

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

(Mark one)

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

For the fiscal year ended **December 31, 2016**.

**OR**

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

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

Commission file number: **0-21918**

**FLIR Systems, Inc.**

(Exact name of registrant as specified in its charter)

**Oregon**

(State or other jurisdiction of incorporation or organization)

**93-0708501**

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

**27700 SW Parkway Avenue, Wilsonville, Oregon**

(Address of principal executive offices)

**97070**

(Zip code)

Registrant's telephone number, including area code: **(503) 498-3547**

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

| <u>Title of Each Class</u>     | <u>Name of Each Exchange<br/>on Which Registered</u> |
|--------------------------------|--|
| Common Stock, \$0.01 par value | 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 Section 15(d) of the Act. Yes  No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

As of June 30, 2016, the aggregate market value of the shares of voting and non-voting stock of the registrant held by non-affiliates was \$4,212,638,793.

As of February 17, 2017, there were 136,344,186 shares of the registrant's common stock, \$0.01 par value, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE:**

The registrant has incorporated by reference into Part III of this Form 10-K, portions of its Proxy Statement for its 2017 Annual Meeting of Shareholders.

**FLIR Systems, Inc.**  
**FORM 10-K**  
**ANNUAL REPORT**  
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## Forward-Looking Statements

*This Annual Report on Form 10-K (the "Report"), including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 regarding future events and the future results of FLIR Systems, Inc. and its consolidated subsidiaries ("FLIR" or the "Company") that are based on management's current expectations, estimates, projections and assumptions about the Company's business. Words such as "expects," "anticipates," "intends," "plans," "believes," "sees," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors including, but not limited to, those discussed in "Risk Factors" in Item 1A, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7, and elsewhere in this Report as well as those discussed from time to time in the Company's other Securities and Exchange Commission filings and reports. In addition, such statements could be affected by general industry, economic and market conditions. Such forward-looking statements speak only as of the date of this Report or, in the case of any document incorporated by reference, the date of that document, and the Company does not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Report, or for changes made to this document by wire services or Internet service providers. If the Company updates or corrects one or more forward-looking statements, investors and others should not conclude that the Company will make additional updates or corrections with respect to other forward-looking statements.*

## PART I

### ITEM 1. BUSINESS

#### GENERAL

FLIR Systems, Inc. ("FLIR," the "Company," "we," "us," or "our") is a world leader in developing technologies that enhance perception and awareness. We design, develop, market, and distribute solutions that detect people, objects and substances that may not be perceived by human senses and improve the way people interact with the world around them. We bring these innovative technologies - which include thermal imaging systems, visible-light imaging systems, locater systems, measurement and diagnostic systems, and advanced threat-detection solutions - into daily life.

Founded in 1978, FLIR is a pioneer in advanced sensors and integrated sensor systems that enable the gathering, measurement, and analysis of critical information through a wide variety of applications in commercial, industrial, government, and consumer markets worldwide. We offer the broadest range of infrared, also known as thermal, imaging solutions in the world, with products that range from consumer-use thermal camera smartphone accessories to highly advanced aircraft-mounted imaging systems for military and search and rescue applications, with products in between serving a multitude of markets, customers, and applications. As the cost of thermal imaging technology has declined, our opportunities to increase the adoption of thermal technology and create new markets for the technology have expanded. In order to better serve the customers in these markets, we have augmented our thermal product offerings with complementary sensing technologies, such as visible imaging, radar, laser, sonar, chemical sensing, and environmental sensing technologies.

Our goal is to both enable our customers to benefit from the valuable information produced by advanced sensing technologies and to deliver sustained superior financial performance for our shareholders. We create value for our customers by improving personal and public safety and security, providing advanced intelligence, surveillance, reconnaissance, and tactical defense capabilities, facilitating air, ground, and maritime-based situational awareness, enhancing enjoyment of the outdoors, detecting electrical, mechanical and building envelope problems, displaying process irregularities, detecting volatile organic gas emissions, and a variety of other uses of thermal and other sensing technologies.

Our business model and range of solutions allow FLIR to sell products to various end markets, including industrial, original equipment manufacturing ("OEM"), military, homeland security, enterprise, infrastructure, environmental, and consumer. We sell off-the-shelf products in configurations to suit specific customer requirements in an efficient, timely, and affordable manner, and support those customers with training and ongoing support and services. Centered on the design of products for low-cost manufacturing and high-volume distribution, our commercial operating model has been developed over time and provides us with

a unique ability to adapt to market changes and meet our customers' needs. Because we aggregate product demand and production across these markets, we are able to generate significant volume - this volume drives down cost, which then increases demand, enabling a virtuous cycle of lower prices and higher unit volumes. Our manufacturing and supply processes are vertically integrated, minimizing lead times, facilitating prompt delivery, controlling costs and ensuring that components satisfy our high quality standards.

We have evolved our product suite over time, expanding our reach into markets that are adjacent to thermal imaging, with the intent of expanding the adoption and channel development for thermal imaging technology. Examples of this evolution include our entrance into the visible-image security and surveillance market, the maritime electronics market, the industrial machine vision market, and the traffic monitoring and signal control market. We intend to continue this evolution as we continue to lower the cost of advanced sensing products. As the cost to own thermal technology continues to decline, the application of these sensors is expanding beyond imaging to areas such as data acquisition where thermal sensors can provide important data that can be used for a wide variety of applications.

We believe that FLIR's brand is known for quality, innovation and trust and that customers are drawn to us for products and solutions that are effective, innovative, easy to use, and sold at competitive market prices. We intend to: continue to reduce the cost of thermal technology through higher volumes and new product and process improvements; innovate new applications and form-factors for our technology based on customer feedback; improve the customer experience through improved user-interface, ease-of-use, and software; increase customer loyalty and trust by providing world-class product warranties and support; and improve operational processes to realign resources to be nimble in response to customers' needs and market trends.

We are organized into the following six operating segments:

**Surveillance:** The Surveillance segment provides enhanced imaging and recognition solutions under our commercially developed, military qualified ("CDMQ®") model to a wide variety of military, law enforcement, public safety, and other government customers around the world for the protection of borders, troops, and public welfare. Surveillance also develops hand-held and weapon-mounted thermal imaging systems for use by consumers. These products are sold off-the-shelf or can be customized for specific applications and range in price from under \$1,000 for certain hand-held and weapon-mounted systems to over \$1 million for our most advanced stabilized multi-spectral targeting systems. Revenue from Surveillance was \$532.5 million in 2016, which represented approximately 33 percent of consolidated revenue.

**Instruments:** The Instruments segment provides devices that image, measure, and assess thermal energy, gases, electricity, and other environmental elements for industrial, commercial, and scientific applications under the FLIR and Extech brands. These tools are used by professionals in electrical and mechanical, building envelope, manufacturing plant facility maintenance, petrochemical, utilities, HVAC/R, firefighting, safety and health, and a variety of other sectors. Revenue from Instruments was \$336.1 million in 2016, which represented approximately 20 percent of consolidated revenue.

**Security:** The Security segment develops and manufactures a wide spectrum of cameras and video recording systems for use in commercial, critical infrastructure, and home monitoring applications. The segment sells products under the FLIR and Lorex brands. Revenue from Security was \$240.0 million in 2016, which represented approximately 14 percent of consolidated revenue.

**OEM & Emerging Markets:** The OEM & Emerging Markets segment provides thermal and visible-spectrum imaging camera cores and components that are utilized by third parties to create thermal, industrial, and other types of imaging systems. This segment also houses our emerging businesses, including intelligent traffic systems, imaging solutions for the smartphone and mobile devices market, and thermal imaging solutions for commercial-use unmanned aerial systems ("UAS"). Revenue from OEM & Emerging Markets was \$243.7 million in 2016, which represented approximately 15 percent of consolidated revenue.

**Maritime:** The Maritime segment develops and manufactures electronics and imaging instruments for the recreational and commercial maritime market under the FLIR and Raymarine brands. The segment provides boats of all sizes a full suite of electronic instruments, control systems, and communications equipment. Revenue from Maritime was \$185.7 million in 2016, which represented approximately 11 percent of consolidated revenue.

**Detection:** The Detection segment offers sensors, instruments, and integrated platform solutions for the detection, identification, and suppression of chemical, biological, radiological, nuclear, and explosives ("CBRNE") threats for military force protection, homeland security, first responders, and commercial applications. Detection has strengths in understanding the nature of sophisticated security threats, the technological potential of advanced detection instruments and systems, and the complex

procurement processes of United States and many international government customers. Revenue from Detection was \$124.1 million in 2016, which represented 7 percent of consolidated revenue.

For additional information concerning the Company's segments, including revenues from external customers, earnings from operations, and total assets by segment presented in accordance with our segment structure, see Note 17 to the Consolidated Financial Statements in Item 8.

Our headquarters are located at 27700 SW Parkway Avenue, Wilsonville, Oregon, 97070, and the telephone number at this location is (503) 498-3547. Information about the Company is available on our website at [www.flir.com](http://www.flir.com).

## **TECHNOLOGY AND CAPABILITIES**

Infrared is a portion of the electromagnetic spectrum that is adjacent to the visible spectrum but is invisible to the human eye due to its longer wavelengths. Unlike visible light, infrared radiation (or heat) is emitted directly by all objects above absolute zero in temperature. Thermal imaging systems detect this infrared radiation and convert it into an electronic signal, which is then processed into a video signal and displayed on a video screen. Thermal sensors provide several benefits over ubiquitous visible light-based sensing technologies, including the ability to see in complete darkness, measure temperature remotely and without touching the surface of the object, image through obscurants such as smoke and fog, detect and discriminate living beings in an efficient and reliable way, see over long distances with minimal atmospheric interference, and image many types of otherwise invisible gases. For these reasons we feel the potential of our core technology to grow in prevalence and importance is significant, particularly as the cost to produce the technology continues to decline.

Thermal imaging systems are different than other types of "low light" night vision systems, such as visible light intensification systems used in green or gray sighted night vision goggles, because thermal imaging systems are not adversely affected by the presence of visible light, so they can be used day or night and are not susceptible to rapid changes in visible light levels. Thermal imaging systems are particularly well-suited for security applications involving the early detection of human activity due to the typically large temperature difference found between a human and the surrounding background. Since infrared systems are detecting emitted infrared radiation, they are passive - and thus more covert than certain "active" or "illuminated" infrared systems. Additionally, thermal imaging systems have the ability to measure absolute temperatures remotely, a critical feature for a variety of commercial, industrial, and scientific applications.

An infrared detector, which collects or absorbs infrared radiation and converts it into an electronic signal, is the primary component of thermal imaging systems. The two types of infrared detectors we manufacture and use in our systems are often referred to as "cooled" and "uncooled" detectors. Cooled detectors utilize a mechanical sterling cycle micro-cooler to reduce the operating temperature of the infrared sensor to approximately -200°C. These detectors offer very high sensitivity and spatial resolution for long-range applications or those applications requiring high measurement precision. Cooled detectors, while more sensitive and thus able to see farther, result in a product that is more expensive, heavier, more complex, and uses more power than those using uncooled detectors. Uncooled detectors operate at room temperature and do not require a micro-cooler, resulting in products that are lighter, use less power and are less expensive to produce than those using cooled detectors. The cost of both types of detectors is declining, and we expect to continue reducing costs as volumes rise and the technology advances.

We have expertise in the calibration and repair of our products, and maintain service facilities at many locations worldwide. Each of our service facilities have the capability to perform the complex calibrations required to service thermal imaging systems. We also maintain field service capabilities under the direction of our independent representatives or distributors in certain locations outside the United States.

As our customers have sought, and will continue to seek, new ways to address their needs and requirements in the most cost-effective and efficient manner, we have integrated thermal imaging with complementary technologies such as visible imaging, lasers, radar, and more. The following capabilities and disciplines are integrated into our business and processes:

### *System Design and Integration*

We have developed extensive competencies in the design and integration of numerous capabilities and payloads into integrated systems or sub-systems. Competencies such as stabilization, packaging and systems integration allow us to effectively combine

a wide variety of technologies and payloads to suit our customers' needs. We strive to minimize the size, weight, power consumption, and cost in each of our product designs.

#### *Radiometry*

Our ability to produce thermal imaging systems that can accurately measure temperature remotely is critical in many of our Instruments segment markets. We have demonstrated know-how in designing and producing systems that can measure temperature to within very precise tolerances while maintaining accuracy and stability over time and over a wide range of ambient temperatures. We believe our skills in this area, known as thermal radiometry, offer an important competitive advantage over many of our competitors.

#### *Mechanical Engineering*

The design and production of thermal imaging systems involves highly sophisticated mechanical engineering techniques, particularly in the design and assembly of the supporting structures for system components such as detector arrays, micro-coolers, and optics. We also have expertise in designing stabilized assemblies used in our gimbal-mounted products utilizing precise electro-mechanical control, gyroscopes, electronic stabilization, and specialized optical control mechanisms. Also, through our 2016 acquisition of Prox Dynamics, we develop and manufacture nano-class UAS that are specifically designed to be man-portable and highly covert surveillance and reconnaissance sensors.

#### *Infrared Detector Design Manufacturing*

We design and manufacture both cooled and uncooled infrared detector arrays, in high volumes and at low costs. We believe our uncooled vanadium oxide microbolometers and cooled detectors using indium antimonide and indium gallium arsenide are among the highest performing infrared detectors of their type available in the world. Internal design and manufacturing of these detectors provides significant cost and engineering advantages compared with the use of external sources.

#### *Integrated Circuits and Electronic Design*

We have significant electronic design capabilities across several specialized areas, including readout-integrated circuit design, signal processing, image processing, and electronics integration. Our design expertise lies in the areas of reliability, low power consumption, and extreme environmental survivability.

#### *Software Development*

Software is an increasingly important aspect of our overall engineering and design activity. We offer networking capabilities, video analytics, command and control, and advanced firmware in our camera and other sensing systems. Many of our products are supported by a software eco-system that includes dedicated desktop and mobile platform applications. Our products are typically developed with broad compatibility with common industry standards and protocols.

#### *Optical Design, Fabrication and Coating*

We design and manufacture sophisticated infrared optics using materials such as silicon, germanium, and zinc selenide that are required to produce a thermal imaging system. This capability allows us to rapidly develop optics optimized for use with our cameras and avoid costs and delays associated with reliance on third-party optics suppliers. We also have the capability to produce silicon wafer-level micro-optics at high volumes and the ability to apply custom multi-layer, vapor-deposited coatings to improve the transmission of the lens materials that are used in infrared systems.

#### *Micro-Coolers*

We manufacture some of the industry's smallest, lightest, and lowest power micro-coolers for use in cooling infrared detectors. Our coolers are especially effective in hand-held applications, where light weight and long battery life are essential.

### *Lasers and Laser Components*

Many of our more sophisticated systems are increasingly being offered with various types of laser payloads, including pointers, illuminators, rangefinders, and designators. We design and manufacture purpose-built laser rangefinders and designators for inclusion in some of our gimballed multi-sensor systems. We also manufacture certain laser-related materials and components for external customers.

### *Tactical Platforms*

We develop and manufacture comprehensive and integrated solutions for surveillance, assessment, and response. These platform solutions draw from our Surveillance and Detection products, as well as products sourced outside of the Company. These unmanned and manned networkable mobile and vehicle mounted systems can be deployed in nearly any environment and have provided security at borders, at theme parks, for police and military forces, at national monuments, and at high-profile events, both in the United States and internationally.

## **RESEARCH & DEVELOPMENT**

Our success has been and will continue to be substantially affected by our ability to innovate new products and technologies that both augment our existing offerings and create new avenues for growth. We strive to differentiate ourselves from our competition with our research and development ("R&D") capabilities. Our internally funded R&D expenses were \$147.5 million, \$132.9 million, and \$142.8 million in 2016, 2015 and 2014, respectively. We intend to continue to have significant internal R&D expenses in the future to provide a continuing flow of innovative and high-quality products to maintain and enhance our competitive position in each of our business segments. In addition to these internally funded activities, we engage in R&D projects that were reimbursed by government agencies or prime contractors pursuant to development contracts we undertook. We believe our R&D capabilities are most efficiently deployed in a commercial environment, where we are free to innovate to meet market and customer needs, as such, the amount of externally funded R&D work that we undertake has been declining.

## **COMPETITIVE STRENGTHS**

With our decades of experience in developing and marketing infrared sensor products, we have built several unique competitive advantages that are core to our success. We look to leverage these strengths to continue to increase the availability of and uses for advanced sensing technologies and to grow our revenue and profitability:

### *Commercial Operating Model*

A key differentiator of our business model is our commercial approach to technology investment and product strategy. This is characterized by our commercial approach to R&D as described above, as well as our focus on global deployment, innovative marketing communications, superior customer service, rapid product development cycles, innovation of new technologies and unique products, ability to design for large-volume and low-cost production, and control of multiple production inputs through our vertically integrated operations.

### *Vertically Integrated Manufacturing and Supply*

We have built a vertically integrated manufacturing operation that provides control over several key component technologies. Through acquisitions and internal development, we have created this internal supply network that allows for optimized manufacturing throughput, rapid response to changes in customer demand, increased product design flexibility, enhanced product reliability, and independence in designing key components. Further, this integrated approach enables us to lower costs and improve the functionality of critical components so that they work together most efficiently within our products. In comparison to competitors that do not possess a similar level of vertical integration, our model helps us deliver products in a more timely and cost-effective manner as we rely less on third-party suppliers for critical components.

### *Industry-Leading Market Position*

We are a leading developer of advanced, proprietary sensor systems that are highly reliable, accurate, and effective. We strive to develop products that lead in the areas of Size, Weight, Power and Cost ("SWAP-c"). We believe we have achieved significant

penetration into many markets, including the government, industrial, commercial, and consumer markets by pioneering new applications and being a "first-mover" in these markets. Having a leading position in the markets we serve allows us to secure new and continuing business while also achieving manufacturing economies of scale. Increased unit volumes work to reduce costs throughout our business, which allows us to create new products that feature lower price points. This creates a virtuous cycle whereby we are able to make advanced sensor technologies more affordable to a wide array of end-users while reducing costs. This established presence across multiple markets enhances our competitive position.

#### *Broad Product Lines*

We offer a wide array of sensor products, including infrared imaging cameras and systems, detector cores, visible-light cameras, CBRNE threat detectors, test and measurement instruments, radars, maritime electronics, and related products and solutions. Our customers can buy these products off the shelf or request a customized sensor solution. This ability to serve a variety of customers with disparate needs and specifications allows us to be successful in facilitating the use of advanced sensors in a broad range of applications. We have the ability to rapidly conceive, design, prototype, and manufacture new products to meet the evolving landscapes of the markets we serve. Our development process incorporates significant customer satisfaction and field-use data and results in the rapid creation of new features that are able to address the changing needs of the end-user. This continual evolution of our products has proven successful through our high level of customer retention and revenue and income growth.

#### *Internally Funded Innovation*

We have expertise in developing sensing instruments that are both highly advanced from a technical standpoint and commercially viable and salable across multiple types of customers. Since the beginning of 2012, we have invested \$703.4 million in internally funded research and development of new technologies and products. Utilizing our own funds for R&D provides us with full ownership of the development process and the end product, and also focuses our R&D teams on projects that will result in products that are commercially viable, yield the highest expected financial return and can be marketed to multiple markets for multiple applications.

#### *Diverse Customer Base*

We sell our products to thousands of commercial and government customers for use in a variety of applications and markets worldwide. The buyers and users of our products include United States and foreign governments and government agencies, aerospace and defense contractors, electricians and tradesmen, commercial seaports, first responders, critical infrastructure operators, electrical generation and gas processing plants, heating and air conditioning technicians, building inspectors, food processors, automobile parts manufacturers, commercial and residential security providers, research and lab technicians, manufacturing companies, recreational boaters, and general commercial consumers. We believe that the diversity of our customers, end-user markets, and applications helps to mitigate fluctuations in demand from any particular customer or market. The diversity of our customers and of the end-users of sensor technologies provides us with multiple long-term growth opportunities.

#### *Global Distribution Capabilities*

Our core infrared imaging products have expanded from high-end products sold primarily to military customers and niche research firms to everyday tools providing valuable information-gathering and assessment capabilities for a multitude of industrial, government, and commercial entities and consumers. With the widening adoption of these technologies, distribution has become a key advantage to our business globally. We believe our sales and distribution organization is among the largest in the industry and effectively covers the world with a combination of direct sales, third-party representatives and distributors, independent dealers, retail outlets, application engineers, and service and training centers. Internationally, we have invested heavily to build a strong presence to sell and service our products, a key advantage in penetrating certain markets, such as foreign governments. Our sales representatives, including third-party distributors, undergo a comprehensive training program on each product's technical specifications, functions, and applications. We also continuously update our training programs to incorporate technological and competitive shifts and changes. We sell in many distinct markets and have established specific sales channels for each market. We intend to continue to expand this distribution platform through internal growth and external acquisitions.

#### *Investment in Research and Development and Intellectual Property Platform*

We have invested heavily in R&D, resulting in industry-leading innovations and a robust and growing patent portfolio that is focused on our core technologies as well as many of our emerging technologies and businesses. To complement our patent portfolio,



we continue to strengthen our key brands by unifying critical design features across product lines, enhancing our worldwide trademark coverage, refining our domain portfolio, and growing brand awareness through social media outlets.

#### *Consistent Generation and Distribution of Cash Flows*

Our earnings, combined with our modest capital expenditure requirements, result in the generation of significant free cash flows. In the years ended December 31, 2016 and 2015, our net cash provided by operating activities was \$312.3 million and \$275.8 million, respectively. Our operating cash flows have exceeded our net earnings in each of the last five years. This ability to consistently convert revenues into net operating cash provides us significant flexibility in making growth and capital deployment decisions, such as consummating strategic acquisitions, undertaking new product and technology development initiatives, expanding our distribution and marketing presence, making capital investments, paying dividends, and repurchasing shares of our common stock in the open market. Since 2012, we have utilized approximately \$637.4 million of cash for acquisitions, \$704.8 million for share repurchases, \$277.7 million for dividends, and \$275.6 million for capital expenditures. Since we began paying dividends in 2011, we have annually increased our dividend at a compound annual growth rate of approximately 15 percent.

## **STRATEGY**

Our clear and consistent strategy has enabled strong and steady business performance while allowing expansion into areas of growth. We look to build on our leading position in advanced sensor systems by leveraging our key competitive strengths through a focused corporate strategy that will yield growth in both revenue and profitability. Key elements of the FLIR growth strategy include:

#### *Control the corners*

We seek to have strong positions in both the entry-level and high-performance price points in each market we serve. We believe this will provide us with the ability to innovate solutions throughout the full solution spectrum of each market and sell products for the broadest customer base in the market. We believe this approach has created a significant competitive advantage for many of our businesses. Our focus will remain on continuous cost reduction of sensor technology, innovative next-generation solutions for evolving customer needs, and creating virtuous cycles of demand across all of our markets.

#### *Lower costs, increase awareness*

We strive to aggressively lower the cost and increase awareness of thermal sensor technology to enable our approach to high-volume markets. The price and awareness of thermal technology have been and continue to be the barriers to broad adoption. By increasing the awareness of thermal imaging, through thoughtful and impactful marketing and solution design, we believe our customers will recognize the benefits of thermal sensing and, as prices decline, recognize the value proposition of infrared technology.

#### *Identify needs*

We consistently look to identify customers' needs that can be solved by our capabilities. When we identify such a market need, we invest in research, distribution, product development, and staffing to create the best product solution and most efficient go-to-market strategy. This has allowed us to pioneer several new markets for thermal imaging. Our experience in finding and building these new markets has allowed us to create a repeatable system for continuing to expand the uses and demand for advanced sensor-based technologies.

#### *Brand, distribution, and innovation*

We intend to grow the size and our share of the markets we participate in as well as develop markets for our technology that do not currently exist through a strong brand, broad distribution, and highly innovative products and solutions. We invest in brand development to support our goal of being the top brand in thermal sensing, and intend to expand our brand power into new arenas. We have developed and utilize both our own distribution infrastructure and that of hundreds of partners, resulting in a diverse, efficient, and effective platform for selling and delivering our products. We also leverage a strong innovation engine, built from a talented and driven employee base and a willingness to invest in high-return opportunities, to create valuable intellectual property and cutting-edge products.

### *Build trust*

We believe trust is our most valuable asset. We focus on building trust with stakeholders - including current and future customers, shareholders, employees, and our communities. We build that trust by operating on an uncompromising foundation of ethical behavior and producing products that deliver a differentiated value proposition to our customers. We also build trust by maintaining an effective and open line of communication with our employees, stakeholders, and community members.

### *Financial discipline*

We intend to continue to operate with financial discipline in order to create value for our stakeholders. We believe that the cornerstones to financial discipline are revenue and profit growth. We are focused on growing our top-line revenues and converting that to profits for bottom-line growth. We also intend to focus on continuous improvement through creating process efficiencies, building operational scale, and utilizing robust financial controls. We believe that these factors will ultimately generate superior long-term returns on investment for our shareholders.

## **BUSINESS SEGMENTS**

### **Surveillance Segment**

The Surveillance segment develops and manufactures enhanced imaging and situational awareness solutions for a wide variety of military, law enforcement, public safety, and other government entities around the world. The segment also develops and sells hand-held and mounted scopes for consumers in the hunting and outdoors markets. Our solutions are used to protect borders, surveil a scene, conduct search and rescue missions, gather intelligence, and protect critical infrastructure by providing the capability to see over long distances, day or night, through adverse weather conditions, through many obscurants, and from a wide variety of vehicle, man-portable, and fixed-installation platforms.

Surveillance infrared imaging systems typically employ cooled infrared detector and numerous other imaging technologies to identify and track objects from long distances and at high resolution. The Surveillance segment also utilizes uncooled thermal technology to enable markets where size, weight, power consumption, and cost are important considerations. Uncooled Surveillance segment products include hand-held and tripod-mount monoculars and binoculars, weapon sights, man-portable UAS, and military-vehicle vision systems. We also design and manufacture lasers and laser components, such as rangefinders, illuminators, and target markers.

Our customers require systems that operate in demanding environments such as extreme climatic conditions, battlefield and military environments, or maritime conditions. Systems are often installed onto larger platforms and must be able to integrate with other systems such as aircraft avionics, radars, remote weapon systems, laser systems, command and control centers, and large, broad-based security networks.

We address our core markets through either a commercial, off-the-shelf ("COTS") model or CDMQ model. The products we develop under the COTS model are applicable to a range of commercial and government customers and markets, including military applications. CDMQ products are specifically designed to meet military specifications. In both the COTS and CDMQ product development models, we use internally generated funds for research and development, and we generally own all rights to the products and their design.

### **Markets**

#### **Search and rescue**

Thermal imaging systems are used in airborne, shipborne, and land-based missions to rescue individuals in danger, distress, or who are wounded or lost in adverse conditions. These systems are in use today by organizations such as the United States Army, United States Air Force, United States Coast Guard, United States Marine Corps, United States Air National Guard, and many international customers.

#### **Force protection**

In instances where military or other personnel are deployed in hostile areas, thermal imaging systems and radars mounted on towers or other platforms are deployed to detect, identify, and defeat potential threats at an early stage. Our systems are deployed for this purpose by the United States Army, United States Marine Corps, and other organizations worldwide.

**Border and maritime patrol**

Our systems are used in airborne, shipborne, hand-held and fixed-installation applications for border and maritime surveillance, particularly at night, to enforce borders and monitor coastal waters, to support national fishing boundaries and to prevent smuggling. Our cameras are currently deployed along numerous borders worldwide, including in the United States, Europe, and the Middle East.

**Surveillance and reconnaissance**

High-definition thermal imaging systems are used in surveillance and reconnaissance applications for the precise positioning of objects or people from substantial distances and for enhanced situational awareness, particularly at night or in conditions of reduced or obscured visibility. We also offer high-resolution, frequency-modulated, continuous-wave radars that enable wide-area surveillance capable of detecting potential threats before they cross a perimeter. These systems can be installed on fixed platforms, manned-mobile platforms, and UAS. And with our acquisition of Prox Dynamics in 2016, we develop and sell nano-class UAS solutions that are highly portable and rapidly deployable real-time imaging solutions.

**Airborne law enforcement**

We are a leader in the supply of stabilized airborne thermal imaging systems for federal, state, and local law enforcement agencies. This type of equipment gives those agencies the ability to track suspects, locate lost persons, and provide situational awareness to officers on the ground.

**Targeting**

We offer several products that provide precise target location and designation capabilities in applications ranging from man-portable devices to high-definition, multi-spectral, stabilized airborne laser designator systems.

**Drug interdiction**

Thermal imaging systems enable government agencies to expand their drug interdiction and support activities by allowing 24/7 wide-area surveillance and detection capabilities. Our systems are in use by the United States Customs Service, United States Drug Enforcement Agency and United States Federal Bureau of Investigation, as well as by similar foreign government agencies.

**Personal vision**

We develop easy to use, affordable, and lightweight personal vision thermal and image-intensified cameras, such as monoculars and hunting scopes, that provide people the ability to see at night and stay safe in various settings. They enhance people's enjoyment of the outdoors by enabling them to keep track of their camping party, see and track animals, and navigate during deteriorated weather conditions. We believe the personal vision systems market is very large and is becoming increasingly accessible as we reduce the price of advanced thermal imaging products.

***Sales and Distribution***

Our Surveillance business has a direct sales staff and a network of independent representatives and distributors covering major government markets worldwide. Included in this organization are technical and customer support staff in the United States, Europe, the Middle East, and Asia Pacific regions who provide application development, technical training, and operational assistance to direct and indirect sales personnel as well as to customers.

The Surveillance segment typically has the highest backlog of our segments relative to revenue and in absolute terms. At December 31, 2016, the Surveillance segment had a total backlog of \$328 million. Backlog represents orders that have been received for products, contract research and development, or other services for which a contractual agreement is in place and delivery or performance is expected to occur within 12 months.

***Customers***

Surveillance segment customers generally consist of United States and foreign government agencies, including civilian, military, paramilitary, and police forces, as well as defense contractors and aircraft manufacturers. A substantial portion of Surveillance segment consolidated revenue is derived from sales to United States and foreign government agencies, and our business will continue to be substantially dependent upon such sales. We expect revenue outside the United States to continue to account for a significant portion of our Surveillance segment's revenue. The Surveillance segment is susceptible to some seasonality in its orders primarily based on the United States government budget year end. The result is that the third quarter tends to exhibit the largest amount of orders for our Surveillance segment. However, fiscal policy trends, increased revenue from outside the United States, budget delays, and general economic trends can overshadow this seasonality in any given year.

## ***Competition***

The Surveillance segment operates in a highly competitive market. Many of our competitors in the government sector are well-established contractors for various governments and have more financial and other resources than we possess. The principal competitive factors in the government markets include technical innovation, agency relationships, product quality and reliability, price, and ability to deliver. We believe we compete successfully in these markets with our best-in-class technologies, our products' abilities to outperform customer requirements and competitors' products, our lower-priced solutions that result from our CDMQ operating model, and our service and support functions that exist in the field and near the customer. Our current principal competitors in the Surveillance markets include divisions of BAE Systems, DRS (a Finmeccanica company), Elbit Systems, General Dynamics, L-3 Communications, Lockheed Martin, Raytheon, Sagem, Sofradir, and Thales.

## **Instruments Segment**

The Instruments segment develops hand-held, fixed mount, and desktop imaging and measurement products. Thermal imaging camera products detect and measure heat and surface temperature differences, offering high accuracy, sophisticated diagnostic functionality, and a product range that spans a wide price spectrum. The Instruments segment's thermal cameras and related products are utilized by a growing number of industrial plant professionals, residential construction and contracting firms, energy production workers, manufacturing equipment and production line technicians, tradesmen, and homeowners.

The Instruments segment offers a broad range of cooled and uncooled thermal products, with thermal cameras for laboratory and research and development applications; optical gas imagers for oil, power, and chemical production applications; highly ruggedized cameras for firefighters that are used for fire attack, overhaul, and search-and-rescue operations; fixed and pan-tilt thermal cameras for factory line automation and plant safety monitoring; and multiple lines of professional and mid-level thermal cameras for building analysis, predictive maintenance, and electrical systems analysis.

Under our FLIR and Extech brands, the Instruments segment provides a comprehensive line of rugged and reliable test and measurement instruments, such as moisture meters, electrical test clamp meters, power analyzers, and multi-functional meters. These measurement instruments are used to evaluate electrical and environmental factors, including voltage, sound, light, heat index, and water quality. Leveraging our low-cost thermal sensors, we augment and enhance these familiar tools used in many industrial and commercial trades with Infrared Guided Measurement ("IGM"). IGM allows users to more efficiently address issues by first discovering via a thermal image the precise area of over-heating, moisture damage, or air ingress, allowing them to then apply the relevant sensor, such as voltage, current, spot temperature, or moisture probe, at the point of concern.

## ***Markets***

### **Building and HVAC/R**

Thermal imaging cameras are increasingly used by building and home inspectors, roofing specialists, plumbers, general contractors, and real estate firms to evaluate and measure the integrity of buildings by quickly revealing structural problems, such as air leaks and missing insulation, to help ensure efficient use of energy and other resources. Heating, ventilation, air conditioning, and refrigeration ("HVAC/R") and mechanical contractors use thermal cameras and test and measurement equipment to ensure comfort in residences and workplaces by discovering, monitoring, and documenting airflow, leaks, and temperatures in ductwork and other forms of heating/cooling distribution systems. Hand-held test and measurement tools are used to measure airflow, humidity, carbon monoxide levels, light, sound, and other environmental factors.

### **Electrical**

Electricians and mechanical technicians utilize thermal cameras and test and measurement equipment to quickly conduct electrical diagnostics, such as identifying circuit overloads, finding loose wire connections, and measuring currents, all without having to touch dangerous components. From overheating electrical circuits to corroded connections, thermal cameras and test meters provide the diagnostic functions needed to verify correct installations, quickly trace the source of problems, and enable efficient electrical systems. Hand-held test and measurement tools are used to measure currents, voltage, resistance, continuity, and other electrical parameters.

