

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

FORM 10-Q

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

For the quarterly period ended July 3, 2020

Or

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

For the transition period from _____ to _____

Commission File No.: 001-35083

NOVANTA INC.

(Exact name of registrant as specified in its charter)

New Brunswick, Canada

(State or other jurisdiction of
incorporation or organization)

125 Middlesex Turnpike

Bedford, Massachusetts, USA

(Address of principal executive offices)

98-0110412

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

01730

(Zip Code)

Registrant's telephone number, including area code: (781) 266-5700

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common shares, no par value	NOVT	The Nasdaq Global Select Market

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

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

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

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated Filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

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

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

As of July 31, 2020, there were 35,155,466 of the Registrant's common shares, no par value, issued and outstanding.

NOVANTA INC.
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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

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

	July 3, 2020	December 31, 2019
ASSETS		
Current assets		
Cash and cash equivalents	\$ 97,494	\$ 78,944
Accounts receivable, net of allowance of \$415 and \$297, respectively	88,360	91,078
Inventories	107,380	116,618
Prepaid income taxes and income taxes receivable	6,720	5,905
Prepaid expenses and other current assets	10,423	11,967
Total current assets	310,377	304,512
Property, plant and equipment, net	75,276	77,556
Operating lease assets	34,300	35,180
Deferred tax assets	12,092	8,890
Other assets	2,995	2,713
Intangible assets, net	152,170	166,175
Goodwill	273,817	274,710
Total assets	\$ 861,027	\$ 869,736
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt	\$ 5,054	\$ 5,031
Accounts payable	46,427	52,585
Income taxes payable	4,790	1,861
Current portion of operating lease liabilities	4,875	5,043
Accrued expenses and other current liabilities	68,131	70,326
Total current liabilities	129,277	134,846
Long-term debt	211,946	215,334
Operating lease liabilities	33,400	34,108
Deferred tax liabilities	26,028	26,676
Income taxes payable	5,143	4,713
Other liabilities	23,335	36,887
Total liabilities	429,129	452,564
Commitments and contingencies (Note 15)		
Stockholders' equity:		
Common shares, no par value; Authorized shares: unlimited; Issued and outstanding: 35,155 and 35,052, respectively	423,856	423,856
Additional paid-in capital	45,338	49,748
Accumulated deficit	(14,712)	(38,319)
Accumulated other comprehensive loss	(22,584)	(18,113)
Total stockholders' equity	431,898	417,172
Total liabilities and stockholders' equity	\$ 861,027	\$ 869,736

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

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

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Revenue	\$ 144,728	\$ 155,145	\$ 300,196	\$ 312,331
Cost of revenue	86,026	89,363	177,049	180,260
Gross profit	58,702	65,782	123,147	132,071
Operating expenses:				
Research and development and engineering	14,440	13,388	29,774	27,385
Selling, general and administrative	24,908	29,204	55,663	61,051
Amortization of purchased intangible assets	3,410	3,772	6,855	7,770
Restructuring, acquisition, and related costs	2,243	4,313	3,904	6,367
Total operating expenses	45,001	50,677	96,196	102,573
Operating income	13,701	15,105	26,951	29,498
Interest income (expense), net	(1,701)	(2,160)	(3,379)	(4,204)
Foreign exchange transaction gains (losses), net	(282)	27	(28)	68
Other income (expense), net	(22)	(70)	61	(138)
Income before income taxes	11,696	12,902	23,605	25,224
Income tax provision (benefit)	36	2,522	(2)	2,591
Consolidated net income	\$ 11,660	\$ 10,380	\$ 23,607	\$ 22,633
Earnings per common share (Note 5):				
Basic	\$ 0.33	\$ 0.30	\$ 0.67	\$ 0.65
Diluted	\$ 0.33	\$ 0.29	\$ 0.66	\$ 0.64
Weighted average common shares outstanding—basic	35,137	34,998	35,145	34,981
Weighted average common shares outstanding—diluted	35,579	35,503	35,570	35,491

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

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

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Consolidated net income	\$ 11,660	\$ 10,380	\$ 23,607	\$ 22,633
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax (1)	1,498	(2,662)	(5,308)	(323)
Pension liability adjustments, net of tax (2)	100	553	837	570
Total other comprehensive income (loss)	1,598	(2,109)	(4,471)	247
Total consolidated comprehensive income (loss)	<u>\$ 13,258</u>	<u>\$ 8,271</u>	<u>\$ 19,136</u>	<u>\$ 22,880</u>

- (1) The tax effect on this component of comprehensive income was nominal for all periods presented.
- (2) The tax effect on this component of comprehensive income was nominal for all periods presented. See Note 4 for the total amount of pension liability adjustments reclassified out of accumulated other comprehensive income (loss).

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

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

	<u>Common Shares</u>		<u>Additional Paid-In</u>	<u>Accumulated</u>	<u>Accumulated Other Comprehensive</u>	
	<u># of Shares</u>	<u>Amount</u>	<u>Capital</u>	<u>Deficit</u>	<u>Loss</u>	<u>Total</u>
Three Months Ended July 3, 2020						
Balance at April 3, 2020	35,122	\$ 423,856	\$ 39,801	\$ (26,372)	\$ (24,182)	\$ 413,103
Consolidated net income	—	—	—	11,660	—	11,660
Common shares issued under stock plans	34	—	—	—	—	—
Common shares withheld for taxes on vested stock awards	(1)	—	(111)	—	—	(111)
Share-based compensation	—	—	5,648	—	—	5,648
Other comprehensive income, net of tax	—	—	—	—	1,598	1,598
Balance at July 3, 2020	<u>35,155</u>	<u>\$ 423,856</u>	<u>\$ 45,338</u>	<u>\$ (14,712)</u>	<u>\$ (22,584)</u>	<u>\$ 431,898</u>
Six Months Ended July 3, 2020						
Balance at December 31, 2019	35,052	\$ 423,856	\$ 49,748	\$ (38,319)	\$ (18,113)	\$ 417,172
Consolidated net income	—	—	—	23,607	—	23,607
Common shares issued under stock plans	256	—	179	—	—	179
Common shares withheld for taxes on vested stock awards	(88)	—	(7,936)	—	—	(7,936)
Repurchases of common shares	(65)	—	(5,500)	—	—	(5,500)
Share-based compensation	—	—	8,847	—	—	8,847
Other comprehensive income, net of tax	—	—	—	—	(4,471)	(4,471)
Balance at July 3, 2020	<u>35,155</u>	<u>\$ 423,856</u>	<u>\$ 45,338</u>	<u>\$ (14,712)</u>	<u>\$ (22,584)</u>	<u>\$ 431,898</u>
Three Months Ended June 28, 2019						
Balance at March 29, 2019	34,998	\$ 423,856	\$ 42,855	\$ (66,839)	\$ (20,171)	\$ 379,701
Consolidated net income	—	—	—	10,380	—	10,380
Common shares issued under stock plans	23	—	—	—	—	—
Common shares withheld for taxes on vested stock awards	(10)	—	(829)	—	—	(829)
Repurchases of common shares	(39)	—	(3,339)	—	—	(3,339)
Share-based compensation	—	—	2,378	—	—	2,378
Other comprehensive income, net of tax	—	—	—	—	(2,109)	(2,109)
Balance at June 28, 2019	<u>34,972</u>	<u>\$ 423,856</u>	<u>\$ 41,065</u>	<u>\$ (56,459)</u>	<u>\$ (22,280)</u>	<u>\$ 386,182</u>
Six Months Ended June 28, 2019						
Balance at December 31, 2018	34,886	\$ 423,856	\$ 46,018	\$ (79,092)	\$ (22,527)	\$ 368,255
Consolidated net income	—	—	—	22,633	—	22,633
Common shares issued under stock plans	209	—	—	—	—	—
Common shares withheld for taxes on vested stock awards	(84)	—	(6,719)	—	—	(6,719)
Repurchases of common shares	(39)	—	(3,339)	—	—	(3,339)
Share-based compensation	—	—	5,105	—	—	5,105
Other comprehensive income, net of tax	—	—	—	—	247	247
Balance at June 28, 2019	<u>34,972</u>	<u>\$ 423,856</u>	<u>\$ 41,065</u>	<u>\$ (56,459)</u>	<u>\$ (22,280)</u>	<u>\$ 386,182</u>

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

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

	Six Months Ended	
	July 3, 2020	June 28, 2019
Cash flows from operating activities:		
Consolidated net income	\$ 23,607	\$ 22,633
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	18,767	18,114
Provision for inventory excess and obsolescence	2,272	1,426
Share-based compensation	8,847	5,105
Deferred income taxes	(3,280)	(2,037)
Inventory acquisition fair value adjustments	188	175
Other	817	1,294
Changes in assets and liabilities which (used)/provided cash, excluding effects from business acquisitions:		
Accounts receivable	2,172	(3,150)
Inventories	5,947	(8,162)
Prepaid income taxes, income taxes receivable, prepaid expenses and other current assets	893	(5,168)
Accounts payable, income taxes payable, accrued expenses and other current liabilities	(10,931)	(10,580)
Other non-current assets and liabilities	2,273	1,203
Cash provided by operating activities	51,572	20,853
Cash flows from investing activities:		
Acquisition of businesses, net of cash acquired and working capital adjustments	—	(28,884)
Purchases of property, plant and equipment	(4,640)	(5,601)
Payment of contingent consideration related to acquisition of technology assets	(2,632)	—
Other investing activities	—	41
Cash used in investing activities	(7,272)	(34,444)
Cash flows from financing activities:		
Borrowings under revolving credit facilities	—	23,643
Repayments of term loan and revolving credit facilities	(2,520)	(16,100)
Payments of debt issuance costs	(1,614)	—
Payments of withholding taxes from share-based awards	(7,936)	(6,719)
Repurchases of common shares	(5,500)	(3,339)
Payment of contingent consideration related to an acquisition	(1,135)	—
Payments of deferred and escrowed purchase price related to acquisitions	(5,772)	—
Other financing activities	(501)	(283)
Cash used in financing activities	(24,978)	(2,798)
Effect of exchange rates on cash and cash equivalents	(772)	439
Increase (decrease) in cash and cash equivalents	18,550	(15,950)
Cash and cash equivalents, beginning of the period	78,944	82,043
Cash and cash equivalents, end of the period	\$ 97,494	\$ 66,093
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 2,797	\$ 3,899
Cash paid for income taxes	\$ 2,433	\$ 7,858
Income tax refunds received	\$ 1,979	\$ 407

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

NOVANTA INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF JULY 3, 2020
(Unaudited)

1. Basis of Presentation

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

The accompanying unaudited interim consolidated financial statements have been prepared by the Company in United States (“U.S.”) dollars and pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”), the instructions to Form 10-Q and the provisions of Regulation S-X pertaining to interim financial statements. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. have been condensed or omitted. The interim consolidated financial statements and notes included in this report should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2019. In the opinion of management, these interim consolidated financial statements include all adjustments and accruals of a normal and recurring nature necessary to fairly state the results of the interim periods presented. The results for interim periods are not necessarily indicative of results to be expected for the full year or for any future periods.

The Company’s unaudited interim consolidated financial statements are prepared for each quarterly period ending on the Friday closest to the end of the calendar quarter, with the exception of the fourth quarter which always ends on December 31.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting periods. Estimates and assumptions are reviewed on an on-going basis and the effects of revisions are reflected in the period in which such revisions are deemed to be necessary. The Company evaluates its estimates based on historical experience, current conditions, including estimated economic implications of the COVID-19 pandemic, and various other assumptions that it believes are reasonable under the circumstances. The accounting estimates assessed included, but were not limited to, the Company’s allowance for doubtful accounts and credit losses, inventory and related reserves and the carrying value of goodwill and other long-lived assets. While there was not a material change to the consolidated financial statements related to these estimates as of and for the three and six months ended July 3, 2020, the Company’s future assessment of the magnitude and duration of the COVID-19 pandemic, as well as other factors, could result in material impacts to the Company’s consolidated financial statements in future reporting periods.

