfeitable upon grant.

The table below summarizes activities relating to restricted and deferred stock units issued and outstanding under the Amended and Restated 2010 Incentive Plan during 2018:

	Restricted and Deferred Stock Units (In thousands)	Weighted Average Grant Date Fair Value	Weighted Average Remaining Vesting Period (in years)	Aggregate Intrinsic Value (1) (In thousands)
Unvested at December 31, 2017	614	\$ 18.35		
Granted	130	\$ 55.27		
Vested	(188)	\$ 18.77		
Forfeited	(27)	\$ 24.53		
Unvested at December 31, 2018	<u>529</u>	\$ 26.98	1.59 years	\$ 33,308
Expected to vest as of December 31, 2018	<u>509</u>	\$ 26.31	1.59 years	\$ 32,041

- (1) The aggregate intrinsic value is calculated based on the fair value of \$63.00 per share of the Company's common stock on December 31, 2018 due to the fact that the restricted stock units carry a \$0 purchase price.

The total fair value of restricted stock units that vested in 2018 and deferred stock units that were granted and vested in 2018, based on the market price of the underlying stock on the day of vesting, was \$10.5 million.

**Performance Stock Units**

The Company granted two types of performance-based stock awards to certain members of the executive management team: non-GAAP EPS performance-based restricted stock units ("EPS-PSUs") and relative total shareholder return performance-based restricted

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stock units (“TSR-PSUs”). Both types of performance-based restricted stock units generally cliff vest on the first day following the end of the three-year performance period.

The number of common shares to be issued upon settlement following vesting of the EPS-PSUs is determined based on the Company’s cumulative non-GAAP EPS over the three-year performance period against the target established by the Company’s Board of Directors at the time of grant and will be in the range of zero to 200% of the target number of shares. The Company recognizes compensation expense ratably over the performance period based on the number of shares that are deemed probable of vesting at the end of the three-year performance cycle. This probability assessment is performed quarterly and the cumulative effect of a change in the estimated compensation expense, if any, is recognized in the consolidated statement of operations in the period in which such determination is made.

The number of common shares to be issued upon settlement following vesting of the TSR-PSUs is determined based on the relative market performance of the Company’s common stock compared to the Russell 2000 Index over the three-year performance period using a payout formula established by the Company’s Board of Directors at the time of grant and will be in the range of zero to 200% of the target number of shares. The Company recognizes the related compensation expense based on the fair value of the TSR-PSUs, determined using Monte-Carlo valuation model as of the grant date, on a straight-line basis from the grant date to the end of the three-year performance period. Compensation expense will not be affected by the number of TSR-PSUs that will actually vest at the end of the three-year performance period.

The table below summarizes activities relating to performance-based stock awards issued and outstanding under the Company’s Amended and Restated 2010 Incentive Plan during 2018:

	Performance Stock Units (1) (in thousands)	Weighted Average Grant Date Fair Value	Weighted Average Remaining Vesting Period (in years)	Aggregate Intrinsic Value (2) (in thousands)
Unvested at December 31, 2017	89	\$ 24.00		
Granted	48	\$ 62.17		
Vested	—	\$ —		
Forfeited	—	\$ —		
Unvested at December 31, 2018	137	\$ 37.28	1.14 years	\$ 8,645
Expected to vest as of December 31, 2018	167	\$ 33.21	1.14 years	\$ 10,491

- (1) The unvested PSUs are shown in this table at target, except for the number of shares vested, which reflect the shares earned and number of shares expected to vest. As of December 31, 2018, the maximum number of PSUs available to be earned is approximately 274 thousand.
- (2) The aggregate intrinsic value is calculated based on the fair value of \$63.00 per share of the Company’s common stock on December 31, 2018 due to the fact that the performance stock units carry a \$0 purchase price.

The fair value of the TSR-PSUs at the date of grant was estimated using the Monte-Carlo valuation model with the following assumptions:

	Year Ended December 31, 2018
Grant-date stock price	\$ 53.85
Expected volatility	30.35%
Risk-free interest rate	2.37%
Expected annual dividend yield	—
Weighted average fair value	\$ 70.49

### Stock Options

On March 30, 2016, the Company granted 193 thousand stock options to certain members of the executive management team to purchase common shares of the Company at a price equal to the closing market price of the Company’s common shares on the date of grant. The stock options vest ratably on the anniversary date of the grant date over a three-year period and expire on the tenth anniversary of the grant date. The fair value of stock options is estimated using the Black-Scholes valuation model. Key input

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assumptions used to estimate the fair value of stock options include the expected option term, the expected volatility of the Company's common stock over the expected term of the options, the risk-free interest rate, and the expected dividend yield. The Company recognizes the compensation expense of stock options on a straight-line basis in the consolidated statement of operations over the vesting period. No stock options were granted or exercised during 2018.

The following table shows stock options that were outstanding, exercisable and expected to vest as of December 31, 2018 and the related weighted average exercise price, weighted average remaining contractual term and aggregate intrinsic value:

	Number of Shares (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (1) (In thousands)
Stock options outstanding	103	\$ 14.13	7.25	\$ 5,027
Stock options exercisable	69	\$ 14.13	7.25	\$ 3,351
Stock options expected to vest	34	\$ 14.13	7.25	\$ 1,676

- (1) The aggregate intrinsic value is calculated as the difference between the closing market price of \$63.00 per share of the Company's common stock on December 31, 2018 and the exercise price of the stock options.

#### 14. Employee Benefit Plans

##### *Defined Contribution Plans*

The Company has defined contribution employee savings plans in the U.K., Japan, and the U.S. The Company matches the contributions of participating employees on the basis of percentages specified in each plan. Company matching contributions to the plans were \$3.9 million, \$3.1 million and \$2.5 million for the years ended December 31, 2018, 2017 and 2016, respectively.

##### *Defined Benefit Plans*

The Company maintains a frozen defined benefit pension plan in the United Kingdom (the "U.K. Plan"). The U.K. Plan was closed to new membership in 1997 and stopped accruing additional pension benefits for existing members in 2003. Benefits under the U.K. Plan were based on the employees' years of service and compensation as of the date the plan was frozen in 2003, adjusted for inflation. The Company continues to fund the plan in accordance with the pension regulations in the U.K. and based on periodic agreements with the trustees of the U.K. Plan.

The net periodic pension cost consisted of the following components (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Components of the net periodic pension cost:			
Interest cost	\$ 939	\$ 991	\$ 1,232
Expected return on plan assets	(1,717)	(1,665)	(1,566)
Amortization of actuarial losses	826	1,045	726
Net periodic pension cost	\$ 48	\$ 371	\$ 392

The actuarial assumptions used to compute the net periodic pension cost for the years ended December 31, 2018, 2017 and 2016, respectively, were as follows:

	Year Ended December 31,		
	2018	2017	2016
Weighted-average discount rate	2.4%	2.6%	3.8%
Weighted-average long-term rate of return on plan assets	4.8%	5.2%	5.3%

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The actuarial assumptions used to compute the benefit obligations as of December 31, 2018 and 2017, respectively, were as follows:

	December 31,	
	2018	2017
Weighted-average discount rate	2.7%	2.4%
Rate of inflation	2.8%	2.9%

The discount rates used are derived from (AA) corporate bonds that have maturities approximating the terms of the pension obligations under the U.K. Plan. In estimating the expected return on plan assets, the Company considered the historical performance of the major asset classes held by the U.K. Plan and current forecasts of future rates of return for these asset classes.

The following table provides a reconciliation of benefit obligations and plan assets of the U.K. Plan (in thousands):

	December 31,	
	2018	2017
<b>Change in benefit obligation:</b>		
Projected benefit obligation at beginning of year	\$ 40,329	\$ 37,261
Interest cost	939	991
Actuarial (gains) losses	(1,718)	(27)
Benefits paid	(1,301)	(1,313)
Prior service cost <sup>(1)</sup>	754	—
Foreign currency exchange rate changes	(2,121)	3,417
Projected benefit obligation at end of year	\$ 36,882	\$ 40,329
Accumulated benefit obligation at end of year	\$ 36,882	\$ 40,329
<b>Change in plan assets:</b>		
Fair value of plan assets at beginning of year	\$ 36,476	\$ 31,304
Actual return on plan assets	(1,083)	2,605
Employer contributions	941	887
Benefits paid	(1,301)	(1,313)
Foreign currency exchange rate changes	(1,909)	2,993
Fair value of plan assets at end of year	\$ 33,124	\$ 36,476
<b>Funded status at end of year</b>	<b>\$ (3,758)</b>	<b>\$ (3,853)</b>
Amounts included in accumulated other comprehensive loss not yet recognized in net periodic pension cost:		
Net actuarial losses at beginning of year	\$ (10,493)	\$ (11,697)
Net actuarial gains (losses) during the year	(1,082)	967
Prior service cost arising during the year <sup>(1)</sup>	(754)	—
Amounts reclassified from accumulated other comprehensive income to income before income taxes	826	1,045
Foreign currency exchange rate changes	383	(808)
Net actuarial loss	\$ (11,120)	\$ (10,493)
Amounts expected to be amortized from accumulated other comprehensive loss into net periodic pension cost over the next fiscal year consists of:		
Net actuarial loss	\$ 959	\$ 957
Prior service cost	29	—

- (1) On October 26, 2018, the High Court of Justice in the U.K. ruled that the Guaranteed Minimum Pensions (“GMPs”) provided by pension schemes need to equalize lifetime GMP benefits between genders. In order to meet the requirements set out by the High Court, the Company recorded an estimate of \$0.8 million additional benefit obligations based on the existing plan participants, the date the U.K. Plan was allowed to stop accruing additional benefits, the pension plan rules and the approach taken to equalize the benefits. The additional benefit obligation will

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be amortized and recognized as part of net periodic pension cost in the consolidated statement of operations over the average remaining life expectancy of the plan participants.