### **Predictive maintenance**

Thermal imaging systems are used for monitoring the condition of mechanical and electrical equipment. Such monitoring enables factory and plant maintenance technicians to quickly reveal equipment faults, manifested as hot or cold spots, so they can be

repaired before they fail. This increases equipment productivity and avoids catastrophic failures or major damage, which reduces operating expenses by lowering repair costs and reducing downtime. Improved functionality of image analysis software, smaller size and weight, and simplicity of system operation are critical factors for this well-established market segment. Hand-held test and measurement tools are used to measure airflow, humidity, carbon monoxide levels, sound, vibration and other environmental factors.

### **Firefighting**

Thermal imaging is a well-known technology in the firefighting market, with firefighters and first responders worldwide utilizing thermal imaging cameras for protecting their own life and saving the lives of others. Thermal imaging technology allows first responders to assess conditions of a space prior to and after entry by providing them the ability to see through most forms of smoke. This also allows them to search for people and animals and identify fire hot spots in burning buildings or smoke filled environments. Providing the ability to measure temperatures in a non-contact mode from a safe distance helps firefighters to protect themselves against dangerous phenomena like roll-overs and flash-overs.

### **Research and science**

High-end thermal imaging systems provide the unique ability to detect very small differences in temperature. This capability is useful in industrial R&D, where developers study, see, and quantify the heat dissipation, stress tolerance, and thermal characteristics of their materials, components, and products. At colleges and universities, instructors use thermal imagery to help students visualize the theories of heat transfer and thermodynamics, improving student comprehension of key concepts, and for both fundamental and applied research. In the defense sector, cooled thermal imaging cameras are used in the development of firearms, ammunition, guided missiles, and aircraft.

### **Oil and gas production**

Thermal imaging cameras can visualize and pinpoint certain gas leaks. In industrial, utility, and oil and gas refinery settings, optical gas imagers visually reveal plumes of gases such as SF<sub>6</sub> (Sulfur Hexafluoride), hydrocarbons, carbon monoxide and carbon dioxide from a safe distance. Optical gas imaging cameras can continuously scan installations in remote areas or in zones that are difficult to access. Continuous monitoring allows the user to be informed when a dangerous or costly gas leak appears. Typical examples are monitoring pipelines, petrochemical industry and offshore operations.

### **Manufacturing process control**

Temperature consistency is critical to the quality of many manufactured components, materials, and products, including metals, plastics, paper, and glass. Thermal cameras, both fixed and mobile, help factories ensure product quality and identify other defects in both products and in the manufacturing process itself through the continuous monitoring of the production line, resulting in higher output and nearly perfect quality control. Other users of thermal cameras in the manufacturing sectors include worker safety and fire prevention, analysis of welding and fastening effectiveness, food inspection, packaging quality, and electronic and mechanical component manufacturing, ranging in size from small hybrid integrated circuits to jet engines.

### ***Sales and Distribution***

Our Instruments business has a direct sales staff and a network of distributors and retailers covering major markets worldwide, including technical and customer support staff in the United States and internationally who provide application development, technical training, and operational assistance to direct and indirect sales personnel as well as to customers. Dedicated staffs of business development managers for the firefighting, science, optical gas imaging and automation markets assist the distribution channel with application development, technical training, and operational assistance. With a focused sales organization and specialized sales teams that serve the specific R&D market, we have been successful at building and leveraging strong relationships with various research institutes and universities worldwide.

At December 31, 2016, the Instruments segment had a total backlog of \$27 million. Backlog represents orders that have been received for products or services for which a contractual agreement is in place and delivery or performance is expected to occur within 12 months.

### ***Customers***

Instruments segment customers are found around the world in commercial, government, trades, educational, research, agricultural, and non-professional/consumer segments. They include utility companies, electrical contractors, building inspectors, damage restoration contractors, first responders, universities, and numerous commercial enterprises. Given the high-value nature of many of our thermography-related instruments, our thermography products' revenues tend to be correlated with seasonal trends, in

particular capital spending trends. In general, customers in markets like predictive maintenance and R&D are sensitive to the broad economy because our cameras are viewed as capital expenditure items. We expect revenue outside the United States to continue to account for more than half of our Instrument segment revenue.

### ***Competition***

The Instruments segment operates in highly competitive markets. The primary competitive factors include brand reputation, technical innovation, product breadth, functionality, quality, reliability, and price. We believe we compete successfully in these markets with our innovative products, multi-function capabilities, our high value-to-price ratio, and our service and support functions. Our current principal competitors in the Instruments segment's markets include Fortive, Testo, Seek Thermal, SATIR, OPGAL, Infratec, Guide Infrared, and Nippon Avionics for thermal imaging cameras. The test and measurement products compete with products from Fortive, Testo, Gossen Metrawatt, Textron, General Tools, Ideal Industries, and others. The firefighting camera products compete primarily with Bullard, ISG/Scott, Argus, Dräger, and MSA.

### **Security Segment**

The Security segment provides security solutions for a multitude of applications, from home and small business monitoring to enterprise and infrastructure security. The segment develops video security solutions for use in commercial, critical infrastructure, and home security applications. These solutions include thermal and visible-spectrum cameras, digital and networked video recorders, and related video management systems ("VMS") software and video analytics software accessories that enable the efficient and effective safeguarding of assets at all hours of the day and night and during adverse weather conditions.

Our video security cameras are marketed under the FLIR brand name, for thermal and professional-grade visible spectrum cameras, and the Lorex brand name, for the consumer do-it-yourself ("DIY") and small business user. Security segment cameras come in indoor/outdoor, fixed, pan/tilt, and dome configurations, are network-ready, available with a variety of lens options, and provide analog and digital video outputs. Our Megapixel over Coax ("MPX") products allow customers to upgrade security systems to high-definition resolution using an existing coax cable that may already be present, saving the time and money of rewiring their building. With the acquisition of DVTEL, Inc., acquired in November 2015, we also offer a full spectrum of end to end security systems complete with video analytics and advanced VMS capability. In addition, our security products comply with several industry standards, can be integrated with dozens of video management systems and video analytics providers, and are accessible remotely on Apple iOS, Android, PC, or Mac devices through our FLIR Cloud service.

### ***Markets***

#### **Utilities**

Power plants, electrical substations, and water facilities utilize visible spectrum and thermal imaging cameras to provide continuous surveillance day or night. Our cameras are integrated with video analytics to provide automated alarm notification. At electrical substations, our thermal products provide protection against materials theft and acts of sabotage, and provide notifications when connections switchgear and transformers reach dangerous operating temperatures.

#### **Nuclear power**

Recent rules from the United States Nuclear Regulatory Commission require nuclear facilities to provide continuous 24-hour surveillance, observation, and monitoring of their perimeter and control areas. Our thermal security cameras are well suited for this requirement, providing true 24/7 monitoring capability even during most adverse weather conditions.

#### **Petrochemical**

Our thermal security cameras help petrochemical facilities meet the United States Department of Homeland Security's new Chemical Facility Anti-Terrorism Standards. Thermal security cameras are highly effective in meeting the standards' requirements for monitoring a facility's perimeter, securing applicable assets, and solidifying a deter, detect, and delay strategy.

#### **Ports and borders**

Our long range thermal and visible security cameras provide "beyond the fence" situational awareness and advanced warning capabilities. Airport and border authorities around the world utilize our thermal security cameras to help keep people and equipment safe, operating day and night, in nearly all weather or lighting conditions.

## **Commercial and residential**

FLIR's full-spectrum security solutions offer a comprehensive line of thermal and visible cameras to protect commercial facilities. Our products are also used in a wide range of home applications that may include the use of thermal, visible or image-intensified cameras as well as network video recorders and other peripheral equipment.

### ***Sales and Distribution***

Our Security segment sales organization specializes in delivering complete solutions for thermal and visible security. Our Lorex products are sold through both brick and mortar and online retail outlets. Commercial and professional-grade security products utilize direct sales, a network of independent reps, and distributors covering major markets worldwide.

At December 31, 2016, the Security segment had a total backlog of \$21 million. Backlog represents orders that have been received for products or services for which a contractual agreement is in place and delivery or performance is expected to occur within 12 months.

### ***Customers***

Our Security segment serves a broad customer base that is expanding every year. Our visible-spectrum solutions are purchased by high-end critical infrastructure users, security hardware distributors, systems integrators, contractors, and homeowners. Thermal security cameras are currently sold in all global regions, with most customers falling into the high-end critical infrastructure category. However, recent volume production of our thermal camera cores has allowed us to drop the cost of thermal security cameras to a point where it is an affordable option for many commercial security networks.

### ***Competition***

The Security segment operates in highly competitive markets. Many of our competitors are well-established brands. Key competitive factors include technical innovation, analytics, video monitoring, system integration and compatibility, price, and ability to deliver. Our competitive advantages include our broad line of thermal camera offerings, which combined with our DIY consumer product line offers both high- and low-end solutions to our customers. Our current principal competitors include Axis Communications, Bosch, Hikvision, Dahua, Infinova, Avigilon, Sony, Samsung, Q-see, and Panasonic.

## **OEM & Emerging Markets Segment**

The OEM & Emerging Markets segment develops and manufactures thermal and visible spectrum imaging camera cores and related components. A thermal camera core is an integrated, plug-and-play camera system that includes the infrared or visible spectrum sensor as well as the related image processing electronics and an optical lens. We offer cooled and uncooled thermal cores that are based on long wave infrared ("LWIR"), mid-wave infrared ("MWIR"), and short wave infrared ("SWIR") sensors. Our visible spectrum camera cores are utilized primarily for machine vision and people counting applications and are based on complementary metal-oxide semiconductors ("CMOS") and charged-coupled device ("CCD") sensors that are produced by third parties. We also sell to third parties thermal sensors and readout integrated circuit ("ROIC") products, which are used to convert pixel-level information into digital information, essential in the design of infrared, visible, ultra violet, and X-Ray sensors.

Our vertically integrated manufacturing capability, built over many years, enables us to provide thermal camera core and component products to other FLIR segments at low cost as well as sell cores and components to third party customers. Our cores and components are designed for easy and efficient integration into higher levels of product assembly. Third party OEMs integrate these cores and components into their own branded products. We operate under this model so to aggregate the largest amount of volume possible, which lowers our total cost to produce camera cores and components.

The OEM & Emerging Markets segment also houses our Emerging Markets businesses, which are businesses that are identified as high-potential but do not yet have the scale to represent their own segment. Included in Emerging Markets is our Intelligent Traffic Systems business, which develops and manufactures software-enabled automotive and pedestrian monitoring and control systems, our Mobile products business, makers of thermal imaging accessories for the smartphone market, and our commercial UAS business, which provides thermal cameras and cores for use on or integration into UAS systems, which are often referred to as "drones."

## ***Markets***

### **OEM**

We supply cooled and uncooled thermal and visible spectrum camera cores, sensors, and ROICs on an OEM basis to an array of manufacturers of finished products in both the military and commercial spaces. These customers require a product at a lower level of integration than a fully developed thermal imaging system. Examples of major applications in this segment are automotive, industrial automation systems, firefighting, smartphones, UAS, medical devices, military, digital X-ray, and security.

### **Mobile**

Leveraging our ability to produce thermal sensors at a low cost and with low size, weight, and power consumption, we created a line of personal thermal imaging cameras that attach to smartphones. The mass adoption of smartphones has driven significant growth in the development of tools that extend the utility of these devices, and our FLIR ONE™ products do this by empowering consumers with thermal imaging on their phones. We believe that the potential of thermal imaging as a tool for consumers provides this segment with an emerging opportunity for growth.

### **Intelligent Transportation**

Visible and thermal imaging helps transportation departments all over the world monitor vehicles and pedestrians in urban environments, detect incidents on highways and in tunnels, collect traffic data, control traffic signals, and ensure the safety on public roads and railways. These systems are able to detect vehicles and use the information to control traffic lights in order to improve traffic flow. While road-embedded magnetic loops have historically been the primary technology for analyzing intersections and roadways, visible and thermal imaging are increasingly being used for this application. Thermal imaging technology has shown to be highly effective at detecting the presence of vehicles as it is not impeded by darkness, colors, shadows, direct sunlight, light from oncoming traffic, or weather effects. We believe that the value of these solutions in terms of improved traffic flow, fuel conservation, and public safety is significant.

### ***Sales and Distribution***

We employ primarily a direct sales force for selling and distributing our thermal cores and components and both direct sales and distributors for our visible-spectrum camera cores. The majority of our Mobile market sales are generated through wholesale channels, which include national and regional consumer electronics chains, large online retailers, and specialty retailers. We also sell our Mobile products directly to consumers through our own network of e-commerce websites. In addition, we sell our products to independent distributors in various countries where we generally do not have direct sales operations, and through licensees. A dedicated staff of business development managers for the Intelligent Traffic products assists the distribution channel, made up of traffic control systems integrators and engineering consultants, with application development, technical training, and operational assistance.

At December 31, 2016, the OEM & Emerging Markets segment had a total backlog of \$143 million. Backlog represents orders that have been received for products, contract research and development, or other services for which a contractual agreement is in place and delivery or performance is expected to occur within 12 months.

### ***Customers***

Typical OEM customers include makers of military aircraft and vehicles, automotive safety equipment, firefighting equipment, manufacturing automation systems, security cameras, hunting equipment, smartphones, UAS, and maritime equipment. Our OEM sales personnel maintain direct relationships with most of these customers. We sell our Mobile products to a diverse group of consumers, including homeowners, outdoors people, and technology enthusiasts. Customers for our Intelligent Traffic products are traffic and public transportation authorities in cities and municipalities all over the world who deploy thermal imaging cameras and other equipment in urban areas, on highways, in tunnels, and on bridges.

### ***Competition***

While our market share in OEM cores and components is estimated to be nearly 50 percent based on independent industry research, we view the thermal OEM market as highly competitive. We believe the key drivers of success in these markets are: technological proficiency in imaging sensors, product quality, product cost, and scalability of operations. We believe we are well positioned to operate in this competitive environment given our demonstrated ability to innovate high-quality sensors at low cost due to our vertically-integrated operating model, our advanced R&D capabilities, and our broad product offering. Our primary competitors in the OEM space are ULIS, DRS, L-3, BAE Systems, Basler, and Allied Vision. In Mobile products, our competitors include



Seek Thermal and Opgal. In the Intelligent Traffic product space, our major competitors include Image Sensing Systems, Iteris, and Citilog.

## **Maritime Segment**

The Maritime segment develops and manufactures a broad range of thermal imaging and marine electronic products for recreational and commercial customers globally. The segment provides boats of all sizes a full suite of electronic systems including multi-function helm displays, navigational instruments, autopilots, radars, sonar systems, thermal and visible imaging systems, and communications equipment. These products are utilized for general navigation, sport fishing, cruising, and sailing.

Our primary product offering is multifunction navigation displays ("MFDs"). Our MFDs are designed to provide boaters visual navigation data from multiple sensors, including GPS, autopilot, sonar, and radar. We have several lines of MFD products, serving leisure and fishing boats of all sizes, in saltwater or freshwater environments. Our Dragonfly® product line addresses the MFD needs of the small-boat recreational fishermen, including kayakers and freshwater bass anglers, while our larger MFDs serve large saltwater boat end-users. We also integrate our MFDs to use and control thermal and visual cameras, onboard entertainment products, engine instruments, and data services like satellite weather. Recognizing the importance of mobile devices to boaters, we offer Wi-Fi enabled MFDs along with mobile apps that give boaters access to the MFD and sensors from anywhere on board the vessel.

Our marine instrument products are dedicated displays and sensors for monitoring depth, boat speed, and wind information. Our sonar solutions are engineered to serve the needs of both the inland and saltwater fishing customers. These sonars serve as fishermen's eyes below the water so they can detect fish, locate underwater structure, and identify the habitat of the fish they are trying to catch. We also offer autopilot solutions that provide precision steering control for open water passages. To keep boaters connected, we offer several communication products, such as VHF marine radios for ship-to-ship and ship-to-shore communications, and our automatic identification system ("AIS") solutions enable the wireless exchange of navigation status between vessels and vessel-monitoring centers. The Maritime segment's thermal camera solutions are designed to enhance a boater's overall situational awareness in limited visibility and are used primarily to identify other vessels, navigation aids, and hazards. Thermal maritime cameras are also utilized for search and rescue and local law enforcement surveillance operations.

We market our Maritime segment products under both the FLIR and Raymarine brands. FLIR-branded maritime products consist of thermal cameras designed for recreational, commercial, and first-responder vessels. The Raymarine line of marine electronics is designed and marketed primarily to recreational boaters and light-commercial customers.

### ***Markets***

#### **Recreational Boating**

The recreational boating market, which represents the majority of our sales, is comprised of fresh and saltwater fishing, sport/cruising, and sailing. Our core MFD products are engineered to address the needs of all three segments. We also develop products specifically for strategic markets and customers, such as Dragonfly® sonars for freshwater fishermen, wind instruments for sailors, and vessel automation for boat builders.

#### **Commercial Maritime**

The commercial maritime market is comprised of light commercial, heavy commercial, and light-defense segments. We address these commercial markets with both our thermal maritime cameras and our marine electronics systems.

### ***Sales and Distribution***

Our Maritime segment sells products worldwide through a network of aftermarket distributors, technical dealers, boat builders/OEMs, and retailers. We have a dedicated business development team to address the unique requirements of our OEM boat-builder channel. With our OEM boat builders, we differentiate ourselves by providing full system solutions. We also add value to our boat-building partners through technical installation training of the OEM factory staff. In the United States, we devote special teams to the retail channel so we can address this channel's dynamic and unique merchandising and promotional needs. Our sales team is supported by technical support teams and applications engineers. The technical teams provide customer support and conduct regular training sessions with our technical dealer and OEM customers.

At December 31, 2016, the Maritime segment had a total backlog of \$16 million. Backlog represents orders that have been received for products or services for which a contractual agreement is in place and delivery or performance is expected to occur within 12 months.

### ***Customers***

Our FLIR maritime thermal cameras are supplied to an array of commercial customers including tugboats, work boats, and passenger vessels. Both FLIR and Raymarine maritime-branded thermal cameras are supplied to recreational sport fishing and cruising powerboat customers. Raymarine's primary end consumers include freshwater and saltwater fishing boat owners, cruising power boats, and sailboat owners. In the fishing segment, Raymarine customers include kayakers, bass boat owners, bay boats, center consoles, and offshore sport fish boat owners. The cruising segment includes owners of sport boats, cruisers, and trawlers. Sailing customers include owners of day sailors, racers, cruising yachts and multi-hull sailboats.

Our Maritime segment also supplies thermal cameras to maritime first responders and maritime law enforcement organizations around the globe, including the United States Coast Guard. Our cameras are used by marine divisions of city fire and police departments along with local fish and wildlife enforcement organizations.

### ***Competition***

Our Maritime segment operates in a highly competitive market for marine electronics. Like consumer electronics, delivering innovative features and lower price points are critical to the success of our marine electronics products. Consumers typically purchase marine electronics as a system of products from one brand, so it is critical that we deliver a competitive offering in each of our product lines. Our primary marine electronic competitors include Garmin, Navico, Furuno, and Humminbird.

### **Detection Segment**

Our Detection segment develops and manufactures field-ready sensor instruments and integrated platform solutions for the accurate detection, identification, classification, and suppression of chemical, biological, radiological, nuclear, and explosives ("CBRNE") threats for military force protection, homeland security, and commercial applications.

Detection segment solutions combine multi-threat detection and identification technologies into single hand-held or desktop instruments. Product lines include hand-held and fixed radiation detectors, hand-held and desktop explosives trace detectors, desktop and portable mass spectrometers, and continuous air monitoring devices for aerosolized biological threats and disclosure sprays. The segment also manufactures integrated systems of multiple pieces of equipment to create turn-key solutions used by first responders for the detection, identification, sample collection, decontamination, marking, and hazard reporting of CBRNE threats.

Our products utilize mission-based user interfaces to expedite decision-making for field operators and advanced technicians. Our advanced CBRNE detection instruments provide lab-quality confidence in a field-proven, highly reliable, and ruggedized package. Customers around the world use our products for forensic analysis, military reconnaissance, force protection, public security, law enforcement, emergency response, environmental monitoring, building and event security, teaching, and research.

The Detection segment leverages an established technical R&D organization that enables the business to offer smart, simple, and reliable products that meet the evolving needs of government and commercial security providers. With many years of experience working in collaboration with multiple government agencies, the Detection segment has developed relationships with various government decision-makers and has substantial knowledge of the governmental procurement process.

### ***Markets***

Government and private sector entities continue to seek new ways to address increasingly sophisticated terrorist threats and to respond to other security risks, natural disasters, and unintentional incidents that threaten public safety. Our multi-purpose products meet the requirements for a broad range of end-users and end uses.

We offer biological air monitors that are used by various governmental agencies for security at facilities and events. Our explosives detection products are used to identify military-grade explosives and homemade explosive devices in a wide array of military and

public safety applications, such as screening high-risk individuals at checkpoints and identifying improvised explosive device ("IED") makers, and our radiation products protect the public by warning of radionuclide exposure.

### ***Sales and Distribution***

The Detection segment sells products worldwide primarily through a combination of a direct sales force and a distributor network, but also utilizes third-party sales representatives, value-added resellers, and systems integrators. With a centralized sales organization and specialized sales teams that serve specific markets, we have been successful at building and leveraging strong relationships with key decision-makers at various government agencies and commercial entities. Some Detection segment products are designed as components or sub-systems that are incorporated into third-party products or systems.

The Detection segment derives a portion of its revenue, approximately 10 percent in 2016, from funding received from agencies of the United States government pursuant to research projects. The revenue recognized under these contracts represents reimbursement by the customer for time periods ranging from several months to several years. Our participation in these and other development programs has culminated in the development of a number of commercial products. In general, our contracts with the United States government permit us to retain all rights to patents emerging from the funded R&D efforts.

At December 31, 2016, the Detection segment had a total backlog of \$57 million. Backlog represents orders that have been received for products, contract research and development, or other services for which a contractual agreement is in place and delivery or performance is expected to occur within 12 months.

### ***Customers***

The Detection segment sells its products, systems, and services to a broad base of federal, state, and local government customers, to all branches of the United States military, foreign militaries, private sector businesses and commercial ports both in the United States and internationally. Using a regionally deployed sales force, the business sells to agencies of the United States government, such as the Departments of Homeland Security, Defense, and Energy, as well as the Transportation Security Administration, the Federal Bureau of Investigation, NASA, the Secret Service, the Coast Guard, and agencies of multiple state and local governments in the United States. Similar to our Surveillance segment, the Detection segment experiences some seasonality in its orders due to the United States government budget year end.

### ***Competition***

The markets in which the Detection segment competes are dynamic and highly competitive. Success in these markets depends on our ability to develop new technologies to meet rapidly evolving customer needs, reduce production and development costs, integrate with third-party devices and systems, establish and foster relationships with key government and commercial customers, and recruit highly technical personnel. The Detection segment competes in various markets with companies such as Agilent Technologies, Canberra Industries, Safran, SAIC, Smiths Detection, Thermo Fisher Scientific, and United Technologies.

## **SALES, MARKETING, CUSTOMER SUPPORT, AND TRAINING**

Our sales and distribution organization covers the world with a combination of direct sales, third-party representatives and distributors, system integrators, independent dealers, retail outlets, application engineers, and service and training centers. Internationally, we have invested heavily to build a strong presence to sell and service our products, a key advantage in penetrating certain markets, such as foreign governments. Our sales representatives, including third-party distributors, undergo a comprehensive training program on each product's technical specifications, functions, and applications. We also continuously update our training programs to incorporate technological and competitive shifts and changes. We sell in many distinct markets and have established specific sales channels for each market.

Our primary marketing activities include online advertising, participating in trade shows, partner sponsorships, optimizing our website for search keywords so that prospects searching for imaging and sensing solutions online find FLIR quickly, press releases about new products and company developments, social media outreach, and cooperative advertising.

We offer a strong product warranty coupled with responsive support accessible via phone, web, and e-mail, and our localized support locations for high-end systems helps us stand out in our markets.

Our Infrared Training Center ("ITC") offers training, certification, and re-certification in all aspects of thermography, including specialized instruction in building diagnostics, roofing, electrical, mechanical, research and science, and optical gas imaging. Online courses cover the basics of thermal camera operation and reporting software. The ITC is also the premier sponsor of InfraMation, thermal imaging's leading users conference which is typically held annually.

## **MANUFACTURING**

We manufacture many of the critical components for our products, including but not limited to infrared detectors, gimbals, pan-tilts, optics and coatings, laser sub-systems, and micro-coolers, and develop much of the software and middleware for our systems. This vertical integration minimizes lead times, facilitates prompt delivery of our products, controls costs, and ensures that these components satisfy our quality standards. We purchase other parts pre-assembled, including certain detectors, coolers and optics, circuit boards, cables, and wire harnesses. These purchased and manufactured components are then assembled into finished systems and tested at one of our primary production facilities located in the United States, Sweden, Estonia, and Canada. Certain components and finished goods, including some of our visible-spectrum cameras, test and measurement products and maritime electronics, are produced by contract manufacturers.

Our manufacturing operations are, from time to time, audited by certain customers, which include several major aircraft manufacturers, and have been certified as meeting their quality standards. Substantially all of our manufacturing locations are either ISO 9001:2000 or :2008 certified with certain locations having higher certifications.

## **INTELLECTUAL PROPERTY**

To support our focus on being an innovation leader in our key markets and protect our proprietary information, we rely on a combination of patent, trademark, copyright, and trade secret rights, a strong Internet domain presence, confidentiality agreements, joint development agreements, and contractual provisions. Over the past several years we have intensified our efforts to protect our innovations through increased United States and international patent filings, and to strengthen our core brands through thoughtful trademark procurement and domain portfolio refinement. We will continue to actively develop our intellectual property and intend to emphasize initiatives that will further promote innovation and leadership in marketable technologies. We cannot, however, be certain or give any assurance that we can secure patent or trademark protection on all our innovations, maintain our competitive advantage or that competitors will not develop similar or superior capabilities.

## **GOVERNMENT REGULATION**

Thermal technology is controlled for export, re-export and retransfer by the United States government. Depending on the technology, the export of infrared products may be controlled by the United States Department of State or the Bureau of Industry and Security. In general, the more sophisticated the technology and the higher the performance of the product, the more restrictive are the licensing requirements. Licensing requirements differ from country to country, end user to end user and differ with product performance and field of intended use. The export of some of our products are controlled by the International Traffic and Arms Regulation ("ITAR") or are identified on the Commerce Control List ("CCL") requiring an export license from the United States Department of Commerce. Thermal and infrared products identified in Category XII of the United States Munitions List like those manufactured by the Company have recently been the subject of export control reform moving classification and control of some products from the ITAR to the CCL and adding additional license restrictions under regulations administered by the United States Department of Commerce.

As a United States government supplier, we must comply with specific procurement regulations and other requirements and are subject to routine audits and investigations by United States government agencies. If we fail to comply with these rules and regulations, the results could include: reductions in the value of contracts; contract modifications or termination; the assessment of penalties and fines; and/or suspension or debarment from United States government contracting or subcontracting for a period of time or permanently.

## **EMPLOYEES**

As of December 31, 2016, we had 3,436 employees of which 1,812 were located in the United States and 1,624 located outside of the United States. We have generally been successful in attracting highly skilled technical, marketing, and management personnel. None of our employees in the United States are represented by a union or other bargaining group. Certain employees in Europe are represented by unions and workers councils whose contracts are subject to periodic renegotiations. We believe our relationships with our employees, unions and workers councils are generally good.

## **ENVIRONMENTAL MATTERS**

Our operations are subject to a variety of federal, state, local and foreign environmental laws and regulations relating to the discharge, treatment, storage, disposal and remediation of certain materials, substances, and wastes used in our operations. We continually assess our obligations and compliance with respect to these requirements. We have also assessed the risk for environmental contamination for our various manufacturing facilities, including our acquired businesses and facilities and, where appropriate, have obtained indemnification from the sellers of those businesses and facilities.

We believe that our current operations are in substantial compliance with all existing applicable environmental laws and permits. Operating and maintenance costs associated with environmental compliance are a normal, recurring part of our operations. Historically, these costs have not been material.

## **AVAILABLE INFORMATION**

Our Internet website address is [www.flir.com](http://www.flir.com). This Report, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and other required filings are available through our Internet website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Our Internet website and the information contained therein or connected thereto are not intended to be incorporated into this Report.

## ITEM 1A. RISK FACTORS

The following are important factors that could cause actual results or events to differ materially from those contained in any forward-looking statements made by or on behalf of the Company. If we are unable to adequately respond to these risks and uncertainties, our business, financial condition and results of operations could be materially adversely affected. Additionally, we cannot be certain or give any assurance that any actions taken to reduce known risks and uncertainties will be effective.

### **Risks, Uncertainties and Other Factors Related to Our Business**

*We depend on the United States government for a material portion of our business and changes in government spending could adversely affect our business*

We derive significant revenue from contracts or subcontracts funded by United States government agencies. A significant reduction in the purchase of our products by these agencies or contractors for these agencies would have an adverse effect on our business. For the fiscal years ended December 31, 2016, 2015 and 2014, approximately 25 percent, 21 percent and 20 percent, respectively, of our revenues were derived directly or indirectly from sales to the United States government and its agencies. The funding of contracts awarded to us depends on the overall United States government budget and appropriations process, which is beyond our control. In addition, at its discretion, the United States government may change its spending priorities and/or terminate, reduce or modify contracts.

Substantial uncertainty exists in the spending levels and priorities of the United States government, particularly with respect to military expenditures. Continued and further reductions in military spending could have a material adverse effect on our results from operations.

*As a United States government supplier, we are subject to a number of procurement rules and regulations*

Government contractors must comply with specific procurement regulations and other requirements and are subject to routine audits and investigations by United States government agencies. In addition, violations of unrelated laws and statutes can lead to debarment and other penalties. If we fail to comply with procurement rules and regulations and other laws and statutes, the results could include: reductions in the value of contracts; contract modifications or termination; the assessment of penalties and fines; and/or suspension or debarment from United States government contracting or subcontracting for a period of time or permanently. An adverse action by the United States government could also result in lost sales to non-governmental customers who might disqualify us as a result of such adverse action.

*Operating margins may be negatively impacted by reduction in sales or by a change in the mix of products sold*

Our expense levels are based, in part, on our expectations regarding future sales and these expenses are largely fixed in the short term. Some expenses, such as those related to research and development activities, would likely be maintained in the event of a sales downturn in order to maintain and enhance the long-term competitiveness of the Company. We maintain inventories of finished goods, components and raw materials at levels we believe are necessary to meet anticipated sales. Accordingly, we may not be able to reduce our costs in a timely manner to compensate for any unexpected shortfall between forecasted and actual sales. Any significant shortfall of sales may result in us carrying higher levels of inventories of finished goods, components and raw materials thereby increasing our risk of inventory obsolescence and corresponding inventory write-downs and write-offs. Our fixed costs, including facilities and information technology costs, compliance and public company costs, and depreciation and amortization related to previous acquisitions and capital expenditures, are significant and are difficult to reduce in the short term. Our operating margins vary by product and substantial changes in the mix of products sold could also have a negative impact on our operating margins.

*We may experience impairment in the value of our tangible and intangible assets*

Our industry is subject to rapid changes in technology, which may result in unexpected obsolescence or impairment of our assets. As of December 31, 2016, our intangible assets, including goodwill, totaled \$969.9 million and represented approximately 37 percent of our total assets. Most of these intangibles are the result of acquisitions in which the purchase price exceeded the value of the tangible assets acquired. We amortize certain of these intangibles over their anticipated useful life and review goodwill and

indefinite-lived intangible assets for impairment annually or more frequently if warranted by events. To date we have not experienced any impairment of our intangible assets, but there can be no assurance that we will not experience such impairment in the future. In addition, certain of our tangible assets such as inventory and machinery and equipment may experience impairment in their value as a result of such events as the introduction of new products, changes in technology or changes in customer demand patterns. We depreciate our machinery and equipment at levels we believe are adequate; however, there can be no assurance that there will not be a future impairment that may have a material impact on our business, financial condition and results of operations.

*We face risks from international sales and business activities*

We market and sell our products worldwide and international sales have accounted for, and are expected to continue to account for, a significant portion of our revenue. For the years ended December 31, 2016, 2015 and 2014, international sales accounted for 46 percent, 47 percent and 49 percent, respectively, of our total revenue. We also manufacture certain products and subassemblies in Europe and we have several contract manufacturing agreements with third parties in Europe and in Asia. Certain of these products, particularly our thermal and infrared products, are subject to substantial government regulation and licensing and end use restrictions throughout the world. Our international business activities are subject to a number of risks, including:

- the imposition of and changes to governmental licensing restrictions and controls impacting our technology and products;
- restrictions and prohibitions on the export of technology and products, including recent changes in regulation prohibiting the sale of certain of our products to certain end users without a license;
- trade restrictions;
- difficulty in collecting receivables and governmental restrictions with respect to currency;
- inadequate protection of intellectual property;
- labor union activities;
- changes in tariffs and taxes;
- restrictions on repatriation of earnings;
- restriction on the importation and exportation of goods and services;
- risks, costs, impacts and obligations associated with the United States Foreign Corrupt Practices Act ("FCPA"), and other anti-bribery and anti-corruption laws applicable to us, and costs and penalties from violations of such laws and related regulations;
- difficulties in staffing and managing international operations; and
- political and economic instability.