NOVANTA INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
AS OF JULY 3, 2020
(Unaudited)

Recent Accounting Pronouncements

The following table provides a brief description of recent Accounting Standards Updates (“ASU”) issued by the Financial Accounting Standards Board (“FASB”):

Standard	Description	Effective Date	Effect on the Financial Statements or Other Significant Matters
In December 2019, the FASB issued ASU 2019-12, “Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes.”	ASU 2019-12 simplifies the accounting for income taxes by removing certain exceptions to the general principles of Accounting Standards Codification (“ASC”) 740, including: (i) the exception to the incremental approach for intraperiod tax allocation when there is a loss from continuing operations and income or a gain from other items; (ii) the exception to the requirement to recognize a deferred tax liability for equity method investments when a foreign subsidiary becomes an equity method investment (or vice-versa); and (iii) the exception for calculating income taxes in an interim period when a year-to-date loss exceeds the anticipated loss for the year. ASU 2019-12 also simplifies GAAP for other areas of ASC 740 by clarifying and amending the existing guidance.	January 1, 2021. Early adoption is permitted.	The Company is currently evaluating the impact of ASU 2019-12 on its consolidated financial statements.
In June 2016, the FASB issued ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.”	ASU 2016-13 requires the measurement of all expected credit losses of financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward looking information to better inform their credit loss estimates.	January 1, 2020.	The Company adopted ASU 2016-13 during the first quarter of 2020. The adoption of ASU 2016-13 did not have a material impact on the Company’s consolidated financial statements.
In March 2020, the FASB issued ASU 2020-04, “Reference rate reform (Topic 848): Facilitation of the effects of reference rate reform on financial reporting.”	ASU 2020-04 provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met.	Upon issuance. ASU 2020-04 is elective.	The Company is currently evaluating the impact of ASU 2020-04 on its consolidated financial statements.

2. Revenue

The Company recognizes revenue when control of promised goods or services is transferred to customers. The transfer of control generally occurs upon shipment when title and risk of loss pass to the customer. The vast majority of the Company’s revenue is generated from the sale of distinct products. Revenue is measured as the amount of consideration the Company expects to receive

NOVANTA INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
AS OF JULY 3, 2020
(Unaudited)

in exchange for such products, which is generally at contractually stated prices. Sales taxes and value added taxes collected concurrently with revenue generating activities are excluded from revenue.

Performance Obligations

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

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

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

Shipping & Handling Costs

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

Warranties

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

Practical Expedients and Exemptions

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

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

NOVANTA INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
AS OF JULY 3, 2020
(Unaudited)

Contract Liabilities

Contract liabilities consist of deferred revenue and advance payments from customers, including amounts that are refundable. These contract liabilities are classified as either current or long-term liabilities in the consolidated balance sheet based on the timing of when the Company expects to recognize the related revenue. As of July 3, 2020 and December 31, 2019, contract liabilities were \$4.6 million and \$3.6 million, respectively, and are included in accrued expenses and other current liabilities and other liabilities in the accompanying consolidated balance sheets. The increase in the contract liability balance during the six months ended July 3, 2020 is primarily due to cash payments received in advance of satisfying performance obligations, partially offset by \$2.6 million of revenue recognized during the period that was included in the contract liability balance at December 31, 2019.

Disaggregated Revenue

See Note 16 for the Company's disaggregation of revenue by segment, geography and end market.

3. Business Combinations

On July 31, 2019, the Company acquired 100% of the outstanding shares of ARGES GmbH ("ARGES"), a Wackersdorf, Germany-based supplier of innovative laser scanning subsystems used in industrial materials processing and medical applications, for a total purchase price of €65.7 million (\$73.2 million), including net working capital adjustments. The purchase price consists of €24.0 million (\$26.7 million) cash paid at closing, 124 thousand Novanta common shares issued upon closing (with a fair market value of €9.8 million, or \$10.9 million, based on the closing market price of \$87.58 per share on July 30, 2019), €7.1 million (\$7.9 million) estimated fair value of contingent consideration and €24.8 million (\$27.7 million) deferred cash consideration. In connection with the Company's initiatives to preserve cash during a prolonged economic downturn caused by the COVID-19 pandemic, the Company reached an agreement with the former owner of ARGES in April 2020 to settle net working capital adjustments and to postpone a portion of the deferred cash consideration. The Company paid the seller €5.0 million in cash in June 2020 and expects to pay €20.0 million in cash in December 2020.

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

	Amount
Cash	\$ 3,159
Accounts receivable	1,430
Inventories	7,129
Property, plant and equipment	14,095
Intangible assets	24,713
Goodwill	44,162
Other assets	2,244
Total assets acquired	96,932
Accounts payable	2,598
Deferred tax liabilities	6,721
Other liabilities	14,462
Total liabilities assumed	23,781
Total assets acquired, net of liabilities assumed	73,151
Less: cash acquired	3,159
Total purchase price, net of cash acquired	\$ 69,992

NOVANTA INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
AS OF JULY 3, 2020
(Unaudited)

4. Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss was as follows (in thousands):

	Total Accumulated Other Comprehensive Loss	Cumulative Translation Adjustments	Pension Liability Adjustments
Balance at December 31, 2019	\$ (18,113)	\$ (9,218)	\$ (8,895)
Other comprehensive income (loss)	(4,817)	(5,308)	491
Amounts reclassified from accumulated other comprehensive loss (1)	346	—	346
Balance at July 3, 2020	<u>\$ (22,584)</u>	<u>\$ (14,526)</u>	<u>\$ (8,058)</u>

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

5. Earnings per Common Share

Basic earnings per common share is computed by dividing consolidated net income by the weighted average number of common shares outstanding during the period.

For diluted earnings per common share, the denominator includes the dilutive effect of outstanding common share equivalents. For the three and six months ended July 3, 2020 and June 28, 2019, respectively, weighted average shares outstanding for the diluted earnings per common share included the dilutive effect of outstanding restricted stock units, stock options, and total shareholder return performance-based restricted stock units, determined using the treasury stock method. The dilutive effects of market-based contingently issuable shares are included in the weighted average common share calculation based on the number of shares, if any, that would be issuable as of the end of the reporting period assuming the end of the reporting period is also the end of the performance period. Dilutive effects of attainment-based contingently issuable shares granted to the former Laser Quantum Limited (“Laser Quantum”) noncontrolling interest shareholders, as well as the non-GAAP EPS performance-based restricted stock units will be included in the weighted average common share calculation when the performance targets have been achieved.

NOVANTA INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
AS OF JULY 3, 2020
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The following table sets forth the computation of basic and diluted earnings per common share (amounts in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	July 3, 2020⁽¹⁾	June 28, 2019⁽²⁾	July 3, 2020⁽¹⁾	June 28, 2019⁽²⁾
Numerators:				
Consolidated net income	\$ 11,660	\$ 10,380	\$ 23,607	\$ 22,633
Denominators:				
Weighted average common shares outstanding— basic	35,137	34,998	35,145	34,981
Dilutive potential common shares	442	505	425	510
Weighted average common shares outstanding— diluted	35,579	35,503	35,570	35,491
Antidilutive potential common shares excluded from above	—	36	26	47
Earnings per Common Share:				
Basic	\$ 0.33	\$ 0.30	\$ 0.67	\$ 0.65
Diluted	\$ 0.33	\$ 0.29	\$ 0.66	\$ 0.64

- (1) 71 thousand non-GAAP EPS performance-based restricted stock units granted to certain members of the executive management team and 213 thousand shares of restricted stock issued to the former Laser Quantum non-controlling interest shareholders are considered contingently issuable shares and were excluded from the calculation of the denominator as the contingent conditions had not been met as of July 3, 2020.
- (2) 45 thousand non-GAAP EPS performance-based restricted stock units granted to certain members of the executive management team and 213 thousand shares of restricted stock issued to the former Laser Quantum non-controlling interest shareholders were considered contingently issuable shares and were excluded from the calculation of the denominator as the contingent conditions had not been met as of June 28, 2019.

6. Fair Value Measurements

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

- Level 1: Quoted prices for identical assets or liabilities in active markets which the Company can access
- Level 2: Observable inputs other than those described in Level 1
- Level 3: Unobservable inputs

Current Assets and Liabilities

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

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Foreign Currency Contracts

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

Contingent Considerations

On July 31, 2019, the Company acquired ARGES. Under the purchase and sale agreement for the ARGES acquisition, the former owner of ARGES is eligible to receive contingent consideration based on the achievement of certain revenue targets by the Company from August 2019 through December 2026. The undiscounted range of possible contingent consideration is zero to €10.0 million. If the revenue targets are achieved, the contingent consideration would be payable annually with the first payment due in the first quarter of 2021. The estimated fair value of the contingent consideration of €7.1 million (\$7.9 million) was determined based on the Monte Carlo valuation method and was recorded as part of the purchase price as of the acquisition date. Subsequent changes in the estimated fair value of the contingent consideration liability are recorded in the consolidated statement of operations in restructuring, acquisition, and related costs until the liability is fully settled. There were no changes to the fair value of the contingent consideration during the six months ended July 3, 2020.

On April 16, 2019, the Company acquired Ingenia CAT, S.L. (“Ingenia”). Under the purchase and sale agreement for the Ingenia acquisition, the shareholders of Ingenia are eligible to receive contingent consideration based on the achievement of certain revenue targets by the Company from April 2019 through March 2022. The undiscounted range of possible contingent consideration is zero to €8.0 million. If the revenue targets are achieved, the contingent consideration would be payable in cash in three annual installments from 2020 to 2022. The estimated fair value of the contingent consideration of €5.8 million (\$6.6 million) was determined based on the Monte Carlo valuation method and was recorded as part of the purchase price as of the acquisition date. Subsequent changes in the estimated fair value of the contingent consideration liability are recorded in the consolidated statement of operations in restructuring, acquisition, and related costs until the liability is fully settled. In June 2020, the Company made the first installment payment of €1.0 million (\$1.1 million), which is included in cash flows from financing activities in the consolidated statement of cash flows for the six months ended July 3, 2020. There were no changes to the fair value of the contingent consideration during the six months ended July 3, 2020.

On December 14, 2016, the Company acquired certain video signal processing and management technologies used in medical visualization solutions. Under the purchase and sale agreement, the former owners are eligible to receive contingent consideration based on the achievement of certain revenue targets by the Company from 2018 to 2021 from products utilizing the acquired technologies. The undiscounted range of possible contingent consideration is zero to €5.5 million (\$6.6 million). If the revenue targets are achieved, the contingent consideration would be payable in cash in four installments from 2019 to 2022. As the acquired assets did not meet the definition of a business, the fair value of the contingent consideration is recognized when probable and estimable and is capitalized as part of the cost of the acquired assets. Subsequent changes in the estimated fair value of this contingent liability are recorded as adjustments to the carrying value of the asset acquired and amortized over the remaining useful life of the underlying asset. In February 2020, the Company made the first installment payment of €2.4 million (\$2.6 million), which is included in cash flows from investing activities in the consolidated statement of cash flows for the six months ended July 3, 2020. There were no other changes in the fair value of the contingent consideration during the six months ended July 3, 2020.

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Summary by Fair Value Hierarchy

The following table summarizes the fair values of the Company's assets and liabilities measured at fair value on a recurring basis as of July 3, 2020 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	\$ 5,585	\$ 5,585	\$ —	\$ —
Prepaid expenses and other current assets:				
Foreign currency forward contracts	133	—	133	—
	<u>\$ 5,718</u>	<u>\$ 5,585</u>	<u>\$ 133</u>	<u>\$ —</u>
Liabilities				
Accrued expenses and other current liabilities:				
Contingent considerations - Current	\$ 6,758	\$ —	\$ —	\$ 6,758
Foreign currency forward contracts	4	—	4	—
Other liabilities:				
Contingent considerations - Long-term	9,852	—	—	9,852
	<u>\$ 16,614</u>	<u>\$ —</u>	<u>\$ 4</u>	<u>\$ 16,610</u>

The following table summarizes the fair values of the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2019 (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash equivalents	\$ 9,262	\$ 9,262	\$ —	\$ —
Prepaid expenses and other current assets:				
Foreign currency forward contracts	50	—	50	—
	<u>\$ 9,312</u>	<u>\$ 9,262</u>	<u>\$ 50</u>	<u>\$ —</u>
Liabilities				
Accrued expenses and other current liabilities:				
Contingent considerations - Current	\$ 3,813	\$ —	\$ —	\$ 3,813
Foreign currency forward contracts	99	—	99	—
Other liabilities:				
Contingent considerations - Long-term	16,504	—	—	16,504
	<u>\$ 20,416</u>	<u>\$ —</u>	<u>\$ 99</u>	<u>\$ 20,317</u>

Changes in the fair value of Level 3 contingent considerations during the six months ended July 3, 2020 were as follows (in thousands):

	Contingent Considerations
Balance at December 31, 2019	\$ 20,317
Payments	(3,767)
Effect of foreign exchange rates	60
Balance at July 3, 2020	<u>\$ 16,610</u>

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The following table provides qualitative information associated with the fair value measurement of the Company's Level 3 liabilities:

Liability	July 3, 2020 Fair Value (in thousands)	Valuation Technique	Unobservable Inputs	Percentage Applied
Contingent consideration (ARGES)	\$7,932	Monte Carlo method	Historical and projected revenues from August 2019 through December 2026 Revenue volatility Cost of debt Discount rate	N/A 36.0% 1.4% 7.3%
Contingent consideration (Ingenia)	\$5,544	Monte Carlo method	Historical and projected revenues from April 2019 through March 2022 Revenue volatility Cost of debt Discount rate	N/A 36.0% 0.9% 15.3%
Contingent consideration (Other)	\$3,134	Discounted cash flow method	Historical and projected revenues for fiscal years 2018 to 2021 Revenue discount rate	N/A 22.8%

Increases or decreases in the unobservable inputs noted above would result in a higher or lower fair value measurement.