The funded status of the U.K. Plan is included in other long term liabilities in the accompanying consolidated balance sheets.

The following table reflects the total expected benefit payments to plan participants and have been estimated based on the same assumptions used to measure the Company's benefit obligations as of December 31, 2018 (in thousands):

	Amount
2019	\$ 859
2020	1,133
2021	1,197
2022	1,038
2023	1,137
2024-2026	8,370
Total	<u>\$ 13,734</u>

In the U.K., funding valuations are conducted every three years in order to determine the future level of contributions. Based on the results of the most recent valuation, the Company's annual contributions will be approximately \$0.9 million in 2019 and will increase by 2.9% per year thereafter.

**Fair Value of Plan Assets**

The trustees of the U.K. Plan have the fiduciary responsibilities to manage the plan assets in consultation with the Company. The overall objective is to invest plan assets in a portfolio of diversified assets, primarily through the use of institutional collective funds, to achieve balanced growth through a combination of investments in equities for long-term growth and investments in debt instruments that match a portion of the expected future benefit payments and to maintain adequate liquidity to make pension payments to pensioners.

The following table summarizes the fair values of Plan assets by asset category as of December 31, 2018 (in thousands):

Asset Category	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Not Subject to Leveling
Mutual Funds:					
Balanced (1)	\$ 24,564	\$ —	\$ —	\$ —	\$ 24,564
Fixed income (2)	8,451	—	—	—	8,451
Cash	109	109	—	—	—
Total	<u>\$ 33,124</u>	<u>\$ 109</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 33,015</u>

- (1) This class comprises a diversified portfolio of global investments which seeks a balanced return between capital growth and fixed income and is allocated on a weighted average basis as follows: equities (42%), bonds (19%), other assets (38%) and cash (1%).
- (2) This class comprises a diversified portfolio of global investments which seeks fixed income growth and is allocated on a weighted average basis as follows: bonds (86%) and cash (14%).

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The following table summarizes the fair values of Plan assets by asset category as of December 31, 2017 (in thousands):

Asset Category	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Not Subject to Leveling
Mutual Funds:					
Balanced (1)	\$ 26,816	\$ —	\$ —	\$ —	\$ 26,816
Fixed income (2)	9,524	—	—	—	9,524
Cash	136	136	—	—	—
Total	<u>\$ 36,476</u>	<u>\$ 136</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 36,340</u>

- (1) This class comprises a diversified portfolio of global investments which seeks a balanced return between capital growth and fixed income and is allocated on a weighted average basis as follows: equities (38%), bonds (27%), other assets (31%) and cash (4%).
- (2) This class comprises a diversified portfolio of global investments which seeks long-term capital growth and is allocated on a weighted average basis as follows: bonds (92%) and cash (8%).

## 15. Income Taxes

Components of the Company's income (loss) before income taxes are as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Income (loss) before income taxes:			
Canada	\$ (796)	\$ (2,036)	\$ (1,872)
U.S.	39,356	37,327	20,422
Other	22,742	40,843	13,972
Total	<u>\$ 61,302</u>	<u>\$ 76,134</u>	<u>\$ 32,522</u>

Components of the Company's income tax provision (benefit) are as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
Current			
Canada	\$ 75	\$ 146	\$ 43
U.S.	8,095	9,434	9,678
Other	8,113	6,807	2,564
	<u>16,283</u>	<u>16,387</u>	<u>12,285</u>
Deferred			
Canada	—	—	—
U.S.	(2,272)	2,396	(2,378)
Other	(3,804)	(4,956)	612
	<u>(6,076)</u>	<u>(2,560)</u>	<u>(1,766)</u>
Total	<u>\$ 10,207</u>	<u>\$ 13,827</u>	<u>\$ 10,519</u>

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The Company is incorporated in Canada and therefore uses the Canadian statutory rate for income tax disclosure. The reconciliation of the statutory Canadian tax rate to the effective tax rate related to income before income taxes is as follows (in thousands, except percentage data):

	Year Ended December 31,		
	2018	2017	2016
Statutory Canadian tax rate	29.00%	29.00%	28.50%
Expected income tax provision at Canadian statutory tax rate	\$ 17,778	\$ 22,079	\$ 9,269
International tax rate differences	(4,474)	(2,038)	891
U.S. state income taxes, net	831	674	503
Withholding and other taxes	550	484	441
Permanent differences and other	1,015	1,582	84
Section 199 deduction	—	(1,148)	(1,063)
Foreign-derived intangible income	(1,628)	—	—
Tax credits	(1,250)	(984)	(1,095)
Statutory tax rate changes	(285)	2,823	(856)
Uncertain tax positions	190	(1,607)	(103)
Change in valuation allowance	(262)	(354)	1,202
Acquisition contingent consideration adjustments	833	149	762
Transaction costs	172	1,011	649
Provision to return differences	(385)	225	(93)
Benefit from share-based compensation	(931)	(837)	(72)
Gain on Laser Quantum acquisition	—	(6,586)	—
UK patent box	(1,947)	(1,646)	—
Reported income tax provision	<u>\$ 10,207</u>	<u>\$ 13,827</u>	<u>\$ 10,519</u>
Effective tax rate	<u>16.7%</u>	<u>18.2%</u>	<u>32.3%</u>

On December 22, 2017, the President of the United States signed into law the Tax Reform Act. The Tax Reform Act significantly changed U.S. tax law by, among other things, lowering corporate income tax rates, implementing a territorial tax system, providing a one-time transition tax on the repatriation of foreign earnings (the “Toll Charge”), creating a new limitation on deductible interest expense and modifying the limitation on officer compensation. The Tax Reform Act permanently reduced the U.S. corporate income tax rate from a maximum of 35% to a flat 21% rate, effective January 1, 2018.

As a result of the Tax Reform Act, the Company revalued its deferred tax assets and liabilities as of December 31, 2017 at the new 21% U.S. federal corporate income tax rate. Because of the ownership structure of the Company, the Company’s foreign entities outside the U.S. are not considered controlled foreign corporations of the U.S. company, as defined under U.S. tax principles, and accordingly, the accumulated earnings of these foreign subsidiaries are not subject to the one-time Toll Charge or global intangible low-taxed income (the “GILTI”) under the Tax Reform Act. In addition, the Company is not currently subject to the base erosion anti-abuse tax (the “BEAT”) as the Company’s revenue is below the threshold requirement under the Tax Reform Act.

During the year ended December 31, 2018, there were no changes made to the provisional amounts recognized in 2017 in connection with the enactment of the Tax Reform Act. The accounting for the income tax effects of the Tax Reform Act is completed as of December 31, 2018.

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Deferred income taxes result principally from temporary differences in the recognition of certain revenue and expense items and operating loss and tax credit carryforwards for financial and tax reporting purposes. Significant components of the Company's deferred tax assets and liabilities as of December 31, 2018 and 2017 are as follows (in thousands):

	December 31,	
	2018	2017
Deferred tax assets:		
Losses	\$ 9,385	\$ 9,407
Compensation related deductions	4,780	3,687
Inventories	4,170	3,400
Tax credits	2,785	2,594
Unrealized currency gains/losses	—	183
Restructuring related liabilities	202	172
Warranty	35	768
Other	885	—
Total deferred tax assets	22,242	20,211
Valuation allowance on deferred tax assets	(12,884)	(12,811)
Net deferred tax assets	\$ 9,358	\$ 7,400
Deferred tax liabilities:		
Depreciation	\$ (1,867)	\$ (1,353)
Amortization	(20,258)	(23,496)
Unrealized currency gains/losses	(373)	—
Other	—	(1,171)
Total deferred tax liabilities	\$ (22,498)	\$ (26,020)
Net deferred income tax assets (liabilities)	\$ (13,140)	\$ (18,620)

In determining its income tax provisions, the Company calculated deferred tax assets and liabilities for each separate jurisdiction. The Company then considered a number of factors, including positive and negative evidence related to the realization of its deferred tax assets, to determine whether a valuation allowance should be recognized with respect to its deferred tax assets.

In 2018, the Company recorded an additional \$0.4 million valuation allowance associated with an increase in deferred tax assets in Canada. In 2018, the Company released valuation allowance of \$0.3 million recorded on net operating losses and other timing items in certain tax jurisdictions. In 2017, the Company released valuation allowance of \$0.4 million recorded on net operating losses and other timing items in certain tax jurisdictions.

Valuation allowance continues to be provided on the remaining balances of certain U.S. state net operating losses and certain foreign tax attributes that the Company has determined that it is more likely than not that they will not be realized. In conjunction with the Company's ongoing review of its actual results and anticipated future earnings, the Company continuously reassesses the possibility of releasing the valuation allowance currently in place on its deferred tax assets.

As of December 31, 2018, the Company had net operating loss carryforwards of \$3.7 million (tax effected) available to reduce future taxable income. Of this amount, approximately \$0.7 million relates to the U.S. and expires through 2037; and \$3.0 million relates to Canada and expires starting in 2033. In addition, the Company had capital loss carryforwards of \$5.7 million, which had a full valuation allowance. Of this amount, \$5.2 million and \$0.5 million related to Canada and the U.K., respectively.