Some of these factors recently have had an adverse impact on our sales and operations and increased the Company's cost of doing business and subjected the business to additional rules, policies and procedures that impacted the operation of the Company. No assurance can be given that these factors will not have a material adverse effect on our future international sales and operations and, consequently, on our business, financial condition and results of operations. Furthermore, compliance with complex foreign and U.S. laws and regulations that apply to our international operations increases our cost of doing business both in the United States and in international jurisdictions. These regulations include import and export laws, anti-competition laws, anti-corruption laws, such as the FCPA and the U.K. Bribery Act, and other local laws prohibiting corrupt payments to governmental officials, data privacy requirements, tax laws, and accounting, internal control and disclosure requirements. For example, on April 8, 2015, the Company and the Securities and Exchange Commission ("SEC") entered into an agreement through entry of an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities and Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (the "SEC Order"). The SEC Order settled charges under the FCPA with respect to incidents of improper travel and gifts involving FLIR's Middle East operation. Pursuant to the SEC Order, the Company is obligated to "cease and desist" from committing any future violations of the Securities Exchange Act of 1934, as amended. Violations of these laws and regulations could result in civil and criminal fines, penalties and sanctions against us, our officers or our employees, prohibitions on the conduct of our business and on our ability to offer our products and services in one or more countries, and could also materially affect our reputation, business and results of operations. In certain foreign jurisdictions, there is a higher risk of fraud or corruption and greater difficulty in maintaining effective internal controls and compliance programs. Although we have implemented policies and procedures designed to promote compliance with applicable laws and regulations, there can be no assurance that our employees, contractors or agents will not violate our policies or applicable laws and regulations. In addition, our international contracts may include industrial cooperation agreements requiring specific in-country purchases, investments, manufacturing agreements or other financial obligations, known as offset obligations, and may provide for penalties if we fail to meet such requirements. The impact

of these factors is difficult to predict, but one or more of them could have a material adverse effect on our financial position, results of operations, or cash flows.

*We face risks from currency fluctuations*

Historically, currency fluctuations have affected our operating results. Changes in the value of foreign currencies in which our sales or costs incurred are denominated have in the past caused, and could in the future cause, fluctuations in our operating results. We seek to reduce our exposure to currency fluctuations by denominating, where possible, our international sales in United States dollars, by balancing expenses and revenues in various currencies and by undertaking limited hedging of forecasted currency exposures. With respect to international sales denominated in United States dollars, a decrease in the value of foreign currencies relative to the United States dollar could make our products less price competitive.

*We may not be successful in obtaining the necessary export licenses to conduct operations abroad and the United States government may prevent proposed sales to foreign governments and customers*

Export and other licenses are required from United States government agencies under the ITAR, the Export Administration Act, the Trading with the Enemy Act of 1917, and the Arms Export Control Act of 1976 and other similar laws and regulations for the sale, use and export of many of our products. Thermal and infrared products identified in Category XII of the United States Munitions List like those manufactured by the Company have recently been the subject of export control reform moving classification and control of some products from the ITAR to the CCL and adding additional license requirements and restrictions under regulations administered by the United States Department of Commerce. We can give no assurance that we will be successful in obtaining the necessary licenses from the United States Department of State or Department of Commerce necessary to conduct our business as presently or historically conducted. The aftermath of 9/11, the rise of terrorism and the changing geopolitical environment, and heightened tensions with other countries (which shift and evolve over time), and the Company's 2014 submission to the United States Department of State Office of Defense Trade Controls Compliance ("DDTC"), pursuant to International Traffic in Arms Regulation ("ITAR") § 127.12(c), regarding the unauthorized export of technical data and defense services to dual and third country nationals in at least four facilities of the Company, have led to heightened scrutiny of export licenses for products in our markets and has resulted in lengthened review periods for our license applications, including in countries where we have historically made significant sales. Failures to obtain or delays in obtaining licenses prevent or delay us from selling our products outside the United States and has had and could continue to have a material adverse effect on our business, financial condition and results of operations. See also Item 3 "Legal Proceedings" for additional information regarding the Company's 2014 submission to DDTC.

*General economic conditions may adversely affect our business, operating results and financial condition*

Our operations and performance depend significantly on worldwide economic conditions and their impact on levels of capital investment and consumer spending. Economic factors that could adversely influence demand for the Company's products include uncertainty about global economic conditions leading to reduced levels of investment, changes in government spending levels and/or priorities, the size and availability of government budgets, customers' and suppliers' access to credit, consumer confidence and other macroeconomic factors affecting government, industrial or consumer spending behavior.

In recent years, our performance has been negatively impacted by reduced spending by United States government agencies, global economic weakness, and the Eurozone crisis. Continuation of the conditions that led to reduced spending and potential further reductions in spending globally by either consumers or government agencies could have a material adverse effect on our business, financial condition and results of operations.

*Our primary markets are volatile and unpredictable*

Our business depends on the demand for our products and solutions in a variety of commercial, industrial and government markets. In the past, the demand for our products in these markets has fluctuated due to a variety of factors, some of which are beyond our control, including:

- the timing, number and size of orders from, and shipments to, our customers, as well as the relative mix of those orders;
- variations in the volume of orders for a particular product or product line in a particular fiscal quarter;



- the size and timing of new contract awards;
- the timing of the release of government funds for procurement of our products; and
- the timing of orders and shipments within a given fiscal quarter.

Seasonal fluctuations in our operating results result from:

- the seasonal pattern of contracting by the United States government and certain foreign governments;
- the desire of customers to take delivery of equipment prior to fiscal year ends due to funding considerations; and
- the tendency of commercial enterprises to fully utilize annual capital budgets prior to expiration.

*Competition in our markets is intense and our failure to compete effectively could adversely affect our business*

Competition in the markets for our products is intense. The speed with which companies can identify new applications for thermal imaging, develop products to meet those needs and supply commercial quantities at low prices to the market are important competitive factors. We believe the principal competitive factors in our markets are product performance, price, customer service and training, product reputation, and effective marketing and sales efforts. Many of our competitors have greater financial, technical, research and development, and marketing resources than we do. All of these factors, as well as the potential for increased competition from new market entrants, require us to continue to invest in, and focus on, research and development and new product innovation. No assurance can be given that we will be able to compete effectively in the future and a failure to do so could have a material adverse effect on our business, financial condition and results of operations.

*Our products may suffer from defects or errors leading to substantial product liability, damage or warranty claims*

We include complex system designs and components in our products that may contain errors or defects, particularly when we incorporate new technology into our products or release new versions. If any of our products are defective, we might be required to redesign or recall those products or pay substantial damages or warranty claims. Such an event could result in significant expenses including expenses arising from product liability and warranty claims, disrupt sales and affect our reputation and that of our products, which could have a material adverse effect on our business, financial condition and results of operations. As we expand our presence into new markets, we may face increased exposure to product liability claims. We maintain product liability insurance but cannot be certain that it will be sufficient or will continue to be available on acceptable terms.

### **Risks, Uncertainties and Other Factors Related to Our Technology and Intellectual Property**

*Our inability to protect our intellectual property and proprietary rights and avoid infringing the rights of others could harm our competitive position and our business*

Our ability to compete successfully and achieve future revenue growth depends, in part, on our ability to protect our proprietary technology and operate without infringing the rights of others. To accomplish this, we rely on a combination of patent, trademark, copyright and trade secret laws, confidentiality agreements and contractual provisions to protect our proprietary rights. Many of our proprietary rights are held in confidence as trade secrets and are not covered by patents, making them more difficult to protect. Although we currently hold worldwide patents covering certain aspects of our technologies and products, and we are actively pursuing additional patents, we cannot be certain that we will obtain additional patents or trademarks on our technology, products and trade names. Furthermore, we cannot be certain that our patents or trademarks will not be challenged or circumvented by our competitors or that measures taken by us to protect our proprietary rights will adequately deter their misappropriation or disclosure. Any failure by us to meaningfully protect our intellectual property could have a material adverse effect on our business, financial condition and results of operations. Moreover, because intellectual property does not necessarily prevent our competitors from entering the markets we serve, there can be no assurance that we will be able to maintain our competitive advantage or that our competitors will not develop capabilities equal or superior to ours.

Litigation over patents and other intellectual property is common in our industry. We have been the subject of patent and other intellectual property litigation in the past and cannot be sure that we will not be subject to such litigation in the future. Similarly, there exists the possibility we will assert claims in litigation to protect our intellectual property. Lawsuits defending or prosecuting intellectual property claims and related legal and administrative proceedings could result in substantial expense to us and significant diversion of effort of our personnel. An adverse determination in a patent suit or in any other proceeding in which we are a party

could subject us to significant liabilities, result in the loss of intellectual property rights we claim or impact our competitive position. Additionally, an adverse determination could require us to seek licenses from third parties. If such licenses are not available on commercially reasonable terms or at all, our business, financial condition and results of operations could be adversely affected.

*Our future success will depend on our ability to respond to the rapid technological change in the markets in which we compete, our ability to introduce new or enhanced products and enter into new markets*

The markets in which we compete are characterized by rapid technological developments and frequent new product introductions, enhancements and modifications. Our ability to develop new products and technologies that anticipate changing customer requirements, reduce costs and otherwise retain or enhance our competitive position in existing and new markets will be an important factor in our future results from operations. We will continue to make substantial capital expenditures and incur significant research and development costs to improve our manufacturing capability, reduce costs, and develop and introduce new products and enhancements. If we fail to develop and introduce new products and technologies in a timely manner, our business, financial condition and results of operations would be adversely affected. In addition, we cannot be certain that our new products and technologies will be successful or that customers will accept any of our new products.

*Our business could be negatively impacted by cybersecurity threats and other security threats and technology disruptions*

We face certain security threats and technology disruptions, including threats to our information technology infrastructure, attempts to gain access to our or our customers' proprietary or classified information, threats to the physical security of our facilities and employees, threats of terrorism events, and failures of our technology tools and systems. We are subject to laws and rules issued by various agencies concerning safeguarding and maintaining infrastructure and physical security and information confidentiality. Our information technology networks and related systems are critical to the operation of our business and essential to our ability to successfully perform day-to-day operations. We are also involved with information technology systems for certain customers and other third parties, for which we face similar security threats as for our own. In particular, cybersecurity threats-which include, but are not limited to, computer viruses, spyware and malware, attempts to access information, denial of service attacks and other electronic security breaches-are persistent and evolve quickly. Such threats have increased in frequency, scope and potential impact in recent years. Further, a variety of technological tools and systems, including both company-owned information technology and technological services provided by outside parties, support our critical functions. These technologies, as well as our products, are subject to failure and the user's inability to have such technologies properly supported, updated, expanded or integrated into other technologies and may contain open source and third party software which may unbeknownst to us contain defects or viruses that pose unintended risks to our customers. These risks if not effectively mitigated or controlled could materially harm our business or reputation. While we believe that we have implemented appropriate measures and controls, there can be no assurance that such actions will be sufficient to prevent disruptions to critical systems, unauthorized release of confidential information or corruption of data.

We require user names and passwords in order to access our information technology systems. We use encryption and authentication technologies designed to secure the transmission and storage of data and prevent access to our data or accounts. These security measures are subject to third-party security breaches, employee error, malfeasance, faulty password management or other irregularities. For example, third parties may attempt to fraudulently induce employees or customers into disclosing user names, passwords or other sensitive information, which may in turn be used to access our information technology systems. These security systems cannot provide absolute security. To the extent we were to experience a breach of our systems and were unable to protect sensitive data, such a breach could materially damage business partner and customer relationships, and curtail or otherwise impact the use of our information technology systems. Moreover, if a security breach of our information technology system affects our computer systems or results in the release of personally identifiable or other sensitive information of customers, business partners, employees and other third parties, our reputation and brand could be materially damaged, use of our products and services could decrease, and we could be exposed to a risk of loss, litigation and potential liability.

Although we have in the past and continue to be subject to cybersecurity threats and other security threats and technology disruptions, to date none has had a material impact on our business, financial condition or results of operations. Nonetheless, in the future, these types of events could disrupt our operations and customer and other third party information technology systems. They also could require significant management attention and resources, negatively impact our reputation among our customers and the public and challenge our eligibility for future work on sensitive or classified systems, which could have a material adverse effect on our business, financial condition and results of operations.

## **Risks, Uncertainties and Other Factors Related to Our Corporate Structure and Organization**

*Our future success depends in part on attracting and retaining key senior management and qualified technical, sales and other personnel*

Our future success depends in part on the efforts and continued services of our key executives and our ability to attract and retain qualified technical, sales and other personnel. Significant competition exists for such personnel and we cannot assure the retention of our key executives, technical and sales personnel or our ability to attract, integrate and retain other such personnel that may be required in the future. On February 14, 2017, we announced that Andrew C. Teich, our President, Chief Executive Officer, and a member of our Board of Directors, plans to retire. Mr. Teich will continue to serve in his current roles until his successor is appointed. Failure to attract, integrate and retain a qualified successor could adversely affect our business, financial condition and results of operations.

We also cannot assure that employees will not leave and subsequently compete against us. If we are unable to attract and retain key personnel, our business, financial condition and results of operations could be adversely affected.

*We must successfully manage a complex global organization*

As we have grown, the size and scope of our worldwide operations have also increased substantially. We currently design, manufacture and market numerous product lines in locations worldwide. Significant management time and effort is required to effectively manage the increased complexity of the business and our failure to successfully do so could have a material adverse effect on our business, financial condition and results of operations. Our inability to continue to manufacture our products at one or more of our facilities as a result of, for example, a prolonged power outage, earthquake, fire or other natural disaster, or labor or political unrest, could prevent us from supplying products to our customers and could have a material adverse effect on our business, financial condition and results of operations.

*We may be unable to successfully integrate recent or future acquisitions into our operations, thereby disrupting our business and harming our financial condition and results of operations*

We have made twelve acquisitions of various sizes in the past five years. The integration of businesses, personnel, product lines and technologies can be difficult, time consuming and subject to significant risks. For example, we could lose key personnel from companies that we acquire, incur unanticipated costs, lose major sources of revenue, fail to integrate critical technologies, suffer business disruptions, fail to capture anticipated synergies, fail to establish satisfactory internal controls, or incur unanticipated liabilities. Any of these difficulties could disrupt our ongoing business, distract our management and employees, increase our expenses and decrease our revenue.

We frequently evaluate strategic opportunities available to us and it is likely that we will make additional acquisitions in the future. Such acquisitions may vary in size and complexity. Any future acquisitions are subject to the risks described above. Furthermore, we might assume or incur additional debt or issue additional equity securities to pay for future acquisitions. Additional debt may negatively impact our results and increase our financial risk, and the issuance of any additional equity securities could dilute our then existing shareholders' ownership. No assurance can be given that we will realize anticipated benefits of any future acquisitions, or that any such acquisition or investment will not have a material adverse effect on our business, financial condition and results of operations.

*We have indebtedness as a result of the issuance of our 3.125 percent senior unsecured notes (the "Notes") and borrowings against our unsecured credit facility, and we are subject to certain restrictive covenants under our unsecured credit facility and the indenture governing the Notes which may limit our operational and financial flexibility*

Our ability to meet our debt service obligations and comply with the financial covenants under our credit facility will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control. Our inability to meet our debt service obligations or comply with the required covenants could result in a default under the credit facility or indenture. In the event of any such default, under the credit facility, the lenders thereunder could elect to declare all outstanding debt, accrued interest and fees under the facility to be due and immediately payable. In the event

of any such default under our indenture, either the trustee or the holders of at least 25 percent of the outstanding principal amount of the Notes could declare the principal amount of all of the Notes to be due and payable immediately.

*We may not be able to refinance our indebtedness on favorable terms, if at all. Our inability to refinance our indebtedness could materially and adversely affect our liquidity and our ongoing results of operations.*

Our ability to refinance indebtedness, including the Notes, will depend in part on our operating and financial performance, which, in turn, is subject to prevailing economic conditions and to financial, business, legislative, regulatory and other factors beyond our control. In addition, prevailing interest rates or other factors at the time of refinancing could increase our interest expense. A refinancing of our indebtedness, including the Notes, could also require us to comply with more onerous covenants and further restrict our business operations. Our inability to refinance our indebtedness or to do so upon attractive terms could materially and adversely affect our business, results of operations, financial condition and cash flows, and make us vulnerable to adverse industry and general economic conditions.

*Changes in our effective income tax rate may have an adverse effect on our results of operations*

We are subject to taxes in the United States and numerous foreign jurisdictions, including Belgium, where a number of our subsidiaries are organized. Due to economic and political conditions, tax rates in various jurisdictions may be subject to significant change. Our future effective tax rate could be affected by changes in the mix of earnings in countries with different statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in the enforcement environment, and changes in tax laws or their interpretations, including in the United States and in foreign jurisdictions. For example, in January 2016, the European Commission announced a decision concluding that certain rules under Belgian tax legislation are deemed to be incompatible with European Union regulations on state aid. As a result of this decision, the European Commission has directed the Belgian Government to recover past taxes from certain entities, reflective of disallowed state aid, which impacts one of the Company's international subsidiaries. The Belgian Government announced they have appealed this decision and filed action for an annulment in the General Court of the European Union, and in July 2016 the Company filed a separate appeal with the General Court of the European Union. The Company recorded discrete tax expense of \$39.6 million during 2016 related to this matter and on January 10, 2017, received tax assessments from the Belgium government for a similar amount. The Company has filed a complaint against the Belgian tax assessments, and the result of this complaint, the appeal with the General Court of the European Union, new information received from the Belgian Government, or other future events may cause the income tax provision associated with the decision to be entirely or partially reversed.

Our future effective tax rate may be adversely affected by a number of additional factors including:

- the jurisdictions in which profits are determined to be earned and taxed;
- the resolution of issues arising from tax audits with various tax authorities;
- changes in the valuation of our deferred tax assets and liabilities;
- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes;
- changes in available tax credits;
- changes in share-based compensation expense;
- changes in tax laws or the interpretation of such tax laws and changes in generally accepted accounting principles;
- changes in foreign tax rates or agreed upon foreign taxable base; and/or
- the repatriation of earnings from outside the United States for which we have not previously provided for United States taxes.

Any significant increase in our future effective tax rates could adversely impact net income for future periods. In addition, the United States Internal Revenue Service ("IRS") and other tax authorities regularly examine our income tax returns. Our financial condition and results of operations could be adversely impacted if any assessments resulting from the examination of our income tax returns by the IRS or other taxing authorities are not resolved in our favor.

*State of Oregon law and our charter documents contain provisions that could discourage or prevent a potential takeover, even if the transaction would benefit our shareholders*

Other companies may seek to acquire or merge with us. An acquisition or merger of our Company could result in benefits to our shareholders, including an increase in the value of our common stock. Some provisions of our Articles of Incorporation and Bylaws, including our ability to issue preferred stock without further action by our shareholders, as well as provisions of the State of Oregon law, may discourage, delay or prevent a merger or acquisition that a shareholder may consider favorable.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

## ITEM 2. PROPERTIES

At December 31, 2016, we conducted manufacturing, research and development, and sales and administration in 94 facilities worldwide. Of these, we owned 7 facilities with approximately 712 thousand square feet and leased 27 facilities with approximately 441 thousand square feet in the United States, and we owned 7 facilities with approximately 328 thousand square feet and leased 53 facilities with approximately 296 thousand square feet outside the United States, primarily in Europe. Our headquarters is located in Wilsonville, Oregon.

Our major facilities include the following locations:

| <u>Location</u>                               | <u>Owned</u>                      | <u>Leased</u> |
|---|-----------------------------------|---------------|
|   | <u>(Square feet in Thousands)</u> |               |
| Wilsonville (Portland), Oregon .....          | 154                               | —             |
| North Billerica (Boston), Massachusetts ..... | 133                               | —             |
| Täby (Stockholm), Sweden .....                | 205                               | —             |
| Elkridge (Baltimore), Maryland .....          | —                                 | 109           |
| Nashua, New Hampshire .....                   | 140                               | —             |
| Tallinn, Estonia .....                        | 46                                | —             |
| Markham (Toronto), Ontario, Canada .....      | —                                 | 27            |
| Goleta (Santa Barbara), California .....      | 169                               | —             |
| Fareham (Portsmouth), United Kingdom .....    | 63                                | —             |
| Stillwater, Oklahoma .....                    | —                                 | 28            |
| Meer (Antwerp), Belgium .....                 | —                                 | 12            |
| Other .....                                   | 130                               | 561           |
| Total .....                                   | <u>1,040</u>                      | <u>737</u>    |

Our reportable segments operate out of facilities as follows:

Surveillance: Wilsonville, Oregon; North Billerica, Massachusetts; Täby, Sweden; Elkridge, Maryland; and 14 facilities in the United States and 15 facilities located outside the United States.

Instruments: Täby, Sweden; Nashua, New Hampshire; Tallinn, Estonia; and 2 facilities in the United States and 23 facilities located outside the United States.

Security: Markham, Ontario, Canada and 1 facility in the United States and 23 facilities outside the United States.

OEM & Emerging Markets: Goleta, California and 2 facilities in the United States and 20 facilities located outside the United States.

Maritime: Fareham, United Kingdom and 1 facility in the United States and 19 facilities located outside the United States.

Detection: Stillwater, Oklahoma; Elkridge, Maryland; and 6 facilities in the United States and 2 facilities located outside the United States.

We believe all of our properties are suitable for their intended use, adequate to meet our current and near-term business needs, and in good condition. We do not anticipate difficulty in renewing existing leases as they expire or in finding alternative facilities.

### ITEM 3. LEGAL PROCEEDINGS

FLIR Systems, Inc. and its subsidiary, FLIR Commercial Systems, Inc. (formerly known as Indigo Systems Corporation) (together, the “FLIR Parties”), were named in a lawsuit filed by Raytheon Company (“Raytheon”) on March 2, 2007 in the United States District Court for the Eastern District of Texas. Raytheon's complaint, as amended, asserted claims for tortious interference, patent infringement, trade secret misappropriation, unfair competition, breach of contract and fraudulent concealment. The FLIR Parties filed an answer to the complaint on September 2, 2008, in which they denied all material allegations. On October 27, 2010, the FLIR Parties and Raytheon entered into a settlement agreement that resolved the patent infringement claims (the "Patent Claims") pursuant to which the FLIR Parties paid \$3 million to Raytheon and entitles the FLIR Parties to certain license rights in the patents that were the subject of the Patent Claims. On October 28, 2014, a four-week trial began with respect to Raytheon's remaining claims of misappropriations of trade secrets and claims related to 31 alleged trade secrets. On November 24, 2014, a jury in the United States District Court for the Eastern District of Texas rejected Raytheon's claims and determined that 27 of the alleged trade secrets were not in fact trade secrets and that neither of the FLIR Parties infringed any of the trade secrets claimed and awarded Raytheon no damages. On March 31, 2016 the United States District Court for the Eastern District of Texas issued a Final Judgment denying Raytheon's claims and awarding FLIR court costs and denying each of Raytheon's and FLIR's Renewed Motions for Judgment as a Matter of Law and denying FLIR's Amended Rule 54(d) Motion for Attorneys' Fees and Costs Under the Texas Theft Liability Act.

On April 29, 2016, Raytheon filed a Notice of Appeal to the United States Court of Appeals for the Federal Circuit of the denial by the United States District Court for the Eastern District of Texas of Raytheon's Renewed Motion for Judgment as a Matter of Law, or in the Alternative, Motion for New Trial. On May 11, 2016, the FLIR Parties filed a Notice of Appeal to the United States Court of Appeals for the Federal Circuit of the Order of the United States District Court for the Eastern District of Texas Denying the FLIR Parties' Amended Rule 54(d) Motion for Attorneys' Fees and Costs under the Texas Theft Liability Act, the Order Denying the FLIR Parties' Renewed Motion For Judgment as a Matter Of Law, and the Final Judgment to the extent it denied the FLIR Parties Attorneys' Fees and Costs under the Texas Theft Liability Act. The matter remains ongoing and is subject to appeal and the Company is unable to estimate the amount or range of potential loss or recovery, if any, which might result if the final determination of this matter is favorable or unfavorable, but an adverse ruling on the merits of the original claims against the FLIR Parties, while remote, could be material.

On October 22, 2014, the Company initially contacted the United States Department of State Office of Defense Trade Controls Compliance (“DDTC”), pursuant to International Traffic in Arms Regulation (“ITAR”) § 127.12(c), regarding the unauthorized export of technical data and defense services to dual and third country nationals in at least four facilities of the Company. On April 27, 2015, the Company submitted its initial report to DDTC regarding the details of the issues raised in the October 22, 2014 submission. DDTC subsequently notified the Company that it was considering administrative proceedings under Part 128 of ITAR and requested a tolling agreement, which the Company executed on June 16, 2015. On June 6, 2016, the Company executed a subsequent tolling agreement extending the tolling period for matters to be potentially included in an administrative proceeding for an additional 18 months until December 2017. DDTC continues its review and the Company is unable to reasonably estimate the time it may take to resolve the matter or the amount or range of potential loss, penalty or other government action, if any, that may be incurred in connection with this matter. However, an unfavorable outcome could result in fines and penalties, or loss, or modification of exporting privileges that could potentially be material to the financial condition, results of operations, and cash flows of the Company in and following the period in which such an outcome becomes estimable or known.

In March 2016, the Company learned of potential quality concerns with respect to as many as 312 Level III and Level IV SkyWatch Surveillance Towers sold by FLIR and companies acquired by FLIR from 2002 through 2014. During the quarter ended September 30, 2016, the Company identified the cause of these quality issues and tested certain remedial solutions which may be required to repair the affected SkyWatch Towers. Testing of the remedial solution is ongoing. The Company has notified customers who purchased the affected SkyWatch Towers of the potential concerns and, as a precautionary measure, has also temporarily suspended production of all Level III and Level IV SkyWatch Towers pending the completion of its review and the implementation of any necessary remedial measures. While there still remains uncertainty related to estimating the costs associated with a potential remedy and number of units which may require such remedy, the Company currently estimates the range of potential loss to be between \$2.5 million and \$15 million. As no single amount within the range is a better estimate than any other amount within the range, the Company has recorded a liability of \$2.5 million as of December 31, 2016. Factors underlying this estimated range of loss may change from time to time, and actual results may vary significantly from this estimate.

The Company is also subject to other legal and administrative proceedings, investigations, claims and litigation arising in the ordinary course of business not specifically identified above. In these identified matters and others not specifically identified, the Company makes a provision for a liability with respect to a matter when it is both probable that a liability has been incurred and the amount of loss can be reasonably estimated for such matter. The Company believes it has recorded adequate provisions for any probable and estimable losses for matters in existence on the date hereof. While the outcome of each of these matters is currently not determinable, the Company does not expect that the ultimate resolution of any such matter will individually have a material adverse effect on the Company's financial position, results of operations or cash flows. The costs to resolve all such matters may in the aggregate have a material adverse effect on the Company's financial position, results of operations or cash flows.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable.



**PART II**

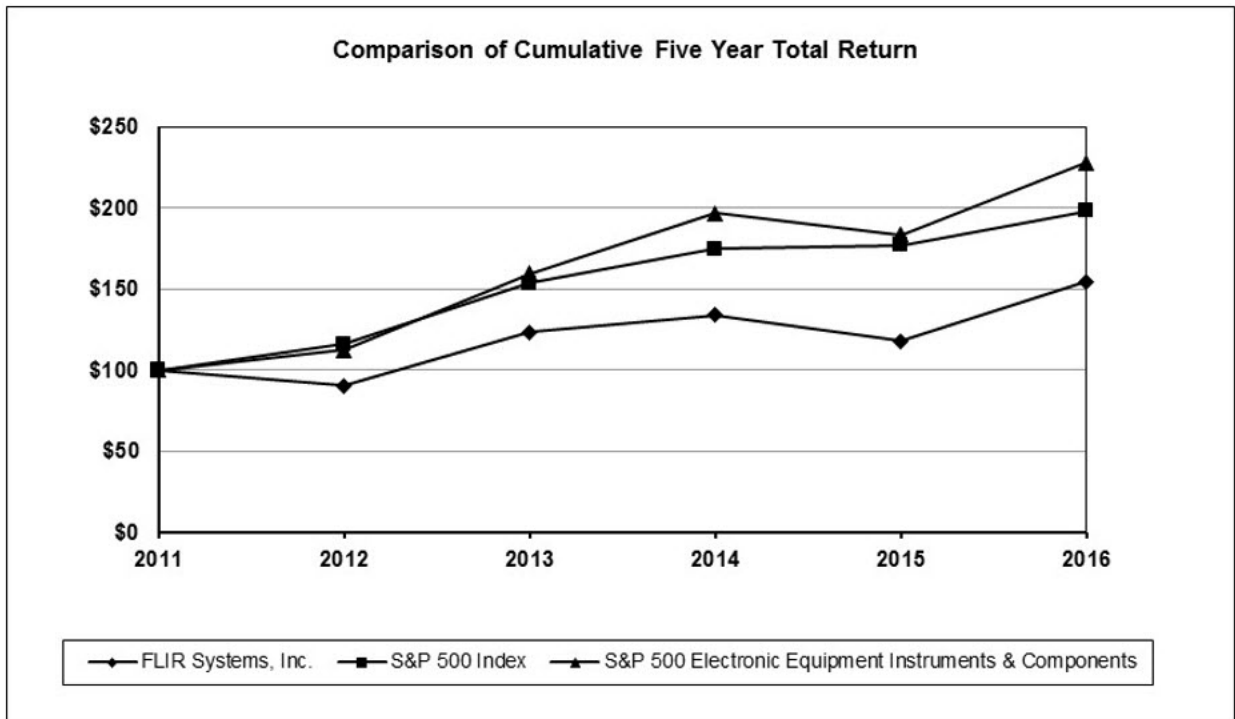
**ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The common stock of the Company has been traded on the NASDAQ Global Market since June 22, 1993, under the symbol “FLIR.” The following table sets forth, for the quarters indicated, the high and low closing sales price for our common stock as reported on the NASDAQ Global Select Market, a segment of the NASDAQ Global Market.

|                      | 2016     |          | 2015     |          |
|----------------------|----------|----------|----------|----------|
|                      | High     | Low      | High     | Low      |
| First Quarter .....  | \$ 33.78 | \$ 27.60 | \$ 33.97 | \$ 29.80 |
| Second Quarter ..... | 33.92    | 29.08    | 31.93    | 30.09    |
| Third Quarter .....  | 33.23    | 30.41    | 31.99    | 27.06    |
| Fourth Quarter ..... | 36.77    | 28.97    | 30.56    | 26.01    |

At December 31, 2016, there were approximately 88 holders of record of our common stock and 136,333,957 shares outstanding. During the year ended December 31, 2015, we paid dividends quarterly at the rate of \$0.11 per share for a total of \$61.4 million. During the year ended December 31, 2016, we paid dividends quarterly at the rate of \$0.12 per share for a total of \$65.9 million. On February 9, 2017, the Company’s Board of Directors declared a quarterly dividend of \$0.15 per share on its common stock, payable on March 10, 2017, to shareholders of record as of the close of business on February 24, 2017. We currently intend to continue to pay cash dividends to holders of our common stock for the foreseeable future, but such payment remains at the discretion of our Board of Directors and will depend upon many factors, including our financial condition, earnings, and other factors our Board of Directors deems relevant.

The graph below shows a comparison of the five-year cumulative total shareholder return for the Company’s common stock with the cumulative total returns on the Standard & Poor’s (“S&P”) 500 Index and the S&P 500 Electronic Equipment & Instruments Index for the same five-year period. The data used for this graph assumes that \$100 was invested in the Company and in each index on December 31, 2011, and that all dividends were reinvested.



The stock performance graph was plotted using the following data:

|  | <u>2011</u> | <u>2012</u> | <u>2103</u> | <u>2014</u> | <u>2015</u> | <u>2016</u> |
|--|-------------|-------------|-------------|-------------|-------------|-------------|
| FLIR Systems, Inc. ....  | \$ 100.00   | \$ 90.19    | \$ 123.23   | \$ 133.91   | \$ 118.00   | \$ 154.48   |
| S&P 500 Index .....  | 100.00      | 116.00      | 153.57      | 174.60      | 177.01      | 198.18      |
| S&P 500 Electronic Equipment Instruments &<br>Components Index ..... | 100.00      | 112.57      | 159.85      | 196.70      | 183.33      | 228.02      |

During 2016, we repurchased approximately 2.1 million shares for a total of approximately \$66.1 million. The following table summarizes our 2016 common stock repurchase activities:

| <b>Period</b>                           | <b>Total Number of<br/>Shares Purchased</b> | <b>Average Price Paid<br/>per Share</b> | <b>Total Number of<br/>Shares Purchased<br/>as Part of Publicly<br/>Announced<br/>Plans or Programs</b> | <b>Maximum Number<br/>of Shares that May<br/>Yet Be Purchased at<br/>December 31, 2016<br/>Under the Plans or<br/>Programs</b> |
|---|---|---|---|--|
| June 1 to June 30, 2016 .....           | 950,000                                     | \$ 31.31                                | 950,000   |  |
| August 1 to August 31, 2016 .....       | 598,900                                     | \$ 30.63                                | 598,900   |  |
| September 1 to September 30, 2016 ..... | 582,770                                     | \$ 30.83                                | 582,770   |  |
| <b>Total</b> .....                      | <u>2,131,670</u>                            | <u>\$ 30.99</u>                         | <u>2,131,670</u>  | <u>8,699,461</u>   |

All share repurchases are subject to applicable securities laws, and are at times and in amounts as management deems appropriate. All shares of our common stock repurchased in 2016 were repurchased under authorization by our Board of Directors, granted on February 5, 2015, pursuant to which we were authorized to repurchase up to 15.0 million shares of our outstanding common stock in the open market or through privately negotiated transactions. This authorization expired on February 5, 2017. On February 8, 2017, our Board of Directors authorized the repurchase of up to 15.0 million shares of our outstanding common stock. This authorization will expire on February 8, 2019.