See Note 10 to Consolidated Financial Statements for a discussion of the estimated fair value of the Company's outstanding debt.

7. Foreign Currency Contracts

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

As of July 3, 2020, the aggregate notional amount and fair value of the Company's foreign currency forward contracts was \$26.7 million and a net gain of \$0.1 million, respectively. As of December 31, 2019, the aggregate notional amount and fair value of the Company's foreign currency forward contracts was \$12.4 million and a net loss of less than \$0.1 million, respectively.

The Company recognized an aggregate net gain of \$0.7 million and \$0.4 million for the three and six months ended July 3, 2020, respectively, and an aggregate net gain of \$0.9 million and \$0.4 million for the three and six months ended June 28, 2019, respectively. These amounts were included in foreign exchange transaction gains (losses) in the consolidated statement of operations for all periods presented.

8. Goodwill and Intangible Assets

Goodwill

Goodwill is recorded when the consideration for a business combination exceeds the fair value of net tangible and identifiable intangible assets acquired. The Company tests its goodwill balances for impairment annually as of the beginning of the second quarter or more frequently if indicators are present or changes in circumstances suggest that an impairment may exist. The Company performed the most recent annual goodwill and indefinite-lived intangible asset impairment test as of the beginning of the second quarter of 2020 and noted no impairment.

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The following table summarizes changes in goodwill during the six months ended July 3, 2020 (in thousands):

Balance at beginning of the period	\$ 274,710
Net working capital adjustments from a prior-year acquisition	1,118
Effect of foreign exchange rate changes	(2,011)
Balance at end of the period	<u>\$ 273,817</u>

Goodwill by reportable segment as of July 3, 2020 was as follows (in thousands):

	Reportable Segment			Total
	Photonics	Vision	Precision Motion	
Goodwill	\$ 212,876	\$ 160,320	\$ 51,850	\$ 425,046
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)	(151,229)
Total	<u>\$ 110,415</u>	<u>\$ 128,598</u>	<u>\$ 34,804</u>	<u>\$ 273,817</u>

Goodwill by reportable segment as of December 31, 2019 was as follows (in thousands):

	Reportable Segment			Total
	Photonics	Vision	Precision Motion	
Goodwill	\$ 213,413	\$ 160,086	\$ 52,440	\$ 425,939
Accumulated impairment of goodwill	(102,461)	(31,722)	(17,046)	(151,229)
Total	<u>\$ 110,952</u>	<u>\$ 128,364</u>	<u>\$ 35,394</u>	<u>\$ 274,710</u>

Intangible Assets

Intangible assets as of July 3, 2020 and December 31, 2019, respectively, are summarized as follows (in thousands):

	July 3, 2020			December 31, 2019		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizable intangible assets:						
Patents and developed technologies	\$ 158,055	\$ (102,368)	\$ 55,687	\$ 159,217	\$ (97,523)	\$ 61,694
Customer relationships	160,216	(83,978)	76,238	161,807	(78,206)	83,601
Customer backlog	—	—	—	2,316	(2,316)	—
Trademarks and trade names	17,663	(10,445)	7,218	17,871	(10,018)	7,853
Amortizable intangible assets	<u>335,934</u>	<u>(196,791)</u>	<u>139,143</u>	<u>341,211</u>	<u>(188,063)</u>	<u>153,148</u>
Non-amortizable intangible assets:						
Trade names	13,027	—	13,027	13,027	—	13,027
Totals	<u>\$ 348,961</u>	<u>\$ (196,791)</u>	<u>\$ 152,170</u>	<u>\$ 354,238</u>	<u>\$ (188,063)</u>	<u>\$ 166,175</u>

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

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Amortization expense – cost of revenue	\$ 2,716	\$ 2,446	\$ 5,450	\$ 4,757
Amortization expense – operating expenses	3,410	3,772	6,855	7,770
Total amortization expense	<u>\$ 6,126</u>	<u>\$ 6,218</u>	<u>\$ 12,305</u>	<u>\$ 12,527</u>

Estimated amortization expense for each of the five succeeding years and thereafter as of July 3, 2020 was as follows (in thousands):

Year Ending December 31,	Cost of Revenue	Operating Expenses	Total
2020 (remainder of year)	\$ 5,501	\$ 6,896	\$ 12,397
2021	11,220	13,511	24,731
2022	9,613	12,712	22,325
2023	8,449	11,058	19,507
2024	6,285	9,127	15,412
Thereafter	14,619	30,152	44,771
Total	<u>\$ 55,687</u>	<u>\$ 83,456</u>	<u>\$ 139,143</u>

9. Supplementary Balance Sheet Information

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

Inventories

	July 3, 2020	December 31, 2019
Raw materials	\$ 64,510	\$ 76,268
Work-in-process	16,760	15,096
Finished goods	24,317	23,431
Demo and consigned inventory	1,793	1,823
Total inventories	<u>\$ 107,380</u>	<u>\$ 116,618</u>

Accrued Expenses and Other Current Liabilities

	July 3, 2020	December 31, 2019
Accrued compensation and benefits	\$ 9,941	\$ 15,359
Accrued warranty	5,084	5,756
Contract liabilities, current portion	4,235	3,219
Deferred purchase price for acquisitions	22,535	27,735
Finance lease obligations	9,263	1,307
Other	17,073	16,950
Total	<u>\$ 68,131</u>	<u>\$ 70,326</u>

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Accrued Warranty

	Six Months Ended	
	July 3, 2020	June 28, 2019
Balance at beginning of the period	\$ 5,756	\$ 4,510
Provision charged to cost of revenue	1,166	1,477
Warranty liabilities from acquisitions	—	78
Use of provision	(1,798)	(1,167)
Foreign currency exchange rate changes	(40)	(8)
Balance at end of the period	<u>\$ 5,084</u>	<u>\$ 4,890</u>

Other Long Term Liabilities

	July 3, 2020	December 31, 2019
Finance lease obligations	\$ 6,194	\$ 14,845
Accrued pension liabilities	654	1,473
Accrued contingent considerations	9,852	16,504
Other	6,635	4,065
Total	<u>\$ 23,335</u>	<u>\$ 36,887</u>

10. Debt

Debt consisted of the following (in thousands):

	July 3, 2020	December 31, 2019
Senior Credit Facilities – term loan	\$ 5,094	\$ 5,073
Less: unamortized debt issuance costs	(40)	(42)
Total current portion of long-term debt	<u>\$ 5,054</u>	<u>\$ 5,031</u>
Senior Credit Facilities – term loan	\$ 93,959	\$ 96,095
Senior Credit Facilities – revolving credit facility	122,903	123,384
Less: unamortized debt issuance costs	(4,916)	(4,145)
Total long-term debt	<u>\$ 211,946</u>	<u>\$ 215,334</u>
Total Senior Credit Facilities	<u>\$ 217,000</u>	<u>\$ 220,365</u>

Senior Credit Facilities

On December 31, 2019, the Company entered into an amended and restated credit agreement (the “Third Amended and Restated Credit Agreement”) with existing lenders for an aggregate credit facility of \$450.0 million, consisting of a \$100.0 million U.S. dollar equivalent euro-denominated (approximately €90.2 million) 5-year term loan facility and a \$350.0 million 5-year revolving credit facility (collectively, the “Senior Credit Facilities”). The Senior Credit Facilities mature in December 2024 and included an uncommitted “accordion” feature pursuant to which the commitments under the revolving credit facility may be increased by an additional \$200.0 million in aggregate, subject to certain customary conditions.

On March 27, 2020, the Company entered into an amendment (the “First Amendment”) to the Third Amended and Restated Credit Agreement and exercised a portion of the uncommitted accordion feature. The First Amendment increased the revolving credit facility commitment under the Third Amended and Restated Credit Agreement by \$145.0 million, from \$350.0 million to \$495.0 million and reset the uncommitted accordion feature to \$200.0 million for potential future expansion.

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The outstanding principal balance under the term loan facility is payable in quarterly installments of €1.1 million beginning in March 2020, with the remaining balance due upon maturity. The Company may make additional principal payments at any time, which will reduce the next quarterly installment payment due. Borrowings under the revolving credit facility may be repaid at any time through December 2024. The Company repaid €2.3 million (\$2.5 million) of its term loan during the six months ended July 3, 2020.

The Company is required to satisfy certain financial and non-financial covenants under the Third Amended and Restated Credit Agreement. The Third Amended and Restated Credit Agreement also contains customary events of default. The Company was in compliance with these covenants as of July 3, 2020.

Liens

The Company's obligations under the Senior Credit Facilities are secured, on a senior basis, by a lien on substantially all of the assets of Novanta Inc.

Fair Value of Debt

As of July 3, 2020 and December 31, 2019, the outstanding balance of the Company's debt approximated its fair value based on current rates available to the Company for debt of similar maturities. The fair value of the Company's debt is classified as Level 2 under the fair value hierarchy.

11. Leases

Most leases held by the Company expire between 2020 and 2034. In the U.K., where longer lease terms are more common, the Company has a land lease that extends through 2078. Certain leases include terms such as an option to purchase the property, one or more options to renew, with renewal terms that can extend the lease term from one to 10 years, and options to terminate the leases within one year. The exercise of lease renewal or termination options is at the Company's sole discretion; therefore, the majority of renewals to extend the lease terms are not included in the Company's right-of-use assets and operating lease liabilities as they are not reasonably certain of being exercised. The Company regularly evaluates the renewal options and includes the renewal periods in the lease term when they are reasonably certain of being exercised. The depreciable lives of the right-of-use assets and leasehold improvements are limited to the expected lease terms.

The following table summarizes the components of lease costs (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Operating lease cost	\$ 1,870	\$ 2,042	\$ 3,907	\$ 3,865
Finance lease cost				
Amortization of right-of-use assets	247	177	495	355
Interest on lease liabilities	108	101	218	206
Variable lease cost	344	408	723	546
Total lease cost	<u>\$ 2,569</u>	<u>\$ 2,728</u>	<u>\$ 5,343</u>	<u>\$ 4,972</u>

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The following table provides additional details of balance sheet information related to the Company's leases (in thousands, except lease term and discount rate):

	<u>July 3, 2020</u>	<u>December 31, 2019</u>
Operating leases		
Operating lease right-of-use assets	\$ 34,300	\$ 35,180
Current portion of operating lease liabilities	\$ 4,875	\$ 5,043
Operating lease liabilities	33,400	34,108
Total operating lease liabilities	\$ 38,275	\$ 39,151
Finance leases		
Property, plant and equipment, gross	\$ 19,822	\$ 19,748
Accumulated depreciation	(5,215)	(4,649)
Finance lease assets included in property, plant and equipment, net	\$ 14,607	\$ 15,099
Accrued expenses and other current liabilities	\$ 9,263	\$ 1,307
Other liabilities	6,194	14,845
Total finance lease liabilities	\$ 15,457	\$ 16,152
Weighted-average remaining lease term (in years)		
Operating leases	9.8	10.2
Finance leases	4.2	4.7
Weighted-average discount rate		
Operating leases	5.58%	5.60%
Finance leases	3.07%	3.09%

The following table provides additional details of cash flow information related to the Company's leases (in thousands):

	<u>Six Months Ended</u>	
	<u>July 3, 2020</u>	<u>June 28, 2019</u>
Cash paid for amounts included in lease liabilities:		
Operating cash flows from finance leases	\$ 218	\$ 294
Operating cash flows from operating leases	\$ 3,993	\$ 4,264
Financing cash flows from finance leases	\$ 680	\$ 283
Supplemental non-cash information:		
Right-of-use assets obtained in exchange for new operating lease liabilities	\$ 2,164	\$ 5,471

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Future minimum lease payments under operating and finance leases expiring subsequent to July 3, 2020, including operating leases associated with facilities that have been vacated as a result of the Company's restructuring actions, are summarized as follows (in thousands):

Year Ending December 31,	Operating Lease	Finance Lease ⁽¹⁾
2020 (remainder of year)	\$ 2,842	\$ 788
2021	6,929	9,314
2022	6,036	907
2023	5,091	930
2024	4,559	954
Thereafter	25,975	4,440
Total minimum lease payments	51,432	17,333
Less: Interest	(13,157)	(1,876)
Present value of lease liabilities	\$ 38,275	\$ 15,457

(1) Future minimum lease payments under finance leases include the exercise price of an option to purchase a facility in Germany in 2021.