As of December 31, 2017, the Company had net operating loss carryforwards of \$3.7 million (tax effected) available to reduce future taxable income. Of this amount, approximately \$1.0 million relates to the U.S. and expires through 2036; and \$2.7 million relates to Canada and expires starting in 2032. In addition, the Company had capital loss carryforwards of \$5.7 million, which had a full valuation allowance. Of this amount, \$5.2 million and \$0.5 million related to Canada and the U.K., respectively.

As of December 31, 2018, the Company had tax credit carryforwards of approximately \$2.8 million available to reduce income taxes in future years. Approximately \$0.9 million relates to the U.S. state tax credits, of which \$0.8 million will expire through 2033 and \$0.1 million can be carried forward indefinitely. The remaining \$1.9 million tax credit carryforwards were related to Canada, of which \$1.2 million expires through 2022 and \$0.7 million can be carried forward indefinitely.

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As of December 31, 2017, the Company had tax credit carryforwards of approximately \$2.6 million available to reduce income taxes in future years. Approximately \$0.7 million relates to the U.S. state tax attributes, of which \$0.6 million will expire through 2032 and \$0.1 million can be carried forward indefinitely. The remaining \$1.9 million tax credit carryforwards were related to Canada, of which \$1.2 million expires through 2022 and \$0.7 million can be carried forward indefinitely.

Income and foreign withholding taxes have not been recognized on the excess of the amount for financial reporting purposes over the tax basis of investments in foreign subsidiaries that are essentially permanent in nature. This amount becomes taxable upon a repatriation of assets from a subsidiary or a sale or liquidation of a subsidiary. The amount of undistributed earnings of foreign subsidiaries totaled \$135.6 million as of December 31, 2018. However, these undistributed earnings are generally not subject to the repatriation taxes under the Tax Reform Act. The estimated unrecognized income tax and foreign withholding tax liability on this temporary difference is approximately \$0.3 million.

As of December 31, 2018, the Company's total amount of gross unrecognized tax benefits was \$4.7 million, of which \$3.6 million would favorably affect the effective tax rate if benefited. Over the next twelve months, the Company may need to record up to \$0.5 million of previously unrecognized tax benefits due to statute of limitations closures. The Company believes there are no jurisdictions in which the outcome of unresolved issues or claims is likely to be material to its results of operations, financial position or cash flows. Furthermore, the Company believes that it has adequately provided for all income tax uncertainties.

As of December 31, 2017, the Company's total amount of gross unrecognized tax benefits was \$4.1 million, of which \$3.4 million would favorably affect the effective tax rate if benefited. Over the next twelve months, the Company may need to record up to \$0.2 million of previously unrecognized tax benefits due to statute of limitations closures. The Company believes there are no jurisdictions in which the outcome of unresolved issues or claims is likely to be material to its results of operations, financial position or cash flows. Furthermore, the Company believes that it has adequately provided for all income tax uncertainties.

The reconciliation of the total amounts of unrecognized tax benefits is as follows (in thousands):

Balance at December 31, 2015	\$ 5,490
Additions based on tax positions related to the current year	561
Additions for tax positions of prior years	88
Reductions to tax positions of prior years	(45)
Reductions to tax positions resulting from a lapse of the applicable statute of limitations	(842)
Settlements with tax authorities	(290)
Balance at December 31, 2016	4,962
Additions based on tax positions related to the current year	991
Additions for tax positions of prior years	496
Reductions to tax positions of prior years	(28)
Reductions to tax positions resulting from a lapse of the applicable statute of limitations	(1,577)
Settlements with tax authorities	(755)
Balance at December 31, 2017	4,089
Additions based on tax positions related to the current year	394
Additions for tax positions of prior years	655
Reductions to tax positions of prior years	(69)
Reductions to tax positions resulting from a lapse of the applicable statute of limitations	(239)
Settlements with tax authorities	(105)
Balance at December 31, 2018	<u>\$ 4,725</u>

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of December 31, 2018 and 2017, the Company had approximately \$0.5 million and \$0.4 million, respectively, of accrued interest and penalties related to uncertain tax positions. During the years ended December 31, 2018 and 2017, the Company recognized less than \$0.1 million of expense for an increase in interest and penalties related to uncertain tax positions.

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The Company files income tax returns in Canada, the U.S., and various foreign jurisdictions. Generally, the Company is no longer subject to U.S. or foreign income tax examinations, including transfer pricing tax audits, by tax authorities for the years before 2009.

The Company's income tax returns may be reviewed by tax authorities in the following countries for the following periods under the appropriate statute of limitations:

United States	2015 - Present
Canada	2015 - Present
United Kingdom	2017 - Present
Germany	2014 - Present
The Netherlands	2012 - Present
China	2009 - Present
Japan	2013 - Present

# 16. Restructuring, Acquisition and Divestiture Related Costs

The following table summarizes restructuring, acquisition and divestiture related costs recorded in the accompanying consolidated statements of operations (in thousands):

	Year Ended December 31,		
	2018	2017	2016
2019 restructuring	\$ 378	\$ —	\$ —
2018 restructuring	1,647	—	—
2016 restructuring	—	332	3,049
2011 restructuring	—	14	(79)
Total restructuring and divestiture related charges	\$ 2,025	\$ 346	\$ 2,970
Acquisition and related charges	6,016	7,196	4,975
Total restructuring, acquisition and divestiture related costs	\$ 8,041	\$ 7,542	\$ 7,945

## 2019 Restructuring

During the fourth quarter of 2018, the Company implemented a restructuring plan intended to realign operations, reduce costs, achieve operational efficiencies and focus resources on growth initiatives. In 2018, the Company recorded \$0.4 million in severance and related costs in connection with the 2019 restructuring plan. These costs were primarily reported in the Vision reportable segment. The Company anticipates completing the 2019 restructuring program in 2019 and expects to incur restructuring charges of \$2.0 million to \$3.5 million related to the 2019 restructuring program in the next twelve months.

## 2018 Restructuring

During the second quarter of 2018, the Company initiated a program to integrate manufacturing operations as a result of recent acquisition activities. In 2018, the Company recorded \$1.6 million in severance and related costs in connection with the 2018 restructuring plan. The Company anticipates completing the 2018 restructuring program during the third quarter of 2019.

The following table summarizes restructuring costs incurred to date and the Company's expected cumulative costs associated with the 2018 restructuring program (in thousands):

	Year Ended	Expected Cumulative Costs
	December 31, 2018	December 31, 2018
Photonics	\$ —	\$ —
Vision	1,579	\$2,300 - \$2,600
Precision Motion	—	—
Unallocated Corporate and Shared Services	68	\$100
Total	\$ 1,647	\$ 2,400 - \$2,700

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**2016 Restructuring**

During the third quarter of 2015, the Company initiated the 2016 restructuring program, which included consolidating certain manufacturing operations to optimize facility footprint and better utilize resources, and reducing redundant costs due to productivity cost savings and business volume reductions. As of December 31, 2017, the Company incurred cumulative costs related to this restructuring plan totaling \$6.5 million, net of the gain on the sale of the Chatsworth, California facility. The plan was completed in 2017.

The following table summarizes restructuring costs associated with the 2016 restructuring program for each segment and unallocated corporate costs (in thousands):

	Year Ended		Cumulative
	December 31, 2017	December 31, 2016	Costs as of December 31, 2017
Photonics	\$ —	\$ 813	\$ 868
Vision	331	1,862	4,393
Precision Motion	—	106	939
Unallocated Corporate and Shared Services	1	268	329
Total	<u>\$ 332</u>	<u>\$ 3,049</u>	<u>\$ 6,529</u>

**2011 Restructuring**

In November 2011, the Company announced a strategic initiative (“2011 restructuring”) which aimed to consolidate operations to reduce the Company’s cost structure and improve operational efficiency. In total, eleven facilities have been exited as part of the 2011 restructuring plan. The Company substantially completed the 2011 restructuring program in 2013. In March 2016, the Company sold its previously exited Laser Systems facility located in Orlando, Florida for cash at the net carrying value of \$3.5 million. In December 2016, the lease agreement for the Company’s previously exited laser scanner business facility was terminated, which resulted in a benefit of \$0.2 million.

The following table summarizes restructuring costs for each segment and unallocated corporate costs related to the 2011 restructuring plan (in thousands):

	Year Ended December 31,		Cumulative
	2017	2016	Costs as of December 31, 2017
Photonics	\$ —	\$ (188)	\$ 1,751
Vision	—	—	48
Precision Motion	—	—	122
Unallocated Corporate and Shared Services	14	109	3,276
Total	<u>\$ 14</u>	<u>\$ (79)</u>	<u>\$ 5,197</u>

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
AS OF DECEMBER 31, 2018

***Rollforward of Accrued Expenses Related to Restructuring***

The following table summarizes the accrual activities, by component, related to the Company's restructuring charges recorded in the accompanying consolidated balance sheets (in thousands):

	Total	Severance	Facility	Other (a)
Balance at December 31, 2016	\$ 1,736	\$ 611	\$ 1,111	\$ 14
Restructuring charges	346	185	146	15
Cash payments	(1,212)	(692)	(503)	(17)
Non-cash write-offs and other adjustments	(64)	(65)	9	(8)
Balance at December 31, 2017	806	39	763	4
Restructuring charges	2,025	1,862	—	163
Cash payments	(1,490)	(962)	(373)	(155)
Non-cash write-offs and other adjustments	(65)	(63)	(2)	—
Balance at December 31, 2018	<u>\$ 1,276</u>	<u>\$ 876</u>	<u>\$ 388</u>	<u>\$ 12</u>

(a) Other restructuring charges mainly related to consulting fees and relocation costs.