**ITEM 6. SELECTED FINANCIAL DATA**

The following selected financial data should be read in conjunction with Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Item 8 “Financial Statements and Supplementary Data.”

|   | Year Ended December 31,                  |                   |                   |                   |                   |
|---|--|-------------------|-------------------|-------------------|-------------------|
|   | 2016                                     | 2015              | 2014              | 2013              | 2012              |
|   | (in thousands, except per share amounts) |                   |                   |                   |                   |
| <b>Statement of Income Data:</b>                        |  |                   |                   |                   |                   |
| Revenue   | \$ 1,662,167                             | \$ 1,557,067      | \$ 1,530,654      | \$ 1,496,372      | \$ 1,405,358      |
| Cost of goods sold                                      | 895,046                                  | 803,506           | 780,281           | 759,362           | 670,174           |
| Gross profit  | 767,121                                  | 753,561           | 750,373           | 737,010           | 735,184           |
| Operating expenses:                                     |  |                   |                   |                   |                   |
| Research and development                                | 147,537                                  | 132,892           | 142,751           | 147,696           | 137,354           |
| Selling, general and administrative                     | 322,435                                  | 313,544           | 331,995           | 322,739           | 292,500           |
| Restructuring expenses                                  | 1,431                                    | 1,361             | 16,383            | 25,832            | 2,000             |
| Total operating expenses                                | 471,403                                  | 447,797           | 491,129           | 496,267           | 431,854           |
| Earnings from operations                                | 295,718                                  | 305,764           | 259,244           | 240,743           | 303,330           |
| Interest expense  | 18,071                                   | 14,086            | 14,593            | 14,091            | 11,659            |
| Interest income   | (1,402)                                  | (1,167)           | (1,405)           | (1,058)           | (1,582)           |
| Other expense (income), net                             | 3,092                                    | (12,601)          | (3,473)           | (1,276)           | 1,341             |
| Earnings from continuing operations before income taxes | 275,957                                  | 305,446           | 249,529           | 228,986           | 291,912           |
| Income tax provision                                    | 109,331 <sup>(1)</sup>                   | 63,760            | 49,268            | 51,971            | 66,556            |
| Earnings from continuing operations                     | 166,626                                  | 241,686           | 200,261           | 177,015           | 225,356           |
| Loss from discontinued operations, net of tax           | —  | —                 | —                 | —                 | (2,958)           |
| Net earnings  | <u>\$ 166,626</u>                        | <u>\$ 241,686</u> | <u>\$ 200,261</u> | <u>\$ 177,015</u> | <u>\$ 222,398</u> |
| Basic earnings per share:                               |  |                   |                   |                   |                   |
| Continuing operations                                   | \$ 1.22                                  | \$ 1.73           | \$ 1.42           | \$ 1.24           | \$ 1.49           |
| Discontinued operations                                 | —  | —                 | —                 | —                 | (0.02)            |
| Basic earnings per share                                | <u>\$ 1.22</u>                           | <u>\$ 1.73</u>    | <u>\$ 1.42</u>    | <u>\$ 1.24</u>    | <u>\$ 1.47</u>    |
| Diluted earnings per share:                             |  |                   |                   |                   |                   |
| Continuing operations                                   | \$ 1.20                                  | \$ 1.72           | \$ 1.39           | \$ 1.22           | \$ 1.47           |
| Discontinued operations                                 | —  | —                 | —                 | —                 | (0.02)            |
| Diluted earnings per share                              | <u>\$ 1.20</u>                           | <u>\$ 1.72</u>    | <u>\$ 1.39</u>    | <u>\$ 1.22</u>    | <u>\$ 1.45</u>    |

(1) The 2016 tax provision is higher than in prior years due to a discrete tax charge for certain tax legislation in Belgium of \$39.6 million. See Note 14, "Income Taxes," of the Notes to the Consolidated Financial Statements for additional information.

|   | December 31,                             |            |            |              |            |
|---|--|------------|------------|--------------|------------|
|   | 2016                                     | 2015       | 2014       | 2013         | 2012       |
|   | (in thousands, except per share amounts) |            |            |              |            |
| <b>Balance Sheet Data:</b>                |  |            |            |              |            |
| Working capital                           | \$ 802,945                               | \$ 702,169 | \$ 990,771 | \$ 1,033,216 | \$ 923,679 |
| Total assets                              | 2,619,706                                | 2,406,400  | 2,349,311  | 2,343,359    | 2,190,655  |
| Short-term debt                           | 15,025                                   | 264,707    | 15,041     | 15,064       | 374        |
| Long-term debt, excluding current portion | 501,921                                  | 93,750     | 357,986    | 372,528      | 248,319    |
| Total shareholders' equity                | 1,678,326                                | 1,649,515  | 1,609,773  | 1,613,380    | 1,599,901  |
| <b>Other Financial Data:</b>              |  |            |            |              |            |
| Cash dividends declared per common share  | \$ 0.48                                  | \$ 0.44    | \$ 0.40    | \$ 0.36      | \$ 0.28    |

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

### Overview

We are a world leader in sensor systems that enhance perception and awareness. We were founded in 1978 and have since become a premier designer, manufacturer, and marketer of thermal imaging and other sensing products and systems. Our advanced sensors and integrated sensor systems enable the gathering and analysis of critical information through a wide variety of applications in commercial, industrial, and government markets worldwide.

Our goal is to both enable our customers to benefit from the valuable information produced by advanced sensing technologies and to deliver sustained superior financial performance for our shareholders. We create value for our customers by providing advanced surveillance and tactical defense capabilities, improving personal and public safety and security, facilitating air, ground, and maritime navigation, enhancing enjoyment of the outdoors, providing infrastructure inefficiency information, conveying pre-emptive structural deficiency data, displaying process irregularities, and enabling commercial business opportunities through our continual support and development of new thermal imaging data and analytics applications. Our business model meets the needs of a wide range of customers – we sell off-the-shelf products to many markets and also offer a variety of system configurations to suit specific customer requirements. Centered on the design of products for low cost manufacturing and high volume distribution, our commercial operating model has been developed over time and provides us with a unique ability to adapt to market changes and meet our customers' needs.

This Management's Discussion and Analysis of Financial Condition and Results of Operations is prepared and reported based on our reporting structure of six operating segments. For a more detailed description of our segments, see "Business Segments" within Item 1.

International revenue accounted for approximately 46 percent, 47 percent and 49 percent of our revenue in 2016, 2015 and 2014, respectively. We anticipate that international sales will continue to account for a significant percentage of revenue in the future. We have exposure to foreign exchange fluctuations and changing dynamics of foreign competitiveness based on variations in the value of the United States dollar relative to other currencies. Factors contributing to this variability include significant manufacturing activity in Europe, significant sales denominated in currencies other than the United States dollar, and cross currency fluctuations between such currencies as the United States dollar, euro, Swedish kronor and British pound sterling. The impact of those fluctuations is reflected throughout our consolidated financial statements, but in the aggregate, did not have a material impact on our results of operations in 2016.

We experience fluctuations in orders and sales due to seasonal variations and customer sales cycles, such as the seasonal pattern of contracting by the United States and certain foreign governments, the desire of customers to take delivery of equipment prior to fiscal year ends due to funding considerations, and the tendency of commercial enterprises to fully utilize annual capital budgets prior to expiration. Such events have resulted and could continue to result in fluctuations in quarterly results in the future. As a result of such quarterly fluctuations in operating results, we believe that quarter-to-quarter comparisons of our results of operations are not necessarily meaningful and should not be relied upon as indicators of future performance.

We expect that macroeconomic factors, including reduced spending by United States government agencies and economic weaknesses in certain geographic markets, will continue to present challenges for us and render predictions regarding future performance difficult to make.

### Critical Accounting Policies and Estimates

This discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with United States generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, inventories, goodwill, warranty obligations, contingencies and income taxes on an on-going basis. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Senior management has discussed the development, selection and disclosure of these estimates with the Audit Committee of our Board of Directors. We believe the following critical accounting policies and the related judgments and estimates affect the preparation of our consolidated financial statements.

*Revenue recognition.* Revenue is recognized when persuasive evidence of an arrangement exists, upon delivery of the product to the customer at a fixed or determinable price with a reasonable assurance of collection, passage of title and risk of loss to the customer as indicated by the contractual terms and fulfillment of all significant obligations.

We design, market and sell our products primarily as commercial, off-the-shelf products. Certain customers request different system configurations, generally based on standard options or accessories that we offer. In general, our revenue arrangements do not involve acceptance provisions based upon customer specified acceptance criteria. In those circumstances when customer specified acceptance criteria exist, revenue is deferred until customer acceptance if we cannot demonstrate that the system meets those specifications prior to shipment. For any contracts with multiple elements (i.e., training, installation, additional parts, etc.) we allocate revenue among the deliverables primarily based upon objective and reliable evidence of fair value of each element in the arrangement. If objective and reliable evidence of fair value of any element is not available, we use an estimated selling price for purposes of allocating the total arrangement consideration among the elements. In addition, judgments are required in evaluating the credit worthiness of our customers. Credit is not extended to customers and revenue is not recognized until we have determined that collectability is reasonably assured.

*Allowance for doubtful accounts.* Our policy is to maintain allowances for estimated losses resulting from the inability of our customers to make required payments. Credit limits are established through a process of reviewing the financial history and stability of each customer. Where appropriate, we obtain credit rating reports and financial statements of the customer when determining or modifying their credit limits. We regularly evaluate the collectability of our trade receivable balances based on a combination of factors. When a customer's account balance becomes past due, we initiate dialogue with the customer to determine the cause. If it is determined that the customer will be unable to meet its financial obligation to us, such as in the case of a bankruptcy filing, deterioration in the customer's operating results or financial position or other material events impacting their business, we record a specific allowance to reduce the related receivable to the amount we expect to recover given all information presently available. Actual write-offs during the past three years have not been material to our results of operations.

We also record an allowance for all other customers based on certain other factors including the length of time the receivables are past due and historical collection experience with individual customers. As of December 31, 2016, our accounts receivable balance of \$352.0 million is reported net of allowances for doubtful accounts of \$6.5 million. We believe our reported allowances at December 31, 2016 are adequate. If the financial conditions of those customers were to deteriorate, however, resulting in their inability to make payments, we may need to record additional allowances that would result in additional selling, general and administrative expenses being recorded for the period in which such determination is made.

*Inventory.* Our policy is to record inventory write-downs when conditions exist that indicate that our inventories are likely to be in excess of anticipated demand or are obsolete based upon our assumptions about future demand for our products and market conditions. We regularly evaluate the ability to realize the value of our inventories based on a combination of factors including the following: historical usage rates, forecasted sales or usage, product end of life dates, estimated current and future market values and new product introductions. Purchasing requirements and alternative usages are evaluated within these processes to mitigate inventory exposure. When recorded, our write-downs are intended to reduce the carrying value of our inventories to their net realizable value and establish a new cost basis. As of December 31, 2016, our inventories of \$371.4 million are stated net of inventory write-downs. If actual demand for our products deteriorates or market conditions are less favorable than those that we project, additional inventory write-downs may be required in the future.

*Goodwill.* Goodwill represents the excess purchase price of an acquired enterprise or assets over the estimated fair value of identifiable net assets acquired. We assess goodwill for potential impairment at the reporting unit level during the third quarter of each year, or whenever events or circumstances indicate that the carrying value of these assets may exceed their fair value. We may assess qualitative factors to make this determination, or bypass such a qualitative assessment and proceed directly to testing goodwill for impairment using a two-step process. Qualitative factors we may consider include, but are not limited to, macroeconomic conditions, industry conditions, the competitive environment, changes in the market for our products and services, regulatory and political developments and entity specific factors such as strategies and financial performance. If there are indicators that goodwill has been impaired we proceed to a two-step impairment test, whereby the first step is comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds the carrying value, goodwill is not impaired and no further testing is performed. The second step is performed if the carrying value of a reporting unit exceeds its fair value. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, an impairment loss equal to the difference is recorded. Our impairment test in the current year did not indicate an impairment of goodwill in any of our reporting units.

*Product warranties.* Our products are sold with warranty provisions that require us to remedy deficiencies in quality or performance of our products over a specified period of time, generally twelve to twenty-four months, at no cost to our customers. Our policy is to record warranty liabilities at levels that represent our estimate of the costs that will be incurred to fulfill those

warranty requirements at the time that revenue is recognized. We believe that our recorded liability of \$20.8 million at December 31, 2016 is adequate to cover our future cost of materials, labor and overhead for the servicing of our products sold through that date. If actual product failures or material or service delivery costs differ from our estimates, our warranty liability would need to be revised accordingly.

*Contingencies.* We are subject to the possibility of loss contingencies arising in the normal course of business. We consider the likelihood of loss or impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals and disclosures should be adjusted.

*Income taxes.* We account for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of the assets and liabilities measured using the enacted tax rates in effect in the years in which the differences are expected to reverse. Valuation allowances against deferred tax assets are recorded when a determination is made that the deferred tax assets are not more likely than not to be realized in the future. In making that determination, on a jurisdiction by jurisdiction basis, we estimate our future taxable income based upon historical operating results and external market data. Future levels of taxable income are dependent upon, but not limited to, general economic conditions, competitive pressures and other factors beyond our control. As of December 31, 2016, we have determined that a valuation allowance against our deferred tax assets of \$2.9 million is required. If we should determine that we may be unable to realize our deferred tax assets to the extent reported, an adjustment to the deferred tax assets would be recorded in the period such determination is made.

We are subject to income taxes in the United States and in numerous foreign jurisdictions, and in the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. While we believe the positions we have taken are appropriate, we have reserves for taxes to address potential exposures involving tax positions that are being challenged or that could be challenged by the tax authorities. We record a benefit on a tax position when we determine that it is more likely than not that the position is sustainable upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. For tax positions that are more likely than not to be sustained, we measure the tax position at the largest amount of benefit that has a greater than 50 percent likelihood of being realized when it is effectively settled, using information that is available at the reporting date. We review the tax reserves as circumstances warrant and adjust the reserves as changes in available facts arise that affect our potential liability for additional taxes.

## Consolidated Operating Results

The following table sets forth for the indicated periods certain items as a percentage of revenue:

|   | Year Ended December 31, <sup>(1)</sup> |        |        |
|---|--|--------|--------|
|   | 2016                                   | 2015   | 2014   |
| Revenue .....                             | 100.0%                                 | 100.0% | 100.0% |
| Cost of goods sold .....                  | 53.8                                   | 51.6   | 51.0   |
| Gross profit .....                        | 46.2                                   | 48.4   | 49.0   |
| Operating expenses:                       |  |        |        |
| Research and development .....            | 8.9                                    | 8.5    | 9.3    |
| Selling, general and administrative ..... | 19.4                                   | 20.1   | 21.7   |
| Restructuring expenses .....              | 0.1                                    | 0.1    | 1.1    |
| Total operating expenses .....            | 28.4                                   | 28.8   | 32.1   |
| Earnings from operations .....            | 17.8                                   | 19.6   | 16.9   |
| Interest expense .....                    | 1.1                                    | 0.9    | 1.0    |
| Interest income .....                     | (0.1)                                  | (0.1)  | (0.1)  |
| Other expense (income), net .....         | 0.2                                    | (0.8)  | (0.2)  |
| Earnings before income taxes .....        | 16.6                                   | 19.6   | 16.3   |
| Income tax provision .....                | 6.6                                    | 4.1    | 3.2    |
| Net earnings .....                        | 10.0%                                  | 15.5%  | 13.1%  |

(1) Totals may not recompute due to rounding.

The following discussion of operating results provides an overview of our operations by addressing key elements in our Consolidated Statements of Income. The “Segment Operating Results” section that follows describes the contributions of each of our business segments to our consolidated revenue and earnings from operations for 2016, 2015 and 2014. Given the nature of our business, we believe revenue and earnings from operations (including operating margin percentage) are most relevant to an understanding of our performance at a segment level. Additionally, at the segment level we disclose backlog, which represents orders received for products or services for which a sales agreement is in place and delivery is expected within twelve months.

*Revenue.* Revenue for 2016 totaled \$1,662.2 million, an increase of 6.7 percent from 2015 revenue of \$1,557.1 million. Year over year revenue growth was primarily due to increases in our OEM & Emerging, Surveillance, and Security segments, partially offset by a decline in our Instruments segment. Acquisitions made during the year ended December 31, 2016 constitute approximately 2.1% of consolidated revenue.

Revenue for 2015 totaled \$1,557.1 million, an increase of 1.7 percent over 2014 revenue of \$1,530.7 million. Year over year revenue growth was primarily due to increases in our Security and Detection segments, partially offset by declines in our Surveillance, Instruments, OEM & Emerging Markets, and Maritime segments. The revenue increase was negatively impacted by year over year changes in foreign currency rates, particularly in our Instruments and Maritime segments.

International revenue in 2016 totaled \$758.6 million, representing 45.6 percent of revenue. This compares with international revenue in 2015 which totaled \$726.6 million, representing 46.7 percent of revenue, and \$747.0 million in 2014, representing 48.8 percent of revenue. While the sales mix between United States and international sales may fluctuate from year to year, we expect revenue from customers outside the United States to continue to comprise a significant portion of our total revenue on a long-term basis.

*Cost of goods sold.* Cost of goods sold for the years ended December 31, 2016 and 2015 was \$895.0 million and \$803.5 million, respectively. The increase is primarily due to the increase in revenues year over year as discussed above and changes in product mix and increased manufacturing variances and period costs.

Cost of goods sold in 2015 was \$803.5 million, compared to cost of goods sold of \$780.3 million in 2014. The increase is primarily due to the increase in revenues year over year as discussed above and changes in product mix.

Cost of goods sold includes materials, labor and overhead costs incurred in the manufacturing of products and services sold in the period as well as warranty costs. Material costs include raw materials, purchased components and sub-assemblies, outside processing and inbound freight costs. Labor and overhead costs consist of direct and indirect manufacturing costs, including wages and fringe benefits, operating supplies, depreciation and amortization, occupancy costs, and purchasing, receiving and inspection costs.

*Gross profit.* Gross profit for the year ended December 31, 2016 was \$767.1 million compared to \$753.6 million in 2015. Gross margin, defined as gross profit divided by revenue, decreased from 48.4 percent in 2015 to 46.2 percent in 2016 primarily due to changes in product mix and increased manufacturing variances and period costs.

Gross profit for the year ended December 31, 2015 was \$753.6 million compared to \$750.4 million in 2014. Gross margin decreased slightly from 49.0 percent in 2014 to 48.4 percent in 2015 primarily due to changes in product mix and the negative impact of year over year changes in foreign currency rates.

*Research and development.* Research and development expenses were \$147.5 million, or 8.9 percent of revenue, in 2016, compared to \$132.9 million, or 8.5 percent of revenue, in 2015, and \$142.8 million, or 9.3 percent of revenue, in 2014.

We believe that spending levels are sufficient to support the development of new products and the continued growth of the business. We expect research and development expenses to be approximately 8 to 10 percent of revenue on a long-term basis.

*Selling, general and administrative expenses.* Selling, general and administrative expenses were \$322.4 million, or 19.4 percent of revenue, in 2016 compared to \$313.5 million, or 20.1 percent of revenue, in 2015 and \$332.0 million, or 21.7 percent of revenue, in 2014. The increase in selling, general and administrative expenses in 2016 compared to 2015 was primarily due to an increase in selling expenses to support the increase in revenue mentioned above as well as increased operating expenses associated with the acquisitions of DVTEL in November 2015 and Armasight in June 2016. The decrease in selling, general, and administrative expenses as a percentage of revenue in 2016 compared to 2015 is due to the successful implementation of cost cutting measures in 2016. The decrease in selling, general and administrative expenses in 2015 compared to 2014 was primarily due to a \$15.6 million decrease in corporate expenses primarily related to 2014 legal expenses incurred for litigation matters and costs of a regulatory settlement. While selling, general and administrative expenses may be affected in the future by acquisitions with different cost structures, we anticipate selling, general and administrative expenses to increase at a slower rate than revenue in our existing businesses.



*Restructuring expenses.* During the years ended December 31, 2016, 2015 and 2014, we recorded net pre-tax restructuring expenses totaling \$1.4 million, \$1.4 million and \$17.0 million, respectively. Restructuring expenses recorded in 2016 and 2015 were recorded in operating expenses. Of the restructuring expenses recorded in 2014, \$16.4 million was recorded in operating expenses and \$0.6 million was recorded in costs of goods sold. In the fourth quarter of 2013, we initiated a realignment plan that included closing six not-to-scale sites in the United States and Europe and a transfer of those operations to larger facilities. We also consolidated our optics and laser manufacturing businesses to better realize the benefits of vertical integration in these areas. The benefits from these actions are reflected in our operating results. As of December 31, 2016, we have completed the majority of the actions in our realignment plan.

*Interest expense.* Interest expense totaled \$18.1 million, \$14.1 million and \$14.6 million for the years ended December 31, 2016, 2015 and 2014, respectively. Interest expense for the year was primarily associated with the \$250 million aggregate principal amount of our 3.75 percent senior unsecured notes that were repaid in July 2016, the \$425 million aggregate principal amount of 3.125 percent senior unsecured notes that were issued in June 2016, and amounts drawn under our credit facility. The increase in interest expense in 2016 compared to 2015 is primarily due to the increased amount of interest bearing debt as well as a \$1.3 million loss on the extinguishment of the \$250 million unsecured notes that were repaid in July 2016.

*Other expense (income), net.* Other expense totaled \$3.1 million for the year ended December 31, 2016. Other income totaled \$12.6 million and \$3.5 million for the years ended December 31, 2015 and 2014, respectively. The change in other expenses (income), net in 2016 compared to 2015 is primarily attributed to the gain on the sale of our cost-basis investment in a private technology company during the year ended December 31, 2015.

*Income taxes.* Our income tax provision was \$109.3 million, \$63.8 million and \$49.3 million in 2016, 2015 and 2014, respectively. The effective tax rates for 2016, 2015 and 2014 were 39.6 percent, 20.9 percent and 19.7 percent, respectively. The mix in taxable income between our United States and international operations has a significant impact on our annual income tax provision and effective tax rates. Our effective tax rate in 2016 is higher than the United States federal tax rate of 35 percent mainly due to discrete charges, partially offset by the mix of lower foreign tax rates. In 2016, the discrete items included \$39.6 million primarily related to the European Commission's decision regarding certain tax legislation in Belgium impacting one of the Company's international subsidiaries. In 2015, the discrete items included a \$12.1 million release of a previously recorded tax valuation allowance, and in 2014, the discrete items included a \$9.4 million release of previously recorded unrecognized tax benefits that were no longer required due to closure of the applicable statute. We expect the effective tax rate for 2017 to be approximately 25 percent excluding discrete items.

At December 31, 2016, we had United States tax net operating loss carry-forwards totaling approximately \$4.2 million which expire between 2019 and 2031. In addition, we have various state net operating loss carry-forwards totaling approximately \$27.8 million which expire between 2017 and 2033. The federal and state net operating losses were primarily generated by ICx Technologies, Inc. prior to being acquired by us in 2010. Finally, we have various foreign net operating loss carry-forwards totaling approximately \$74.3 million, a portion of which expire between 2018 and 2033 and a portion of which have an indefinite carry-forward period.

Tax benefits as described above are recorded as assets when the benefits are more likely than not to be recognized. To the extent that we assess the realization of such assets to not be more likely than not, a valuation allowance is required to be recorded. As of December 31, 2016, we have determined that a valuation allowance against our deferred tax assets of \$2.9 million is required, primarily related to certain acquired net operating losses. A review of all available positive and negative evidence is considered, including past and future performance, the market environment in which we operate, utilization of tax attributes in the past, length of carry-back and carry-forward periods, and evaluation of potential tax planning strategies, when evaluating whether the deferred tax assets will be realized.

On January 11, 2016, the European Commission announced a decision concluding that certain rules under Belgian tax legislation are deemed to be incompatible with European Union regulations on state aid. As a result of this decision, the European Commission has directed the Belgian Government to recover past taxes from certain entities, reflective of disallowed state aid, which impacts one of the Company's international subsidiaries. The Belgian Government announced they have appealed this decision and filed action for an annulment in the General Court of the European Union, and in July 2016 the Company filed a separate appeal with the General Court of the European Union. In accordance with FASB ASC Topic 740, "Income Taxes," the Company recorded discrete tax expense of \$39.6 million during 2016 related to this matter and on January 10, 2017, received tax assessments from the Belgium government for a similar amount, which the Company has classified as current taxes payable on

the Consolidated Balance Sheet as of December 31, 2016. The Company has filed a complaint against the Belgian tax assessments, and the result of this complaint, the appeal with the General Court of the European Union, new information received from the Belgian Government, or other future events may cause the income tax provision associated with the decision to be entirely or partially reversed.

### Segment Operating Results

We have six reportable operating segments. The following discusses the operating results of each of our segments for that three year period.

#### *Surveillance*

Surveillance operating results are as follows (in millions, except percentages):

|                                | Year Ended December 31, |          |          |
|--------------------------------|-------------------------|----------|----------|
|                                | 2016                    | 2015     | 2014     |
| Revenue .....                  | \$ 532.5                | \$ 503.0 | \$ 520.0 |
| Earnings from operations ..... | 144.9                   | 145.6    | 127.2    |
| Operating margin .....         | 27.2%                   | 29.0%    | 24.5%    |
| Backlog .....                  | 328                     | 309      | 297      |

Surveillance revenue increased by 5.9 percent in 2016 compared to 2015. The increase in revenue was primarily due to the acquisition of Armasight in June 2016. Earnings from operations decreased by 0.5 percent in 2016 compared to 2015. The decrease in earnings from operations was primarily due to a change in product mix, as we sold more products with lower gross margins in 2016 compared to 2015, and acquisition-related amortization and costs associated with the Armasight acquisition in June 2016 and the Prox Dynamics acquisition in November 2016.

Revenue decreased by 3.3 percent in 2015 compared to 2014, primarily due to reductions in demand from United States government funded customers and decreases in airborne and integrated systems product line revenues, partially offset by an increase in revenues in the land product line. Earnings from operations increased by 14.5 percent primarily due to lower operating expenses and higher gross margins, partially offset by the decrease in revenues. During the year ended December 31, 2015, Surveillance had restructuring charges of \$0.2 million, compared to \$5.2 million in 2014.

#### *Instruments*

Instruments operating results are as follows (in millions, except percentages):

|                                | Year Ended December 31, |          |          |
|--------------------------------|-------------------------|----------|----------|
|                                | 2016                    | 2015     | 2014     |
| Revenue .....                  | \$ 336.1                | \$ 347.5 | \$ 354.1 |
| Earnings from operations ..... | 96.7                    | 112.4    | 99.0     |
| Operating margin .....         | 28.8%                   | 32.3%    | 27.9%    |
| Backlog .....                  | 27                      | 27       | 35       |

Instruments segment revenue decreased by 3.3 percent in 2016 compared to 2015. The decrease in revenue was primarily due to a revenue decline in Europe and APAC regions. On a product line basis, declines in our building and predictive maintenance and science products lines were partially offset by increases in our firefighting and automation products lines. Earnings from operations decreased 13.9% in 2016 compared to 2015. The decrease in earnings from operations was due to a change in product mix, as we sold more products with lower gross margins in 2016 compared to 2015, and increased manufacturing cost under-absorption.

Revenue decreased by 1.9 percent in 2015 compared to 2014, primarily due to a revenue decline in the Americas region, partially offset by an increase in the Asia Pacific region; on a product line basis, declines in our higher end thermography and in

our optical gas imaging product lines were partially offset by increases in our science, test and measurement, and fire product lines. Revenues for the year ended December 31, 2015 were also negatively impacted by year over year changes in currency exchange rates. The increase in earnings from operations for the year ended December 31, 2015 compared to the year ended December 31, 2014 is primarily due to lower restructuring expenses and costs savings associated with restructuring activities. As a large portion of segment expenses are incurred in Europe, the segment experienced a favorable impact on its operating expenses from the changes in foreign currency rates which largely offset the associated decline in revenues in that region. During the year ended December 31, 2015, Instruments recorded restructuring charges of \$1.2 million compared to \$11.0 million in the year ended December 31, 2014.

### **Security**

Security operating results are as follows (in millions, except percentages):

|                                | Year Ended December 31, |          |          |
|--------------------------------|-------------------------|----------|----------|
|                                | 2016                    | 2015     | 2014     |
| Revenue .....                  | \$ 240.0                | \$ 226.6 | \$ 179.1 |
| Earnings from operations ..... | 10.2                    | 28.1     | 24.9     |
| Operating margin .....         | 4.2%                    | 12.4%    | 13.9%    |
| Backlog .....                  | 21                      | 16       | 18       |

Security segment revenue increased by 5.9 percent in 2016 compared to 2015. The increase in revenue was primarily due to the acquisition of DVTEL in November 2015 and the inclusion of the associated revenues in the current year, partially offset by a decrease in consumer-grade security products. Earnings from operations decreased 63.9 percent in 2016 compared to 2015. The decrease in earnings from operations was primarily due to acquisition-related amortization and higher operating expenses associated with the DVTEL acquisition.

Security segment revenue for the year ended December 31, 2015 increased by 26.5 percent compared to the prior year primarily due to increased deliveries across all product families and in the Americas and Europe geographic regions. The increase in earnings from operations in 2015 of 13.1 percent over 2014 was primarily due to the increase in revenues, partially offset by increases in sales and marketing support operating expenses.

### **OEM & Emerging Markets**

OEM & Emerging Markets operating results are as follows (in millions, except percentages):

|                                | Year Ended December 31, |          |          |
|--------------------------------|-------------------------|----------|----------|
|                                | 2016                    | 2015     | 2014     |
| Revenue .....                  | \$ 243.7                | \$ 186.7 | \$ 199.1 |
| Earnings from operations ..... | 59.7                    | 41.1     | 50.2     |
| Operating margin .....         | 24.5%                   | 22.0%    | 25.2%    |
| Backlog .....                  | 143                     | 140      | 129      |

OEM & Emerging Markets segment revenue increased by 30.5 percent in 2016 compared to 2015. The increase in revenue was primarily due to higher deliveries in most of the segment product lines, particularly in cores and components and mobile accessories, and the acquisition of Point Grey in November 2016. Earnings from operations increased 45.3% in 2016 compared to 2015. The increase in earnings from operations is primarily due to the increase in revenue.

Revenue decreased by 6.2 percent in 2015 compared to 2014, primarily due to the loss of approximately \$8.8 million in 2014 revenue from our former optical components group which was sold in August 2014 and the negative impacts of changes in currency exchange rates. Earnings from operations declined in 2015 compared to 2014 primarily due to the decrease in revenue and lower gross margins, partially offset by lower operating expenses.

### **Maritime**

Maritime operating results are as follows (in millions, except percentages):

|                                | Year Ended December 31, |          |          |
|--------------------------------|-------------------------|----------|----------|
|                                | 2016                    | 2015     | 2014     |
| Revenue .....                  | \$ 185.7                | \$ 177.9 | \$ 192.6 |
| Earnings from operations ..... | 15.4                    | 13.6     | 24.5     |
| Operating margin .....         | 8.3%                    | 7.6%     | 12.7%    |
| Backlog .....                  | 16                      | 28       | 17       |

Maritime segment revenue increased by 4.4 percent in 2016 compared to 2015. The increase in revenue is primarily due to an increase in the Americas and Europe regions. On a product basis, increased shipments of multifunction displays, radar, and thermal cameras more than offset declines in autopilot and instrument shipments. Earnings from operations increased 13.3% in 2016 compared to 2015. The increase in earnings from operations is due an increase in revenue and a decrease in operating expenses, partially offset by an increase in warranty costs.

Maritime segment revenue for the year ended December 31, 2015 decreased by 7.6 percent compared to the same period of 2014 primarily due to the negative impact of year over year changes in currency exchange rates in the Europe and Asia Pacific regions. Since the majority of the segment's costs of goods sold are incurred in United States dollars, those costs did not receive the favorable impact of changes in currency exchange rates. Consequently, the decrease in earnings from operations in 2015 compared to 2014 was primarily due to the revenue decline.

### **Detection**

Detection operating results are as follows (in millions, except percentages):

|                                | Year Ended December 31, |          |         |
|--------------------------------|-------------------------|----------|---------|
|                                | 2016                    | 2015     | 2014    |
| Revenue .....                  | \$ 124.1                | \$ 115.3 | \$ 85.7 |
| Earnings from operations ..... | 33.8                    | 26.9     | 11.0    |
| Operating margin .....         | 27.3%                   | 23.3%    | 12.8%   |
| Backlog .....                  | 57                      | 82       | 51      |

Detection segment revenue increased by 7.7 percent in 2016 compared to 2015. The increase in revenue was primarily due to increased shipments from our CBRNE threat response systems to United States government customers. Earnings from operations increased 25.8 percent in 2016 compared to 2015. The increase in earnings from operations and operating margin were primarily due to increases in revenue and reduced operating expenses. The decrease in backlog was primarily due to significant orders for our CBRNE threat response systems that were received in the first quarter and fourth quarter of 2015 and delivered in 2016.

Detection segment revenue for the year ended December 31, 2015 increased by 34.5 percent compared to 2014. The increase in revenue was primarily due to increased deliveries of our CBRNE threat response systems and related spare parts and services against orders received in the second half of 2014 on a large program with the United States government. The increase in earnings from operations and operating margin were primarily due to the increases in revenues and higher gross margins.

## Liquidity and Capital Resources

At December 31, 2016, we had a total of \$361.3 million in cash and cash equivalents, \$98.3 million of which was in the United States and \$263.0 million at our foreign subsidiaries, compared to cash and cash equivalents at December 31, 2015 of \$472.8 million, of which \$129.6 million was in the United States and \$343.2 million at our foreign subsidiaries. We intend to indefinitely reinvest the cash at our foreign subsidiaries in operations and other activities outside the United States. The decrease in cash and cash equivalents in 2016 was primarily due to \$419.2 million spent on the acquisitions of Innovative Security Designs, LLC, Armasight, Inc, Point Grey Research Inc. and Prox Dynamics AS, \$367.4 million spent on the repayment of long-term debt and a credit agreement, \$66.0 million spent for the repurchase of our common stock, dividends paid of \$65.9 million and \$35.9 million spent on capital expenditures, partially offset by \$524.6 million of net proceeds from long-term debt and the new credit agreement and cash provided from operations of \$312.3 million.

Cash provided by operating activities in 2016 totaled \$312.3 million compared to \$275.8 million in 2015 and \$226.2 million in 2014. The increase in cash provided from operations in 2016 compared to 2015 was primarily due to changes in current balances and a gain from the sale of a cost-basis investment in 2015, partially offset by a decrease in net earnings. The increase in cash provided from operations in 2015 compared to 2014 was primarily due to the increase in net earnings.