12. Common Shares and Share-Based Compensation

Common Share Repurchases

In October 2018, the Company's Board of Directors approved a share repurchase plan (the "2018 Repurchase Plan") authorizing the repurchase of \$25.0 million worth of the Company's common shares. During the six months ended July 3, 2020, the Company repurchased 65 thousand shares for an aggregate purchase price of \$5.5 million at an average price of \$84.55 per share under the 2018 Repurchase Plan.

In February 2020, the Company's Board of Directors approved a new share repurchase plan (the "2020 Repurchase Plan") authorizing the repurchase of an additional \$50.0 million worth of the Company's common shares.

As of July 3, 2020, the Company had \$59.5 million available under the 2018 and 2020 share repurchase plans for future share repurchases. In an effort to preserve cash in light of the economic slowdown caused by the COVID-19 pandemic, the Company has temporarily suspended repurchases under the share repurchase plans since April 2020.

Share-Based Compensation Expense

The table below summarizes share-based compensation expense recorded in the consolidated statements of operations (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Selling, general and administrative	\$ 3,162	\$ 2,089	\$ 5,960	\$ 4,620
Research and development and engineering	861	184	1,054	295
Cost of revenue	1,388	105	1,596	190
Restructuring, acquisition, and related costs	237	—	237	—
Total share-based compensation expense	\$ 5,648	\$ 2,378	\$ 8,847	\$ 5,105

Share-based compensation reported in selling, general and administrative expenses included expenses related to restricted stock units and deferred stock units granted to the members of the Company's Board of Directors of \$1.0 million and \$0.9 million during the six months ended July 3, 2020 and June 28, 2019, respectively.

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Restricted Stock Units and Deferred Stock Units

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

Deferred stock units ("DSUs") are granted to the members of the Company's Board of Directors. Compensation expense associated with the DSUs is recognized in full on the date of grant, as the DSUs are fully vested and non-forfeitable upon grant. There were 162 thousand and 187 thousand DSUs outstanding as of July 3, 2020 and December 31, 2019, respectively, which were included in the calculation of weighted average basic shares outstanding for the respective periods.

The table below summarizes activities relating to RSUs and DSUs issued and outstanding under the Company's Amended and Restated 2010 Incentive Plan during the six months ended July 3, 2020:

	Shares (In thousands)	Weighted Average Grant Date Fair Value
Unvested at December 31, 2019	453	\$ 39.74
Granted	284	\$ 84.90
Vested	(97)	\$ 51.71
Forfeited	(4)	\$ 71.89
Unvested at July 3, 2020	636	\$ 58.06
Expected to vest as of July 3, 2020	600	

The total fair value of RSUs and DSUs that vested during the six months ended July 3, 2020 was \$9.4 million based on the market price of the underlying shares on the date of vesting.

Performance Stock Units

The Company typically grants two types of performance-based stock awards to certain members of the executive management team: non-GAAP EPS performance-based restricted stock units ("EPS-PSUs") and relative total shareholder return performance-based restricted stock units ("TSR-PSUs"). Both types of performance-based restricted stock units generally cliff vest on the first day following the end of the three-year performance period.

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

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

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The table below summarizes the activities relating to the performance-based awards issued and outstanding under the Company's Amended and Restated 2010 Incentive Plan during the six months ended July 3, 2020:

	Shares ⁽¹⁾ (In thousands)	Weighted Average Grant Date Fair Value
Unvested at December 31, 2019	152	\$ 57.09
Granted	50	\$ 111.47
Performance adjustment ⁽²⁾	60	\$ 28.80
Vested	(120)	\$ 28.80
Unvested at July 3, 2020	142	\$ 89.05
Expected to vest as of July 3, 2020	158	

- (1) The unvested PSUs are shown in this table at target, except for the number of shares vested, which reflects the number of shares earned and expected to vest. As of July 3, 2020, the maximum number of PSUs available to be earned was approximately 284 thousand shares.
- (2) The amount shown represents performance adjustment for performance-based awards granted on February 28, 2017. These units vested at 200% during the six months ended July 3, 2020 based on the achievement of cumulative Non-GAAP EPS and applicable relative TSR performance conditions during the performance period of fiscal years 2017 through 2019.

The total fair value of PSUs that vested during the six months ended July 3, 2020 was \$10.8 million based on the market price of the underlying shares on the date of vesting.

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

	Six Months Ended July 3, 2020
Grant-date stock price	\$ 96.28
Expected volatility	34.25%
Risk-free interest rate	1.35%
Expected annual dividend yield	—
Fair value	\$ 126.65

Stock Options

The total intrinsic value of stock options exercised during the six months ended July 3, 2020, based on the difference between market price on the date of exercise and the date of grant, was \$1.0 million. The total amount of cash received from the exercise of these stock options was \$0.2 million. No stock options were granted during the six months ended July 3, 2020. There were 60 thousand fully-vested stock options outstanding as of July 3, 2020.

13. Income Taxes

The Company determines its estimated annual effective tax rate at the end of each interim period based on full-year forecasted pre-tax income and facts known at that time. The estimated annual effective tax rate is applied to the year-to-date pre-tax income at the end of each interim period with the cumulative effect of any changes in the estimated annual effective tax rate being recorded in the fiscal quarter in which the change is determined. The tax effect of significant unusual items is reflected in the period in which they occur. Since the Company is incorporated in Canada, it is required to use Canada's statutory tax rate of 29.0% in the determination of the estimated annual effective tax rate.

The Company maintains a valuation allowance on balances of certain U.S. state net operating losses and certain non-U.S. tax attributes that the Company has determined that it is more likely than not that they will not be realized. A valuation allowance is

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required when, based upon an assessment of various factors, including recent operating loss history, anticipated future earnings, and prudent and reasonable tax planning strategies, it is more likely than not that some portion of the deferred tax assets will not be realized. In conjunction with the Company's ongoing review of its actual results and anticipated future earnings, the Company continuously reassesses the possibility of releasing the valuation allowance currently in place on its deferred tax assets. For the three and six months ended July 3, 2020, the Company recognized a tax benefit of \$1.3 million due to the release of a portion of a valuation allowance on deferred tax assets which the Company believes will more likely than not be realized.

The Company's effective tax rate of 0.3% for the three months ended July 3, 2020 differs from the Canadian statutory tax rate of 29.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, estimated deductions for Foreign Derived Intangible Income, U.K. patent box deductions and other tax credits, and a release of a portion of the valuation allowance. For the three months ended July 3, 2020, the valuation allowance release had a benefit of 11.4% on the Company's effective tax rate.

The Company's effective tax rate of (0%) for the six months ended July 3, 2020 differs from the Canadian statutory tax rate of 29.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, estimated deductions for Foreign Derived Intangible Income, U.K. patent box deductions and other tax credits, windfall tax benefits upon vesting of certain stock-based compensation awards during the period, and a release of a portion of the valuation allowance. For the six months ended July 3, 2020, the windfall tax benefits upon vesting of certain share-based compensation awards and the valuation allowance release had a benefit of 11.2% and 5.7%, respectively, on the Company's effective tax rate.

The Company's effective tax rate of 19.5% for the three months ended June 28, 2019 differs from the Canadian statutory tax rate of 29.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, estimated deductions for Foreign Derived Intangible Income, and U.K. patent box deductions and other tax credits.

The Company's effective tax rate of 10.3% for the six months ended June 28, 2019 differs from the Canadian statutory tax rate of 29.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, estimated deductions for Foreign Derived Intangible Income, U.K. patent box deductions and other tax credits, and windfall tax benefits upon vesting of certain stock-based compensation awards during the period. For the six months ended June 28, 2019, the windfall tax benefits upon vesting of certain share-based compensation awards had a benefit of 10.6% on the Company's effective tax rate.

On March 27, 2020, the U.S. federal government enacted the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") in response to the COVID-19 pandemic. The CARES Act is an emergency economic stimulus package which, among other things, contains numerous provisions concerning income taxes. The CARES Act will not have a material impact on the Company's income taxes or related disclosures.

14. Restructuring, Acquisition, and Related Costs

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

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
2019 restructuring	\$ 30	\$ 1,965	\$ 599	\$ 2,932
2018 restructuring	668	169	754	438
Total restructuring charges	698	2,134	1,353	3,370
Acquisition and related charges	1,545	2,179	2,551	2,997
Total restructuring, acquisition, and related costs	\$ 2,243	\$ 4,313	\$ 3,904	\$ 6,367

2019 Restructuring

During the fourth quarter of 2018, the Company implemented a restructuring plan intended to realign operations, reduce costs, achieve operational efficiencies and focus resources on growth initiatives (the "2019 restructuring plan"). During the six months ended July 3, 2020, the Company recorded \$0.1 million in severance and related costs, \$0.2 million in facility related costs, and other costs of \$0.3 million in connection with the 2019 restructuring plan. As of July 3, 2020, the Company incurred cumulative costs

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related to this restructuring plan totaling \$8.4 million. The 2019 restructuring program was substantially completed in the first quarter of 2020.

The following table summarizes restructuring costs associated with the 2019 restructuring program by reportable segment (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Photonics	\$ 8	\$ 1,357	\$ 211	\$ 1,550
Vision	2	306	291	656
Precision Motion	14	147	78	194
Unallocated Corporate and Shared Services	6	155	19	532
Total	\$ 30	\$ 1,965	\$ 599	\$ 2,932

2018 Restructuring

During the second quarter of 2018, the Company initiated a program to integrate manufacturing operations as a result of acquisition activities (the “2018 restructuring plan”). During the six months ended July 3, 2020, the Company recorded \$0.8 million in severance and other costs in connection with the 2018 restructuring plan. These costs were reported in the Vision reportable segment. As of July 3, 2020, the Company incurred cumulative costs related to this restructuring plan totaling \$3.6 million. The 2018 restructuring program has been substantially completed.

Rollforward of Accrued Expenses Related to Restructuring

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

	Total	Severance	Facility	Other
Balance at December 31, 2019	\$ 2,073	\$ 1,988	\$ —	\$ 85
Restructuring charges	1,353	820	222	311
Cash payments	(1,974)	(1,542)	(80)	(352)
Non-cash charges and other adjustments	(237)	(237)	—	—
Balance at July 3, 2020	\$ 1,215	\$ 1,029	\$ 142	\$ 44

Acquisition and Related Charges

Acquisition costs in connection with business combinations, including finders’ fees, legal, valuation, and other professional or consulting fees, totaled less than \$0.1 million and \$0.1 million for the three and six months ended July 3, 2020, respectively, and \$1.4 million and \$1.6 million for the three and six months ended June 28, 2019, respectively. During the three and six months ended July 3, 2020, we incurred \$0.6 million in legal costs related to an arbitration demand in connection with a pre-acquisition contract dispute from a 2019 acquisition. Acquisition and related costs recognized under earn-out agreements in connection with acquisitions totaled \$0.9 million and \$1.8 million for the three and six months ended July 3, 2020, respectively, and \$0.8 million and \$1.4 million for the three and six months ended June 28, 2019, respectively. The majority of acquisition and related costs for the three and six months ended July 3, 2020 were included in the Company’s Precision Motion and Vision reportable segments. The majority of acquisition and related costs for the three and six months ended June 28, 2019 were included in the Company’s Precision Motion and Unallocated Corporate and Shared Services reportable segments.