The Company expects to make \$1.1 million in cash payments during the twelve months ending December 31, 2019.

***Acquisition and Divestiture Related Charges***

Acquisition related costs incurred to effect business combinations, primarily including finders' fees, legal, valuation and other professional or consulting fees, totaled \$1.4 million, \$6.8 million, and \$2.5 million during 2018, 2017, and 2016, respectively. Acquisition related costs recognized under earn-out agreements in connection with acquisitions totaled \$4.6 million, \$0.4 million, and \$2.5 million during 2018, 2017, and 2016, respectively. The majority of acquisition related costs for 2018 were included in the Company's Precision Motion reportable segment.

**17. Commitments and Contingencies**

***Operating Leases***

The Company leases certain equipment and facilities under operating lease agreements. Most of these lease agreements expire between 2019 and 2031. In the U.K., where longer lease terms are more common, the Company has a land lease that extends through 2078. During 2018, 2017 and 2016, the Company recorded lease expense of \$7.4 million, \$5.5 million and \$4.2 million, respectively. In addition to the base rent, the Company is generally required to pay insurance, real estate taxes and maintenance costs which are recorded in lease expense.

***Capital Leases***

Gross assets under capital lease as of December 31, 2018 and 2017, respectively, are summarized as follows (in thousands):

	2018	2017
Land, buildings and improvements	\$ 9,133	\$ 9,133
Machinery and equipment	4,404	4,429
Total gross assets under capital lease	<u>\$ 13,537</u>	<u>\$ 13,562</u>

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
AS OF DECEMBER 31, 2018

***Future Lease Payments***

Future minimum lease payments under operating and capital leases expiring subsequent to December 31, 2018, including operating leases associated with facilities that have been vacated as a result of the Company's restructuring actions, are summarized as follows (in thousands):

Year Ended December 31,	Operating Lease	Capital Lease <sup>(1)</sup>
2019	\$ 7,797	\$ 990
2020	6,263	980
2021	5,757	907
2022	5,264	907
2023	4,719	930
Thereafter	26,149	5,394
Total minimum lease payments	<u>\$ 55,949</u>	<u>\$ 10,108</u>

(1) Capital lease payments include interest payments of \$2.3 million.

***Purchase Commitments***

As of December 31, 2018, the Company had purchase commitments primarily for inventory purchases of \$99.0 million. These purchase commitments are expected to be incurred as follows: \$93.9 million in 2019 and \$5.1 million in 2020.

***Legal Proceedings***

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. The Company reviews the status of each significant matter and assesses the potential financial exposure on a quarterly basis. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, the Company accrues a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure is reasonably estimable. Because of uncertainties related to these matters, accruals are based only on the best information available as of the date of the consolidated balance sheet. As additional information becomes available, the Company reassesses the potential liability related to any pending claims and litigation and may revise its estimates. The Company does not believe that the outcome of these claims will have a material adverse effect upon its consolidated financial statements but there can be no assurance that any such claims, or any similar claims, would not have a material adverse effect upon its consolidated financial statements.

***Guarantees and Indemnifications***

In the normal course of its operations, the Company executes agreements that provide for indemnification and guarantees to counterparties in transactions such as business dispositions, sale of assets, sale of products and operating leases. Additionally, the by-laws of the Company require it to indemnify certain current or former directors, officers, and employees of the Company against expenses incurred by them in connection with each proceeding in which he or she is involved as a result of serving or having served in certain capacities. Indemnification is not available with respect to a proceeding as to which it has been adjudicated that the person did not act in good faith in the reasonable belief that the action was in the best interests of the Company. Certain of the Company's officers and directors are also a party to indemnification agreements with the Company. These indemnification agreements provide, among other things, that the director and officer shall be indemnified to the fullest extent permitted by applicable law against all expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred by such officer or director in connection with any proceeding by reason of his or her relationship with the Company. In addition, the indemnification agreements provide for the advancement of expenses incurred by such director or officer in connection with any proceeding covered by the indemnification agreement, subject to the conditions set forth therein and to the extent such advancement is not prohibited by law. The indemnification agreements also set out the procedures for determining entitlement to indemnification, the requirements relating to notice and defense of claims for which indemnification is sought, the procedures for enforcement of indemnification rights, the limitations on and exclusions from indemnification, and the minimum levels of directors' and officers' liability insurance to be maintained by the Company.

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
AS OF DECEMBER 31, 2018

On July 1, 2013, the Company provided a Guarantee (the “Guarantee”) in favor of the trustees of the U.K. Plan with respect to all present and future obligations and liabilities (whether actual or contingent and whether owed jointly or severally and in any capacity whatsoever) of Novanta Technologies UK Limited, a wholly owned subsidiary of Novanta Inc.

***Credit Risks and Other Uncertainties***

The Company maintains financial instruments such as cash and cash equivalents and trade receivables. From time to time, certain of these instruments may subject the Company to concentrations of credit risk whereby one institution may hold a significant portion of the cash and cash equivalents, or one customer may represent a large portion of the accounts receivable balances.

There was no significant concentration of credit risk related to the Company’s position in trade accounts receivable as no individual customer represented 10% or more of the Company’s outstanding accounts receivable at December 31, 2018 and 2017. Credit risk with respect to trade accounts receivables is generally minimized because of the diversification of the Company’s operations, as well as its large customer base and its geographical dispersion.

Certain of the components and materials included in the Company’s products are currently obtained from single source suppliers. There can be no assurance that a disruption of the supply of such components and materials would not create substantial manufacturing delays and additional cost to the Company.

The Company’s operations involve a number of other risks and uncertainties including, but not limited to, the effects of general economic conditions, rapidly changing technology, and international operations.

**18. Related Party Transactions**

Certain members of the Company’s board of directors currently serve on the board of directors or as an advisor of companies that are customers of the Company. All contracts with related parties are executed at arm’s length in the ordinary course of business. The aggregate revenue from these customers was \$40.0 million in 2018. There was \$0.6 million in accounts receivable due from these customers as of December 31, 2018. There were no material transactions with related parties in 2017 or 2016.

**19. Segment Information**

***Reportable Segments***

The Company’s Chief Operating Decision Maker (“CODM”) utilizes financial information to make decisions about allocating resources and assessing performance for the entire Company. The Company evaluates the performance of, and allocates resources to, its segments based on revenue, gross profit and operating profit. The Company’s reportable segments have been identified based on commonality and adjacency of technologies, applications and customers amongst the Company’s individual product lines. The Company determined that disclosing revenue by specific product was impracticable due to the highly customized and extensive portfolio of technologies offered to customers.

Based upon the information provided to the CODM, the Company has determined it operates in three reportable segments: Photonics, Vision, and Precision Motion. The reportable segments and their principal activities consist of the following:

***Photonics***

The Photonics segment designs, manufactures and markets photonics-based solutions, including laser scanning, laser beam delivery, CO2 laser, continuous wave and ultrafast laser, and optical light engine products to customers worldwide. The segment serves highly demanding photonics-based applications for advanced industrial processes, metrology, medical and life science imaging, DNA sequencing, and medical laser procedures. The vast majority of the segment’s product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

***Vision***

The Vision segment designs, manufactures and markets a range of medical grade technologies, including medical insufflators, pumps and related disposables; visualization solutions; wireless imaging and operating room integration technologies; optical data

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
AS OF DECEMBER 31, 2018

collection and machine vision technologies; radio frequency identification (“RFID”) technologies; thermal chart recorders; spectrometry technologies, and embedded touch screen solutions. The vast majority of the segment’s product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

*Precision Motion*

The Precision Motion segment designs, manufactures and markets optical and inductive encoders, precision motor and motion control sub-assemblies, air bearings, air bearing spindles and precision machined components to customers worldwide. The vast majority of the segment’s product offerings are sold to OEM customers. The segment sells these products both directly, utilizing a highly technical sales force, and indirectly, through resellers and distributors.