Cash used for investing activities for the year ended December 31, 2016 totaled \$447.8 million, consisting of \$419.2 million spent primarily on the acquisitions of Innovative Security Designs, LLC, Armasight, Inc, Point Grey Research Inc. and Prox Dynamics AS, and capital expenditures of \$35.9 million. Cash used for investing activities for the year ended December 31, 2015 totaled \$134.8 million, consisting of \$92.3 million, net of cash acquired, for the acquisition of DVTEL, Inc. and capital expenditures of \$68.2 million, partially offset by \$25.6 million of proceeds from the sale of an investment in a third party. Cash used for investing activities for the year ended December 31, 2014 totaled \$49.3 million, consisting of capital expenditures of \$61.3 million, offset by \$12.0 million of proceeds from the sale of certain tangible assets and intellectual property related to the design and manufacturing of non-thermal micro-optics. Capital expenditures in 2015 and 2014 included \$33.0 million and \$19.1 million, respectively, for building improvements for our new facility in Goleta, California.

Cash provided by financing activities for the year ended December 31, 2016 totaled \$38.6 million, primarily consisting of the net proceeds from long-term debt and the new credit agreement, partially offset by the repayment of long-term debt, repurchases of common stock and the payment of dividends. Cash used by financing activities for the years ended December 31, 2015 and 2014 totaled \$166.5 million and \$152.0 million, respectively, primarily consisting of the repurchase of shares of our common stock and the payment of dividends, partially offset by proceeds from shares issued pursuant to stock-based compensation plans.

On February 8, 2011, we entered into a Credit Agreement (“Credit Agreement”) with Bank of America, N.A., U.S. Bank National Association, JPMorgan Chase Bank N.A. and other Lenders. The Credit Agreement provides for a \$200 million, five-year revolving line of credit. On April 5, 2013, the Credit Agreement was amended to extend the maturity of the revolving credit facility from April 8, 2016 to April 5, 2018 in addition to incorporating a \$150 million term loan facility maturing April 5, 2019. On May 31, 2016, the Credit Agreement was further amended to increase the borrowing capacity to \$500 million and to extend the maturity of the revolving credit facility from April 5, 2018 to May 31, 2021. The amendment also incorporated a revised schedule of fees and interest rate spreads. We have the right, subject to certain conditions, including approval of additional commitments by qualified lenders, to increase the revolving line of credit under the Credit Agreement by an additional \$200 million until May 31, 2021. The Credit Agreement allows us and certain designated subsidiaries to borrow in United States dollars, European euros, Swedish kronor, British pound sterling, Japanese yen, Canadian dollars, Australian dollars and other agreed upon currencies. Interest rates under the Credit Agreement are determined based on the type of borrowing. Interest associated with borrowings can be based on either the prime lending rate of Bank of America, N.A. or the published Eurocurrency rate (i.e. LIBOR). The borrowings have an applicable margin that ranges from 0.125 percent to 2.125 percent depending on the applicable base rate and our consolidated total leverage ratio. Including the respective spreads and ignoring the effects of hedging, the one-month LIBOR interest rate was 2.145 percent per annum and the prime lending rate was 4.125 percent per annum at December 31, 2016. The Credit Agreement requires us to pay a commitment fee on the amount of unused revolving commitments at a rate, based on our total leverage ratio, which ranges from 0.150 percent to 0.300 percent of unused revolving commitments. The Credit Agreement contains two financial covenants that require the maintenance of a total leverage ratio and an interest coverage ratio, with which the Company was in compliance at December 31, 2016. The credit facilities available under the Credit Agreement are unsecured.

As noted above, the Credit Agreement amendment of April 5, 2013 incorporated a \$150 million term loan facility that was scheduled to mature on April 5, 2019. On May 31, 2016, we drew down \$105 million under the revolving credit facility and repaid the term loan facility in full. Interest is accrued at the one-month LIBOR rate plus the scheduled spread and paid monthly. By entering into interest rate swap agreements, we have effectively fixed the basis for calculating the interest rate on the revolving

credit facility. The effective interest rate paid for the revolving credit facility is equal to the median fixed rate in the swap agreements plus the credit spread then in effect. At December 31, 2016, the effective interest rate on the revolving credit facility was 2.37 percent. Principal payments of \$3.75 million, at our option, will continue to be made in quarterly installments through December 31, 2018 with the final maturity payment including any accrued interest due on April 5, 2019.

At December 31, 2016, we had \$97.5 million outstanding under the Credit Agreement and the commitment fee on the amount of unused revolving credit was 0.175 percent per annum. We had \$17.9 million and \$30.1 million of letters of credit outstanding under the Credit Agreement at December 31, 2016 and 2015, respectively, which reduced the total available revolving credit under the Credit Agreement.

On August 19, 2011, we issued \$250 million aggregate principal amount of our 3.75 percent senior unsecured notes due September 1, 2016 (the "2011 Notes"). The interest on the Notes was payable semiannually in arrears on March 1 and September 1. The proceeds from the Notes were used for general corporate purposes, which include working capital and capital expenditure needs, business acquisitions and repurchases of our common stock. The 2011 Notes were repaid on July 5, 2016.

In June 2016, we issued \$425 million aggregate principal amount of our 3.125 percent senior unsecured notes due June 15, 2021 (the "2016 Notes"). The net proceeds from the issuance of the 2016 Notes were approximately \$421.0 million, after deducting underwriting discounts and offering expenses, which are being amortized over a period of five years. Interest on the 2016 Notes is payable semiannually in arrears on December 15 and June 15. The proceeds from the 2016 Notes were used to repay the 2011 Notes in July 2016 and are being used for general corporate purposes, which include working capital and capital expenditure needs, business acquisitions and repurchases of our common stock.

On February 5, 2015, our Board of Directors authorized the repurchase of up to 15.0 million shares of our outstanding common stock. As of December 31, 2016, an aggregate of 6.3 million shares had been repurchased under this authorization, which expired on February 5, 2017. On February 8, 2017, our Board of Directors authorized the repurchase of up to 15.0 million shares of our outstanding common stock. This authorization will expire on February 8, 2019.

United States income taxes have not been provided for on accumulated earnings of certain subsidiaries outside of the United States as we currently intend to reinvest the earnings in operations outside the United States indefinitely. Should we subsequently elect to repatriate such foreign earnings, we would need to accrue and pay United States income taxes, thereby reducing the amount of our cash.

We believe that our existing cash combined with the cash we anticipate generating from operating activities, and our available credit facilities and financing available from other sources will be sufficient to meet our cash requirements for the next twelve months. We do not have any significant commitments nor are we aware of any significant events or conditions that are likely to have a material impact on our liquidity or capital resources.

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

As of December 31, 2016, we leased our non-owned facilities under operating lease agreements. We also leased certain operating machinery and equipment and office equipment under operating lease agreements. Except for these operating lease agreements, we do not have any off-balance sheet arrangements that have or are likely to have a material current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

## Contractual Obligations

As of December 31, 2016, our contractual obligations were as follows (in thousands):

|   | Payments Due by Period |                     |                  |                   |                      |
|---|------------------------|---------------------|------------------|-------------------|----------------------|
|   | Total                  | Less than<br>1 Year | 1 – 3<br>Years   | 3 – 5<br>Years    | More than<br>5 Years |
| Long-term debt, including interest            | \$ 484,766             | \$ 13,281           | \$ 26,563        | \$ 444,922        | \$ —                 |
| Revolving credit facility, including interest | 107,706                | 2,311               | 4,622            | 100,774           | —                    |
| Operating leases                              | 24,058                 | 9,265               | 11,312           | 2,674             | 808                  |
| Licensing rights                              | 1,100                  | 550                 | 550              | —                 | —                    |
| Post-retirement obligations                   | 12,212                 | 417                 | 787              | 9,616             | 1,391                |
| Belgium tax assessment                        | 39,641                 | 39,641              | —                | —                 | —                    |
| Other obligations                             | 715                    | 499                 | 216              | —                 | —                    |
|   | <u>\$ 670,198</u>      | <u>\$ 65,964</u>    | <u>\$ 44,050</u> | <u>\$ 557,986</u> | <u>\$ 2,199</u>      |

Principal and interest on long-term debt, operating leases and licensing rights obligations are based upon contractual terms. Revolving credit facility assumed to be held to maturity with interest paid at the effective rate in effect at December 31, 2016. Actual payments may differ in terms of both timing and amounts. We did not include approximately \$17.9 million of standby letters of credit and performance bonds due to the unlikely event of payment, if any, of amounts under those arrangements.

Aside from the discrete tax charge of \$39.6 million recorded in 2016 related to the Belgian tax assessment, the Company cannot make a reasonably reliable estimate of the period of potential cash settlement of its remaining unrecognized tax benefits of \$12.3 million and, therefore, has not included the related unrecognized tax benefits in the table of contractual obligations as of December 31, 2016. For further detail on unrecognized tax benefits, see Note 14 to the Consolidated Financial Statements in Item 8.

## Recent Accounting Pronouncements

See Note 1 to the Consolidated Financial Statements in Item 8 for a discussion of recent accounting pronouncements.

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

### *Foreign Currency Exchange Rate Risk*

We have assets and liabilities outside the United States that are subject to fluctuations in foreign currency exchange rates. Similarly, certain revenues from products sold in countries outside the United States and costs associated with non-United States operations are denominated in foreign currencies. For more information on our foreign currency translation, see Note 1 to the Consolidated Financial Statements in Item 8. Assets and liabilities located outside the United States are primarily located in Europe. Our investments in subsidiaries outside the United States with functional currencies other than the United States dollar are considered long-term. We currently engage in forward currency exchange contracts and other similar hedging activities to reduce our economic exposure to changes in exchange rates. At December 31, 2016, exchange contracts with a notional amount of approximately \$262.1 million were outstanding. Because we market, sell and license our products throughout the world, we could be adversely affected by weak economic conditions in international markets that could reduce demand for our products.

Our net investment in subsidiaries outside the United States, translated into United States dollars using the period-end exchange rates, was approximately \$959.5 million at December 31, 2016. The potential loss in fair value resulting from a hypothetical 10 percent adverse change in foreign exchange rates would be approximately \$96.0 million at December 31, 2016. The increase in the potential loss in fair value is primarily due to the increase in the net investment of subsidiaries outside the United States. We have no plans to liquidate any of our subsidiaries outside the United States, and therefore, foreign exchange rate gains or losses on our international investments are reflected as a cumulative translation adjustment and do not increase or reduce our reported net earnings.

### *Interest Rate Risk*

Our exposure to changes in market interest rates relates primarily to interest paid on our floating rate long-term debt. Our floating rate long-term debt consists of amounts borrowed under our revolving loan facility that bears interest at the one-month LIBOR rate plus a scheduled spread. Fluctuations in market interest rates will cause interest expense increases or decreases on such long-term debt.

As our risk management objectives include mitigating the risk of changes in cash flows attributable to changes in the designated one-month LIBOR rate for the revolving loan facility, we entered into two interest rate swaps for the aggregate notional amount borrowed under the revolving loan facility and fixed interest rates of 1.016 percent and 0.97 percent to hedge this exposure. Changes in the cash flows of the interest rate swaps are expected to exactly offset the changes in cash flows attributable to fluctuations in the one-month LIBOR based interest payments. The net effect of these swap agreements is to convert the floating interest rate basis to fixed rates of 1.016 percent and 0.97 percent.

See Liquidity and Capital Resources in Item 7 and Note 3, Note 9, and Note 11 to the Consolidated Financial Statements in Item 8, for additional information on the Company's interest rate risk.



**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

This item includes the following financial information:

| <u>Statement</u>   | <u>Page</u> |
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| Report of Independent Registered Public Accounting Firm .....  | 48          |
| Consolidated Statements of Income for the Years Ended December 31, 2016, 2015 and 2014 .....               | 49          |
| Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2016, 2015 and 2014 ..... | 50          |
| Consolidated Balance Sheets as of December 31, 2016 and 2015 .....   | 51          |
| Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2016, 2015 and 2014 ..... | 52          |
| Consolidated Statements of Cash Flows for the Years Ended December 31, 2016, 2015 and 2014 .....           | 53          |
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## Report of Independent Registered Public Accounting Firm

The Board of Directors and  
Shareholders of FLIR Systems, Inc.:

We have audited the accompanying consolidated balance sheets of FLIR Systems, Inc. (an Oregon Corporation) and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FLIR Systems, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), FLIR Systems, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 24, 2017 expressed an unqualified opinion on the effectiveness of FLIR Systems, Inc.'s internal control over financial reporting. Our report on the effectiveness of internal control over financial reporting as of December 31, 2016, contains an explanatory paragraph that states that management's assessment of the effectiveness of internal control over financial reporting and our audit of internal control over financial reporting of FLIR Systems, Inc. excludes an evaluation of internal control over financial reporting of the acquired Innovative Security Designs, LLC, Armasight, Inc., Point Grey Research, Inc. and Prox Dynamics AS.

/s/ KPMG LLP

Portland, Oregon  
February 24, 2017

**FLIR SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(in thousands, except per share amounts)

|   | Year Ended December 31, |                   |                   |
|---|-------------------------|-------------------|-------------------|
|   | 2016                    | 2015              | 2014              |
| Revenue .....                             | \$ 1,662,167            | \$ 1,557,067      | \$ 1,530,654      |
| Cost of goods sold .....                  | 895,046                 | 803,506           | 780,281           |
| Gross profit .....                        | 767,121                 | 753,561           | 750,373           |
| Operating expenses:                       |                         |                   |                   |
| Research and development .....            | 147,537                 | 132,892           | 142,751           |
| Selling, general and administrative ..... | 322,435                 | 313,544           | 331,995           |
| Restructuring expenses .....              | 1,431                   | 1,361             | 16,383            |
| Total operating expenses .....            | 471,403                 | 447,797           | 491,129           |
| Earnings from operations .....            | 295,718                 | 305,764           | 259,244           |
| Interest expense .....                    | 18,071                  | 14,086            | 14,593            |
| Interest income .....                     | (1,402)                 | (1,167)           | (1,405)           |
| Other expense (income), net .....         | 3,092                   | (12,601)          | (3,473)           |
| Earnings before income taxes .....        | 275,957                 | 305,446           | 249,529           |
| Income tax provision .....                | 109,331                 | 63,760            | 49,268            |
| Net earnings .....                        | <u>\$ 166,626</u>       | <u>\$ 241,686</u> | <u>\$ 200,261</u> |
| Net earnings per share:                   |                         |                   |                   |
| Basic earnings per share .....            | <u>\$ 1.22</u>          | <u>\$ 1.73</u>    | <u>\$ 1.42</u>    |
| Diluted earnings per share .....          | <u>\$ 1.20</u>          | <u>\$ 1.72</u>    | <u>\$ 1.39</u>    |

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

**FLIR SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands)

|  | <u>Year Ended December 31,</u> |                   |                   |
|--|--------------------------------|-------------------|-------------------|
|  | <u>2016</u>                    | <u>2015</u>       | <u>2014</u>       |
| Net earnings .....   | \$ 166,626                     | \$ 241,686        | \$ 200,261        |
| Other comprehensive income (loss), net of tax:   |                                |                   |                   |
| Change in minimum liability for pension plans, net of tax effects of<br>\$48, \$238 and \$(27), respectively ..... | 102                            | 661               | (212)             |
| Fair value adjustment on interest rate swap contracts .....  | (16)                           | (602)             | (735)             |
| Foreign currency translation adjustments .....   | (40,911)                       | (61,776)          | (88,462)          |
| Total other comprehensive loss .....   | <u>(40,825)</u>                | <u>(61,717)</u>   | <u>(89,409)</u>   |
| Comprehensive income .....   | <u>\$ 125,801</u>              | <u>\$ 179,969</u> | <u>\$ 110,852</u> |

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

**FLIR SYSTEMS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except for par value)

|  | <b>December 31,</b> |              |
|--|---------------------|--------------|
|  | <b>2016</b>         | <b>2015</b>  |
| <b><u>ASSETS</u></b>   |                     |              |
| Current assets:  |                     |              |
| Cash and cash equivalents .....  | \$ 361,349          | \$ 472,785   |
| Accounts receivable, net .....   | 352,020             | 326,098      |
| Inventories .....  | 371,371             | 393,092      |
| Prepaid expenses and other current assets .....  | 79,917              | 95,539       |
| Total current assets .....   | 1,164,657           | 1,287,514    |
| Property and equipment, net .....  | 271,785             | 272,629      |
| Deferred income taxes, net .....   | 45,243              | 55,429       |
| Goodwill .....   | 801,406             | 596,316      |
| Intangible assets, net .....   | 168,460             | 141,302      |
| Other assets .....   | 168,155             | 53,210       |
| Total assets .....   | \$ 2,619,706        | \$ 2,406,400 |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>   |                     |              |
| Current liabilities:   |                     |              |
| Accounts payable .....   | \$ 114,225          | \$ 139,540   |
| Deferred revenue .....   | 34,420              | 31,933       |
| Accrued payroll and related liabilities .....  | 52,874              | 54,806       |
| Accrued product warranties .....   | 17,476              | 13,406       |
| Advance payments from customers .....  | 26,019              | 33,848       |
| Accrued expenses .....   | 34,022              | 40,930       |
| Accrued income taxes .....   | 51,017              | 201          |
| Other current liabilities .....  | 16,659              | 5,987        |
| Current portion, long-term debt .....  | 15,000              | 264,694      |
| Total current liabilities .....  | 361,712             | 585,345      |
| Long-term debt .....   | 501,921             | 93,750       |
| Deferred income taxes .....  | 2,331               | 3,623        |
| Accrued income taxes .....   | 9,643               | 10,457       |
| Pension and other long-term liabilities .....  | 65,773              | 63,710       |
| Commitments and contingencies (Notes 12 and 13)  |                     |              |
| Shareholders' equity:  |                     |              |
| Preferred stock, \$0.01 par value, 10,000 shares authorized; no shares issued at December 31, 2016 or 2015 .....   | —                   | —            |
| Common stock, \$0.01 par value, 500,000 shares authorized, 136,334 and 137,350 shares issued at December 31, 2016 and 2015, respectively, and additional paid-in capital ..... | 12,139              | 1,374        |
| Retained earnings .....  | 1,832,138           | 1,773,267    |
| Accumulated other comprehensive loss .....   | (165,951)           | (125,126)    |
| Total shareholders' equity .....   | 1,678,326           | 1,649,515    |
| Total liabilities and shareholders' equity .....   | \$ 2,619,706        | \$ 2,406,400 |

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

**FLIR SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(in thousands)

|   | Common Stock and<br>Additional<br>Paid-in Capital |                  | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Earnings<br>(Loss) | Total<br>Shareholders'<br>Equity |
|---|---|------------------|----------------------|---|----------------------------------|
|   | Shares  | Amount           |                      |   |                                  |
| Balance, December 31, 2013  | 140,782   | \$ 42,955        | \$ 1,544,425         | \$ 26,000   | \$ 1,613,380                     |
| Net earnings for the year   | —   | —                | 200,261              | —   | 200,261                          |
| Income tax benefit of common stock options exercised                | —   | 12,751           | —                    | —   | 12,751                           |
| Repurchase of common stock  | (4,243)   | (122,851)        | (16,387)             | —   | (139,238)                        |
| Common stock issued pursuant to stock-based compensation plans, net | 3,040   | 37,774           | —                    | —   | 37,774                           |
| Stock-based compensation  | —   | 30,767           | —                    | —   | 30,767                           |
| Dividends paid  | —   | —                | (56,513)             | —   | (56,513)                         |
| Other comprehensive income  | —   | —                | —                    | (89,409)  | (89,409)                         |
| Balance, December 31, 2014  | 139,579   | 1,396            | 1,671,786            | (63,409)  | 1,609,773                        |
| Net earnings for the year   | —   | —                | 241,686              | —   | 241,686                          |
| Income tax benefit of common stock options exercised                | —   | 1,611            | —                    | —   | 1,611                            |
| Repurchase of common stock  | (4,169)   | (44,387)         | (78,806)             | —   | (123,193)                        |
| Common stock issued pursuant to stock-based compensation plans, net | 1,940   | 17,071           | —                    | —   | 17,071                           |
| Stock-based compensation  | —   | 25,683           | —                    | —   | 25,683                           |
| Dividends paid  | —   | —                | (61,399)             | —   | (61,399)                         |
| Other comprehensive loss  | —   | —                | —                    | (61,717)  | (61,717)                         |
| Balance, December 31, 2015  | 137,350   | 1,374            | 1,773,267            | (125,126)   | 1,649,515                        |
| Net earnings for the year   | —   | —                | 166,626              | —   | 166,626                          |
| Income tax benefit of common stock options exercised                | —   | 1,329            | —                    | —   | 1,329                            |
| Repurchase of common stock  | (2,132)   | (24,222)         | (41,835)             | —   | (66,057)                         |
| Common stock issued pursuant to stock-based compensation plans, net | 1,116   | 5,985            | —                    | —   | 5,985                            |
| Stock-based compensation  | —   | 27,673           | —                    | —   | 27,673                           |
| Dividends paid  | —   | —                | (65,920)             | —   | (65,920)                         |
| Other comprehensive loss  | —   | —                | —                    | (40,825)  | (40,825)                         |
| Balance, December 31, 2016  | <u>136,334</u>                                    | <u>\$ 12,139</u> | <u>\$ 1,832,138</u>  | <u>\$ (165,951)</u>   | <u>\$ 1,678,326</u>              |

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

**FLIR SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

|   | Year Ended December 31, |                   |                   |
|---|-------------------------|-------------------|-------------------|
|   | 2016                    | 2015              | 2014              |
| <b>CASH PROVIDED BY OPERATING ACTIVITIES:</b>                                       |                         |                   |                   |
| Net earnings  | \$ 166,626              | \$ 241,686        | \$ 200,261        |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                         |                   |                   |
| Depreciation and amortization   | 57,513                  | 49,534            | 57,245            |
| Deferred income taxes   | 5,613                   | 2,863             | (1,242)           |
| Stock-based compensation arrangements   | 27,797                  | 25,748            | 30,788            |
| Gain on sale of assets, net   | —                       | (19,166)          | (4,129)           |
| Other, net  | 11,992                  | 7,722             | (791)             |
| Increase (decrease) in cash, net of acquisitions, resulting from changes in:        |                         |                   |                   |
| Accounts receivable   | (10,704)                | 28,258            | (76,705)          |
| Inventories   | 51,170                  | (74,816)          | 11,363            |
| Prepaid expenses  | (7,706)                 | 1,858             | 5,754             |
| Other assets  | (10,750)                | (4,333)           | (24,261)          |
| Accounts payable  | (33,465)                | 38,660            | 15,040            |
| Deferred revenue  | 2,928                   | 3,503             | 93                |
| Accrued payroll and other liabilities   | (16,138)                | (20,072)          | 17,240            |
| Accrued income taxes  | 64,822                  | (9,319)           | (8,501)           |
| Pension & other long term liabilities   | 2,582                   | 3,688             | 4,089             |
| Net cash provided by operating activities   | <u>312,280</u>          | <u>275,814</u>    | <u>226,244</u>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                         |                   |                   |
| Additions to property and equipment   | (35,940)                | (68,234)          | (61,262)          |
| Business acquisitions, net of cash acquired   | (419,203)               | (92,260)          | —                 |
| Proceeds from sale of assets  | 7,331                   | 25,649            | 12,000            |
| Net cash used by investing activities   | <u>(447,812)</u>        | <u>(134,845)</u>  | <u>(49,262)</u>   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                         |                   |                   |
| Net proceeds of long-term debt, including current portion                           | 524,560                 | —                 | —                 |
| Repayment of long-term debt   | (367,435)               | (15,000)          | (15,000)          |
| Repurchase of common stock  | (66,057)                | (123,193)         | (139,238)         |
| Dividends paid  | (65,920)                | (61,399)          | (56,513)          |
| Proceeds from shares issued pursuant to stock-based compensation plans              | 11,966                  | 24,835            | 47,581            |
| Excess tax benefit of stock options exercised                                       | 1,480                   | 8,243             | 11,161            |
| Other financing activities  | 13                      | (24)              | (18)              |
| Net cash provided (used) by financing activities                                    | <u>38,607</u>           | <u>(166,538)</u>  | <u>(152,027)</u>  |
| Effect of exchange rate changes on cash   | (14,511)                | (33,020)          | (36,057)          |
| Net decrease in cash and cash equivalents   | (111,436)               | (58,589)          | (11,102)          |
| Cash and cash equivalents, beginning of year  | 472,785                 | 531,374           | 542,476           |
| Cash and cash equivalents, end of year  | <u>\$ 361,349</u>       | <u>\$ 472,785</u> | <u>\$ 531,374</u> |

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

**FLIR SYSTEMS, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Nature of Business and Significant Accounting Policies**

FLIR Systems, Inc. (the "Company") is a world leader in sensor systems that enhance perception and awareness. The Company was founded in 1978 and has since become a premier designer, manufacturer, and marketer of thermal imaging and other sensing products and systems. The Company's advanced sensors and integrated sensor systems enable the gathering and analysis of critical information through a wide variety of applications in commercial, industrial, and government markets worldwide.

The Company's goal is to both enable its customers to benefit from the valuable information produced by advanced sensing technologies and to deliver sustained superior financial performance for its shareholders. The Company creates value for its customers by providing advanced surveillance and tactical defense capabilities, improving personal and public safety and security, facilitating air, ground, and maritime navigation, enhancing enjoyment of the outdoors, providing infrastructure inefficiency information, conveying pre-emptive structural deficiency data, displaying process irregularities, and enabling commercial business opportunities through its continual support and development of new thermal imaging data and analytics applications. The Company's business model meets the needs of a multitude of customers—it sells off-the-shelf products to a wide variety of markets in an efficient, timely, and affordable manner as well as offers a variety of system configurations to suit specific customer requirements. Centered on the design of products for low cost manufacturing and high volume distribution, the Company's commercial operating model has been developed over time and provides it with a unique ability to adapt to market changes and meet its customers' needs.

*Principles of consolidation*

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions were eliminated.

*Reclassification*

The Company made certain reclassifications to the prior years' notes to the financial statements to conform them to the presentation as of and for the year ended December 31, 2016. These reclassifications had no effect on consolidated financial position, net earnings, shareholders' equity, or net cash flows for any of the periods presented.

*Foreign currency translation*

The assets and liabilities of the Company's subsidiaries outside the United States are translated into United States dollars at current exchange rates in effect at the balance sheet date. Revenues and expenses are translated at monthly average exchange rates. Resulting translation adjustments are reflected in accumulated other comprehensive earnings (loss) within shareholders' equity. Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in currencies other than the functional currency are reflected as other expense (income), net, in the Consolidated Statements of Income as incurred.

The cumulative translation adjustment included in accumulated other comprehensive earnings (loss) is a loss of \$164.6 million and \$123.7 million at December 31, 2016 and 2015, respectively. Transaction gains and losses included in other expense (income), net, are a net loss of \$2.2 million, a net loss of \$2.5 million, and a net gain of \$0.2 million for the years ended December 31, 2016, 2015 and 2014, respectively.

*Revenue recognition*

Revenue is recognized when persuasive evidence of an arrangement exists, upon delivery of the product to the customer at a fixed or determinable price with a reasonable assurance of collection, passage of title and risk of loss to the customer as indicated by the contractual terms and fulfillment of all significant obligations.



**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 1. Nature of Business and Significant Accounting Policies—(Continued)**

*Revenue recognition - (Continued)*

The Company designs, markets and sells products primarily as commercial, off-the-shelf products. Certain customers request different system configurations, based on standard options or accessories that the Company offers. In general, revenue arrangements do not involve acceptance provisions based upon customer specified acceptance criteria. In those limited circumstances when customer specified acceptance criteria exist, revenue is deferred until customer acceptance if the Company cannot demonstrate the system meets those specifications prior to shipment. For any contracts with multiple elements (i.e., training, installation, additional parts, etc.) the Company allocates revenue among the deliverables primarily based upon objective and reliable evidence of fair value of each element in the arrangement. If objective and reliable evidence of fair value of any element is not available, the Company uses an estimated selling price for purposes of allocating the total arrangement consideration among the elements. Credit is not extended to customers and revenue is not recognized until the Company has determined that the risk of uncollectability is minimal.

The Company's products are sold with warranty provisions that require it to remedy deficiencies in quality or performance of the Company's products over a specified period of time, generally twelve to twenty-four months, at no cost to its customers. Warranty liabilities are established at the time that revenue is recognized at levels that represent the Company's estimate of the costs that will be incurred to fulfill those warranty requirements.

Provisions for estimated losses on sales or related receivables are recorded when identified. Revenue includes certain shipping and handling costs and is stated net of representative commissions and sales taxes. Service revenue is deferred and recognized over the contract period, as is the case for extended warranty contracts, or recognized as services are provided.

*Cost of goods sold*

Cost of goods sold includes materials, labor and overhead costs incurred in the manufacturing of products and services sold in the period as well as warranty costs. Material costs include raw materials, purchased components and sub-assemblies, outside processing and inbound freight costs. Labor and overhead costs consist of direct and indirect manufacturing costs, including wages and fringe benefits, operating supplies, depreciation, occupancy costs, and purchasing, receiving and inspection costs.

*Research and development*

Expenditures for research and development activities are expensed as incurred.

*Cash equivalents*

The Company considers short-term investments that are highly liquid, readily convertible into cash and have maturities of less than three months when purchased to be cash equivalents. Cash equivalents at December 31, 2016 and 2015 were \$8.3 million and \$29.0 million, respectively, which were primarily investments in money market funds.

*Accounts receivable and allowance for doubtful accounts*

Accounts receivable are stated at the amounts the Company expects to collect. Credit limits are established through a process of reviewing the financial history and stability of each customer. The Company regularly evaluates the collectability of its trade receivables balances based on a combination of factors. If it is determined that a customer will be unable to fully meet its financial obligation, the Company records a specific allowance to reduce the related receivable to the amount expected to be recovered. In addition, the Company also records an allowance for all other customers based on certain other factors including the length of time the receivables are past due and historical collection experience with individual customers.

*Inventories*

Inventories are stated at the lower of cost or market and include materials, labor, and manufacturing overhead. Cost is determined based on a currently adjusted standard cost basis that approximates actual manufacturing cost on a first-in, first-out basis.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 1. Nature of Business and Significant Accounting Policies—(Continued)**

*Inventories - (Continued)*

Inventory write-downs are recorded when conditions exist to indicate that inventories are likely to be in excess of anticipated demand or are obsolete based upon the Company's assumptions about future demand for its products and market conditions. The Company regularly evaluates its ability to realize the value of inventories based on a combination of factors including the following: historical usage rates, forecasted sales or usage, product end of life dates, estimated current and future market values and new product introductions. When recorded, write-downs reduce the carrying value of the Company's inventories to their net realizable value and create a new cost-basis in the inventories. Write-downs are reflected in cost of goods sold in the Consolidated Statements of Income.

*Demonstration units*

The Company's products which are being used as demonstration units are stated at the lower of cost or market and are included in prepaid expenses and other current assets in the Consolidated Balance Sheets. Demonstration units are available for sale and the Company periodically evaluates them as to marketability and realizable values. The carrying value of demonstration units was \$36.9 million and \$36.8 million at December 31, 2016 and 2015, respectively.

*Property and equipment*

Property and equipment are stated at cost and are depreciated using a straight-line methodology over their estimated useful lives. Repairs and maintenance are charged to expense as incurred.

*Goodwill*

Goodwill is reviewed during the third quarter of each year, or more frequently if warranted, for impairment to determine if events or changes in business conditions indicate that the carrying value may not be recoverable. The Company did not recognize any impairment charges on goodwill during the years ended December 31, 2016, 2015 and 2014. See Note 7, "Goodwill," for additional information.

*Intangible assets*

Intangible assets are amortized using a straight-line methodology over their estimated useful lives. Intangible assets with indefinite useful lives are evaluated annually for impairment, or more frequently if required. The Company did not recognize any impairment charges on intangible assets with indefinite lives during the years ended December 31, 2016, 2015 and 2014.

*Impairment of long-lived assets*

Long-lived asset groups are reviewed for impairment when circumstances indicate that the carrying amounts may not be recoverable. Impairment exists when the carrying value is greater than the expected undiscounted future cash flows expected to be provided by the asset group. If impairment exists, the asset group is written down to its fair value. The Company did not recognize any impairment charges on long-lived assets during the years ended December 31, 2016, 2015 and 2014.

*Advertising costs*

Advertising costs, which are included in selling, general and administrative expenses, are expensed as incurred. Advertising costs for the years ended December 31, 2016, 2015 and 2014 were \$19.3 million, \$18.7 million and \$12.6 million, respectively.

*Cost-basis investments*

The Company has private company investments, which consist of investments for which the Company does not have the ability to exercise significant influence, and are accounted for under the cost method. The investments are carried at cost and adjusted only when the Company believes that events have occurred that are likely to have a significant other-than-temporary adverse effect on the estimated fair value of the investments. If no such events have occurred, the fair value of the investments is not calculated as it is not required. The carrying value of those investments were \$3.2 million and \$5.2 million at December 31, 2016 and 2015, respectively. The investments are included in other assets in the Consolidated Balance Sheets.

FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Note 1. Nature of Business and Significant Accounting Policies—(Continued)**

*Contingencies*

The Company is subject to the possibility of loss contingencies arising in the normal course of business. An estimated loss is accrued when the Company determines that it is probable that an asset has been impaired or a liability has been incurred and the amount can be reasonably estimated. The Company regularly evaluates current available information to determine whether such accruals and disclosures should be adjusted.

*Earnings per share*

Basic earnings per share is based on the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed similar to basic earnings per share except that the weighted shares outstanding are increased to include additional shares from the assumed exercise of stock options, if dilutive, and the assumed issuance of shares upon vesting of restricted stock awards.