15. Commitments and Contingencies

Purchase Commitments

There have been no material changes to the Company’s purchase commitments since December 31, 2019.

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Legal Contingencies

In April 2020, the Company received notification of an arbitration demand filed with the American Arbitration Association against a business acquired by the Company in June 2019. The arbitration demand was filed by a contract counterparty to a joint product development agreement entered into by the business before Novanta acquired it. The arbitration demand alleges breach of contract and other claims arising out of allegations that the business failed to engage in required marketing activities for the product developed under the joint product development agreement. The claimant is seeking compensatory and punitive damages, lost profits and other relief. The Company believes that the claims are without merit and no amount has been accrued for in the consolidated financial statements.

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

Guarantees and Indemnifications

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

16. Segment Information

Reportable Segments

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

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

Photonics

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

Vision

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

Precision Motion

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

Reportable Segment Financial Information

Revenue, gross profit, gross profit margin, operating income (loss), and depreciation and amortization expenses by reportable segment were as follows (in thousands, except percentage data):

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Revenue				
Photonics	\$ 47,803	\$ 58,286	\$ 102,943	\$ 117,511
Vision	64,740	65,895	133,748	131,831
Precision Motion	32,185	30,964	63,505	62,989
Total	\$ 144,728	\$ 155,145	\$ 300,196	\$ 312,331
	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Gross Profit				
Photonics	\$ 20,898	\$ 27,308	\$ 45,559	\$ 54,622
Vision	24,515	25,211	51,090	51,184
Precision Motion	13,834	13,759	27,742	27,280
Unallocated Corporate and Shared Services	(545)	(496)	(1,244)	(1,015)
Total	\$ 58,702	\$ 65,782	\$ 123,147	\$ 132,071

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	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Gross Profit Margin				
Photonics	43.7%	46.9%	44.3%	46.5%
Vision	37.9%	38.3%	38.2%	38.8%
Precision Motion	43.0%	44.4%	43.7%	43.3%
Total	40.6%	42.4%	41.0%	42.3%

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Operating Income (Loss)				
Photonics	\$ 6,937	\$ 11,666	\$ 15,852	\$ 23,976
Vision	4,665	4,215	10,299	8,772
Precision Motion	6,515	5,983	13,053	11,618
Unallocated Corporate and Shared Services	(4,416)	(6,759)	(12,253)	(14,868)
Total	\$ 13,701	\$ 15,105	\$ 26,951	\$ 29,498

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Depreciation and Amortization Expenses				
Photonics	\$ 2,790	\$ 2,589	\$ 5,439	\$ 5,210
Vision	5,272	5,197	10,549	10,226
Precision Motion	1,333	1,183	2,686	2,552
Unallocated Corporate and Shared Services	42	71	93	126
Total	\$ 9,437	\$ 9,040	\$ 18,767	\$ 18,114

Revenue by Geography

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

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
United States	\$ 54,524	\$ 62,010	\$ 113,729	\$ 126,770
Germany	22,148	18,838	45,381	42,315
Rest of Europe	30,713	35,971	63,798	66,741
China	17,472	15,392	32,876	30,500
Rest of Asia-Pacific	17,842	20,702	39,542	41,149
Other	2,029	2,232	4,870	4,856
Total	\$ 144,728	\$ 155,145	\$ 300,196	\$ 312,331

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The majority of revenue from our Photonics, Vision and Precision Motion segments is generated from sales to customers within the United States and Europe. Each segment also generates revenue across the other geographies, with no significant concentration of any segment's remaining revenue.

Revenue by End Market

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

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Medical	55%	55%	57%	55%
Advanced Industrial	45%	45%	43%	45%
Total	100%	100%	100%	100%

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

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the Consolidated Financial Statements and Notes included in Item 1 of this Quarterly Report on Form 10-Q. The MD&A contains certain forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. In addition to historical financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. These forward-looking statements include, but are not limited to the anticipated impacts of the COVID-19 pandemic on our business, our financial results and our financial condition; our belief that the Purchasing Managers Index ("PMI") may provide an indication of the impact of general economic conditions on our sales into the advanced industrial end market; our strategy; anticipated financial performance; expected liquidity and capitalization; drivers of revenue growth and our growth expectations in various markets; management's plans and objectives for future operations, expenditures and product development and investments in research and development; business prospects; potential of future product releases and expansion of our product and service offerings; anticipated revenue performance; industry trends; market conditions; our competitive positions; changes in economic and political conditions; changes in accounting principles; changes in actual or assumed tax liabilities; expectations regarding tax exposures; anticipated reinvestment of future earnings and dividend policy; anticipated expenditures in regard to the Company's benefit plans; future acquisitions; integration and anticipated benefits from acquisitions and dispositions; anticipated economic benefits, costs and timelines of restructuring programs; ability to repay our indebtedness; our intentions regarding the use of cash; expectations regarding legal and regulatory environmental requirements and our compliance thereto; and other statements that are not historical facts. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including, but not limited to, the following: economic and political conditions and the effects of these conditions on our customers' businesses and level of business activities; our significant dependence upon our customers' capital expenditures, which are subject to cyclical market fluctuations; our dependence upon our ability to respond to fluctuations in product demand; our ability to continually innovate and successfully commercialize our innovations; failure to introduce new products in a timely manner; customer order timing and other similar factors beyond our control; disruptions or breaches in security of our information technology systems; our failure to comply with data privacy regulations; changes in interest rates, credit ratings or foreign currency exchange rates; risks associated with our operations in foreign countries; risks associated with the COVID-19 pandemic and other events outside our control; our increased use of outsourcing in foreign countries; risks associated with increased outsourcing of components manufacturing; our exposure to increased tariffs, trade restrictions or taxes on our products; negative effects on global economic conditions, financial markets and our business as a result of the United Kingdom's impending withdrawal from the European Union and the actions of the current U.S. government, including its policies on trade tariffs and reactions from other countries to any new tariffs imposed by the U.S.; violations of our intellectual property rights and our ability to protect our intellectual property against infringement by third parties; risk of losing our competitive advantage; our failure to successfully integrate recent and future acquisitions into our business; our ability to attract and retain key personnel; our restructuring and realignment activities and disruptions to our operations as a result of consolidation of our operations; product defects or problems integrating our products with other vendors' products; disruptions in the supply of certain key components or other goods from our suppliers; our failure to accurately forecast component and raw material requirements leading to excess inventories or delays in the delivery of our products; production difficulties and product delivery delays or disruptions; our exposure to medical device regulations, which may impede or hinder the approval or sale of our products and, in some cases, may ultimately result in an inability to obtain approval of certain products or may result in the recall or seizure of previously approved products; potential penalties for violating foreign, U.S. federal, and state healthcare laws and regulations; changes in governmental regulations affecting our business or products; our compliance, or failure to comply, with environmental regulations; our failure to implement new information technology systems and software successfully; our failure to realize the full value of our intangible assets; our exposure to the credit risk of some of our customers and in weakened markets; our reliance on third party distribution channels; being subject to U.S. federal income taxation even though we are a non-U.S. corporation; changes in tax laws, and fluctuations in our effective tax rates; any need for additional capital to adequately respond to business challenges or opportunities and repay or refinance our existing indebtedness, which may not be available on acceptable terms or at all; our existing indebtedness limiting our ability to engage in certain activities; volatility in the market price for our common shares; and our failure to maintain appropriate internal controls in the future. Other important risk factors that could affect the outcome of the events set forth in these statements and that could affect the Company's operating results and financial condition are discussed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2019 under the heading "Risk Factors" as updated in Part 2, Item 1A of this Quarterly Report on Form 10-Q. In this Quarterly Report on Form 10-Q, the words "anticipates," "believes," "expects," "intends," "future," "could," "estimates," "plans," "would," "should," "potential," "continues," and similar words or expressions (as well as other words or expressions referencing future events, conditions or circumstances) identify forward-looking statements. Readers should not place undue reliance on any such forward-looking statements, which speak only as of the date they are made. Management and the Company disclaim any obligation to publicly update or revise any such statement to reflect any change in its expectations or in events, conditions, or circumstances on which any such statements may be based, or that may affect the likelihood that actual results will differ from those contained in the forward-looking statements, except as required under applicable law.

Accounting Period

The interim financial statements of Novanta Inc. and its subsidiaries (collectively referred to as the “Company”, “we”, “us”, “our”) are prepared for each quarterly period ending on the Friday closest to the end of the calendar quarter, with the exception of the fourth quarter which always ends on December 31.

Business Overview

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

Reportable Segments

We operate in three reportable segments: Photonics, Vision, and Precision Motion. The reportable segments and their principal activities consist of the following:

Photonics

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

Vision

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

Precision Motion

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

End Markets

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

Medical Market

For the three and six months ended July 3, 2020, the medical market accounted for approximately 55% and 57%, respectively, of our revenue. Revenue from our products sold to the medical market is generally affected by hospital and other healthcare provider capital spending, growth rates of surgical procedures, changes in regulatory requirements and laws, aggregation of purchasing by healthcare networks, changes in technology requirements, timing of OEM customers' product development and new product launches, changes in customer or patient preferences, and general demographic trends.

Advanced Industrial Market

For the three and six months ended July 3, 2020, the advanced industrial market accounted for approximately 45% and 43%, respectively, of our revenue. Revenue from our products sold to the advanced industrial market is affected by a number of factors, including changing technology requirements and preferences of our customers, productivity or quality investments in a manufacturing

environment, the financial condition of our customers, changes in regulatory requirements and laws, and general economic conditions. We believe that the Purchasing Managers Index (PMI) on manufacturing activities specific to different regions around the world may provide an indication of the impact of general economic conditions on our sales into the advanced industrial market.

Strategy

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

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

Significant Events and Updates

Amendment to Third Amended and Restated Credit Agreement

On March 27, 2020, we entered into an amendment (the “First Amendment”) to the third amended and restated credit agreement, dated as of December 31, 2019 (the “Third Amended and Restated Credit Agreement”). The First Amendment exercised a portion of the \$200 million uncommitted accordion feature under the Third Amended and Restated Credit Agreement and increased the revolving credit facility commitment by \$145 million, from \$350 million to \$495 million, and reset the uncommitted accordion feature to \$200 million for potential future expansion.

Impact of COVID-19 on Our Business

Our Employees

In response to the COVID-19 pandemic, we have taken proactive, aggressive action to protect the health and safety of our employees. We established steering committees at both the corporate level and at each of our facilities to provide leadership for and manage our COVID-19 risk mitigation actions and countermeasures. We enacted rigorous safety measures in all of our facilities, including implementing social distancing protocols, requiring working from home for those employees that do not need to be physically present on the manufacturing floor or in our facilities to perform their work, suspending travel, spreading production over more shifts, implementing temperature checks at the entrances to our facilities, frequently disinfecting our workspaces and providing masks to those employees who must be physically present in our facilities. We instituted frequent, often daily, employee communications, providing guidance and updates to our employees with regard to COVID-19 safety procedures and status. We expect to continue these measures until we determine that the COVID-19 pandemic is adequately contained for purposes of our business. We

have incurred and expect to continue to incur additional costs to protect the health of our employees. We may take further actions as government authorities require or recommend or as we determine to be in the best interest of our employees.

We are committed to retaining and supporting our employees during this pandemic. To retain our employees, we issued to substantially all of our employees a special one-time restricted stock unit grant in April 2020 totaling \$14.4 million in the aggregate, which will vest in February 2021. During the three months ended July 3, 2020, we provided special cash incentive bonuses to the majority of our on-site production staff for keeping our factories open and running during the pandemic. In addition to retention, these actions were implemented to create an ownership mindset and focus among all employees for the duration of the crisis and through the expected recovery, while maintaining the Company's talent and capabilities.

Executive Compensation

The Compensation Committee of our Board of Directors approved the 2020 compensation plans for our executive officers and a Section 16 officer (collectively, the "Officers") in February 2020. To support our business during the COVID-19 pandemic, the Officers agreed to waive their 2020 merit and promotional increases, eliminate their 2020 cash bonuses, and take two weeks of unpaid time-off. Further, the Officers will not receive the one-time special restricted stock unit grant issued to the rest of the employees. These actions will result in an aggregate amount of \$1.6 million (approximately 50%) reduction in the 2020 cash compensation, assuming bonuses were paid at target, for these Officers previously approved by the Compensation Committee in February 2020.