**Reportable Segment Financial Information**

Revenue, gross profit, operating income (loss), depreciation and amortization expenses, accounts receivable and inventories by reportable segments are as follows (in thousands):

	Year Ended December 31,		
	2018	2017	2016
<b>Revenue</b>			
Photonics	\$ 249,339	\$ 232,359	\$ 174,158
Vision	232,902	183,074	122,250
Precision Motion	132,096	105,857	88,350
<b>Total</b>	<u>\$ 614,337</u>	<u>\$ 521,290</u>	<u>\$ 384,758</u>

	Year Ended December 31,		
	2018	2017	2016
<b>Gross Profit</b>			
Photonics	\$ 117,109	\$ 106,117	\$ 76,696
Vision	87,198	69,249	47,181
Precision Motion	59,477	46,564	40,044
Unallocated Corporate and Shared Services	(2,256)	(1,399)	(1,469)
<b>Total</b>	<u>\$ 261,528</u>	<u>\$ 220,531</u>	<u>\$ 162,452</u>

	Year Ended December 31,		
	2018	2017	2016
<b>Operating Income (Loss)</b>			
Photonics	\$ 59,285	\$ 51,660	\$ 35,217
Vision	8,991	7,883	(1,277)
Precision Motion	31,674	27,146	21,101
Unallocated Corporate and Shared Services	(28,937)	(29,123)	(22,086)
<b>Total</b>	<u>\$ 71,013</u>	<u>\$ 57,566</u>	<u>\$ 32,955</u>

	Year Ended December 31,		
	2018	2017	2016
<b>Depreciation and Amortization Expenses</b>			
Photonics	\$ 12,042	\$ 13,806	\$ 6,738
Vision	20,657	13,590	10,402
Precision Motion	3,627	2,308	2,439
Unallocated Corporate and Shared Services	726	1,054	1,394
<b>Total</b>	<u>\$ 37,052</u>	<u>\$ 30,758</u>	<u>\$ 20,973</u>

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
AS OF DECEMBER 31, 2018

	December 31,	
	2018	2017
<b>Accounts Receivable</b>		
Photonics	\$ 31,536	\$ 33,490
Vision	34,414	36,089
Precision Motion	18,005	11,903
Total accounts receivable	\$ 83,955	\$ 81,482
<b>Inventories</b>		
Photonics	41,623	44,451
Vision	42,498	33,836
Precision Motion	20,643	12,991
Total inventories	\$ 104,764	\$ 91,278
<b>Total segment assets</b>	<u>\$ 188,719</u>	<u>\$ 172,760</u>

	December 31,	
	2018	2017
<b>Total Assets</b>		
Total segment assets	\$ 188,719	\$ 172,760
Cash and cash equivalents	82,043	100,057
Prepaid income taxes and income taxes receivable	1,852	4,387
Prepaid expenses and other current assets	9,155	10,675
Property, plant and equipment, net	65,464	61,718
Deferred tax assets	9,492	7,052
Other assets	2,269	4,018
Intangible assets, net	142,920	155,048
Goodwill	217,662	210,988
<b>Total</b>	<u>\$ 719,576</u>	<u>\$ 726,703</u>

**Geographic Information**

The Company aggregates geographic revenue based on the customer location where products are shipped. Revenue from these customers is as follows (in thousands, except percentage data):

	Year Ended December 31,					
	2018		2017		2016	
	Revenue	% of Total	Revenue	% of Total	Revenue	% of Total
United States	\$ 242,243	39.4%	\$ 220,583	42.3%	\$ 154,756	40.2%
Germany	88,027	14.3	68,003	13.0	55,940	14.5
Rest of Europe	105,608	17.2	81,001	15.5	51,705	13.4
China	66,414	10.8	56,128	10.8	44,225	11.5
Rest of Asia-Pacific	104,300	17.0	84,727	16.3	60,104	15.6
Other	7,745	1.3	10,848	2.1	18,028	4.8
<b>Total</b>	<u>\$ 614,337</u>	<u>100.0%</u>	<u>\$ 521,290</u>	<u>100.0%</u>	<u>\$ 384,758</u>	<u>100.0%</u>

NOVANTA INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)  
AS OF DECEMBER 31, 2018

Long-lived assets consist of property, plant and equipment, net, and are aggregated based on the location of the assets. A summary of these long-lived assets is as follows (in thousands):

	December 31,	
	2018	2017
United States	\$ 32,029	\$ 29,920
Europe	31,696	30,621
China	1,636	1,127
Rest of Asia-Pacific	103	50
Total	<u>\$ 65,464</u>	<u>\$ 61,718</u>

**Revenue by End Market**

The Company primarily operates in two end markets: the advanced industrial market and the medical market. Revenue by end market was approximately as follows:

	Year Ended December 31,		
	2018	2017	2016
Advanced Industrial	50%	50%	60%
Medical	50%	50%	40%
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

The majority of revenue from the Photonics and Precision Motion segments is generated from sales to customers in the advanced industrial market. The majority of revenue from the Vision segment is generated from sales to customers in the medical market.

**Significant Customers**

No customer accounted for greater than 10% of the Company's revenue during the years ended December 31, 2018, 2017 or 2016.

**Supplementary Information**  
**(Unaudited)**

The Company's interim financial statements are prepared on a quarterly basis ending on the Friday closest to the end of the calendar quarter, with the exception of the fourth quarter which always ends on December 31.

The following tables reflect the Company's unaudited condensed consolidated statements of operations (in thousands except per share data):

	Three Months Ended			
	December 31, 2018	September 28, 2018	June 29, 2018	March 30, 2018
Revenue	\$ 156,178	\$ 160,794	\$ 150,400	\$ 146,965
Cost of revenue	91,672	91,160	85,171	84,806
Gross profit	64,506	69,634	65,229	62,159
Operating expenses:				
Research and development and engineering	13,280	13,204	12,551	11,989
Selling, general and administrative	28,302	29,147	29,231	29,220
Amortization of purchased intangible assets	4,012	3,947	3,893	3,698
Restructuring, acquisition and divestiture related costs	3,236	2,341	2,439	25
Total operating expenses	48,830	48,639	48,114	44,932
Operating income	15,676	20,995	17,115	17,227
Interest income (expense), foreign exchange transaction gains (losses) and other income (expense), net	(2,101)	(2,374)	(2,430)	(2,806)
Income before income taxes	13,575	18,621	14,685	14,421
Income tax provision	1,931	3,632	3,060	1,584
Consolidated net income	11,644	14,989	11,625	12,837
Less: Net income attributable to noncontrolling interest	—	(435)	(625)	(926)
Net income attributable to Novanta Inc.	\$ 11,644	\$ 14,554	\$ 11,000	\$ 11,911
Earnings per common share attributable to Novanta Inc.				
Basic	\$ 0.33	\$ 0.61	\$ 0.32	\$ 0.19
Diluted	\$ 0.33	\$ 0.60	\$ 0.32	\$ 0.18

	Three Months Ended			
	December 31, 2017	September 29, 2017	June 30, 2017	March 31, 2017
Revenue	\$ 146,918	\$ 146,296	\$ 119,102	\$ 108,974
Cost of revenue	84,677	87,589	65,613	62,880
Gross profit	62,241	58,707	53,489	46,094
Operating expenses:				
Research and development and engineering	11,795	11,659	9,004	9,215
Selling, general and administrative	27,380	27,590	23,810	22,874
Amortization of purchased intangible assets	2,683	3,217	3,347	2,849
Restructuring, acquisition and divestiture related costs	1,310	3,834	1,581	817
Total operating expenses	43,168	46,300	37,742	35,755
Operating income	19,073	12,407	15,747	10,339
Interest income (expense), foreign exchange transaction gains (losses), other income (expense), net and gain on acquisition of business	(2,503)	(2,910)	(1,068)	25,049
Income before income taxes	16,570	9,497	14,679	35,388
Income tax provision	6,893	1,131	4,689	1,114
Consolidated net income	9,677	8,366	9,990	34,274
Less: Net income attributable to noncontrolling interest	(812)	(834)	(588)	(22)
Net income attributable to Novanta Inc.	\$ 8,865	\$ 7,532	\$ 9,402	\$ 34,252
Earnings (loss) per common share attributable to Novanta Inc.				
Basic	\$ (0.00)	\$ (0.00)	\$ 0.16	\$ 0.99
Diluted	\$ (0.00)	\$ (0.00)	\$ 0.16	\$ 0.98

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

None.

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

The required certifications of our Chief Executive Officer and Chief Financial Officer are included in Exhibits 31.1 and 31.2 to this Annual Report on Form 10-K. The disclosures set forth in this Item 9A contain information concerning the evaluation of our disclosure controls and procedures, management's report on internal control over financial reporting and changes in internal control over financial reporting referred to in those certifications. Those certifications should be read in conjunction with this Item 9A for a more complete understanding of the matters covered by the certifications.

#### **Evaluation of Disclosure Controls and Procedures as of December 31, 2018**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2018.

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

During the quarter ended December 31, 2018, we completed the process of incorporating the internal controls for W.O.M. World of Medicine GmbH ("WOM") and Laser Quantum Limited ("Laser Quantum") into our internal control over financial reporting and extending our Section 404 compliance program under the Sarbanes-Oxley Act of 2002 and the applicable rules and regulations under such Act to include WOM and Laser Quantum.

Except as otherwise described above, there has been no change to our internal control over financial reporting during the fiscal quarter ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### **Management's Annual Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) under the Exchange Act. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our 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 and that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2018. In making their assessment, our management utilized the criteria set forth in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in 2013. Based on our evaluation under the framework in *Internal Control—Integrated Framework*, issued by COSO in 2013, our management concluded that our internal control over financial reporting was effective as of December 31, 2018.

The effectiveness of our internal control over financial reporting as of December 31, 2018 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is contained in Item 8 of this Annual Report on Form 10-K.

**Item 9B. Other Information**

None.

Certain information required by Part III is omitted from this Annual Report on Form 10-K and is incorporated herein by reference to the Company's Definitive Proxy Statement for the 2019 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission.