The following table sets forth the reconciliation of the numerator and denominator utilized in the computation of basic and diluted earnings per share (in thousands):

|  | Year Ended December 31, |            |            |
|--|-------------------------|------------|------------|
|  | 2016                    | 2015       | 2014       |
| Numerator for earnings per share:  |                         |            |            |
| Net earnings for basic and diluted earnings per share . . . . .  | \$ 166,626              | \$ 241,686 | \$ 200,261 |
| Denominator for earnings per share:  |                         |            |            |
| Weighted average number of common shares outstanding . . . . .   | 137,138                 | 139,353    | 141,143    |
| Assumed exercise of stock options and vesting of restricted stock awards, net of shares assumed reacquired under the treasury stock method . . . . . | 1,359                   | 1,421      | 2,426      |
| Diluted shares outstanding . . . . .   | 138,497                 | 140,774    | 143,569    |

The effect of stock-based compensation awards for the years ended December 31, 2016, 2015 and 2014 that aggregated 233,000, 354,000 and 171,000 shares, respectively, have been excluded for purposes of diluted earnings per share since the effect of their inclusion would have been anti-dilutive.

*Supplemental cash flow disclosure (in thousands)*

|                    | Year Ended December 31, |           |           |
|--------------------|-------------------------|-----------|-----------|
|                    | 2016                    | 2015      | 2014      |
| Cash paid for:     |                         |           |           |
| Interest . . . . . | \$ 15,815               | \$ 13,039 | \$ 13,410 |
| Taxes . . . . .    | \$ 32,465               | \$ 68,534 | \$ 47,434 |

*Stock-based compensation*

The Company uses the Black-Scholes option pricing model to estimate the fair value of stock option awards and shares expected to be issued under the Company's employee stock purchase plan. Nonvested stock awards (referred to as restricted stock unit awards) are valued based on the fair market value of the Company's stock, discounted for expected dividends, on the date of grant. Restricted stock units containing performance-based vesting criteria are valued on the date of grant based on the fair value of the Company's stock, discounted for expected dividends and an estimate for illiquidity. The fair value of market-based restricted stock units is determined on the date of grant using a lattice-based option-pricing valuation model that incorporates a Monte-Carlo simulation and a discount for illiquidity. The estimated discount for illiquidity is relevant for share based awards that require the plan participant to hold the shares for a specified period of time after the award vests and is estimated using the protective put method. The Company recognizes the compensation expense for all stock-based compensation awards on a straight-line basis over the requisite service period of each award.

FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Note 1. Nature of Business and Significant Accounting Policies—(Continued)**

*Stock-based compensation - (Continued)*

The following table sets forth the stock-based compensation expense recognized in the Consolidated Statements of Income for the years ended December 31, 2016, 2015 and 2014 (in thousands):

|  | Year Ended December 31, |                  |                  |
|--|-------------------------|------------------|------------------|
|  | 2016                    | 2015             | 2014             |
| Cost of goods sold .....                                   | \$ 3,103                | \$ 3,001         | \$ 2,706         |
| Research and development .....                             | 4,815                   | 4,694            | 5,218            |
| Selling, general and administrative .....                  | 19,879                  | 18,053           | 22,864           |
| Stock-based compensation expense before income taxes ..... | <u>\$ 27,797</u>        | <u>\$ 25,748</u> | <u>\$ 30,788</u> |

Stock-based compensation expense capitalized in the Consolidated Balance Sheets as of December 31, 2016, 2015 and 2014 is as follows (in thousands):

|                                | December 31,  |               |               |
|--------------------------------|---------------|---------------|---------------|
|                                | 2016          | 2015          | 2014          |
| Capitalized in inventory ..... | <u>\$ 567</u> | <u>\$ 691</u> | <u>\$ 713</u> |

As of December 31, 2016, the Company had approximately \$41.0 million of total unrecognized stock-based compensation costs, net of estimated forfeitures, to be recognized over a weighted average period of 1.90 years.

The fair value of the stock-based awards granted in the years ended December 31, 2016, 2015 and 2014 was estimated with the following weighted-average assumptions:

|  | 2016      | 2015      | 2014      |
|--|-----------|-----------|-----------|
| Stock option awards:                       |           |           |           |
| Risk-free interest rate .....              | 0.9%      | 0.2%      | 1.0%      |
| Expected dividend yield .....              | 1.6%      | 1.4%      | 1.2%      |
| Expected term .....                        | 4.3 years | 4.1 years | 4.4 years |
| Expected volatility .....                  | 25.6%     | 26.6%     | 28.7%     |
| Performance-based restricted stock awards: |           |           |           |
| Expected dividend yield .....              | 1.6%      | —         | —         |
| Discount for illiquidity .....             | 9.9%      | —         | —         |
| Market-based restricted stock awards:      |           |           |           |
| Risk-free interest rate .....              | 0.9%      | 0.9%      | —         |
| Expected dividend yield .....              | 1.6%      | 1.4%      | —         |
| Expected term .....                        | 4.0 years | 4.0 years | —         |
| Expected volatility .....                  | 25.8%     | 27.5%     | —         |
| Expected volatility of S&P 500 .....       | 25.0%     | 23.4%     | —         |
| Discount for illiquidity .....             | 9.9%      | 10.9%     | —         |
| Employee stock purchase plan:              |           |           |           |
| Risk-free interest rate .....              | 0.5%      | 0.4%      | 0.3%      |
| Expected dividend yield .....              | 1.5%      | 1.5%      | 1.2%      |
| Expected term .....                        | 6 months  | 6 months  | 6 months  |
| Expected volatility .....                  | 27.0%     | 21.5%     | 23.9%     |
| Discount for illiquidity .....             | 10.5%     | —         | —         |

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 1. Nature of Business and Significant Accounting Policies—(Continued)**

*Stock-based compensation - (Continued)*

The Company uses the United States Treasury (constant maturity) interest rate on the date of grant as the risk-free interest rate and uses historical volatility as the expected volatility. The Company's determination of expected term is based on an analysis of historical and expected exercise patterns. In 2016, 2015 and 2014, all stock options granted were time-based options. The Company uses an estimated forfeiture rate of 5 percent of the stock-compensation expense of non-executive employees based on an analysis of historical and expected forfeitures.

During the years ended December 31, 2016, 2015 and 2014, the Company granted approximately 865,000, 804,000 and 685,000 time-vested restricted stock units, respectively. The fair value of time-vested restricted stock units is fixed and determined on the date of grant based upon the Company's stock price on the date of grant. The weighted average fair values of the time-vested restricted stock units granted during the years ended December 31, 2016, 2015 and 2014 were \$29.48, \$26.30 and \$32.80 per share, respectively.

During the years ended December 31, 2016 and 2015, the Company granted approximately 64,000 and 128,000 market-based restricted stock units. These units may be earned based upon the Company's total shareholder return compared to the total shareholder return over a three year period of the component company at the 60th percentile level in the S&P 500 Index. Shares vested under the market-based restricted stock unit awards must be held by the participant for a period of one year from the vest date. The fair value of the market-based restricted stock units granted during the year ended December 31, 2016 and 2015 was \$22.89 and \$25.55 per share, respectively.

During the years ended December 31, 2016, the Company granted approximately 62,000 performance-based restricted stock units. These units are earned based upon the Company's return on invested capital over a three year period. The fair value of the performance-based restricted units granted during the year ended December 31, 2016 was \$26.41 per share.

The total fair value of the restricted stock unit awards granted during the year ended December 31, 2016 in the table below of \$28.6 million includes \$1.5 million of grant date fair value associated with the market-based restricted stock units and \$1.6 million of grant date fair value associated with the performance-based restricted stock units.

The weighted-average fair value of stock-based compensation awards granted and vested, and the intrinsic value of options exercised during the period were (in thousands, except per share amounts):

|   | <b>Years Ended December 31,</b> |             |             |
|---|---------------------------------|-------------|-------------|
|   | <b>2016</b>                     | <b>2015</b> | <b>2014</b> |
| <b>Stock option awards:</b>                                 |                                 |             |             |
| Weighted average grant date fair value per share . . . . .  | \$ 5.68                         | \$ 5.60     | \$ 7.41     |
| Total fair value of awards granted . . . . .                | \$ 4,716                        | \$ 4,170    | \$ 4,947    |
| Total fair value of awards vested . . . . .                 | \$ 4,407                        | \$ 4,290    | \$ 4,662    |
| Total intrinsic value of options exercised . . . . .        | \$ 6,170                        | \$ 15,585   | \$ 35,663   |
| <b>Restricted stock unit awards:</b>                        |                                 |             |             |
| Weighted average grant date fair value per share . . . . .  | \$ 28.86                        | \$ 29.12    | \$ 32.80    |
| Total fair value of awards granted . . . . .                | \$ 28,603                       | \$ 27,150   | \$ 22,484   |
| Total fair value of awards vested . . . . .                 | \$ 21,130                       | \$ 24,458   | \$ 30,277   |
| <b>Employee stock purchase plan:</b>                        |                                 |             |             |
| Weighted average grant date fair value per share . . . . .  | \$ 6.33                         | \$ 5.83     | \$ 7.38     |
| Total fair value of shares estimated to be issued . . . . . | \$ 923                          | \$ 951      | \$ 1,144    |

The total amount of cash received from the exercise of stock options in the years ended December 31, 2016, 2015 and 2014 was \$7.7 million, \$20.8 million and \$44.2 million, respectively, and the related tax benefits realized from the exercise of the stock options was \$1.3 million, \$3.9 million and \$12.8 million, respectively.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 1. Nature of Business and Significant Accounting Policies—(Continued)**

*Stock-based compensation - (Continued)*

The Company elected to adopt the “long-haul” method to calculate the historical pool of windfall tax benefits, which calculates on a grant by grant basis, the windfall or excess tax benefit that arose upon the exercise of each stock option, based on a comparison to the total tax deduction to the “as-if” deferred tax asset that would have been recorded had the Company followed the recognition provisions of Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) Topic 718, “Compensation-Stock Compensation.” Additionally, the Company elected to adopt the “tax-law ordering” method of measuring the timing in which tax deductions on stock option exercises should be recognized in the consolidated financial statements.

*Concentration of risk*

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of accounts receivable. Concentration of credit risk with respect to accounts receivable is limited because a relatively large number of geographically diverse customers make up the Company’s customer base, thus diversifying the trade credit risk. The Company controls credit risk through credit approvals, credit limits and monitoring procedures. The Company performs credit evaluations for all new customers and requires letters of credit, bank guarantees and advanced payments, if deemed necessary.

A substantial portion of the Company’s revenue is derived from sales to United States and foreign government agencies (see Note 17, "Operating Segments and Related Information"). The Company also purchases certain key components from sole or limited source suppliers.

The Company maintains cash deposits with major banks that from time to time may exceed federally insured limits. The Company periodically assesses the financial condition of the institutions and instruments in which it invests, and adjusts its investment balances to mitigate the risk of principal loss.

*Use of estimates*

The preparation of financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Significant estimates and judgments made by management of the Company include matters such as collectability of accounts receivable, realizability of inventories, recoverability of deferred tax assets, impairment tests of goodwill, intangible assets and other long-lived assets, recognition and measurement of loss contingencies and adequacy of warranty accruals. Actual results could differ from those estimates. The Company believes that the estimates used are reasonable.

*Accumulated other comprehensive earnings (loss)*

Accumulated other comprehensive earnings (loss) includes cumulative translation adjustments, fair value adjustments on cash flow hedges and changes in minimum liability for pension plans. Foreign currency translation adjustments included in comprehensive income were not tax affected as investments in international affiliates are deemed to be indefinite in duration.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 1. Nature of Business and Significant Accounting Policies—(Continued)**

*Accumulated other comprehensive earnings (loss) - (Continued)*

The following table sets forth the changes in the balances of each component of accumulated other comprehensive earnings (loss) for the year ended December 31, 2016:

|  | <b>Pension<br/>Plans<br/>Items</b> | <b>Cash<br/>Flow<br/>Hedge<br/>Items</b> | <b>Foreign<br/>Currency<br/>Items</b> | <b>Total</b>        |
|--|------------------------------------|--|---------------------------------------|---------------------|
| Balance, December 31, 2015 .....   | \$ (1,717)                         | \$ 323                                   | \$ (123,732)                          | \$ (125,126)        |
| Other comprehensive income (loss) before reclassifications, net of tax ..                      | 78                                 | (357)                                    | (40,911)                              | (41,190)            |
| Amounts reclassified from accumulated other comprehensive earnings<br>(loss), net of tax ..... | 24                                 | 341                                      | —                                     | 365                 |
| Net current period other comprehensive income (loss), net of tax .....                         | 102                                | (16)                                     | (40,911)                              | (40,825)            |
| Balance, December 31, 2016 .....   | <u>\$ (1,615)</u>                  | <u>\$ 307</u>                            | <u>\$ (164,643)</u>                   | <u>\$ (165,951)</u> |

The amounts reclassified from accumulated other comprehensive earnings (loss) for pension plan items have been recorded in selling, general and administrative expenses and amounts reclassified for cash flow hedge items have been recorded to interest expense in the Company's Consolidated Statement of Income for the year ended December 31, 2016.

*Recent accounting pronouncements*

In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), which establishes new guidance under which companies will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. ASU 2014-09 also provides for additional disclosure requirements. The FASB has recently issued several amendments to the new standard, including clarification on accounting for licenses of intellectual property and identifying performance obligations. The amendments include ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606)-Principal versus Agent Considerations, which was issued in March 2016, and clarifies the implementation guidance for principal versus agent considerations in ASU 2014-09, and ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606)-Identifying Performance Obligations and Licensing, which was issued in April 2016, and amends the guidance in ASU No. 2014-09 related to identifying performance obligations and accounting for licenses of intellectual property.

The new standard permits adoption either by using (i) a full retrospective approach for all periods presented in the period of adoption or (ii) a modified retrospective approach with the cumulative effect of initially applying the new standard recognized at the date of initial application and providing certain additional disclosures. While ASU 2014-09 was to be effective for annual periods and interim periods beginning after December 15, 2016, on July 9, 2015, the FASB approved the deferral of the effective date to periods beginning on or after December 15, 2017. Accordingly, the Company currently intends to adopt ASU 2014-09 on January 1, 2018. The Company currently plans to adopt using the modified retrospective approach. However, a final decision regarding the adoption method has not been finalized at this time. The final determination will depend on a number of factors, such as the significance of the impact of the new standard on its financial results, system readiness, and the ability to accumulate and analyze the information necessary to assess the impact on prior period financial statements, as necessary.

The Company has made progress toward completing the evaluation of the potential changes from adopting the new standard on its financial reporting and disclosures. The Company has evaluated the impact of the standard on all of its revenue streams and most of its significant contracts. The Company expects to complete the contract evaluation and validate the impact of the accounting and disclosure changes on its business processes, controls and systems during the first half of 2017, design any changes to such business processes, controls and systems by the middle of 2017, and implement the changes over the remainder of 2017.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 1. Nature of Business and Significant Accounting Policies—(Continued)**

*Recent accounting pronouncements - (Continued)*

In July 2015, the FASB issued Accounting Standards Update No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory" ("ASU 2015-11"). The amendments in this update require inventory to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The amendments in this update should be applied prospectively with earlier application permitted. The Company currently intends to adopt ASU 2015-11 on January 1, 2017, and does not expect the adoption of ASU 2015-11 to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). The amendments in this update require the identification of arrangements that should be accounted for as leases by lessees. In general, for lease arrangements exceeding a twelve month term, these arrangements must now be recognized as assets and liabilities on the balance sheet of the lessee. ASU 2016-02 requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented in the consolidated financial statements. ASU 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted, and the Company currently intends to adopt ASU 2016-02 on January 1, 2019. The Company is assessing the impact ASU 2016-02 will have on its consolidated financial statements and expects that the primary impact upon adoption will be the recognition, on a discounted basis, of its minimum commitments under noncancelable operating leases on its consolidated balance sheets resulting in the recording of right of use assets and lease obligations. The Company's current minimum commitments under noncancelable operating leases are disclosed in Note 12.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, "Compensation - Stock Compensation (Topic 718)" ("ASU 2016-09"). The amendments in this update identify areas for simplification involving several aspects of accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, an option to recognize gross stock compensation expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. ASU 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016, with early adoption permitted. The Company currently intends to adopt ASU 2016-09 on January 1, 2017, and the magnitude of the impact on its consolidated financial statements and disclosures is dependent upon the Company's future grants of stock-based compensation, the Company's future stock price in relation to the fair value of awards on grant date and the exercise behavior of the Company's option holders.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). The amendments in this update provide clarification regarding how certain cash receipts and cash payment are presented and classified in the statement of cash flows. ASU 2016-15 addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. ASU 2016-15 is effective for interim and annual reporting periods beginning after December 15, 2017, including interim periods within those fiscal years, with early adoption permitted. The Company adopted ASU 2016-15 in the third quarter of 2016, and our early adoption of ASU 2016-15 did not have a material impact on our consolidated financial statements or disclosures.

In October 2016, the FASB issued Accounting Standards Update No. 2016-16, "Intra-Entity Transfers of Assets Other Than Inventory" ("ASU 2016-16"). The amendments in this update eliminate the exception of recognizing, at the time of transfer, current and deferred income taxes for intra-entity asset transfers other than inventory. ASU 2016-16 is effective for interim and annual reporting periods beginning after December 15, 2017 and should be applied on a modified retrospective transition basis. Early adoption is permitted. The Company currently intends to adopt ASU 2016-09 on January 1, 2018 and is currently evaluating the potential impact of adopting the provisions of ASU 2016-16.

In January 2017, the FASB issued Accounting Standards Update No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business" ("ASU 2017-01"). The amendments in this update clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for interim and annual reporting periods beginning after December 15, 2017. The Company currently intends to adopt ASU 2017-01 on January 1, 2018, and does not expect the adoption of ASU 2017-01 to have a material impact on its consolidated financial statements.



**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 1. Nature of Business and Significant Accounting Policies—(Continued)**

*Recent accounting pronouncements - (Continued)*

In January 2017, the FASB issued Accounting Standards Updated No. 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”). The amendments in this update simplify the subsequent measurement of goodwill by removing the second step of the two-step impairment test. The amendment requires an entity to perform its annual, or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendment should be applied on a prospective basis. ASU 2017-04 is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company currently intends to adopt ASU 2017-04 on January 1, 2017.

**Note 2. Fair Value of Financial Instruments**

Factors used in determining the fair value of financial assets and liabilities are summarized into three broad categories in accordance with FASB ASC Topic 820, “Fair Value Measurements”:

Level 1 – quoted prices in active markets for identical securities as of the reporting date;

Level 2 – other significant directly or indirectly observable inputs, including quoted prices for similar securities, interest rates, prepayment speeds, credit risk and observable market prices for identical instruments that are traded in less active markets; and

Level 3 – significant inputs that are generally less observable than objective sources, including our own assumptions in determining fair value.

The factors or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

The Company had \$8.3 million and \$29.0 million of cash equivalents at December 31, 2016 and 2015, respectively, which were primarily investments in money market funds. The Company has categorized its cash equivalents as a Level 1 financial asset, measured at fair value based on quoted prices in active markets of identical assets. All cash equivalents are in instruments that are convertible to cash daily. The fair value of the Company's forward currency contracts and interest rate swap contracts as of December 31, 2016 and 2015 are disclosed in Note 3, "Derivative Financial Instruments," and based on Level 2 inputs. The fair value of the Company's senior unsecured notes as described in Note 11, "Long-Term Debt," is approximately \$426.3 million based upon Level 2 inputs at December 31, 2016. The fair value of the Company's credit agreements and borrowings, also described in Note 11, approximates the carrying value due to the variable market rate used to calculate interest payments. The Company does not have any other significant financial assets or liabilities that are measured at fair value.

**Note 3. Derivative Financial Instruments**

*Foreign Currency Exchange Rate Risk*

The Company enters into foreign currency forward contracts not formally designated as hedges to manage the consolidated exchange rate risk associated with the remeasurement of non-functional currency denominated monetary assets and liabilities. Non-functional currency denominated monetary assets and liabilities consist primarily of cash, receivables, payables and intercompany loans. The Company manages exposure to counterparty non-performance credit risk by entering into foreign currency forward contracts only with major financial institutions that are expected to fully perform under the terms of such contracts. Changes in fair value of foreign currency forward contracts are recognized in income at the end of each reporting period based on the difference between the contract rate and the spot rate. The net amount of the gains and losses related to derivative instruments recorded in other expense (income), net for the year ended December 31, 2016, 2015 and 2014 were a loss of \$5.3 million, \$6.7 million and \$8.3 million, respectively.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 3. Derivative Financial Instruments - (Continued)**

*Foreign Currency Exchange Rate Risk - (Continued)*

In general, these gains and losses are offset in the Consolidated Statements of Income by the reciprocal gains and losses from the underlying assets or liabilities which originally gave rise to the exposure.

Notional amounts are used to measure the volume of foreign currency forward contracts and do not represent the Company's total exposure to foreign currency gains or losses. The table below presents the net notional amounts of the Company's outstanding foreign currency forward contracts by currency at December 31, 2016 and 2015 (in thousands):

|                              | Year Ended December 31, |                  |
|------------------------------|-------------------------|------------------|
|                              | 2016                    | 2015             |
| European euro .....          | \$ 156,352              | \$ 281           |
| Swedish kroner .....         | 48,555                  | 59,198           |
| British pound sterling ..... | 33,862                  | 10,203           |
| Canadian dollar .....        | 15,645                  | 10,799           |
| Japanese yen .....           | 3,251                   | 2,124            |
| Brazilian real .....         | 2,747                   | 6,440            |
| Australian dollar .....      | 1,653                   | 2,342            |
| Other .....                  | —                       | 526              |
|                              | <u>\$ 262,065</u>       | <u>\$ 91,913</u> |

At December 31, 2016, the Company's foreign currency forward contracts, in general, had maturities of three months or less.

The carrying amount of the foreign exchange contracts included in the Consolidated Balance Sheets are as follows (in thousands):

|                                  | December 31, 2016                               |                              | December 31, 2015                               |                              |
|----------------------------------|---|------------------------------|---|------------------------------|
|                                  | Prepaid Expenses<br>and Other<br>Current Assets | Other Current<br>Liabilities | Prepaid Expenses<br>and Other<br>Current Assets | Other Current<br>Liabilities |
| Foreign exchange contracts ..... | \$ 2,369  | \$ 75                        | \$ 767  | \$ 1,314                     |

*Interest Rate Swap Contracts*

The Company's outstanding debt at December 31, 2016 consists of fixed rate notes and a floating rate unsecured credit facility. The Company maintains its floating rate revolver for flexibility to fund working capital needs and for other uses of cash. Interest expense on the Company's floating rate debt is typically calculated based on a fixed spread over a reference rate, such as LIBOR (also known as the Eurocurrency rate). Therefore, fluctuations in market interest rates will cause interest expense increases or decreases on a given amount of floating rate debt.

The Company is managing its interest rate risk related to floating rate debt through interest rate swaps in which the Company receives floating rate payments and makes fixed rate payments. The impact of the interest rate swaps is to fix the floating rate basis for the calculation of interest on the unsecured credit facility at the levels indicated in the table below. The effective interest rate paid is equal to the fixed rates shown below plus the credit spread then in effect. At December 31, 2016, the effective interest rate on the borrowings made from the Company's revolving credit facility was 2.37 percent. As of December 31, 2016, the following interest rate swaps were outstanding:

| Contract Date        | Notional Amount<br>(in millions) | Fixed Rate | Effective Date | Maturity Date  |
|----------------------|----------------------------------|------------|----------------|----------------|
| March 15, 2013 ..... | \$ 46.9                          | 1.02%      | April 5, 2013  | March 31, 2019 |
| March 29, 2013 ..... | \$ 46.9                          | 0.97%      | April 5, 2013  | March 31, 2019 |

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 3. Derivative Financial Instruments - (Continued)**

*Interest Rate Swap Contracts - (Continued)*

These interest rate swaps are designated and effective as cash flow hedges and are recorded as an asset or liability in the Company's Consolidated Balance Sheets at fair value. Fair value adjustments are recorded as an adjustment to accumulated other comprehensive earnings (loss), except that any gains and losses on ineffectiveness of the interest rate swaps would be recorded as an adjustment to other (income) expense, net. The net fair value carrying amount of the Company's interest rate swaps was \$0.3 million, all of which has been recorded to other assets in the Consolidated Balance Sheet as of December 31, 2016.

**Note 4. Accounts Receivable**

Accounts receivable are net of an allowance for doubtful accounts. The following table summarizes the Company's allowance for doubtful accounts and the activity for 2016, 2015 and 2014 (in thousands):

|   | Year Ended December 31, |                 |                 |
|---|-------------------------|-----------------|-----------------|
|   | 2016                    | 2015            | 2014            |
| Allowance for doubtful accounts, beginning of year      | \$ 6,853                | \$ 8,014        | \$ 7,674        |
| Charges to costs and expenses                           | 1,460                   | 807             | 1,723           |
| Write-offs of uncollectible accounts, net of recoveries | (1,661)                 | (1,568)         | (961)           |
| Currency translation adjustments                        | (195)                   | (400)           | (422)           |
| Allowance for doubtful accounts, end of year            | <u>\$ 6,457</u>         | <u>\$ 6,853</u> | <u>\$ 8,014</u> |

**Note 5. Inventories**

Inventories consist of the following (in thousands):

|                                | December 31,      |                   |
|--------------------------------|-------------------|-------------------|
|                                | 2016              | 2015              |
| Raw material and subassemblies | \$ 200,640        | \$ 216,107        |
| Work-in-progress               | 43,430            | 38,639            |
| Finished goods                 | 127,301           | 138,346           |
|                                | <u>\$ 371,371</u> | <u>\$ 393,092</u> |

**Note 6. Property and Equipment**

Property and equipment are summarized as follows (in thousands):

|                               | Estimated Useful Life | December 31,      |                   |
|-------------------------------|-----------------------|-------------------|-------------------|
|                               |                       | 2016              | 2015              |
| Land                          | —                     | \$ 22,326         | \$ 22,972         |
| Buildings                     | 30 years              | 162,701           | 163,420           |
| Machinery and equipment       | 3 to 7 years          | 258,023           | 241,310           |
| Office equipment and other    | 3 to 10 years         | 103,798           | 98,308            |
|                               |                       | 546,848           | 526,010           |
| Less accumulated depreciation |                       | (275,063)         | (253,381)         |
|                               |                       | <u>\$ 271,785</u> | <u>\$ 272,629</u> |

Depreciation expense for the years ended December 31, 2016, 2015 and 2014 was \$37.8 million, \$32.5 million and \$34.6 million, respectively.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 7. Goodwill**

The carrying value of goodwill and the activity for the two year period ending December 31, 2016 are as follows (in thousands):

|                                  |                          |
|----------------------------------|--------------------------|
| Balance, December 31, 2014       | \$ 553,335               |
| Goodwill from acquisitions       | 57,992                   |
| Currency translation adjustments | <u>(15,011)</u>          |
| Balance, December 31, 2015       | 596,316                  |
| Goodwill from acquisitions       | 220,795                  |
| Currency translation adjustments | <u>(15,705)</u>          |
| Balance, December 31, 2016       | <u><u>\$ 801,406</u></u> |

During the year ended December 31, 2016, the Company recorded \$220.8 million of goodwill in connection with the purchase price allocation associated with its acquisitions of Armasight, Inc. ("Armasight"), Point Grey Research Inc. ("Point Grey"), Innovative Security Designs, LLC ("ISD") and DVTEL, Inc. ("DVTEL"). During the year ended December 31, 2015, the Company recorded \$58.0 million of goodwill in connection with the purchase price allocation associated with DVTEL. The purchase price allocation for Point Grey is preliminary. See Note 18, "Business Acquisitions," for additional information.

The Company reviews its goodwill for impairment annually during the third quarter, or more frequently, if events or circumstances indicate that the carrying value of a reporting unit exceeds its fair value. During the third quarter of 2016, the Company completed its annual review of goodwill and determined that no impairment of its recorded goodwill was necessary. As of December 31, 2016, there had been no triggering events or indicators of impairment that would require an updated impairment review.

**Note 8. Intangible Assets**

Intangible assets are summarized as follows (in thousands):

|  | Weighted<br>Average<br>Estimated<br>Useful Life | December 31,             |                          |
|--|---|--------------------------|--------------------------|
|  |   | 2016                     | 2015                     |
| Product technology                               | 11 years  | \$ 98,895                | \$ 76,182                |
| Customer relationships                           | 11 years  | 87,013                   | 69,272                   |
| Trademarks and trade name portfolios             | 14 years  | 8,160                    | 7,540                    |
| Trade name portfolio not subject to amortization | indefinite                                      | 37,494                   | 37,673                   |
| In-process research and development              | n/a   | 4,700                    | 2,250                    |
| Other  | 3 years   | <u>1,827</u>             | <u>1,474</u>             |
| Acquired identifiable intangibles                |   | 238,089                  | 194,391                  |
| Less accumulated amortization                    |   | <u>(73,535)</u>          | <u>(58,173)</u>          |
| Net acquired identifiable intangibles            |   | <u>164,554</u>           | <u>136,218</u>           |
| Patents  | 7 years   | 6,083                    | 6,104                    |
| Less accumulated amortization                    |   | <u>(2,531)</u>           | <u>(1,671)</u>           |
| Net patents                                      |   | <u>3,552</u>             | <u>4,433</u>             |
| Acquired in-place leases and other               | 7 years   | 2,074                    | 2,080                    |
| Less accumulated amortization                    |   | <u>(1,720)</u>           | <u>(1,429)</u>           |
| Net acquired in-place leases and other           |   | <u>354</u>               | <u>651</u>               |
|  |   | <u><u>\$ 168,460</u></u> | <u><u>\$ 141,302</u></u> |

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 8. Intangible Assets - (Continued)**

During the year ended December 31, 2016, the Company acquired \$47.4 million of identifiable intangible assets as part of the acquisitions of Armasight and Point Grey and during the year ended December 31, 2015, the Company acquired \$27.4 million of identifiable intangible assets as part of the acquisition of DVTEL, as described in Note 18, "Business Acquisitions."

The aggregate amortization expense recorded in 2016, 2015 and 2014 was \$18.4 million, \$16.4 million and \$21.1 million, respectively. For intangible assets recorded at December 31, 2016, the estimated future aggregate amortization expense for the years ending December 31, 2017 through 2021 is approximately (in thousands):

|            |           |
|------------|-----------|
| 2017 ..... | \$ 23,594 |
| 2018 ..... | 19,962    |
| 2019 ..... | 19,041    |
| 2020 ..... | 16,095    |
| 2021 ..... | 14,411    |

**Note 9. Credit Agreement**

On February 8, 2011, the Company entered into a Credit Agreement ("Credit Agreement") with Bank of America, N.A., U.S. Bank National Association, JPMorgan Chase Bank N.A. and other Lenders. The Credit Agreement provides for a \$200 million, five-year revolving line of credit. On April 5, 2013, the Credit Agreement was amended to extend the maturity of the revolving credit facility from April 8, 2016 to April 5, 2018 in addition to incorporating a \$150 million term loan facility maturing April 5, 2019. On May 31, 2016, the Credit Agreement was further amended to increase the borrowing capacity to \$500 million and to extend the maturity of the revolving credit facility from April 5, 2018 to May 31, 2021. The amendment also incorporated a revised schedule of fees and interest rate spreads. The Company has the right, subject to certain conditions, including approval of additional commitments by qualified lenders, to increase the revolving line of credit under the Credit Agreement by an additional \$200 million until May 31, 2021. The Credit Agreement allows the Company and certain designated subsidiaries to borrow in United States dollars, European euros, Swedish kronor, British pound sterling, Japanese yen, Canadian dollars, Australian dollars and other agreed upon currencies. Interest rates under the Credit Agreement are determined based on the type of borrowing. Interest associated with borrowings can be based on the prime lending rate of Bank of America, N.A. or the published Eurocurrency rate (i.e. LIBOR). The borrowings have an applicable margin of 0.125 percent to 2.125 percent depending on the applicable base rate and our consolidated total leverage ratio. Including the respective spreads and ignoring the effects of hedging, the one-month LIBOR interest rate was 2.145 percent per annum and the prime lending rate was 4.125 percent per annum at December 31, 2016. The Credit Agreement requires the Company to pay a commitment fee on the amount of unused revolving commitments at a rate, based on the Company's total leverage ratio, which ranges from 0.150 percent to 0.300 percent of unused revolving commitments. At December 31, 2016, the commitment fee rate was 0.175 percent per annum. The Credit Agreement contains two financial covenants that require the maintenance of a total leverage ratio and an interest coverage ratio, with which the Company was in compliance at December 31, 2016. The credit facilities available under the Credit Agreement are unsecured.

On May 31, 2016, the Company drew down \$105 million under the revolving credit facility and repaid the term loan facility in full. At December 31, 2016, the Company had \$97.5 million outstanding under the Credit Agreement and had \$17.9 million of letters of credit outstanding, which reduces the total available revolving credit under the Credit Agreement.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 10. Accrued Product Warranties**

The Company generally provides a twelve to twenty-four month warranty on its products. A provision for the estimated future costs of warranty, based upon historical cost and product performance experience, is recorded when revenue is recognized. The following table summarizes the Company's warranty liability and activity for 2016, 2015 and 2014 (in thousands):

|   | Year Ended December 31, |                  |                  |
|---|-------------------------|------------------|------------------|
|   | 2016                    | 2015             | 2014             |
| Accrued product warranties, beginning of year     | \$ 16,514               | \$ 16,175        | \$ 17,732        |
| Amounts paid for warranty services                | (19,592)                | (12,821)         | (10,267)         |
| Warranty provisions for products sold             | 22,928                  | 13,074           | 9,880            |
| Business acquisition                              | 1,215                   | 395              | —                |
| Currency translation adjustments and other        | (220)                   | (309)            | (1,170)          |
| Accrued product warranties, end of year           | <u>\$ 20,845</u>        | <u>\$ 16,514</u> | <u>\$ 16,175</u> |
| Current accrued product warranties, end of year   | <u>\$ 17,476</u>        | <u>\$ 13,406</u> | <u>\$ 13,538</u> |
| Long-term accrued product warranties, end of year | <u>\$ 3,369</u>         | <u>\$ 3,108</u>  | <u>\$ 2,637</u>  |

**Note 11. Long-Term Debt**

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

|   | December 31,      |                   |
|---|-------------------|-------------------|
|   | 2016              | 2015              |
| Unsecured notes   | \$ 425,000        | \$ 250,000        |
| Term loan   | —                 | 108,750           |
| Credit Agreement  | 97,500            | —                 |
| Unamortized discounts and issuance costs of unsecured notes | (5,579)           | (306)             |
|   | <u>\$ 516,921</u> | <u>\$ 358,444</u> |
| Current portion, long-term debt                             | <u>\$ 15,000</u>  | <u>\$ 264,694</u> |
| Long-term debt  | <u>\$ 501,921</u> | <u>\$ 93,750</u>  |

In August 2011, the Company issued \$250 million aggregate principal amount of its 3.75 percent senior unsecured notes due September 1, 2016 (the "Notes"). The 2011 Notes were repaid on July 5, 2016 and the Company recorded a \$1.3 million loss on the extinguishment of the 2011 Notes in Interest Expense.