In June 2020, our Board of Directors agreed to forgo the cash retainers payable to our non-employee directors for the third quarter of 2020. This action will result in an aggregate amount of \$0.1 million (approximately 25%) reduction in cash compensation of our Board of Directors for 2020.

Our Customers

The outbreak has significantly increased economic and demand uncertainty. The spread of COVID-19 has caused a global economic slowdown and may cause a severe global recession. In the event of a prolonged economic recession, overall demand for our products could decline further and our business would be adversely affected to a greater extent.

Our Facilities

Because of the COVID-19 pandemic, governmental authorities worldwide implemented numerous evolving measures to try to contain the spread of the virus, such as travel bans and restrictions, limits on social gatherings, quarantines, shelter-in-place orders, business shutdowns and social distancing. We have important manufacturing operations in the U.S., the U.K., Germany, and China, all of which have been affected by the COVID-19 pandemic. As of the date of this filing, our manufacturing facilities around the world are in operation. While governmental measures may be modified or extended in the event of a resurgence of COVID-19 infections and in the absence of effective vaccines becoming available, we have taken measures to protect our employees and expect that our manufacturing facilities will remain operational. In connection with the COVID-19 pandemic, we have experienced limited absenteeism from those employees who are required to be on-site to perform their jobs.

Our Supply Chain

We have experienced limited disruption to our supply chain as a result of the COVID-19 pandemic to date. We regularly monitor the financial health and manufacturing output of companies in our supply chain. Hardship on our suppliers or sub-suppliers caused by the COVID-19 pandemic could cause further disruption in our ability to obtain raw materials or components required to manufacture our products, adversely affecting our operations. To mitigate the risk of any potential supply interruptions from the COVID-19 pandemic, we are identifying alternative suppliers, sourcing raw materials from different supplier locations, and taking other actions to ensure our supply of raw materials. Although we are mitigating potential supply interruptions from the COVID-19 pandemic, if certain suppliers cannot produce a key component for us, or if the receipt of certain materials is otherwise delayed, we may miss our scheduled shipment deadlines and our relationship with customers may be harmed. Additionally, restrictions on or disruptions of transportation, such as reduced availability of air transport, port closures and increased border controls or closures, has resulted in higher costs and delays, both for obtaining raw materials from suppliers and shipping finished products to customers.

Our Liquidity

With respect to liquidity, we are evaluating and taking actions to reduce costs and cash expenditures across the Company. These actions include reducing hiring activities, restricting travel, adjusting employee compensation by eliminating fiscal year 2020 cash bonuses and base salary increases, implementing an unpaid time-off program for substantially all of our non-production workforce, limiting discretionary spending, reducing or deferring spending on capital investment projects, deferring certain U.S. payroll tax payments for the remainder of 2020 in accordance with relief provisions under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), deferring lease payments on certain facilities and temporarily suspending repurchases under our share repurchase plans. As of July 3, 2020, we deferred \$1.1 million in certain U.S. payroll tax payments under the CARES Act.

As of July 3, 2020, we had cash and cash equivalents of \$97.5 million and available borrowing capacity under our revolving credit facility of \$372.1 million. We have reviewed numerous potential scenarios in connection with the impact of COVID-19 on our business. Based on our analysis, we believe our existing balances of cash and cash equivalents, anticipated cash flows from our operating activities, and available borrowing capacity under our revolving credit facility will be sufficient to meet our cash needs arising in the ordinary course of business for the next twelve months. Additionally, we believe we will remain in compliance with our debt covenants for the next twelve months.

In connection with our initiatives to preserve cash from a prolonged economic downturn caused by the COVID-19 pandemic, we reached an agreement with the former owner of ARGES GmbH (“ARGES”) in April 2020 to postpone a portion of the deferred cash consideration. We paid the seller €5.0 million in cash in June 2020 and expect to pay €20.0 million in cash in December 2020.

Results of Operations for the Three and Six Months Ended July 3, 2020 Compared with the Three and Six Months Ended June 28, 2019

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

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	59.4	57.6	59.0	57.7
Gross profit	40.6	42.4	41.0	42.3
Operating expenses:				
Research and development and engineering	10.0	8.6	9.9	8.8
Selling, general and administrative	17.2	18.8	18.5	19.5
Amortization of purchased intangible assets	2.4	2.4	2.3	2.5
Restructuring, acquisition, and related costs	1.5	2.8	1.3	2.0
Total operating expenses	31.1	32.7	32.0	32.8
Operating income	9.5	9.7	9.0	9.4
Interest income (expense), net	(1.2)	(1.4)	(1.1)	(1.3)
Foreign exchange transaction gains (losses), net	(0.2)	0.0	(0.0)	0.0
Other income (expense), net	(0.0)	(0.0)	0.0	(0.0)
Income before income taxes	8.1	8.3	7.9	8.1
Income tax provision (benefit)	0.0	1.6	(0.0)	0.8
Consolidated net income	8.1%	6.7%	7.9%	7.2%

Overview of Financial Results

Total revenue of \$144.7 million for the three months ended July 3, 2020 decreased \$10.4 million, or 6.7%, from the prior year period primarily due to the COVID-19 pandemic as we experienced decreased demand in the advanced industrial market related to reductions in industrial manufacturing spending and in the medical market as a result of deferrals of elective surgical procedures. The effect of our prior year acquisitions resulted in an increase in revenue of \$1.7 million, or 1.1%. In addition, foreign currency exchange rates adversely impacted our revenue by \$1.3 million, or 0.9%, for the three months ended July 3, 2020.

Total revenue of \$300.2 million for the six months ended July 3, 2020 decreased \$12.1 million, or 3.9%, from the prior year period primarily due to the COVID-19 pandemic as we experienced decreased demand in the advanced industrial market related to reductions in industrial manufacturing spending and in the medical market as a result of deferrals of elective surgical procedures. The effect of our prior year acquisitions resulted in an increase in revenue of \$8.3 million, or 2.6%. In addition, foreign currency exchange rates adversely impacted our revenue by \$2.9 million, or 0.9%, for the six months ended July 3, 2020.

Operating income of \$13.7 million for the three months ended July 3, 2020 decreased \$1.4 million, or 9.3%, from the prior year period. This decrease was primarily attributable to a decrease in gross profit of \$7.1 million as a result of lower revenue and an increase in research and development and engineering ("R&D") spending of \$1.1 million, partially offset by decreases in selling, general and administrative ("SG&A") expenses of \$4.3 million and restructuring, acquisition, and related costs of \$2.1 million.

Operating income of \$27.0 million for the six months ended July 3, 2020 decreased \$2.5 million, or 8.6%, from the prior year period. This decrease was primarily attributable to a decrease in gross profit of \$8.9 million as a result of lower revenue and an increase in R&D spending of \$2.4 million, offset by decreases in SG&A expenses of \$5.4 million and restructuring, acquisition, and related costs of \$2.5 million.

Basic earnings per common share ("Basic EPS") of \$0.33 for the three months ended July 3, 2020 increased \$0.03 from the prior year period. Diluted earnings per common share ("Diluted EPS") of \$0.33 for the three months ended July 3, 2020 increased \$0.04 from the prior year period. The increase was primarily attributable to a decrease in income tax provision, partially offset by a decrease in operating income.

Basic EPS of \$0.67 for the six months ended July 3, 2020 increased \$0.02 from the prior year period. Diluted EPS of \$0.66 for the six months ended July 3, 2020 increased \$0.02 from the prior year period. The increase was primarily attributable to a decrease in income tax provision, partially offset by a decrease in operating income.

Revenue

The following table sets forth external revenue by reportable segment for the periods noted (dollars in thousands):

	Three Months Ended		Increase (Decrease)	Percentage Change
	July 3, 2020	June 28, 2019		
Photonics	\$ 47,803	\$ 58,286	\$ (10,483)	(18.0)%
Vision	64,740	65,895	(1,155)	(1.8)%
Precision Motion	32,185	30,964	1,221	3.9%
Total	<u>\$ 144,728</u>	<u>\$ 155,145</u>	<u>\$ (10,417)</u>	(6.7)%

	Six Months Ended		Increase (Decrease)	Percentage Change
	July 3, 2020	June 28, 2019		
Photonics	\$ 102,943	\$ 117,511	\$ (14,568)	(12.4)%
Vision	133,748	131,831	1,917	1.5%
Precision Motion	63,505	62,989	516	0.8%
Total	<u>\$ 300,196</u>	<u>\$ 312,331</u>	<u>\$ (12,135)</u>	(3.9)%

Photonics

Photonics segment revenue for the three months ended July 3, 2020 decreased by \$10.5 million, or 18.0%, versus the prior year period, primarily due to decreased demand in the advanced industrial market related to reductions in industrial manufacturing spending and in the medical market as a result of deferrals of elective surgical procedures and a reduction in certain medical

diagnostic testing during the COVID-19 pandemic, partially offset by revenue from the ARGES acquisition consummated in July 2019.

Photonics segment revenue for the six months ended July 3, 2020 decreased by \$14.6 million, or 12.4%, versus the prior year period, primarily due to decreased demand in the advanced industrial market related to reductions in industrial manufacturing spending and in the medical market as a result of deferrals of elective surgical procedures and a reduction in certain medical diagnostic testing during the COVID-19 pandemic, partially offset by revenue of \$4.1 million from the ARGES acquisition consummated in July 2019.

Vision

Vision segment revenue for the three months ended July 3, 2020 decreased by \$1.2 million, or 1.8%, versus the prior year period, primarily due to a decrease in revenue from our minimally invasive surgery (“MIS”) products as a result of deferrals of elective surgical procedures during the COVID-19 pandemic, partially offset by an increase in revenue from our optical data collection products and an increase in revenue from the Med X Change acquisition consummated in June 2019.

Vision segment revenue for the six months ended July 3, 2020 increased by \$1.9 million, or 1.5%, versus the prior year period, primarily due to a \$3.7 million increase in revenue from the Med X Change acquisition consummated in June 2019 and an increase in revenue from our optical data collection products, partially offset by a decrease in revenue from our MIS products as a result of deferrals of elective surgical procedures during the COVID-19 pandemic.

Precision Motion

Precision Motion segment revenue for the three months ended July 3, 2020 increased by \$1.2 million, or 3.9%, versus the prior year period, primarily due to an increase in revenue related to microelectronics demand, partially offset by decreased demand in the medical market as a result of deferrals of elective surgical procedures during the COVID-19 pandemic.

Precision Motion segment revenue for the six months ended July 3, 2020 increased by \$0.5 million, or 0.8%, versus the prior year period, primarily due to an increase in revenue related to microelectronics demand and an increase in revenue from the Ingenia acquisition consummated in June 2019, partially offset by decreased demand in the medical market as a result of deferrals of elective surgical procedures during the COVID-19 pandemic.

Gross Profit and Gross Profit Margin

The following table sets forth the gross profit and gross profit margin for each of our reportable segments for the periods noted (dollars in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Gross profit:				
Photonics	\$ 20,898	\$ 27,308	\$ 45,559	\$ 54,622
Vision	24,515	25,211	51,090	51,184
Precision Motion	13,834	13,759	27,742	27,280
Unallocated Corporate and Shared Services	(545)	(496)	(1,244)	(1,015)
Total	<u>\$ 58,702</u>	<u>\$ 65,782</u>	<u>\$ 123,147</u>	<u>\$ 132,071</u>
Gross profit margin:				
Photonics	43.7%	46.9%	44.3%	46.5%
Vision	37.9%	38.3%	38.2%	38.8%
Precision Motion	43.0%	44.4%	43.7%	43.3%
Total	40.6%	42.4%	41.0%	42.3%

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

Photonics

Photonics segment gross profit for the three months ended July 3, 2020 decreased \$6.4 million, or 23.5%, versus the prior year period, primarily due to a decrease in revenue. Photonics segment gross profit margin was 43.7% for the three months ended July 3, 2020, versus a gross profit margin of 46.9% for the prior year period. The decrease in gross profit margin was primarily attributable to higher operational costs in our factories and unfavorable product mix changes as a result of the COVID-19 pandemic.