## **PART III**

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

All of the Company's directors, officers and employees must act in accordance with the Code of Ethics and Business Conduct, which has been adopted by the Company's Board of Directors. A copy of the Code of Ethics and Business Conduct is available on the Company's website at <https://www.novanta.com> in the "About Us" section. (This website address is not intended to function as a hyperlink, and the information contained in our website is not intended to be a part of this filing). The Company will provide to any person without charge, upon request, a copy of the Code of Ethics and Business Conduct. Such a request should be made in writing and addressed to Novanta Inc., Attention: Investor Relations, 125 Middlesex Turnpike, Bedford, MA 01730, United States. The Company intends to satisfy the disclosure requirement under Nasdaq rules regarding waivers or under Item 5.05 of Form 8-K regarding disclosure of an amendment to, or waiver from, a provision of this Code of Ethics and Business Conduct with respect to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, by posting such information on the Company's website at <https://www.novanta.com> in the "About Us" section, unless a Form 8-K is otherwise required by law or applicable listing rules.

The remainder of the response to this item is contained in the Proxy Statement for the Company's Annual Meeting of Shareholders scheduled to be held on May 9, 2019 and is incorporated herein by reference.

### **Item 11. *Executive Compensation***

The information required to be disclosed by this item is contained in the Proxy Statement for the Company's Annual Meeting of Shareholders scheduled to be held on May 9, 2019 and is incorporated herein by reference.

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

The information required to be disclosed by this item is contained in the Proxy Statement for the Company's Annual Meeting of Shareholders scheduled to be held on May 9, 2019 and is incorporated herein by reference.

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

The information required to be disclosed by this item is contained in the Proxy Statement for the Company's Annual Meeting of Shareholders scheduled to be held on May 9, 2019 and is incorporated herein by reference.

### **Item 14. *Principal Accounting Fees and Services***

The information required to be disclosed by this item is contained in the Proxy Statement for the Company's Annual Meeting of Shareholders scheduled to be held on May 9, 2019 and is incorporated herein by reference.

## **PART IV**

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

#### **(a) Documents filed as part of this report:**

##### **1. List of Financial Statements**

The financial statements required by this item are listed in Item 8, “Financial Statements and Supplementary Data” herein.

##### **2. List of Financial Statement Schedules**

All schedules are omitted because they are not applicable, not required or the required information is shown in the consolidated financial statements or notes thereto.

### 3. List of Exhibits

See the Company's SEC filings on Edgar at: <https://www.sec.gov/> for all Exhibits.

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed/ Furnished Herewith
		Form	File No.	Exhibit	Filing Date	
2.1	<u>Securities Purchase Agreement dated January 15, 2013, between NDSSI Holdings, LLC, NDS Surgical Imaging, Inc., GSI Group Inc. and GSI Group Limited UK.</u>	8-K	001-35083	2.1	1/15/2013	
2.2	<u>Equity Purchase Agreement dated February 18, 2014, between JADAK, LLC, JADAK Technologies, Inc., Advanced Data Capture Corporation, GSI Group Inc. and GSI Group Corporation.</u>	8-K	001-35083	10.1	2/18/2014	
2.3	<u>Asset and Equity Purchase Agreement, dated June 24, 2014, by and among GSI Group Inc., Excel Technology, Inc., Continuum Electro-Optics, Inc., GSI Europe GmbH, GSI Group France S.A.S., GSI Group Japan Corporation and Amplitude Laser, Inc. and Amplitude Technologies, S.A. (The registrant hereby agrees to furnish a copy of any omitted schedule to the Commission upon request.)</u>	8-K	001-35083	2.1	7/21/2014	
2.4	<u>Purchase Agreement, dated April 15, 2015, by and among GSI Group Limited, GSI Group Corporation, GSI Group Europe GmbH, GSI Group Japan Corporation, GSI Group Precision Technologies (Suzhou) Co., LTD., GSI Group Inc., JKL Newco Limited, and SPI Lasers UK Limited, SPI Lasers LLC, SPI Lasers (Shanghai) Co., Ltd. and Trumpf Corporation. (The registrant hereby agrees to furnish a copy of any omitted schedule to the Commission upon request.)</u>	8-K	001-35083	10.1	4/20/2015	
2.5	<u>Agreement on the Sale and Transfer of all Shares in W.O.M. World of Medicine GmbH, dated June 6, 2017, between Novanta Europe GmbH, Novanta Inc., and Aton GmbH.</u>	8-K	001-35083	2.1	6/9/2017	
3.1	<u>Certificate and Articles of Continuance of the Registrant, dated March 22, 1999.</u>	S-3	333-202597	3.1	3/9/2015	
3.2	<u>By-Laws of the Registrant, as amended.</u>	10Q	000-25705	3.2	4/13/2010	
3.3	<u>Articles of Reorganization of the Registrant, dated July 23, 2010.</u>	8-K	000-25705	3.1	7/23/2010	
3.4	<u>Articles of Amendment of the Registrant, dated December 29, 2010.</u>	S-3	333-202597	3.2	3/9/2015	
3.5	<u>Articles of Amendment of the Registrant, dated May 11, 2016.</u>	8-K	001-35083	10.1	5/12/2016	
4.1	<u>Specimen Stock Certificate</u>	10-K	001-35083	4.1	2/28/2018	
4.2	<u>Form of Indenture, between the Registrant and Wilmington Trust, National Association.</u>	S-3	333-202597	4.3	3/9/2015	
10.1†	<u>Employment Agreement, dated as of November 16, 2010, between GSI Group Inc. and John Roush.</u>	8-K	000-25705	10.1	11/17/2010	
10.2†	<u>Form of Deferred Stock Unit Award Agreement.</u>	10-K	001-35083	10.59	3/30/2011	
10.3†	<u>Restricted Stock Unit Inducement Award Grant Notice.</u>	S-8	333-194557	99.1	3/14/2014	
10.4†	<u>Form of Stock Option Grant Notice and Stock Option Agreement.</u>	10-Q	001-35083	10.2	8/2/2016	
10.5†	<u>Form of U.S. Restricted Stock Unit Award Agreement.</u>	10-Q	001-35083	10.2	5/16/2011	

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed/ Furnished Herewith
		Form	File No.	Exhibit	Filing Date	
10.6†	<u>Offer Letter, dated June 8, 2011, between GSI Group Inc. and Peter Chang.</u>	10-Q	001-35083	10.1	11/10/2011	
10.7	<u>Amended and Restated Lease, dated May 1, 2012, by and between GSI Group Inc. and 125 Middlesex Turnpike, LLC.</u>	8-K	001-35083	10.1	5/4/2012	
10.8†	<u>Form of Performance Stock Unit Award Grant Notice and Performance Stock Unit Award Agreement.</u>	10-Q	001-35083	10.3	8/2/2016	
10.9†	<u>Severance Agreement, dated as of August 15, 2012, between GSI Group Inc. and Peter Chang.</u>	10-Q	001-35083	10.7	11/7/2012	
10.10	<u>Second Amended and Restated Credit Agreement, dated as of May 19, 2016, by and among Novanta Corporation, Novanta Inc., Novanta UK Investments Holding Limited, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, Merrill Lynch, Pierce, Fenner &amp; Smith Incorporated, as Joint Lead Arranger, JP Morgan Chase Bank, N.A., as Joint Lead Arranger, Co-Syndication Agent and lender, Wells Fargo Securities LLC, as Joint Lead Arranger, Wells Fargo Bank, National Association, as Co-Syndication Agent and lender, Silicon Valley Bank, as Co-Documentation Agent and lender, TD Bank, N.A., as Co-Documentation Agent and lender, Bank of Montreal, as Co-Documentation Agent and lender, and HSBC Bank USA, N.A. as a lender.</u>	8-K	001-35083	10.1	5/20/2016	
10.11	<u>Lease Agreement, dated November 22, 2013, by and between Continuum Electro-Optics, Inc., GSI Group Corporation and Legacy Partners I San Jose, LLC.</u>	8-K	001-35083	10.1	12/2/2013	
10.12	<u>Lease Agreement, dated as of May 31, 2013, by and between JADAK, LLC and Hancock Part Development, LLC.</u>	10-Q	001-35083	10.3	5/6/2014	
10.13†	<u>Amended and Restated Employment Agreement, dated April 21, 2017, between Novanta Inc. and Matthijs Glastra.</u>	8-K	001-35083	10.1	4/24/2017	
10.14†	<u>Amended and Restated Employment Agreement, dated April 21, 2017, between Novanta Inc. and Robert Buckley.</u>	8-K	001-35083	10.2	4/24/2017	
10.15†	<u>Employment Agreement, dated April 21, 2017, between Novanta Inc. and Brian Young.</u>	8-K	001-35083	10.3	4/24/2017	
10.16†	<u>Form of New Restricted Stock Unit Award Agreement.</u>	10-Q	001-35083	10.1	5/8/2017	
10.17†	<u>Form of New Performance Stock Unit Award Grant Notice and Performance Stock Unit Award Agreement.</u>	10-Q	001-35083	10.2	5/8/2017	
10.18	<u>Third Amendment, dated August 1, 2017, to Second Amended and Restated Credit Agreement (dated as of May 19, 2016) by and among Novanta Inc., Novanta Corporation, Novanta UK Investments Holding Limited, Novanta Europe GmbH, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, and the other lenders party thereto.</u>	8-K	001-35083	10.1	8/3/2017	
10.19†	<u>Form of Indemnification Agreement, by and between Novanta Inc. and certain officers and directors.</u>	10-Q	001-35083	10.2	11/1/2017	
10.20†	<u>Form of Indemnification Agreement, by and between Novanta Corporation and certain officers and directors.</u>	10-Q	001-35083	10.3	11/1/2017	