In June 2016, the Company issued \$425 million aggregate principal amount of its 3.125 percent senior unsecured notes due June 15, 2021 (the "2016 Notes"). The net proceeds from the issuance of the 2016 Notes were approximately \$421.0 million, after deducting underwriting discounts and offering expenses, which are being amortized over a period of five years. Interest on the 2016 Notes is payable semiannually in arrears on December 15 and June 15. The proceeds from the 2016 Notes were used to repay the principal amount of the 2011 Notes outstanding in July 2016 and are being used for other general corporate purposes, including working capital and capital expenditure needs, business acquisitions and repurchases of the Company's common stock.

The Credit Agreement discussed in Note 9, "Credit Agreement," of the Notes to the Consolidated Financial Statements above, consisted of a \$150 million term loan facility and a revolving credit facility. On May 31, 2016, the Company repaid its term loan and drew down \$105.0 million under the revolving credit facility. Interest on amounts outstanding under the revolving credit facility accrues at the one-month LIBOR rate plus the applicable margin for the amount outstanding and is paid monthly in arrears. See Note 5, "Derivative Financial Instruments - Interest Rate Swap Contracts," of the Notes to the Consolidated Financial Statements for additional information on the effective interest rate on the revolving credit facility at December 31, 2016.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 11. Long-Term Debt - (Continued)**

On April 5, 2013, the Company borrowed \$150 million under the term loan facility incorporated in the Credit Agreement. As discussed in Note 9, "Credit Agreement," of the Notes to the Consolidated Financial Statement above, on May 31, 2016, the Company repaid its term loan and drew down \$105.0 million under the revolving credit facility. Interest on amounts outstanding under the revolving credit facility accrues at the one-month LIBOR rate plus the applicable scheduled spread for the amount outstanding and is paid monthly in arrears. See Note 3, "Derivative Financial Instruments - *Interest Rate Swap Contracts*," of the Notes to the Consolidated Financial Statements for additional information on the effective interest rate on the revolving credit facility at December 31, 2016.

**Note 12. Commitments**

The Company leases some of its primary facilities under various operating leases that expire in 2017 through 2022. The Company also leases certain operating machinery and equipment and office equipment under operating lease agreements. Total net rent expense for the years ended December 31, 2016, 2015 and 2014 amounted to \$9.0 million, \$12.2 million and \$14.0 million, respectively.

The future minimum obligations under all non-cancelable leases and other contractual obligations are as follows (in thousands):

|                              | Net<br>Operating<br>Leases | Other<br>Contractual<br>Obligations |
|------------------------------|----------------------------|-------------------------------------|
| 2017 .....                   | \$ 9,265                   | \$ 1,049                            |
| 2018 .....                   | 5,660                      | 766                                 |
| 2019 .....                   | 2,805                      |                                     |
| 2020 .....                   | 1,539                      | —                                   |
| 2021 .....                   | 1,135                      | —                                   |
| Thereafter .....             | 808                        | —                                   |
| Total minimum payments ..... | \$ 21,212                  | \$ 1,815                            |

**Note 13. Contingencies**

FLIR Systems, Inc. and its subsidiary, FLIR Commercial Systems, Inc. (formerly known as Indigo Systems Corporation) (together, the "FLIR Parties"), were named in a lawsuit filed by Raytheon Company ("Raytheon") on March 2, 2007 in the United States District Court for the Eastern District of Texas. Raytheon's complaint, as amended, asserted claims for tortious interference, patent infringement, trade secret misappropriation, unfair competition, breach of contract and fraudulent concealment. The FLIR Parties filed an answer to the complaint on September 2, 2008, in which they denied all material allegations. On October 27, 2010, the FLIR Parties and Raytheon entered into a settlement agreement that resolved the patent infringement claims (the "Patent Claims") pursuant to which the FLIR Parties paid \$3 million to Raytheon and entitles the FLIR Parties to certain license rights in the patents that were the subject of the Patent Claims. On October 28, 2014, a four-week trial began with respect to Raytheon's remaining claims of misappropriations of trade secrets and claims related to 31 alleged trade secrets. On November 24, 2014, a jury in the United States District Court for the Eastern District of Texas rejected Raytheon's claims and determined that 27 of the alleged trade secrets were not in fact trade secrets and that neither of the FLIR Parties infringed any of the trade secrets claimed and awarded Raytheon no damages. On March 31, 2016 the United States District Court for the Eastern District of Texas issued a Final Judgment denying Raytheon's claims and awarding FLIR court costs and denying each of Raytheon's and FLIR's Renewed Motions for Judgment as a Matter of Law and denying FLIR's Amended Rule 54(d) Motion for Attorneys' Fees and Costs Under the Texas Theft Liability Act.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 13. Contingencies - (Continued)**

On April 29, 2016, Raytheon filed a Notice of Appeal to the United States Court of Appeals for the Federal Circuit of the denial by the United States District Court for the Eastern District of Texas of Raytheon's Renewed Motion for Judgment as a Matter of Law, or in the Alternative, Motion for New Trial. On May 11, 2016, the FLIR Parties filed a Notice of Appeal to the United States Court of Appeals for the Federal Circuit of the Order of the United States District Court for the Eastern District of Texas Denying the FLIR Parties' Amended Rule 54(d) Motion for Attorneys' Fees and Costs under the Texas Theft Liability Act, the Order Denying the FLIR Parties' Renewed Motion For Judgment as a Matter Of Law, and the Final Judgment to the extent it denied the FLIR Parties Attorneys' Fees and Costs under the Texas Theft Liability Act. The matter remains ongoing and is subject to appeal and the Company is unable to estimate the amount or range of potential loss or recovery, if any, which might result if the final determination of this matter is favorable or unfavorable, but an adverse ruling on the merits of the original claims against the FLIR Parties, while remote, could be material.

On October 22, 2014, the Company initially contacted the United States Department of State Office of Defense Trade Controls Compliance ("DDTC"), pursuant to International Traffic in Arms Regulation ("ITAR") § 127.12(c), regarding the unauthorized export of technical data and defense services to dual and third country nationals in at least four facilities of the Company. On April 27, 2015, the Company submitted its initial report to DDTC regarding the details of the issues raised in the October 22, 2014 submission. DDTC subsequently notified the Company that it was considering administrative proceedings under Part 128 of ITAR and requested a tolling agreement, which the Company executed on June 16, 2015. On June 6, 2016, the Company executed a subsequent tolling agreement extending the tolling period for matters to be potentially included in an administrative proceeding for an additional 18 months until December 2017. DDTC continues its review and the Company is unable to reasonably estimate the time it may take to resolve the matter or the amount or range of potential loss, penalty or other government action, if any, that may be incurred in connection with this matter. However, an unfavorable outcome could result in fines and penalties, or loss, or modification of exporting privileges that could potentially be material to the financial condition, results of operations, and cash flows of the Company in and following the period in which such an outcome becomes estimable or known.

In March 2016, the Company learned of potential quality concerns with respect to as many as 312 Level III and Level IV SkyWatch Surveillance Towers sold by FLIR and companies acquired by FLIR from 2002 through 2014. During the quarter ended September 30, 2016, the Company identified the cause of these quality issues and tested certain remedial solutions which may be required to repair the affected SkyWatch Towers. Testing of the remedial solution is ongoing. The Company has notified customers who purchased the affected SkyWatch Towers of the potential concerns and, as a precautionary measure, has also temporarily suspended production of all Level III and Level IV SkyWatch Towers pending the completion of its review and the implementation of any necessary remedial measures. While there still remains uncertainty related to estimating the costs associated with a potential remedy and number of units which may require such remedy, the Company currently estimates the range of potential loss to be between \$2.5 million and \$15 million. As no single amount within the range is a better estimate than any other amount within the range, the Company has recorded a liability of \$2.5 million as of December 31, 2016. Factors underlying this estimated range of loss may change from time to time, and actual results may vary significantly from this estimate.

The Company is also subject to other legal and administrative proceedings, investigations, claims and litigation arising in the ordinary course of business not specifically identified above. In these identified matters and others not specifically identified, the Company makes a provision for a liability with respect to a matter when it is both probable that a liability has been incurred and the amount of loss can be reasonably estimated for such matter. The Company believes it has recorded adequate provisions for any probable and estimable losses for matters in existence on the date hereof. While the outcome of each of these matters is currently not determinable, the Company does not expect that the ultimate resolution of any such matter will individually have a material adverse effect on the Company's financial position, results of operations or cash flows. The costs to resolve all such matters may in the aggregate have a material adverse effect on the Company's financial position, results of operations or cash flows.



**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 14. Income Taxes**

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events and basis differences that have been recognized in the Company's financial statements and tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amount and the tax basis of assets and liabilities using the enacted tax rates in effect in the years in which the differences are expected to reverse.

Pre-tax earnings by significant geographical locations are as follows (in thousands):

|                     | Year Ended December 31, |                   |                   |
|---------------------|-------------------------|-------------------|-------------------|
|                     | 2016                    | 2015              | 2014              |
| United States ..... | \$ 124,500              | \$ 146,940        | \$ 113,967        |
| Foreign .....       | 151,457                 | 158,506           | 135,562           |
|                     | <u>\$ 275,957</u>       | <u>\$ 305,446</u> | <u>\$ 249,529</u> |

The provisions for income taxes are as follows (in thousands):

|                                  | Year Ended December 31, |                  |                  |
|----------------------------------|-------------------------|------------------|------------------|
|                                  | 2016                    | 2015             | 2014             |
| Current tax expense:             |                         |                  |                  |
| Federal .....                    | \$ 36,771               | \$ 35,029        | \$ 30,224        |
| State .....                      | 5,785                   | 6,074            | 5,511            |
| Foreign .....                    | 64,109                  | 19,884           | 11,389           |
|                                  | <u>106,665</u>          | <u>60,987</u>    | <u>47,124</u>    |
| Deferred tax expense (benefit):  |                         |                  |                  |
| Federal .....                    | 1,404                   | 10,752           | 1,207            |
| State .....                      | 267                     | 1,052            | (1,115)          |
| Foreign .....                    | 995                     | (9,031)          | 2,052            |
|                                  | <u>2,666</u>            | <u>2,773</u>     | <u>2,144</u>     |
| Total income tax provision ..... | <u>\$ 109,331</u>       | <u>\$ 63,760</u> | <u>\$ 49,268</u> |

Net deferred tax assets (liabilities) were classified on the balance sheet as follows (in thousands):

|   | December 31,     |                  |
|---|------------------|------------------|
|   | 2016             | 2015             |
| Deferred tax assets, non-current .....      | 45,243           | 55,429           |
| Deferred tax liabilities, non-current ..... | (2,331)          | (3,623)          |
| Net deferred tax assets .....               | <u>\$ 42,912</u> | <u>\$ 51,806</u> |
| Valuation allowance .....                   | <u>\$ 2,924</u>  | <u>\$ 2,607</u>  |

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 14. Income Taxes—(Continued)**

The tax effects of temporary differences that gave rise to significant portions of deferred tax assets and deferred tax liabilities were as follows (in thousands):

|                                    | December 31, |           |
|------------------------------------|--------------|-----------|
|                                    | 2016         | 2015      |
| Deferred tax assets:               |              |           |
| Accrued liabilities and allowances | \$ 28,909    | \$ 27,170 |
| Tax credit and loss carry-forwards | 25,522       | 29,297    |
| Stock-based compensation           | 17,204       | 15,628    |
| Inventory basis differences        | 11,337       | 10,494    |
| Deferred revenue                   | 4,758        | 6,184     |
| Other assets                       | 917          | 1,373     |
| Gross deferred tax assets          | 88,647       | 90,146    |
| Valuation allowance                | (2,924)      | (2,607)   |
| Total deferred tax assets, net     | 85,723       | 87,539    |
| Deferred tax liabilities:          |              |           |
| Intangible assets                  | (33,564)     | (26,996)  |
| Property and equipment             | (7,212)      | (6,612)   |
| Other liabilities                  | (2,035)      | (2,125)   |
| Total deferred tax liabilities     | (42,811)     | (35,733)  |
| Net deferred tax assets            | \$ 42,912    | \$ 51,806 |

The provision for income taxes differs from the amount of tax determined by applying the applicable United States statutory federal income tax rate to pretax income as a result of the following differences:

|   | Year Ended December 31, |       |        |
|---|-------------------------|-------|--------|
|   | 2016                    | 2015  | 2014   |
| Statutory federal tax rate                    | 35.0%                   | 35.0% | 35.0%  |
| (Decrease) increase in rates resulting from:  |                         |       |        |
| Foreign rate differential                     | (11.3)                  | (7.8) | (12.7) |
| Foreign, federal and state income tax credits | (1.2)                   | (2.1) | (1.7)  |
| State taxes                                   | 2.3                     | 2.4   | 2.1    |
| European Union state aid recovery             | 14.4                    | —     | —      |
| Valuation allowance release                   | —                       | (6.4) | (0.1)  |
| Other   | 0.4                     | (0.2) | (2.9)  |
| Effective tax rate                            | 39.6%                   | 20.9% | 19.7%  |

The Company's foreign tax rate differential in 2015 and 2014 is primarily the result of a three-year agreement in Belgium, which expired on July 31, 2015, as well as the impact of lower statutory rates. The foreign tax rate differential in 2016 is mainly due to the impact of amortization and lower statutory rates. The European Union state aid recovery in 2016 relates to the European Commission's decision regarding the three-year agreement in Belgium, discussed in detail below.

At December 31, 2016, the Company had United States tax net operating loss carry-forwards totaling approximately \$4.2 million which expire between 2019 and 2031. In addition, the Company has various state net operating loss carry-forwards totaling approximately \$27.8 million which expire between 2017 and 2033. The federal and state net operating losses were primarily generated by ICx Technologies, prior to its acquisition by the Company in 2010. Finally, the Company has various foreign net operating loss carry-forwards totaling approximately \$74.3 million, a portion of which expire between 2018 and 2033, and a portion of which have an indefinite carry-forward period.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 14. Income Taxes—(Continued)**

The tax benefits described above are accounted for using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of the assets and liabilities. To the extent that management assesses the realization of such assets to not be more likely than not, a valuation allowance is required to be recorded. As of December 31, 2016, the Company has determined that a valuation allowance against its deferred tax assets of \$2.9 million is required, primarily related to certain acquired net operating losses. A review of all available positive and negative evidence is considered, including past and future performance, the market environment in which the Company operates, utilization of tax attributes in the past, length of carry-back and carry-forward periods, and evaluation of potential tax planning strategies, when evaluating the realizability of deferred tax assets. The Company believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax assets.

United States income taxes have not been provided on accumulated undistributed earnings of certain subsidiaries outside the United States, as the Company intends to reinvest the earnings in operations outside the United States indefinitely. As of December 31, 2016, the cumulative amount of earnings upon which United States income taxes have not been provided is approximately \$785 million. Determination of the amount of unrecognized deferred tax liability related to these earnings is not practicable.

The following table summarizes the activity related to unrecognized tax benefits, including amounts accrued for potential interest and penalties (in thousands):

|   | <b>Year Ended December 31,</b> |                  |                  |
|---|--------------------------------|------------------|------------------|
|   | <b>2016</b>                    | <b>2015</b>      | <b>2014</b>      |
| Balance, beginning of year                      | \$ 14,967                      | \$ 15,401        | \$ 29,533        |
| Increases related to current year tax positions | 1,150                          | 1,446            | 1,457            |
| Increases related to prior year tax positions   | 40,756                         | 299              | 12               |
| Decreases related to prior year tax positions   | (610)                          | (724)            | (781)            |
| Lapse of statute of limitations                 | (4,070)                        | (1,455)          | (5,165)          |
| Settlements                                     | (342)                          | —                | (9,655)          |
| Balance, end of year                            | <u>\$ 51,851</u>               | <u>\$ 14,967</u> | <u>\$ 15,401</u> |

The unrecognized tax benefits at December 31, 2016 relate to the United States, Belgium, United Kingdom and various other foreign jurisdictions, all of which would affect the Company's effective tax rate if recognized.

On January 11, 2016, the European Commission announced a decision concluding that certain rules under Belgian tax legislation are deemed to be incompatible with European Union regulations on state aid. As a result of this decision, the European Commission has directed the Belgian Government to recover past taxes from certain entities, reflective of disallowed state aid, which impacts one of the Company's international subsidiaries. The Belgian Government announced they have appealed this decision and filed action for an annulment in the General Court of the European Union, and in July 2016 the Company filed a separate appeal with the General Court of the European Union. In accordance with FASB ASC Topic 740, "Income Taxes," the Company recorded discrete tax expense of \$39.6 million during 2016 related to this matter and on January 10, 2017, received tax assessments from the Belgium government for a similar amount, which the Company has classified as current taxes payable on the Consolidated Balance Sheet as of December 31, 2016. The Company has filed a complaint against the Belgian tax assessments, and the result of this complaint, the appeal with the General Court of the European Union, new information received from the Belgian Government, or other future events may cause the income tax provision associated with the decision to be entirely or partially reversed.

The Company classifies interest and penalties related to unrecognized tax benefits in the income tax provision. As of December 31, 2016, the Company had \$2.6 million of accrued interest and penalties related to unrecognized tax benefits that are recorded as current and non-current accrued income taxes on the Consolidated Balance Sheet.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 14. Income Taxes—(Continued)**

The Company files United States federal, state and foreign income tax returns in jurisdictions with varying statutes of limitations. The Company currently has the following tax years open to examination by major taxing jurisdictions:

|                              | <b>Tax Years:</b> |
|------------------------------|-------------------|
| United States Federal .....  | 2013 - 2015       |
| State of California .....    | 2013 - 2015       |
| State of Massachusetts ..... | 2012 - 2015       |
| State of Oregon .....        | 2013 - 2015       |
| Sweden .....                 | 2012 - 2015       |
| United Kingdom .....         | 2012 - 2015       |
| Belgium .....                | 2011 - 2015       |

**Note 15. Stock-based Compensation**

*Stock Incentive Plans*

The Company has a stock-based compensation program that provides equity incentives for employees, consultants and directors. This program includes incentive and non-statutory stock options and nonvested stock awards (referred to as restricted stock unit awards) granted under two plans: the FLIR Systems, Inc. 2002 Stock Incentive Plan (the “2002 Plan”) and the FLIR Systems, Inc. 2011 Stock Incentive Plan (the “2011 Plan”). The Company has discontinued issuing awards out of the 2002 Plan but previously granted awards under the 2002 Plan remain outstanding.

The Company has granted time-based options, time-based restricted stock unit awards, market-based restricted stock unit awards and performance-based restricted stock unit awards. Options generally expire ten years from the grant date. Time-based options and restricted stock unit awards generally vest over a three year period. Market-based restricted stock unit awards may be earned based upon the Company’s total shareholder return compared to the total shareholder return of the component company at the 60th percentile level in the S&P 500 Index over a three year period. Performance-based restricted stock unit awards may be earned based upon the Company’s return on invested capital over a two year period. Shares vested under the performance-based restricted stock unit awards and the market-based restricted stock unit awards must be held by the participant for a period of one year from the vest date.

Shares issued as a result of stock option exercises and the distribution of vested restricted stock units are new shares.

The Company also has stock options and restricted stock unit awards issued as replacement awards in connection with the acquisition of ICx Technologies in 2010.

Information with respect to stock option activity for 2016 is as follows:

|  | <b>Shares<br/>(in thousands)</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in thousands)</b> |
|--|----------------------------------|--|--|---|
| Outstanding at December 31, 2015 .....                 | 4,748                            | \$ 27.49   | 5.5  |   |
| Granted .....  | 831                              | 30.75  |  |   |
| Exercised .....  | (456)                            | 17.65  |  |   |
| Forfeited .....  | (14)                             | 31.91  |  |   |
| Outstanding at December 31, 2016 .....                 | 5,109                            | \$ 28.88   | 5.6  | \$ 37,324   |
| Exercisable at December 31, 2016 .....                 | 3,849                            | \$ 28.16   | 4.6  | \$ 30,916   |
| Vested and expected to vest at December 31, 2016 ..... | 5,046                            | \$ 28.86   | 5.6  | \$ 37,004   |

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 15. Stock-based Compensation - (Continued)**

*Stock Incentive Plans - (Continued)*

Information with respect to restricted stock unit activity for 2016 is as follows:

|  | Shares<br>(in thousands) | Weighted<br>Average Grant<br>Date Fair<br>Value |
|--|--------------------------|---|
| Outstanding at December 31, 2015 ..... | 1,706                    | \$ 28.89  |
| Granted .....                          | 992                      | 28.97   |
| Vested and distributed .....           | (691)                    | 30.46   |
| Forfeited .....                        | (77)                     | 30.51   |
| Outstanding at December 31, 2016 ..... | 1,930                    | \$ 30.92  |

As of December 31, 2016, there were 11,906,000 shares of common stock reserved for future issuance under the stock incentive plans.

*Employee Stock Purchase Plan*

The Company has an Employee Stock Purchase Plan (the “ESPP”) which allows employees to purchase shares of the Company’s common stock at 85 percent of the fair market value at the lower of either the date of enrollment or the purchase date. The ESPP provides for six-month offerings commencing on May 1 and November 1 of each year with purchases on April 30 and October 31 of each year. Shares purchased under the ESPP must be held by employees for a period of at least 18 months after the date of purchase. The Company reserved 5,000,000 shares of common stock for issuance under the ESPP.

There were 174,000 shares issued at the average purchase price of \$24.61 during 2016 and 3,136,000 shares remained available under the ESPP at December 31, 2016 for future issuance. Shares issued for ESPP purchases are new shares.

**Note 16. Other Employee Benefit Plans**

*Employee 401(k) Plans*

The Company has a 401(k) Savings and Retirement Plan (the “Plan”) to provide for voluntary salary deferral contributions on a pre-tax basis for employees within the United States in accordance with Section 401(k) of the Internal Revenue Code of 1986, as amended. The Plan allows for contributions by the Company. The Company made and expensed matching contributions of \$8.1 million, \$7.5 million and \$6.9 million during the years ended December 31, 2016, 2015 and 2014, respectively.

*Pension Plans*

The Company previously offered most of the employees outside the United States participation in a defined benefit pension plan that has been curtailed. In addition, the Company provides a Supplemental Executive Retirement Plan (the “SERP”) for certain officers of the Company based in the United States.

The Company has recorded changes to the minimum pension liability to accumulated other comprehensive earnings (loss) and the estimated benefit to be paid in 2017 has been reported in other current liabilities. The remaining obligations are recorded in pension and other long-term liabilities. The measurement date used for the pension plans is December 31.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 16. Other Employee Benefit Plans - (Continued)**

*Pension Plans - (Continued)*

Amounts recognized in other comprehensive income (loss) during the years ended December 31, 2016, 2015 and 2014, net of tax, are as follows (in thousands):

|                           | Year Ended December 31, |        |          |
|---------------------------|-------------------------|--------|----------|
|                           | 2016                    | 2015   | 2014     |
| Net earnings (loss) ..... | \$ 78                   | \$ 500 | \$ (372) |
| Prior service cost .....  | 24                      | 161    | 160      |
|                           | \$ 102                  | \$ 661 | \$ (212) |

Components of accumulated other comprehensive loss related to the Company's pension plans as of December 31, 2016 and 2015 are as follows (in thousands):

|                          | December 31, |            |
|--------------------------|--------------|------------|
|                          | 2016         | 2015       |
| Net loss .....           | \$ (1,630)   | \$ (1,708) |
| Prior service cost ..... | 15           | (9)        |
|                          | \$ (1,615)   | \$ (1,717) |

A summary of the components of the net periodic pension expense for the benefit obligation and fund assets of the plans is as follows (in thousands):

|  | Year Ended December 31, |           |
|--|-------------------------|-----------|
|  | 2016                    | 2015      |
| Change in benefit obligation:                          |                         |           |
| Benefit obligation at January 1 .....                  | \$ 11,426               | \$ 11,813 |
| Service costs .....                                    | —                       | 156       |
| Interest costs .....                                   | 397                     | 353       |
| Actuarial loss (gain) .....                            | 177                     | (199)     |
| Benefits paid .....                                    | (312)                   | (312)     |
| Foreign currency changes .....                         | (269)                   | (385)     |
| Benefit obligation at December 31 .....                | \$ 11,419               | \$ 11,426 |
| Fair value of plan assets at December 31 .....         | \$ —                    | \$ —      |
| Unfunded status at December 31 .....                   | \$ 11,419               | \$ 11,426 |
| Amounts recognized in the Consolidated Balance Sheets: |                         |           |
| Current liabilities .....                              | \$ 292                  | \$ 307    |
| Non-current liabilities .....                          | \$ 11,127               | \$ 11,119 |

FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Note 16. Other Employee Benefit Plans - (Continued)**

*Pension Plans - (Continued)*

The weighted average assumptions used are as follows:

|   | Year Ended December 31, |       |
|---|-------------------------|-------|
|   | 2016                    | 2015  |
| Net periodic benefit cost:  |                         |       |
| SERP:   |                         |       |
| Discount rate .....   | 4.00%                   | 3.75% |
| Rate of increase in compensation levels .....                         | 3.00%                   | 3.00% |
| Defined benefit pension plan for employees outside the United States: |                         |       |
| Discount rate .....   | 2.00%                   | 2.60% |
| Funded status and projected benefit obligation:                       |                         |       |
| SERP:   |                         |       |
| Discount rate .....   | 4.00%                   | 4.00% |
| Rate of increase in compensation levels .....                         | 3.00%                   | 3.00% |
| Defined benefit pension plan for employees outside the United States: |                         |       |
| Discount rate .....   | 2.00%                   | 2.60% |

The discount rates used are based upon publicly listed indices for instruments with average maturities estimated to be consistent with the respective obligations.

A pension liability of \$2.6 million and \$2.8 million as of December 31, 2016 and 2015, respectively, has been recognized for the pension plans representing the excess of the unfunded accumulated benefit obligation over the accrued pension costs.

Benefits expected to be paid under the plans are approximately (in thousands):

|                             |                  |
|-----------------------------|------------------|
| 2017 .....                  | \$ 292           |
| 2018 .....                  | 271              |
| 2019 .....                  | 267              |
| 2020 .....                  | 253              |
| 2021 .....                  | 9,113            |
| Five years thereafter ..... | 1,048            |
|                             | <u>\$ 11,244</u> |

Components of net periodic benefit cost are as follows (in thousands):

|                                     | Year Ended December 31, |                 |                 |
|-------------------------------------|-------------------------|-----------------|-----------------|
|                                     | 2016                    | 2015            | 2014            |
| Service costs .....                 | \$ —                    | \$ 156          | \$ 166          |
| Interest costs .....                | 397                     | 353             | 444             |
| Net amortization and deferral ..... | 260                     | 513             | 279             |
| Settlement loss .....               | —                       | —               | 163             |
| Net periodic pension costs .....    | <u>\$ 657</u>           | <u>\$ 1,022</u> | <u>\$ 1,052</u> |

Components of net periodic benefit cost expected to be recognized from amounts in accumulated other comprehensive earnings (loss) during the year ending December 31, 2017 are as follows (in thousands):

|                              | Year Ending<br>December 31, 2017 |
|------------------------------|----------------------------------|
| Net loss .....               | \$ 155                           |
| Net prior service cost ..... | —                                |
|                              | <u>\$ 155</u>                    |

FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Note 17. Operating Segments and Related Information**

*Operating Segments*

The Company has six reportable operating segments as follows:

*Surveillance*

The Surveillance segment develops and manufactures enhanced imaging and recognition solutions for a wide variety of military, law enforcement, public safety, and other government customers around the world for the protection of borders, troops, and public welfare. Offerings include airborne, land, maritime, and man-portable multi-spectrum imaging systems, radars, lasers, imaging components, integrated multi-sensor system platforms, and services related to these systems.

*Instruments*

The Instruments segment develops and manufactures devices that image, measure, and assess thermal energy, gases, and other environmental elements for industrial, commercial, and scientific applications. Products include thermal imaging cameras, gas detection cameras, firefighting cameras, process automation cameras, and environmental test and measurement devices.

*Security*

The Security segment develops and manufactures cameras and video recording systems for use in commercial, critical infrastructure, and home security applications. Products include thermal and visible-spectrum cameras, digital and networked video recorders, and related software and accessories that enable the efficient and effective safeguarding of assets at all hours of the day and through adverse weather conditions.

*OEM & Emerging Markets*

The OEM & Emerging Markets segment develops and manufactures thermal and visible-spectrum imaging camera cores and components that are utilized by third parties to create thermal, industrial, and other types of imaging systems. The segment also develops and manufactures intelligent traffic monitoring and signal control systems as well as thermal imaging solutions for use by consumers in the smartphone and mobile devices markets.

*Maritime*

The Maritime segment develops and manufactures electronics and imaging instruments for the recreational and commercial maritime market. The segment provides a full suite of networked electronic systems including multi-function helm displays, navigational instruments, autopilots, radars, sonar systems, thermal and visible imaging systems, and communications equipment for boats of all sizes.

*Detection*

The Detection segment develops and manufactures sensor instruments and integrated platform solutions for the detection, identification, and suppression of chemical, biological, radiological, nuclear, and explosives threats for military force protection, homeland security, and commercial applications.

The accounting policies of each of the segments are the same. The Company's President and Chief Executive Officer evaluates the performance of each segment based upon its revenue and earnings from operations. On a consolidated basis, these amounts represent revenue and earnings from operations as represented in the Consolidated Statements of Income. Other consists of corporate expenses and certain other operating expenses not allocated to the operating segments for management reporting purposes. Intersegment revenues are recorded at cost and are eliminated in consolidation.

Accounts receivable and inventories for operating segments are regularly reviewed by management and are reported below as segment assets. All remaining assets, liabilities, capital expenditures and depreciation are managed on a Company-wide basis.



FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Note 17. Operating Segments and Related Information—(Continued)

Operating Segments - (Continued)

Operating segment information is as follows (in thousands):

|                                  | Year Ended December 31, |                     |                     |
|----------------------------------|-------------------------|---------------------|---------------------|
|                                  | 2016                    | 2015                | 2014                |
| Revenue—External Customers:      |                         |                     |                     |
| Surveillance                     | \$ 532,476              | \$ 503,045          | \$ 519,982          |
| Instruments                      | 336,141                 | 347,476             | 354,124             |
| Security                         | 240,010                 | 226,575             | 179,090             |
| OEM & Emerging Markets           | 243,678                 | 186,722             | 199,096             |
| Maritime                         | 185,726                 | 177,948             | 192,636             |
| Detection                        | 124,136                 | 115,301             | 85,726              |
|                                  | <u>\$ 1,662,167</u>     | <u>\$ 1,557,067</u> | <u>\$ 1,530,654</u> |
| Revenue—Intersegments:           |                         |                     |                     |
| Surveillance                     | \$ 18,835               | \$ 10,761           | \$ 7,209            |
| Instruments                      | 4,343                   | 9,951               | 1,793               |
| Security                         | 13,838                  | 12,033              | 11,017              |
| OEM & Emerging Markets           | 33,442                  | 33,059              | 21,856              |
| Maritime                         | 3,450                   | 2,108               | 2,936               |
| Detection                        | 31                      | —                   | 95                  |
| Eliminations                     | (73,939)                | (67,912)            | (44,906)            |
|                                  | <u>\$ —</u>             | <u>\$ —</u>         | <u>\$ —</u>         |
| Earnings (loss) from operations: |                         |                     |                     |
| Surveillance                     | \$ 144,906              | \$ 145,637          | \$ 127,222          |
| Instruments                      | 96,691                  | 112,353             | 98,954              |
| Security                         | 10,172                  | 28,140              | 24,871              |
| OEM & Emerging Markets           | 59,686                  | 41,065              | 50,249              |
| Maritime                         | 15,428                  | 13,611              | 24,494              |
| Detection                        | 33,847                  | 26,904              | 10,958              |
| Other                            | (65,012)                | (61,946)            | (77,504)            |
|                                  | <u>\$ 295,718</u>       | <u>\$ 305,764</u>   | <u>\$ 259,244</u>   |

|  | December 31,      |                   |
|--|-------------------|-------------------|
|  | 2016              | 2015              |
| Segment assets (accounts receivable, net and inventories): |                   |                   |
| Surveillance   | \$ 283,324        | \$ 286,058        |
| Instruments  | 114,681           | 130,135           |
| Security   | 93,174            | 105,509           |
| OEM & Emerging Markets                                     | 144,862           | 93,925            |
| Maritime   | 61,494            | 73,506            |
| Detection  | 25,856            | 30,057            |
|  | <u>\$ 723,391</u> | <u>\$ 719,190</u> |

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 17. Operating Segments and Related Information—(Continued)**

*Operating Segments - (Continued)*

|                              | December 31, |            |
|------------------------------|--------------|------------|
|                              | 2016         | 2015       |
| Segment goodwill:            |              |            |
| Surveillance .....           | \$ 152,383   | \$ 120,145 |
| Instruments .....            | 147,595      | 149,582    |
| Security .....               | 102,983      | 101,955    |
| OEM & Emerging Markets ..... | 252,647      | 69,973     |
| Maritime .....               | 97,860       | 106,549    |
| Detection .....              | 47,938       | 48,112     |
|                              | \$ 801,406   | \$ 596,316 |

*Revenue and Long-Lived Assets by Geographic Area*

Information related to revenue by significant geographical location, determined by the end customer, is as follows (in thousands):

|                            | Year Ended December 31, |                              |              |
|----------------------------|-------------------------|------------------------------|--------------|
|                            | 2016                    | 2015<br>(as<br>reclassified) | 2014         |
| United States .....        | \$ 903,582              | \$ 830,485                   | \$ 783,685   |
| Europe .....               | 338,805                 | 338,886                      | 350,118      |
| Asia .....                 | 195,913                 | 175,616                      | 164,633      |
| Middle East/Africa .....   | 130,890                 | 125,848                      | 138,186      |
| Canada/Latin America ..... | 92,977                  | 86,232                       | 94,032       |
|                            | \$ 1,662,167            | \$ 1,557,067                 | \$ 1,530,654 |

Long-lived assets are comprised of net property and equipment, net identifiable intangible assets, goodwill and other long-term assets. Long-lived assets by significant geographic locations are as follows (in thousands):

|                     | December 31, |              |
|---------------------|--------------|--------------|
|                     | 2016         | 2015         |
| United States ..... | \$ 676,007   | \$ 666,759   |
| Europe .....        | 673,767      | 383,501      |
| Other foreign ..... | 60,032       | 13,197       |
|                     | \$ 1,409,806 | \$ 1,063,457 |

*Major Customers*

Revenue derived from major customers is as follows (in thousands):

|                                | Year Ended December 31, |                              |            |
|--------------------------------|-------------------------|------------------------------|------------|
|                                | 2016                    | 2015<br>(as<br>reclassified) | 2014       |
| United States government ..... | \$ 416,341              | \$ 321,420                   | \$ 310,431 |

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 18. Business Acquisitions**

*DVTEL Inc.*

On November 30, 2015, the Company acquired 100% of the outstanding stock of DVTEL Inc. ("DVTEL"), a provider of software and hardware technologies for advanced video surveillance, for approximately \$97.5 million in cash. At December 31, 2015, the Company initially reported net tangible assets of \$12.1 million in the respective balance sheet accounts, \$27.4 million of identified intangible assets, and \$58.0 million of goodwill, which has been recorded within the Company's Security segment.