Photonics segment gross profit for the six months ended July 3, 2020 decreased \$9.1 million, or 16.6%, versus the prior year period, primarily due to a decrease in revenue. Photonics segment gross profit margin was 44.3% for the six months ended July 3, 2020, versus a gross profit margin of 46.5% for the prior year period. The decrease in gross profit margin was primarily attributable to higher operational costs in our factories and unfavorable product mix changes as a result of the COVID-19 pandemic.

Vision

Vision segment gross profit for the three months ended July 3, 2020 decreased \$0.7 million, or 2.8%, versus the prior year period, primarily due to a decrease in revenue. Vision segment gross profit margin was 37.9% for the three months ended July 3, 2020, versus a gross profit margin of 38.3% for the prior year period. The decrease in gross profit margin was primarily attributable to higher operational costs in our factories and unfavorable product mix changes as a result of the COVID-19 pandemic.

Vision segment gross profit for the six months ended July 3, 2020 decreased \$0.1 million, or 0.2%, versus the prior year period, primarily due to a decrease in gross profit margin. Vision segment gross profit margin was 38.2% for the six months ended July 3, 2020, versus a gross profit margin of 38.8% for the prior year period. The decrease in gross profit margin was primarily attributable to higher operational costs in our factories and unfavorable product mix changes as a result of the COVID-19 pandemic.

Precision Motion

Precision Motion segment gross profit for the three months ended July 3, 2020 increased \$0.1 million, or 0.5%, versus the prior year period, primarily due to an increase in revenue. Precision Motion segment gross profit margin was 43.0% for the three months ended July 3, 2020, versus a gross profit margin of 44.4% for the prior year period. The decrease in gross profit margin was primarily attributable to higher inventory obsolescence related to the discontinuation of a product.

Precision Motion segment gross profit for the six months ended July 3, 2020 increased \$0.5 million, or 1.7%, versus the prior year period, primarily due to an increase in revenue and an increase in gross profit margin. Precision Motion segment gross profit margin was 43.7% for the six months ended July 3, 2020, versus a gross profit margin of 43.3% for the prior year period.

Operating Expenses

The following table sets forth operating expenses for the periods noted (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Research and development and engineering	\$ 14,440	\$ 13,388	\$ 29,774	\$ 27,385
Selling, general and administrative	24,908	29,204	55,663	61,051
Amortization of purchased intangible assets	3,410	3,772	6,855	7,770
Restructuring, acquisition, and related costs	2,243	4,313	3,904	6,367
Total	\$ 45,001	\$ 50,677	\$ 96,196	\$ 102,573

Research and Development and Engineering Expenses

Research and Development and Engineering ("R&D") expenses are primarily comprised of employee compensation related expenses and cost of materials for R&D projects. R&D expenses were \$14.4 million, or 10.0% of revenue, during the three months ended July 3, 2020, versus \$13.4 million, or 8.6% of revenue, during the prior year period. R&D expenses increased in terms of total dollars and as a percentage of revenue primarily due to R&D expenses from 2019 acquisitions.

R&D expenses were \$29.8 million, or 9.9% of revenue, during the six months ended July 3, 2020, versus \$27.4 million, or 8.8% of revenue, during the prior year period. R&D expenses increased in terms of total dollars and as a percentage of revenue primarily due to R&D expenses from 2019 acquisitions.

Selling, General and Administrative Expenses

Selling, general and administrative (“SG&A”) expenses include costs for sales and marketing, sales administration, finance, human resources, legal, information systems, and executive management functions. SG&A expenses were \$24.9 million, or 17.2% of revenue, during the three months ended July 3, 2020, versus \$29.2 million, or 18.8% of revenue, during the prior year period. SG&A expenses decreased in terms of total dollars and as a percentage of revenue primarily due to lower variable compensation as we eliminated 2020 annual bonuses, lower salaries due to unpaid-time off, and lower travel costs and other discretionary spending, partially offset by higher stock-based compensation expense.

SG&A expenses were \$55.7 million, or 18.5% of revenue, during the six months ended July 3, 2020, versus \$61.1 million, or 19.5% of revenue, during the prior year period. SG&A expenses decreased in terms of total dollars and as a percentage of revenue primarily due to lower variable compensation as we eliminated 2020 annual bonuses, lower salaries due to unpaid-time off, and lower travel costs and other discretionary spending, partially offset by higher stock-based compensation expense.

Amortization of Purchased Intangible Assets

Amortization of purchased intangible assets, excluding the amortization of developed technologies included in cost of revenue, was \$3.4 million, or 2.4% of revenue, during the three months ended July 3, 2020, versus \$3.8 million, or 2.4% of revenue, during the prior year period.

Amortization of purchased intangible assets, excluding the amortization of developed technologies included in cost of revenue, was \$6.9 million, or 2.3% of revenue, during the six months ended July 3, 2020, versus \$7.8 million, or 2.5% of revenue, during the prior year period.

Restructuring, Acquisition, and Related Costs

We recorded restructuring, acquisition, and related costs of \$2.2 million during the three months ended July 3, 2020, versus \$4.3 million during the prior year period. The decrease in restructuring, acquisition, and related costs versus the prior year period was primarily due to a decrease in restructuring charges of \$1.4 million as a result of the 2018 and 2019 restructuring programs and a decrease in acquisition and related costs of \$0.6 million. The decrease was primarily attributable to higher acquisition costs associated with acquisitions in the prior year, offset by \$0.6 million legal fees during the three months ended July 3, 2020 related to an arbitration demand in connection with a pre-acquisition contract dispute from a 2019 acquisition.

We recorded restructuring, acquisition, and related costs of \$3.9 million during the six months ended July 3, 2020, versus \$6.4 million during the prior year period. The decrease in restructuring, acquisition, and related costs versus the prior year period was primarily due to a decrease in restructuring charges of \$2.0 million as a result of the 2018 and 2019 restructuring programs and a decrease in acquisition and related costs of \$0.4 million. The decrease was primarily attributable to higher acquisition costs associated with acquisitions in the prior year, offset by \$0.6 million legal fees during the six months ended July 3, 2020 related to an arbitration demand in connection with a pre-acquisition contract dispute from a 2019 acquisition.

Operating Income (Loss) by Segment

The following table sets forth operating income (loss) by segment for the periods noted (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Operating Income (Loss)				
Photonics	\$ 6,937	\$ 11,666	\$ 15,852	\$ 23,976
Vision	4,665	4,215	10,299	8,772
Precision Motion	6,515	5,983	13,053	11,618
Unallocated Corporate and Shared Services	(4,416)	(6,759)	(12,253)	(14,868)
Total	<u>\$ 13,701</u>	<u>\$ 15,105</u>	<u>\$ 26,951</u>	<u>\$ 29,498</u>

Photonics

Photonics segment operating income was \$6.9 million, or 14.5% of revenue, during the three months ended July 3, 2020, versus \$11.7 million, or 20.0% of revenue, during the prior year period. The decrease in operating income was primarily due to a decrease in gross profit of \$6.4 million and an increase in R&D spending of \$1.0 million primarily due to R&D expenses from a prior year

acquisition, offset by a decrease in SG&A expenses of \$0.9 million, a decrease in restructuring related charges of \$1.3 million and a decrease in amortization of purchased intangible assets of \$0.4 million.

Photonics segment operating income was \$15.9 million, or 15.4% of revenue, during the six months ended July 3, 2020, versus \$24.0 million, or 20.4% of revenue, during the prior year period. The decrease in operating income was primarily due to a decrease in gross profit of \$9.1 million and an increase in R&D spending of \$2.2 million primarily due to R&D expenses from a prior year acquisition, partially offset by a decrease in SG&A expenses of \$1.0 million, a decrease in restructuring related charges of \$1.3 million, and a decrease in amortization of purchased intangible assets of \$0.9 million.

Vision

Vision segment operating income was \$4.7 million, or 7.2% of revenue, during the three months ended July 3, 2020, versus \$4.2 million, or 6.4% of revenue, during the prior year period. The increase in operating income was primarily due to a decrease of SG&A expenses of \$2.0 million, partially offset by a decrease in gross profit of \$0.7 million and an increase in acquisition and related charges of \$0.5 million.

Vision segment operating income was \$10.3 million, or 7.7% of revenue, during the six months ended July 3, 2020, versus \$8.8 million, or 6.7% of revenue, during the prior year period. The increase in operating income was primarily due to a decrease of SG&A expenses of \$2.6 million, partially offset by an increase in acquisition and related charges of \$0.5 million and an increase in R&D expenses of \$0.3 million.

Precision Motion

Precision Motion segment operating income was \$6.5 million, or 20.2% of revenue, during the three months ended July 3, 2020, versus \$6.0 million, or 19.3% of revenue, during the prior year period. The increase in operating income was primarily due to a decrease in SG&A expenses of \$0.2 million and a decrease in restructuring, acquisition, and related costs of \$0.2 million.

Precision Motion segment operating income was \$13.1 million, or 20.6% of revenue, during the six months ended July 3, 2020, versus \$ 11.6 million, or 18.4% of revenue, during the prior year period. The increase in operating income was primarily due to an increase in gross profit of \$0.5 million, a decrease in SG&A expenses of \$0.6 million and a decrease in amortization of purchased intangible assets of \$0.3 million.

Unallocated Corporate and Shared Services

Unallocated corporate and shared services costs primarily represent costs of corporate and shared services functions that are not allocated to the operating segments, including certain restructuring and most acquisition costs. These costs for the three months ended July 3, 2020 decreased by \$2.3 million versus the prior year period primarily due to a decrease in SG&A expenses of \$1.1 million and a decrease in restructuring, acquisition, and related costs of \$1.3 million.

Unallocated corporate and shared services costs for the six months ended July 3, 2020 decreased by \$2.6 million versus the prior year period primarily due to a decrease in SG&A expenses of \$1.1 million and a decrease in restructuring, acquisition, and related costs of \$1.8 million.

Other Income and Expense Items

The following table sets forth other income and expense items for the periods noted (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2020	June 28, 2019	July 3, 2020	June 28, 2019
Interest income (expense), net	\$ (1,701)	\$ (2,160)	\$ (3,379)	\$ (4,204)
Foreign exchange transaction gains (losses), net	\$ (282)	\$ 27	\$ (28)	\$ 68
Other income (expense), net	\$ (22)	\$ (70)	\$ 61	\$ (138)

Interest Income (Expense), Net

Net interest expense was \$1.7 million for the three months ended July 3, 2020, versus \$2.2 million in the prior year period. The decrease in net interest expense was primarily due to a decrease in the weighted average interest rate on our senior credit facilities. The weighted average interest rate on our senior credit facilities was 2.40% during the three months ended July 3, 2020, versus 3.51%

during the three months ended June 28, 2019. As of July 3, 2020, our outstanding borrowings under the Third Amended and Restated Credit Agreement denominated in Euro, British Pound, and U.S. Dollars were \$173.2 million, \$13.7 million, and \$35.0 million, respectively.

Net interest expense was \$3.4 million for the six months ended July 3, 2020, versus \$4.2 million in the prior year period. The decrease in net interest expense was primarily due to a decrease in the weighted average interest rate on our senior credit facilities. The weighted average interest rate on our senior credit facilities was 2.40% during the six months ended July 3, 2020, versus 3.64% during the six months ended June 28, 2019.

Foreign Exchange Transaction Gains (Losses), Net

Foreign exchange transaction gains (losses) were \$0.3 million net losses for the three months ended July 3, 2020, versus less than \$0.1 million net gains in the prior year period. The decrease in net gains was primarily due to changes in the value of the U.S. Dollar against the British Pound and Euro and net realized gains from foreign currency contracts.

Foreign exchange transaction gains (losses) were less than \$0.1 million net losses for the six months ended July 3, 2020, versus less than \$0.1 million net gains in the prior year period.

Other Income (Expense), Net

Net other expense was nominal for both the six months ended July 3, 2020 and the six months ended June 28, 2019.

Income Tax Provision (Benefit)

Our effective tax rate for the three months ended July 3, 2020 was 0.3%, versus 19.5% for the prior year period. Our effective tax rate of 0.3% for the three months ended July 3, 2020 differs from the Canadian statutory tax rate of 29.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, estimated deductions for Foreign Derived Intangible Income, U.K. patent box deductions and other tax credits, and a release of a portion of the valuation allowance on our deferred tax assets in Canada. For the three months ended July 3, 2020, the release of the valuation allowance had a benefit of 11.4% on our effective tax rate.