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed/ Furnished Herewith
		Form	File No.	Exhibit	Filing Date	
10.21	<u>Fourth Amendment, dated February 26, 2018, to Second Amended and Restated Credit Agreement (dated as of May 19, 2016) by and among Novanta Inc., Novanta Corporation, Novanta UK Investments Holding Limited, Novanta Europe GmbH, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, and the other lenders party thereto.</u>	10-K	001-35083	10.23	2/28/2018	
10.22	<u>First Amendment, dated May 7, 2018, to Amended and Restated Lease (dated as of May 1, 2012) by and between Novanta Corporation and 125 Middlesex Turnpike, LLC.</u>	10-Q	001-35083	10.2	5/8/2018	
10.23†	<u>Novanta Inc. Non-Employee Director Compensation Policy.</u>	10-Q	001-35083	10.1	11/6/2018	
10.24†	<u>Form of Director Restricted Stock Unit Award Grant Notice and Restricted Stock Unit Award Agreement.</u>	10-Q	001-35083	10.2	11/6/2018	
21.1	Subsidiaries of the Registrant.					*
23.1	Consent of Independent Registered Public Accounting Firm.					*
31.1	Chief Executive Officer Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					*
31.2	Chief Financial Officer Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					*
32.1	Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					**
32.2	Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					**
101.INS	XBRL Instance Document.					*
101.SCH	XBRL Schema Document.					*
101.CAL	XBRL Calculation Linkbase Document.					*
101.DEF	XBRL Definition Linkbase Document.					*
101.LAB	XBRL Labels Linkbase Document.					*
101.PRE	XBRL Presentation Linkbase Document.					*
†	This exhibit constitutes a management contract, compensatory plan, or arrangement.					
*	Filed herewith					
**	Furnished herewith					

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language):

(i) Consolidated Balance Sheets at December 31, 2018 and December 31, 2017, (ii) Consolidated Statements of Operations for the years ended December 31, 2018, December 31, 2017, and December 31, 2016, (iii) Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2018, December 31, 2017, and December 31, 2016, (iv) Consolidated Statements of Stockholders' Equity for the years ended December 31, 2018, December 31, 2017, and December 31, 2016, (v) Consolidated Statements of Cash Flows for the years ended December 31, 2018, December 31, 2017, and December 31, 2016, and (vi) Notes to Consolidated Financial Statements.

#### Item 16. Form 10-K Summary

None.

## SIGNATURES

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

Novanta Inc.

By: /s/ Matthijs Glastra

**Matthijs Glastra**

*Chief Executive Officer*

Date: February 27, 2019

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

**Novanta Inc. (Registrant)**

<u>Name</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Matthijs Glastra</u> <b>Matthijs Glastra</b>	Director, Chief Executive Officer	February 27, 2019
<u>/s/ Robert J. Buckley</u> <b>Robert J. Buckley</b>	Chief Financial Officer	February 27, 2019
<u>/s/ Peter L. Chang</u> <b>Peter L. Chang</b>	Chief Accounting Officer and Corporate Controller	February 27, 2019
<u>/s/ Stephen W. Bershad</u> <b>Stephen W. Bershad</b>	Chairman of the Board of Directors	February 27, 2019
<u>/s/ Brian D. King</u> <b>Brian D. King</b>	Director	February 27, 2019
<u>/s/ Ira J. Lamel</u> <b>Ira J. Lamel</b>	Director	February 27, 2019
<u>/s/ Dominic A. Romeo</u> <b>Dominic A. Romeo</b>	Director	February 27, 2019
<u>/s/ Thomas N. Secor</u> <b>Thomas N. Secor</b>	Director	February 27, 2019
<u>/s/ Lonny J. Carpenter</u> <b>Lonny J. Carpenter</b>	Director	February 27, 2019



## FACTORS AFFECTING FUTURE PERFORMANCE

Certain statements in this Annual Report are “forward looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 and are based on current expectations and assumptions that are subject to risks and uncertainties. All statements contained in this Annual Report that do not relate to matters of historical fact should be considered forward looking statements, and are generally identified by words such as “expect,” “intend,” “anticipate,” “believe,” “future,” “could,” “estimate,” “should,” “plan,” “aim,” and other similar expressions. These forward looking statements are neither promises nor guarantees, but involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward looking statements. Our actual results could differ materially from those anticipated in these forward looking statements for many reasons, including, but not limited to, the following: economic and political conditions and the effects of these conditions on our customers’ businesses and level of business activity; our significant dependence upon our customers’ capital expenditures, which are subject to cyclical market fluctuations; our dependence upon our ability to respond to fluctuations in product demand; our ability to continually innovate and successfully commercialize our innovations; failure to introduce new products in a timely manner; customer order timing and other similar factors beyond our control; disruptions or breaches in security of our information technology systems; our failure to comply with data privacy regulations; changes in interest rates, credit ratings or foreign currency exchange rates; risks associated with our operations in foreign countries; risks associated with increased outsourcing of components manufacturing; our exposure to increased tariffs, trade restrictions or taxes on our products; our failure to comply with local import and export regulations in the jurisdictions in which we operate; negative effects on global economic conditions, financial markets and our business as a result of the United Kingdom’s impending withdrawal from the European Union and the actions of the current U.S. government, including its policies on trade tariffs and reactions from other countries to any new tariffs imposed by the U.S.; violations of our intellectual property rights and our ability to protect our intellectual property against infringement by third parties; risk of losing our competitive advantage; our failure to successfully integrate recent and future acquisitions into our businesses; our ability to attract and retain key personnel; our restructuring and realignment activities and disruptions to our operations as a result of consolidation of our operations; product defects or problems integrating our products with other vendors’ products; disruptions in the supply of certain key components or other goods from our suppliers; production difficulties and product delivery delays or disruptions; our exposure to medical device regulation, which may impede or hinder the approval or sale of our products and, in some cases, may ultimately result in an inability to obtain approval of certain products or may result in the recall or seizure of previously approved products; changes in governmental regulation of our businesses or products; our failure to comply with environmental regulations; our failure to implement new information technology systems and software successfully; our failure to realize the full value of our intangible assets; our exposure to the credit risk of some of our customers and in weakened markets; our reliance on third party distribution channels; being subject to U.S. federal income taxation even though we are a non-U.S. corporation; tax audits by tax authorities; changes in tax laws, and fluctuations in our effective tax rates; anticipated impact from the U.S. Tax Cuts and Jobs Act; any need for additional capital to adequately respond to business challenges or opportunities and repay or refinance our existing indebtedness, which may not be available on acceptable terms or at all; our existing indebtedness limiting our ability to engage in certain activities; volatility in the market price for our common shares; our ability to access cash and other assets of our subsidiaries; provisions of our corporate documents that may delay or prevent a change in control; and our failure to maintain appropriate internal controls in the future.

These forward looking statements involve a number of risks, uncertainties, assumptions and other important factors that could affect future results and cause actual results and events to differ materially from historical and expected results and those expressed or implied in the forward looking statements. Among these important factors are the risks described in Item 1A of the Annual Report on Form 10-K for the year ended December 31, 2018 included in this Annual Report and in the Company’s filings with the Securities and Exchange Commission (the “SEC”) made after the date of the Annual Report on Form 10-K. Such statements are based on management’s beliefs and assumptions and on information currently available to the Company’s management. The Company disclaims any obligation to update any forward looking statements as a result of developments occurring after the date of this document except as required by law.

## FORM 10-K

This Annual Report to Shareholders includes a copy of our Annual Report on Form 10-K for the fiscal year ended December 31, 2018, excluding exhibits, as filed with the SEC and available through our website at <https://www.novanta.com>. We will, upon written request and payment of an appropriate processing fee, provide our shareholders with copies of the exhibits to our Annual Report on Form 10-K. Please address your request to Novanta Inc., 125 Middlesex Turnpike, Bedford, MA 01730, Attention: Investor Relations.

## RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

This Annual Report contains the non-GAAP financial measures of Adjusted EBITDA, Organic Revenue Growth and Adjusted Diluted EPS. A tabular reconciliation of these non-GAAP financial measures to the most comparable GAAP measures are set forth below.

### Adjusted EBITDA (Non-GAAP): <sup>(1)</sup>

	Year Ended December 31,	
	2018	2017
(in thousands of U.S. dollars)	(Unaudited)	(Unaudited)
<b>Consolidated Net Income (GAAP)</b>	\$ 51,095	\$ 62,307
Interest (income) expense, net	9,814	7,165
Income tax provision	10,207	13,827
Depreciation and amortization	37,052	30,758
Share-based compensation	7,647	5,493
Restructuring, acquisition and divestiture related costs	8,041	7,542
Acquisition fair value adjustments	—	4,754
Gain on acquisition of business	—	(26,409)
Other, net	(103)	676
<b>Adjusted EBITDA (non-GAAP)</b>	\$ 123,753	\$ 106,113
<b>Adjusted EBITDA Margin (non-GAAP)</b>	20.1%	20.4%

- (1) The Company defines Adjusted EBITDA as the consolidated net income before deducting interest (income) expense, income taxes, depreciation, amortization, non-cash share-based compensation, restructuring, acquisition and divestiture related costs, acquisition fair value adjustments, prior year gain on the Laser Quantum acquisition, other non-operating income (expense) items, including foreign exchange gains (losses), net periodic pension costs of the Company’s frozen U.K. defined benefit pension plan, and earnings from an equity-method investment. The Company defines Adjusted EBITDA Margin as Adjusted EBITDA as a percentage of Revenue. Management believes Adjusted EBITDA and Adjusted EBITDA Margin provide useful and supplementary information to investors regarding the operating results of the Company because of the significant changes that have occurred outside of the Company’s day-to-day business in accordance with the execution of the Company’s strategy. This strategy includes streamlining the Company’s existing operations through site and functional consolidations, strategic divestitures and product line closures, expanding the Company’s business through significant internal investments, and broadening the Company’s product and service offerings through acquisition of innovative and complementary technologies and solutions. The financial impact of certain elements of these activities, particularly acquisitions, divestitures, and site and functional restructurings, is often large relative to the Company’s overall financial performance and can adversely affect the comparability of its operating results and investors’ ability to analyze the business from period to period. Adjusted EBITDA is used by management to evaluate operating performance, communicate financial results to the Board of Directors, benchmark results against historical performance and the performance of peers, and evaluate investment opportunities, including acquisitions and divestitures. In addition, Adjusted EBITDA is used as one of the performance metrics to determine bonus payments for senior management and employees. Accordingly, the Company believes that these non-GAAP measures provide greater transparency and insight into management’s method of analysis. In evaluating Adjusted EBITDA, you should be aware that, in the future, the Company may incur expenses that are the same as, or similar to, some of the adjustments listed above. The presentation of Adjusted EBITDA should not be construed as an inference that future results will not be affected by unusual or non-recurring items.