During the fourth quarter of 2016 the Company finalized the purchase price allocation, resulting in a \$1.3 million decrease to tangible assets, \$1.2 million decrease to net deferred taxes, and a corresponding \$2.5 million increase in goodwill.

The allocation of the purchase price for DVTEL is as follows (in thousands):

|  |                  |
|--|------------------|
| Cash acquired                              | \$ 5,015         |
| Other tangible assets and liabilities, net | 4,025            |
| Net deferred taxes                         | 582              |
| Identifiable intangible assets             | 27,380           |
| Goodwill                                   | 60,494           |
| Total purchase price                       | <u>\$ 97,496</u> |

The Company made an election under Section 338 of the Internal Revenue Code of 1986, as amended, which resulted in tax-deductible goodwill related to the acquisition of DVTEL. The Company estimates that the tax-deductible goodwill and intangibles resulting from the election will be approximately \$24.8 million, to be amortized for United States tax purposes over a 15-year period. The value of tax-deductible goodwill and intangibles differs from the amounts listed in the purchase price allocation above as the impact of the elections made under Section 338 only affects United States income taxes for the goodwill and intangibles that are owned by the Company's United States subsidiaries.

In connection with the allocation of purchase price to the assets acquired and liabilities assumed, the Company identified certain intangible assets. The following table presents the acquired intangible assets, their estimated fair values, and estimated useful lives (in thousands, except years):

|                                     | <b>Estimated<br/>Useful Life</b> | <b>Amount</b>    |
|-------------------------------------|----------------------------------|------------------|
| Developed technology                | 7.5 years                        | \$ 21,500        |
| Customer relationships              | 10.0 years                       | 3,800            |
| In-process research and development | n/a                              | 1,700            |
| Other                               | 1.0 year                         | 380              |
|                                     |                                  | <u>\$ 27,380</u> |

Acquisition-date identifiable intangible assets primarily consist of intangibles derived from developed technology, customer relationships, and in-process research and development. Developed technology represents completed software related to internal and external software platforms. In-process research and development represents the value assigned to acquired research and development projects that, as of the acquisition date, had not established technological feasibility and had no alternative future use. The in-process research and development intangible assets are capitalized and accounted for as indefinite-lived intangible assets and are subject to impairment testing until completion or abandonment of the projects. Upon successful completion of each project and launch of the product, we will make a separate determination of useful life of the in-process research and development intangible assets and the related amortization will be recorded as an expense over the estimated useful life of the specific projects.

An average 10-year useful life for customer relationships has been estimated based on the projected economic benefits associated with this asset. The average 10-year estimated useful life represents the approximate point in the projection period in which a majority of the asset's cash flows are expected to be realized based on assumed attrition rates.

The developed technology, customer relationships, and in-process research and development were valued using the multi-period excess earnings method.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 18. Business Acquisitions - (Continued)**

*Innovative Security Designs, LLC*

On June 6, 2016, the Company acquired the assets of Innovative Security Designs, LLC ("ISD"), a developer of embedded firmware and advanced camera surveillance platforms, for approximately \$1.8 million in cash. At June 30, 2016, the Company initially reported the \$1.6 million excess of the purchase price over the preliminary net tangible assets acquired in Other assets. The Company has since performed a purchase price allocation which resulted in an allocation of \$1.6 million of goodwill in conjunction with the ISD acquisition, which has been recorded in the Company's Security segment.

*Armasight, Inc.*

On June 28, 2016, the Company acquired 100% of the outstanding stock of Armasight, Inc. ("Armasight"), a developer of sporting and military optics products, for approximately \$43.5 million in cash. At June 30, 2016, the Company initially reported the \$36.0 million excess of the purchase price over the preliminary net tangible assets acquired had been recorded in Other assets. During the third quarter of 2016 the Company performed a preliminary purchase price allocation which resulted in an allocation of \$7.6 million to identifiable intangible assets and \$31.1 million to goodwill which has been recorded in the Company's Surveillance segment.

During the fourth quarter of 2016 the Company finalized the purchase price allocation, resulting in the recording of a \$0.9 million deferred tax asset, \$2.8 million deferred tax liability, and a corresponding \$1.9 million increase in goodwill. The \$33.0 million of goodwill represents future economic benefits expected to arise from synergies from combining operations and the ability of Armasight to provide the Company domain knowledge and distribution channels in adjacent markets.

The allocation of the purchase price for Armasight is as follows (in thousands):

|  |                  |
|--|------------------|
| Cash acquired .....                              | \$ 2,804         |
| Other tangible assets and liabilities, net ..... | 1,925            |
| Net deferred taxes .....                         | (1,855)          |
| Identifiable intangible assets .....             | 7,600            |
| Goodwill .....                                   | 32,994           |
| Total purchase price .....                       | <u>\$ 43,468</u> |

In connection with the allocation of purchase price to the assets acquired and liabilities assumed, the Company identified certain intangible assets. The following table presents the acquired intangible assets, their estimated fair values, and estimated useful lives (in thousands, except years):

|                              | <u>Estimated<br/>Useful Life</u> | <u>Amount</u>   |
|------------------------------|----------------------------------|-----------------|
| Customer relationships ..... | 4.0 years                        | 5,200           |
| Trade name .....             | 3.0 years                        | 1,000           |
| Trade Secrets .....          | 6.0 years                        | 1,400           |
|                              |                                  | <u>\$ 7,600</u> |

Acquisition-date identifiable intangible assets primarily consist of intangibles derived from customer relationships, trade names and trademarks, and trade secrets. Customer relationships represents Armasight's ability to consistently offer compelling products that appeal to consumer preferences which is the critical factor impacting the decisions of retailers to carry Armasight products. The trade name represents the value of the Armasight name within the outdoor and tactical weapons sight industry. The trade secrets represents the knowledge that is institutionalized within the employees and former shareholders of Armasight and their relationships with key suppliers.

Customer relationships were valued using the income approach and the lost income and multi-period excess earnings method. The trade name and trade secrets were valued using the income approach and the relief from royalty method.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 18. Business Acquisitions - (Continued)**

*Point Grey Research, Inc.*

On November 4, 2016, the Company closed a transaction to acquire the assets of Point Grey Research Inc. (“Point Grey”), a global leader in the development of advanced visible imaging cameras and solutions that are used in industrial automation systems, medical diagnostic equipment, people counting systems, intelligent traffic systems, military and defense products, and advanced mapping systems, for approximately \$259.2 million in cash, subject to customary post-closing adjustments. The Company has performed a preliminary purchase price allocation which resulted in an allocation of \$39.8 million to identifiable intangible assets and 183.7 million to goodwill which has been recorded in the Company’s OEM & Emerging Markets segment.

The preliminary allocation of the purchase price for Point Grey is as follows (in thousands):

|  |                   |
|--|-------------------|
| Cash acquired                              | \$ 2,994          |
| Other tangible assets and liabilities, net | 35,127            |
| Net deferred taxes                         | (2,438)           |
| Identifiable intangible assets             | 39,800            |
| Goodwill                                   | 183,678           |
| Total purchase price                       | <u>\$ 259,161</u> |

The allocation of the purchase price related to this acquisition is preliminary and is based on management’s judgments after evaluating several factors, including preliminary valuation assessments of tangible and intangible assets, and preliminary estimates of the fair value of liabilities assumed. The primary areas of the preliminary purchase price allocation that are not yet finalized relate to the valuation of the identifiable intangible assets, property and equipment, and certain other tangible assets and liabilities. The preliminary goodwill of 183.7 million represents future economic benefits expected to arise from synergies from combining operations and the ability of Point Grey to provide the Company domain knowledge and distribution channels in adjacent markets.

In connection with the preliminary allocation of purchase price to the assets acquired and liabilities assumed, the Company identified certain intangible assets. The following table presents the acquired intangible assets, their preliminary estimated fair values, and preliminary estimated useful lives (in thousands, except years):

|                            | <u>Estimated Useful Life</u> | <u>Amount</u>    |
|----------------------------|------------------------------|------------------|
| Developed technology       | 10.0 years                   | \$ 23,100        |
| Customer relationships     | 7.0 years                    | 13,200           |
| Backlog                    | 1.0 year                     | 2,300            |
| Non-Competition Agreements | 5.0 years                    | 1,000            |
| Other                      | n/a                          | 200              |
|                            |                              | <u>\$ 39,800</u> |

Acquisition-date identifiable intangible assets primarily consist of intangibles derived from developed technology, customer relationships, backlog, and non-competition agreements. Developed technology represents the economic advantage of having certain technologies in place that lowers manufacturing and operating costs and drives higher margins. Customer relationships represents the relationships Point Grey has established in the OEM and people counting markets as of the date of the acquisition. Backlog represents “pre-sold” business at the date of acquisition, which provides positive earning streams post acquisition that exceed what is required to provide a return on the other assets employed. Non-competition agreements represent the economic benefit of having agreements with certain current and former employees and shareholders of Point Grey that restrict their ability to compete directly with the Company.

The developed technology was valued using the income approach and relief from royalty method. Customer relationships and backlog were valued using the income approach and multi-period excess earnings method. Non-competition agreements were valued using the income approach and the with-and-without method.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 18. Business Acquisitions - (Continued)**

*Prox Dynamics, AS*

On November 30, 2016, the Company acquired 100% of the outstanding stock of Prox Dynamics AS. (“Prox Dynamics”), a leading developer and manufacturer of nano-class UAS for military and para-military intelligence, surveillance, and reconnaissance applications, for approximately \$134.1 million in cash, subject to customary post-close adjustments. Tangible assets acquired, including accounts receivable and inventories, are included in the Consolidated Balance Sheet as of December 31, 2016 and are recorded in the Company’s Surveillance segment. The allocation of the purchase price to identifiable intangible assets and goodwill is subject to the final determination on the valuation of assets acquired and liabilities assumed. Accordingly, the excess purchase price of approximately \$122.8 million has been recorded in Other assets as of December 31, 2016.

The acquisitions of DVTEL, ISD, Armasight, Point Grey, and Prox Dynamics are not significant as defined in Regulation S-X under the Securities Exchange Act of 1934, nor are they significant compared to the Company's overall results of operations. Consequently, no pro forma financial information is provided.

**Note 19. Shareholders’ Equity**

On February 5, 2013, the Company’s Board of Directors authorized the repurchase of up to 25.0 million shares of the Company’s outstanding shares of common stock in the open market or through privately negotiated transactions. This authorization expired on February 6, 2015. On February 5, 2015, the Company's Board of Directors authorized the repurchase of up to 15.0 million shares of common stock in the open market or through privately negotiated transactions. This authorization expired on February 5, 2017. On February 8, 2017, the Company’s Board of Directors authorized the repurchase of up to 15.0 million shares of common stock in the open market or through privately negotiated transactions. This authorization expires on February 8, 2019.

Under these authorizations, the Company has repurchased 2,132,000 shares for a total of \$66.1 million, 4,169,000 shares for a total of \$123.2 million and 4,243,000 shares for a total of \$139.2 million during the years ended December 31, 2016, 2015 and 2014, respectively.

During the year ended December 31, 2016, the Company paid dividends quarterly at the rate of \$0.12 per share for a total of \$65.9 million. During the year ended December 31, 2015, the Company paid dividends quarterly at the rate of \$0.11 per share for a total of \$61.4 million. During the year ended December 31, 2014, the Company paid dividends quarterly at the rate of \$0.10 per share for a total of \$56.5 million.

**Note 20. Restructuring Costs**

During the years ended December 31, 2016, 2015 and 2014, the Company recorded net pre-tax restructuring expenses totaling \$1.4 million, \$1.4 million and \$17.0 million, respectively. In 2013, the Company initiated a realignment plan that included closing six not-to-scale sites in the United States and Europe and a transfer of those operations to the Company's larger facilities. The Company also consolidated its optics and laser manufacturing businesses to better realize the benefits of vertical integration in these areas.

The Company recorded the restructuring expenses in the segments as follows (in thousands):

|                      | Year Ended December 31, |                 |                  |
|----------------------|-------------------------|-----------------|------------------|
|                      | 2016                    | 2015            | 2014             |
| Surveillance .....   | \$ 107                  | \$ 226          | \$ 5,232         |
| Instruments .....    | 492                     | 1,170           | 10,998           |
| Security .....       | —                       | —               | —                |
| OEM & Emerging ..... | 65                      | (22)            | 170              |
| Maritime .....       | —                       | —               | (90)             |
| Detection .....      | —                       | (13)            | 544              |
| Other .....          | —                       | —               | 120              |
|                      | <u>\$ 664</u>           | <u>\$ 1,361</u> | <u>\$ 16,974</u> |

During the year ended December 31, 2016, the Company also incurred other immaterial restructuring charges representing severance costs associated with cost reduction initiatives executed in the second half of the year that were not related to the realignment plan initiated in 2013.

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Note 20. Restructuring Costs - (Continued)**

Restructuring expenses were recorded in the Consolidated Statements of Income as follows (in thousands):

|                              | Year Ended December 31, |          |           |
|------------------------------|-------------------------|----------|-----------|
|                              | 2016                    | 2015     | 2014      |
| Cost of goods sold .....     | \$ —                    | \$ —     | \$ 591    |
| Restructuring expenses ..... | 664                     | 1,361    | 16,383    |
|                              | \$ 664                  | \$ 1,361 | \$ 16,974 |

The following table summarizes the activity by cost type (in thousands):

|                                   | Severance | Inventory<br>write downs | Facilities Exit,<br>Lease<br>Terminations &<br>Other | Total     |
|-----------------------------------|-----------|--------------------------|--|-----------|
| Balance, December 31, 2013 .....  | \$ 18,191 | \$ —                     | \$ 3,670   | \$ 21,861 |
| 2014 restructuring costs .....    | 11,860    | 590                      | 4,524  | 16,974    |
| Utilization .....                 | (19,110)  | (590)                    | (6,709)  | (26,409)  |
| Balance, December 31, 2014 .....  | \$ 10,941 | \$ —                     | \$ 1,485   | \$ 12,426 |
| 2015 restructuring expenses ..... | 924       | —                        | 437  | 1,361     |
| Utilization .....                 | (8,409)   | —                        | (1,601)  | (10,010)  |
| Balance, December 31, 2015 .....  | \$ 3,456  | \$ —                     | \$ 321   | \$ 3,777  |
| 2016 restructuring expenses ..... | 642       | —                        | 22   | 664       |
| Utilization .....                 | (2,257)   | —                        | (343)  | (2,600)   |
| Balance, December 31, 2016 .....  | \$ 1,841  | \$ —                     | \$ —   | \$ 1,841  |

**Note 21. Subsequent Events**

On February 8, 2017, the Company's Board of Directors authorized the repurchase of up to 15.0 million shares of the Company's outstanding shares of common stock in the open market or through privately negotiated transactions. The authorization will expire on February 8, 2019.

On February 9, 2017, the Company's Board of Directors declared a quarterly dividend of \$0.15 per share on its common stock, payable on March 10, 2017, to shareholders of record as of the close of business on February 24, 2017. The total cash payment of this dividend will be approximately \$20.5 million.

**QUARTERLY FINANCIAL DATA (UNAUDITED)**

**FLIR SYSTEMS, INC.**

(In thousands, except per share data)

|                                      | <u>Q1</u>  | <u>Q2</u>  | <u>Q3</u>  | <u>Q4</u>  |
|--------------------------------------|------------|------------|------------|------------|
| <b>2016</b>                          |            |            |            |            |
| Revenue .....                        | \$ 379,472 | \$ 402,729 | \$ 405,228 | \$ 474,738 |
| Gross profit .....                   | 177,690    | 183,322    | 191,376    | 214,733    |
| Net earnings <sup>(1)(2)</sup> ..... | 1,125      | 45,368     | 58,633     | 61,500     |
| Earnings per share:                  |            |            |            |            |
| Basic earnings per share .....       | \$ 0.01    | \$ 0.33    | \$ 0.43    | \$ 0.45    |
| Diluted earnings per share .....     | \$ 0.01    | \$ 0.33    | \$ 0.43    | \$ 0.45    |
| <b>2015</b>                          |            |            |            |            |
| Revenue .....                        | \$ 344,517 | \$ 392,975 | \$ 381,928 | \$ 437,647 |
| Gross profit .....                   | 175,897    | 189,615    | 180,739    | 207,310    |
| Net earnings <sup>(3)</sup> .....    | 47,910     | 50,500     | 73,072     | 70,204     |
| Earnings per share:                  |            |            |            |            |
| Basic earnings per share .....       | \$ 0.34    | \$ 0.36    | \$ 0.52    | \$ 0.51    |
| Diluted earnings per share .....     | \$ 0.34    | \$ 0.36    | \$ 0.52    | \$ 0.51    |

(1) 2016 Net earnings includes restructuring expenses of \$0.2 million reported in the first quarter, \$0.1 million reported in the second quarter, \$0.9 million reported in the third quarter and \$0.2 million reported in the fourth quarter.

(2) Net earnings for the first quarter of 2016 includes as discrete tax charge for certain tax legislation in Belgium of \$39.6 million.

(3) 2015 Net earnings includes restructuring expenses of \$0.3 million reported in the first quarter, \$0.5 million reported in the second quarter, \$0.3 million reported in the third quarter and \$0.3 million reported in the fourth quarter.

The sum of the quarterly earnings per share does not always equal the annual earnings per share as a result of the computation of quarterly versus annual average shares outstanding.



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

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

As of December 31, 2016, the Company completed its annual evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There were no changes in the Company's internal control over financial reporting that occurred during the Company's fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our internal control over financial reporting is designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in the *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

The Company acquired Innovative Security Designs, LLC on June 6, 2016, Armasight, Inc. on June 28, 2016, Point Grey Research, Inc. on November 4, 2016, and Prox Dynamics AS on November 30, 2016 (the Acquisitions). Management has excluded the Acquisitions from its assessment of internal control over financial reporting as of December 31, 2016. The Acquisitions assets constitute approximately 3.3% of the Company's total assets as of December 31, 2016 and the Acquisitions revenues constitute approximately 2.1% of the Company's revenues for fiscal 2016 covered by this report.

Based on our evaluation using the *Internal Control—Integrated Framework (2013)*, our management concluded that our internal control over financial reporting was effective as of December 31, 2016.

KPMG LLP, an independent registered public accounting firm, has issued an attestation report on the Company's internal control over financial reporting as of December 31, 2016, which is included elsewhere in this Form 10-K.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and  
Shareholders of FLIR Systems, Inc.:

We have audited FLIR Systems, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). FLIR Systems, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit 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 audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, FLIR Systems, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

FLIR Systems, Inc. acquired Innovative Security Designs, LLC on June 6, 2016, Armasight, Inc. on June 28, 2016, Point Grey Research, Inc. on November 4, 2016, and Prox Dynamics AS on November 30, 2016 (the Acquisitions) and management excluded the Acquisitions from its assessment of internal control over financial reporting as of December 31, 2016. The Acquisitions represent 3.3% of FLIR Systems Inc.'s total assets and 2.1% of FLIR Systems Inc.'s total revenues as reported in the consolidated financial statements as of and for the year ended December 31, 2016. Our audit of internal control over financial reporting of FLIR Systems, Inc. also excluded an evaluation of internal control over financial reporting of the Acquisitions.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of FLIR Systems, Inc. and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2016, and our report dated February 24, 2017 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Portland, Oregon  
February 24, 2017

**ITEM 9B. OTHER INFORMATION**

None.

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Information with respect to directors and executive officers of the Company is included under “Election of Directors,” “Management,” “Section 16(a) Beneficial Ownership Reporting Compliance,” “Corporate Governance and Related Matters” and “Audit Committee Report” in the Company’s definitive proxy statement for its 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

The Company has adopted a Code of Ethics for Senior Financial Officers (the “Code of Ethics”) that applies to the Company’s Chief Executive Officer, Chief Financial Officer, Controller and persons performing similar duties. The Code of Ethics is publicly available on the Company’s website ([www.flir.com](http://www.flir.com)) in the Governance area of the Investor Relations segment of the website. None of the material on the Company’s website is part of this Annual Report. If there is any waiver from or amendment to any provision of the Code of Ethics for the Company’s Chief Executive Officer, Chief Financial Officer, Controller and persons performing similar duties, the Company will disclose the nature of such waiver or amendment on its website.

**ITEM 11. EXECUTIVE COMPENSATION**

Information with respect to executive compensation is included under “Compensation Discussion and Analysis,” “Compensation Committee Report,” “Compensation of Named Executive Officers,” and “Director Compensation” in the Company’s definitive proxy statement for its 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Information with respect to security ownership of certain beneficial owners and management is included under “Stock Owned by Management” and “Stock Owned by Principal Shareholders” in the Company’s definitive proxy statement for its 2017 Annual Meeting of Shareholders and is incorporated herein by reference. Information with respect to equity compensation plans is included under “Equity Compensation Plan Information” in the Company’s definitive proxy statement for its 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

Information with respect to certain relationships and related transactions is included under “Certain Relationships and Related Transactions” in the Company’s definitive proxy statement for its 2017 Annual Meeting of Shareholders and is incorporated herein by reference. Information with respect to Director independence is included under “Corporate Governance and Related Matters—Board of Directors Committees” in the Company’s definitive proxy statement for its 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Information with respect to principal accountant fees and services is included under “Ratification of Appointment of the Independent Registered Public Accounting Firm and Related Information—Fees Paid to KPMG LLP” in the Company’s definitive proxy statement for its 2017 Annual Meeting of Shareholders and is incorporated herein by reference.

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

#### (a)(1) *Financial Statements*

The financial statements are included in Item 8 above.

#### (a)(2) *Financial Statement Schedules*

No schedules are included because the required information is inapplicable, not required or are presented in the financial statements or the related notes thereto.

#### (a)(3) *Exhibits*

| <u>Number</u> | <u>Description</u>   |
|---------------|--|
| 2.1           | Asset Purchase Agreement by and among FLIR Integrated Imaging Solutions, Inc., Point Grey Research Inc., FLIR Systems, Inc. and certain shareholders of Point Grey Research Inc., dated as of October 1, 2016 (incorporated by reference to Exhibit 2.1 to the Current Report on Form 8-K filed on October 7, 2016). |
| 3.1           | Second Restated Articles of Incorporation of FLIR Systems, Inc., as amended through May 12, 2008 (incorporated by reference to Exhibit 3.1 to the Annual Report on Form 10-K filed on February 27, 2009).  |
| 3.2           | Fifth Amendment to Second Restated Articles of Incorporation of FLIR Systems, Inc. as amended on April 25, 2013 (incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q filed on August 8, 2013).   |
| 3.3           | Fourth Restated Bylaws of FLIR Systems, Inc., as amended through October 20, 2016 (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed on October 24, 2016).  |
| 4.1           | Indenture, dated August 19, 2011, between FLIR Systems, Inc. and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K filed on August 19, 2011).   |
| 4.2           | First Supplemental Indenture, dated August 19, 2011, between FLIR Systems, Inc. and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.2 to the Current Report on Form 8-K filed on August 19, 2011).  |
| 4.3           | Form of 3.750% Note due September 1, 2016 (incorporated by reference to Exhibit 4.3 to the Current Report on Form 8-K filed on August 19, 2011).   |
| 4.4           | Second Supplemental Indenture, dated January 30, 2012, between FLIR Commercial Systems, Inc., FLIR Government Systems, Inc. and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.4 to the Annual Report on Form 10-K filed on February 29, 2012).                                  |
| 4.5           | Third Supplemental Indenture, dated December 31, 2014, between FLIR Surveillance, Inc. and U.S. Bank National Association, as trustee.   |
| 4.6           | Fourth Supplemental Indenture, dated June 10, 2016, by and between FLIR Systems, Inc. and U.S. Bank National Association (incorporated by reference to Exhibit 4.2 of the Current Report on Form 8-K filed on June 10, 2016).  |
| 4.7           | Form of 3.125% Note due June 15, 2021 (incorporated by reference to Exhibit 4.2 of the Current Report on Form 8-K filed on June 10, 2016).   |
| 10.1          | FLIR Systems, Inc. 2002 Stock Incentive Plan, amended October 23, 2013 (incorporated by reference to Exhibit 10.1 to the Quarterly Report on Form 10-Q filed on November 8, 2013). <sup>(1)</sup>  |
| 10.2          | FLIR Systems, Inc. 2002 Stock Incentive Plan Stock Option Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on February 10, 2005). <sup>(1)</sup>   |
| 10.3          | Form of Stock Option Agreement for 2002 Stock Incentive Plan (incorporated by reference to Exhibit 10.1 on the Current Report on Form 8-K filed on May 4, 2007). <sup>(1)</sup>  |
| 10.4          | Form of Deferred Stock Agreement for 2002 Stock Incentive Plan (incorporated by reference to Exhibit 10.2 on the Current Report on Form 8-K filed on May 4, 2007). <sup>(1)</sup>  |
| 10.5          | FLIR Systems, Inc. 2009 Employee Stock Purchase Plan (incorporated by reference to Exhibit A to the Definitive Proxy Statement on Schedule 14A filed on March 20, 2009) <sup>(1)</sup>   |
| 10.6          | Amended and Restated FLIR Systems, Inc. Supplemental Executive Retirement Plan, as amended and restated on October 22, 2009 (incorporated by reference to Exhibit 10.16 to the Annual Report on Form 10-K filed on February 26, 2010). <sup>(1)</sup>  |

- 10.7 Credit Agreement by and among FLIR Systems, Inc. and certain subsidiaries of FLIR Systems, Inc., as borrowers, Bank of America, N.A., U.S. Bank National Association, JPMorgan Chase Bank N.A. and other Lenders identified therein as of February 8, 2011 (incorporated by reference to Exhibit 10.3 to the Annual Report on Form 10-K filed on March 1, 2011).
- 10.8 First Amendment to Credit Agreement by and among FLIR Systems, Inc. and certain subsidiaries of FLIR Systems, Inc., as borrowers, Bank of America, N.A., U.S. Bank National Association, JPMorgan Chase Bank N.A. and other Lenders dated August 9, 2011 (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed on August 12, 2011).
- 10.9 Joinder Agreement to the Credit Agreement by and among FLIR Commercial Systems, Inc., FLIR Government Systems, Inc and Bank of America, N.A. dated January 30, 2012 (incorporated by reference to Exhibit 10.13 to the Annual Report on Form 10-K filed on February 29, 2012).
- 10.10 FLIR Systems, Inc. 2011 Stock Incentive Plan (incorporated by reference to the Definitive Proxy Statement on Schedule 14A filed on March 18, 2011).<sup>(1)</sup>
- 10.11 Form of Stock Option Agreement (Time-Based Vesting) for the 2011 Stock Incentive Plan, amended May 11, 2015 (incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q filed on August 5, 2015).<sup>(1)</sup>
- 10.12 Form of Stock Option Agreement (Time-Based Vesting - Outside Directors) for the 2011 Stock Incentive Plan, amended May 11, 2015 (incorporated by reference to Exhibit 10.4 to the Quarterly Report on Form 10-Q filed on August 5, 2015).<sup>(1)</sup>
- 10.13 Form of Restricted Stock Unit Agreement (Performance-Based Vesting) for the 2011 Stock Incentive Plan, amended May 11, 2015 (incorporated by reference to Exhibit 10.17 to the Annual Report on Form 10-K filed on February 29, 2012).<sup>(1)</sup>
- 10.14 Form of Restricted Stock Unit Agreement (Time-Based Vesting) for the 2011 Stock Incentive Plan, amended May 11, 2015 (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q filed on August 5, 2015).<sup>(1)</sup>
- 10.15 Form of Restricted Stock Unit Agreement (Market-Based Vesting) for the 2011 Stock Incentive Plan, amended May 11, 2015 (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q filed on August 5, 2015).<sup>(1)</sup>
- 10.16 Third Amendment to Credit Agreement by and among FLIR Systems, Inc. and certain subsidiaries of FLIR Systems, Inc., as borrowers, Bank of America, N.A., U.S. Bank National Association, JPMorgan Chase Bank N.A. and other Lenders dated April 5, 2013 (incorporated by reference to Exhibit 10.1 on the Quarterly Report on Form 10-Q filed on May 8, 2013).
- 10.17 Annex I to Third Amendment to Credit Agreement dated as of April 5, 2013 (incorporated by reference to Exhibit 10.2 on the Quarterly Report on Form 10-Q/A filed on August 29, 2013).
- 10.18 Letter Agreement, dated as of April 26, 2013, by and between FLIR Systems, Inc. and Earl R. Lewis (incorporated by reference to the Current Report on Form 8-K filed on May 1, 2013).<sup>(1)</sup>
- 10.19 Amended and Restated Change of Control Agreement between FLIR Systems, Inc. and Andrew C. Teich dated as of November 6, 2013 (incorporated by reference to Exhibit 10.3 on the Quarterly Report on Form 10-Q filed on November 8, 2013).<sup>(1)</sup>
- 10.20 FLIR Systems, Inc. 2011 Stock Incentive Plan, amended April 25, 2014 (incorporated by reference to the Definitive Proxy Statement on Schedule 14A filed on March 14, 2014).<sup>(1)</sup>
- 10.21 FLIR Systems, Inc. 2012 Executive Bonus Plan (incorporated by reference to Exhibit 10.27 of the Annual Report on Form 10-K filed on February 27, 2015).<sup>(1)</sup>
- 10.22 Joinder Agreement to the Credit Agreement by and between FLIR Surveillance, Inc. and Bank of America, N.A. dated December 31, 2014 (incorporated by reference to Exhibit 10.28 of the Annual Report on Form 10-K filed on February 27, 2015).
- 10.23 Fourth Amendment to Credit Agreement by and among FLIR Systems, Inc., the subsidiaries of FLIR Systems, Inc. party thereto, Bank of America, N.A. and the other lenders party thereto, dated as of October 27, 2015 (incorporated by reference to the Quarterly Report on Form 10-Q filed on November 9, 2015).
- 10.24 Executive Employment Agreement by and between FLIR Systems, Inc. and Amit Singhi, dated as of August 12, 2015 (incorporated by reference to the Current Report on Form 8-K filed on August 12, 2015).<sup>(1)</sup>
- 10.25 Change of Control Agreement by and between FLIR Systems, Inc. and Amit Singhi, dated as of August 12, 2015 (incorporated by reference to the Current Report on Form 8-K filed on August 12, 2015).<sup>(1)</sup>
- 10.26 Amended and Restated Credit Agreement by and among FLIR Systems, Inc., the subsidiaries of FLIR Systems Inc. party thereto, Bank of America N.A. and the other lenders party thereto, dated as of May 31, 2016 (incorporated by reference to Exhibit 10.1 of the Quarterly Report on Form 10-Q filed on August 3, 2016).

- 10.27 Underwriting Agreement by and among FLIR Systems, Inc. and Merrill Lynch, Pierce, Fenner & Smith Incorporated and J.P. Morgan Securities LLC, as representatives of the several underwriters named therein, dated as of June 1, 2016 (incorporated by reference to Exhibit 10.1 of the Current Report on Form 8-K filed on June 3, 2016).
- 21.0 Subsidiaries of FLIR Systems, Inc.
- 23.0 Consent of KPMG LLP.
- 31.1 Principal Executive Officer Certification Pursuant to Sarbanes-Oxley Act of 2002, Section 302.
- 31.2 Principal Financial Officer Certification Pursuant to Sarbanes-Oxley Act of 2002, Section 302.
- 32.1 Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by the Chief Financial Officer 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 Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

(1) This exhibit constitutes a management contract or compensatory plan or arrangement.