**Organic Revenue Growth (Non-GAAP):** <sup>(1)</sup>

	Year Ended December 31, 2018 Compared to Year Ended December 31, 2017
	(Unaudited)
<b>Reported Revenue Growth (GAAP)</b>	17.8%
Less: Change attributable to acquisitions	10.2%
Plus: Change due to foreign currency	(0.6)%
<b>Organic Revenue Growth (non-GAAP)</b>	7.0%

- (1) The Company defines the term "Organic Revenue" as revenue excluding the impact from business acquisitions, divestitures, product line discontinuations, and the effect of foreign currency translation. The Company uses the related term "Organic Revenue Growth" to refer to the financial performance metric of comparing current period Organic Revenue with the reported revenue of the corresponding period in the prior year. The Company believes that this non-GAAP measure, when taken together with our GAAP financial measures, allows the Company and its investors to better measure the Company's performance and evaluate long-term performance trends. Organic Revenue Growth also facilitates easier comparisons of the Company's performance with prior and future periods and relative comparisons to its peers. The Company excludes the effect of foreign currency translation from these measures because foreign currency translation is subject to volatility and can obscure underlying business trends. The Company excludes the effect of acquisitions and divestitures because these activities can vary dramatically between reporting periods and between the Company and its peers, which the Company believes makes comparisons of long-term performance trends difficult for management and investors. Organic Revenue Growth is also used as a performance metric to determine bonus payments for senior management and employees.

**Adjusted Diluted EPS (Non-GAAP):** <sup>(1)</sup>

	Year Ended December 31,	
	2018	2017
	(Unaudited)	(Unaudited)
(in thousands of U.S. dollars except for per share amounts)		
<b>Net income attributable to Novanta Inc. (GAAP)</b>	\$ 49,109	\$ 60,051
Less: Redeemable noncontrolling interest redemption value adjustment	1,781	(20,244)
Net income attributable to Novanta Inc. after adjustment for redeemable noncontrolling interest redemption value	\$ 50,890	\$ 39,807
<b>Diluted EPS (GAAP)</b>	\$ 1.43	\$ 1.13
Redeemable noncontrolling interest redemption value adjustment <sup>(2)</sup>	(1,781)	20,244
<b>Net income attributable to Novanta Inc.</b>	\$ 49,109	\$ 60,051
Non-GAAP adjustments:		
Amortization of intangible assets <sup>(3)</sup>	25,610	20,920
Restructuring, acquisition, and divestiture related costs <sup>(4)</sup>	8,041	7,542
Acquisition fair value adjustment <sup>(5)</sup>	—	4,754
Gain on acquisition of business <sup>(5)</sup>	—	(26,409)
<b>Total Non-GAAP adjustments before income taxes</b>	<b>33,651</b>	<b>6,807</b>
Tax effect of non-GAAP adjustments <sup>(6)</sup>	(5,920)	(9,641)
<b>Non-GAAP tax adjustments <sup>(6)</sup></b>	<b>(377)</b>	<b>(759)</b>
<b>Adjusted net income attributable to Novanta Inc. (non-GAAP)</b>	<b>\$ 76,463</b>	<b>\$ 56,458</b>
<b>Adjusted Diluted EPS (non-GAAP)</b>	<b>\$ 2.16</b>	<b>\$ 1.60</b>
<b>Weighted-average shares outstanding - Diluted</b>	<b>35,473</b>	<b>35,280</b>

- (1) Management believes Adjusted Diluted EPS provides useful and supplementary information to investors regarding the operating results of the Company because Adjusted Diluted EPS is used by management to evaluate operating performance, communicate financial results to the Board of Directors, and benchmark results against historical performance and the performance of peers. The Company also uses Adjusted Diluted EPS as a measurement for performance shares issued to certain executives. Accordingly, the Company believes this non-GAAP measure provides greater transparency and insight into management's method of analysis. In evaluating Adjusted Diluted EPS, you should be aware that in the future the Company may incur expenses that are the same as, or similar to, some of the adjustments listed above.
- (2) Adjustments for changes in estimated redemption value of redeemable noncontrolling interest are excluded from the calculation of Adjusted Diluted EPS because the amounts are noncash and are not part of the consolidated statement of operations.
- (3) Amortization of acquired intangible assets and acquisition fair value adjustments are excluded from Adjusted Diluted EPS because (i) these amounts are non-cash; (ii) the Company cannot influence the timing and amount of future expense recognition; and (iii) excluding such expense provides investors and management better visibility into the components of operating costs.
- (4) These amounts relate to the Company's restructuring programs, business acquisitions, divestitures and related activities. Such expenses are excluded from the calculation of Adjusted Diluted EPS due to the significant changes that have occurred outside of the Company's day-to-day business as a result of the execution of the Company's strategy. The financial impact of certain elements of these activities, particularly acquisitions, divestitures, and site and functional restructurings, is often large relative to the Company's overall financial performance and can adversely affect the comparability of its operating results and investors' ability to analyze the business from period to period.
- (5) The amount relates to the gain recognized upon gaining control of Laser Quantum in January 2017 as a result of acquiring an additional approximately 35% of its outstanding shares because the gain is unusual and nonrecurring in nature and should be excluded from the assessment of long-term performance trends of the Company.
- (6) The Company excluded significant discrete income tax expenses (benefits) related to releases of valuation allowances, benefits or expenses associated with the completion of tax audits, effects of changes in tax laws, effects of acquisition related tax planning actions on our effective tax rate, and the income tax effect of non-GAAP adjustments above.

Non-GAAP financial measures should not be considered as substitutes for, or superior to, measures of financial performance prepared in accordance with GAAP. They are limited in value because they exclude charges that have a material effect on the Company's reported results and, therefore, should not be relied upon as the sole financial measures to evaluate the Company's financial results. The non-GAAP financial measures are meant to supplement, and to be viewed in conjunction with, GAAP financial measures.



## CORPORATE INFORMATION

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### EXECUTIVE OFFICERS

Matthijs Glastra  
Chief Executive Officer and Director

Robert J. Buckley  
Chief Financial Officer

Brian S. Young  
Chief Human Resources Officer

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### BOARD OF DIRECTORS

Stephen W. Bershad  
Chairman of the Board, Novanta Inc.

Lonny J. Carpenter  
Former Group President, Stryker Corporation

Matthijs Glastra  
Chief Executive Officer, Novanta Inc.

Brian D. King  
President and Chief Executive Officer, Viant Medical, LLC

Ira J. Lamel  
Former Executive Vice President and Chief Financial Officer, The Hain Celestial Group, Inc.

Dominic A. Romeo  
Former Senior Vice President and Chief Financial Officer, Thor Industries, Inc.

Thomas N. Secor  
Managing Director, Morningside Heights Capital, an investment firm

## SHAREHOLDER INFORMATION

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### CORPORATE HEADQUARTERS

Novanta Inc.  
125 Middlesex Turnpike  
Bedford, MA 01730  
Phone: 1-781-266-5700  
Fax: 1-781-266-5114

### WEBSITE

<https://www.novanta.com>

### ANNUAL MEETING

Thursday, May 9, 2019 at 2:00 p.m. (ET) at  
Latham & Watkins LLP, 885 Third Avenue, 12<sup>th</sup> Floor,  
New York, New York 10022

An Annual Report, a Management Proxy Circular and a form of Proxy will be furnished to each shareholder as of the record date of March 29, 2019.

### AUDITORS

PricewaterhouseCoopers LLP  
101 Seaport Boulevard  
Boston, MA 02210

### TRANSFER AGENT

Computershare Investor Services

100 University Ave.  
8th Floor, North Tower  
Toronto, Ontario, M5J 2Y1, Canada  
Phone: 1-800-564-6253 or 514-982-7555  
Fax: 1-888-453-0330  
[service@computershare.com](mailto:service@computershare.com)

### STOCK EXCHANGE

Novanta Inc.'s common shares are listed and traded on the Nasdaq Global Select Market under the ticker symbol "NOVT".

**Novanta Inc.**  
125 Middlesex Turnpike  
Bedford, Massachusetts 01730  
Phone: 781-266-5700  
[www.novanta.com](http://www.novanta.com)