Our effective tax rate of 19.5% for the three months ended June 28, 2019 differs from the Canadian statutory tax rate of 29.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, estimated deductions for Foreign Derived Intangible Income, U.K. and patent box deductions and other tax credits.

Our effective tax rate for the six months ended July 3, 2020 was (0%), versus 10.3% for the prior year period. Our effective tax rate of (0%) for the six months ended July 3, 2020 differs from the Canadian statutory tax rate of 29.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, estimated deductions for Foreign Derived Intangible Income, U.K. patent box deductions and other tax credits, windfall tax benefits upon vesting of certain stock-based compensation awards during the period, and a release of a portion of the valuation allowance. For the six months ended July 3, 2020, the windfall tax benefits upon vesting of certain share-based compensation awards and the release of the valuation allowance had a benefit of 11.2% and 5.7%, respectively, on our effective tax rate.

Our effective tax rate of 10.3% for the six months ended June 28, 2019 differs from the Canadian statutory tax rate of 29.0% primarily due to the mix of income earned in jurisdictions with varying tax rates, estimated deductions for Foreign Derived Intangible Income, U.K. patent box deductions and other tax credits, and windfall tax benefits upon vesting of certain stock-based compensation awards during the period. For the six months ended June 28, 2019, the windfall tax benefits upon vesting of certain stock-based compensation awards had a benefit of 10.6% on our effective tax rate.

On March 27, 2020, the U.S. federal government enacted the CARES Act in response to the COVID-19 pandemic. The CARES Act is an emergency economic stimulus package which, among other things, contains numerous provisions concerning income taxes. The CARES Act will not have a material impact on our income taxes or related disclosures.

Liquidity and Capital Resources

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

facility provides another potential source of liquidity for acquisitions. We may also seek to raise additional capital, which could be in the form of bonds, convertible debt or equity, to fund business development activities or other future investing cash requirements, subject to approval by the lenders in the Third Amended and Restated Credit Agreement. There is no assurance that such capital will be available on reasonable terms or at all.

Significant factors affecting the management of our ongoing cash requirements are the adequacy of available bank lines of credit and our ability to attract long term capital with satisfactory terms. The sources of our liquidity are subject to all of the risks of our business and could be adversely affected by, among other factors, risks associated with events outside our control, such as the economic consequences of the COVID-19 pandemic, a decrease in demand for our products, our ability to integrate current and future acquisitions, deterioration in certain financial ratios, availability of borrowings under our revolving credit facility, and market changes in general. See “Risks Relating to Our Common Shares and Our Capital Structure” included in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

Our ability to make payments on our indebtedness and to fund our operations may be dependent upon the earnings and the distribution of funds from our subsidiaries. Local laws and regulations and/or the terms of our indebtedness restrict certain of our subsidiaries from paying dividends and transferring assets to us. There is no assurance that the applicable laws and regulations and/or the terms of our indebtedness will permit our subsidiaries to provide us with sufficient dividends, distributions or loans when necessary.

As of July 3, 2020, \$61.4 million of our \$97.5 million cash and cash equivalents was held by subsidiaries outside of Canada and the United States. Generally, our intent is to use cash held in these foreign subsidiaries to fund our local operations or acquisitions by those local subsidiaries and to pay down borrowings under our Senior Credit Facilities (defined below). Approximately \$187.0 million of our outstanding term loan and revolver borrowings under our Senior Credit Facilities were held in our subsidiaries outside of Canada and the United States. Additionally, we may use intercompany loans to address short-term cash flow needs for various subsidiaries.

In connection with our initiatives to preserve cash from a prolonged economic downturn caused by the COVID-19 pandemic, we reached an agreement with the former owner of ARGES in April 2020 to settle net working capital adjustments and to postpone a portion of the deferred cash consideration. We paid the seller €5.0 million in cash in June 2020 and expect to pay €20.0 million in cash in December 2020. We also are deferring certain U.S. payroll tax payments in 2020 in accordance with relief provisions under the CARES Act. As of July 3, 2020, we deferred \$1.1 million in certain U.S. payroll tax payments under the CARES Act.

In addition, with respect to the COVID-19 pandemic impact on liquidity, we are evaluating and have taken actions to reduce costs and cash expenditures across the Company. These include reducing hiring activities, restricting travel, adjusting employee compensation by eliminating fiscal year 2020 cash bonuses and base salary increases, implementing an unpaid time-off program for substantially all of our non-production workforce, limiting discretionary spending, reducing or deferring spending on capital investment projects, and deferring lease payments on certain facilities.

Senior Credit Facilities

In December 2019, we entered into the Third Amended and Restated Credit Agreement, consisting of a \$100.0 million U.S. dollar equivalent euro-denominated 5-year term loan facility (approximately €90.2 million) and a \$350.0 million 5-year revolving credit facility (collectively, the “Senior Credit Facilities”). The Senior Credit Facilities mature in December 2024 and included an uncommitted “accordion” feature pursuant to which the commitments under the revolving credit facility may be increased by an additional \$200.0 million in aggregate, subject to certain customary conditions. The term loan facility requires quarterly scheduled principal repayments of approximately €1.1 million beginning in March 2020 with the remaining principal balance due upon maturity. We may make additional principal payments at any time, which will reduce the next quarterly installment payment due. We may make payments to pay down our revolving credit facility with cash on hand and cash generated from future operations at any time.

On March 27, 2020, we entered into an amendment (the “First Amendment”) to the Third Amended and Restated Credit Agreement and exercised a portion of the uncommitted accordion feature. The First Amendment increased the revolving credit facility commitment under the Third Amended and Restated Credit Agreement by \$145.0 million, from \$350.0 million to \$495.0 million, and reset the uncommitted accordion feature to \$200.0 million for potential future expansion.

As of July 3, 2020, we had a €87.9 million euro-denominated term loan (approximately \$99.1 million) and \$122.9 million revolver borrowings outstanding under our Senior Credit Facilities. The borrowings outstanding under the Senior Credit Facilities bear interest at rates based on (a) the Base Rate, as defined in the Third Amended and Restated Credit Agreement, plus a margin ranging between 0.25% to 1.25% per annum, determined by reference to our consolidated leverage ratio, or (b) the Eurocurrency Rate, as defined in the Third Amended and Restated Credit Agreement, plus a margin ranging between 1.25% and 2.25% per annum, determined by reference to our consolidated leverage ratio. In addition, we are obligated to pay a commitment fee on the unused

portion of the revolving credit facility, ranging between 0.20% and 0.40% per annum, determined by reference to our consolidated leverage ratio.

The Third Amended and Restated Credit Agreement contains various covenants that we believe are usual and customary for this type of agreement, including a maximum consolidated leverage ratio and a minimum consolidated fixed charge coverage ratio (as defined in the Third Amended and Restated Credit Agreement). The following table summarizes these financial covenants and our compliance therewith as of July 3, 2020:

	Requirement	Actual
Maximum consolidated leverage ratio	3.50	1.66
Minimum consolidated fixed charge coverage ratio	1.50	7.26

Share Repurchase Plans

Our Board of Directors may approve share repurchase plans from time to time. Under these repurchase plans, shares may be repurchased at our discretion based on ongoing assessment of the capital needs of the business, the market price of our common shares, and general market conditions. Shares may also be repurchased through an accelerated share purchase agreement, on the open market or in privately negotiated transactions in accordance with applicable federal securities laws. Repurchases may be made under certain SEC regulations, which would permit common shares to be repurchased when we would otherwise be prohibited from doing so under insider trading laws. While the share repurchase plans are generally intended to offset dilution from equity awards granted to our employees and directors, the plans do not obligate us to acquire any particular amount of common shares. No time limit is typically set for the completion of the share repurchase plans, and the plans may be suspended or discontinued at any time. We expect to fund share repurchases through cash on hand and cash generated from operations.

In October 2018, our Board of Directors approved a share repurchase plan (the “2018 Repurchase Plan”) authorizing the repurchase of \$25.0 million worth of common shares. Share repurchases have been made under the 2018 Repurchase Plan pursuant to Rule 10b-18 under the Securities Exchange Act of 1934. During the six months ended July 3, 2020, we repurchased 65 thousand shares for an aggregate purchase price of \$5.5 million at an average price of \$84.55 per share under the 2018 Repurchase Plan. We had \$9.5 million available for share repurchases under the 2018 Repurchase Plan as of July 3, 2020.

In February 2020, our Board of Directors approved a new share repurchase plan (the “2020 Repurchase Plan”) authorizing the repurchase of an additional \$50.0 million worth of common shares. We expect that share repurchases will be made under the 2020 Repurchase Plan pursuant to Rule 10b-18 under the Securities Exchange Act of 1934 after the 2018 Repurchase Plan is completed. No shares have been repurchased under the 2020 Repurchase Plan to date.

In an effort to preserve cash in light of the economic slowdown caused by the COVID-19 pandemic, we have temporarily suspended repurchases under our share repurchase plans since April 2020.

Cash Flows for the Six Months Ended July 3, 2020 and June 28, 2019

The following table summarizes our cash flows, cash and cash equivalents, and unused and available funds under our revolving credit facility for the periods indicated (in thousands):

	Six Months Ended	
	July 3, 2020	June 28, 2019
Net cash provided by operating activities	\$ 51,572	\$ 20,853
Net cash used in investing activities	\$ (7,272)	\$ (34,444)
Net cash used in financing activities	\$ (24,978)	\$ (2,798)

	July 3, 2020	December 31, 2019
Cash and cash equivalents	\$ 97,494	\$ 78,944
Unused and available funds under revolving credit facility	\$ 372,097	\$ 226,616

Operating Cash Flows

Cash provided by operating activities was \$51.6 million for the six months ended July 3, 2020, versus \$20.9 million for the prior year period. Cash provided by operating activities for the six months ended July 3, 2020 increased from the prior year period primarily

due to working capital improvements resulting in an increase in cash flows from accounts receivable and inventory, and a decrease in income tax payments.

Cash provided by operating activities for the six months ended July 3, 2020 was positively impacted by an increase in our inventory turnover ratio from 3.1 at December 31, 2019 to 3.2 at July 3, 2020 and a decrease in accounts receivable, offset by a decrease in our days payables outstanding which decreased from 53 days at December 31, 2019 to 49 days at July 3, 2020. During the six months ended July 3, 2020, we paid the 2019 annual employee bonuses which had been accrued for as of December 31, 2019.

Cash provided by operating activities for the six months ended June 28, 2019 was negatively impacted by an increase in our days sales outstanding which increased from 51 days at December 31, 2018 to 52 days at June 28, 2019, a decrease in our days payables outstanding which decreased from 52 days at December 31, 2018 to 51 days at June 28, 2019 and an increase in inventories, as our inventory turnover ratio decreased from 3.4 at December 31, 2018 to 3.2 at June 28, 2019. During the six months ended June 28, 2019, we paid the first milestone payment under the earn-out agreement for our acquisition of Zettlex Holdings Limited amounting to \$3.9 million and paid the 2018 annual employee bonuses, both of which had been accrued for as of December 31, 2018.

Investing Cash Flows

Cash used in investing activities was \$7.3 million for the six months ended July 3, 2020, primarily driven by capital expenditures of \$4.6 million and a payment for intangible assets of \$2.6 million related to our 2016 asset acquisition of video signal processing and management technologies.

Cash used in investing activities was \$34.4 million for the six months ended June 28, 2019, primarily driven by the Ingenia and Med X Change acquisitions. In connection with these acquisitions, we paid \$28.9 million cash considerations (net of cash acquired of \$1.0 million) during the six months ended June 28, 2019. We also paid \$5.6 million for capital expenditures during the six months ended June 28, 2019.

We have no material commitments to purchase property, plant, and equipment as of July 3, 2020. We expect to use an aggregate of approximately \$6 million to \$8 million in fiscal 2020 for capital expenditures related to investments in new property, plant and equipment.

Financing Cash Flows

Cash used in financing activities was \$25.0 million for the six months ended July 3, 2020, primarily due to \$7.9 million of payroll tax payments on share-based compensation awards, ARGES deferred purchase price payment of \$5.6 million, \$5.5 million of repurchases of common shares, \$2.5 million repayment of our term loan, and \$1.6 million of fees paid in connection with the First Amendment to our Third Amended and Restated Credit Agreement.

Cash used in financing activities was \$2.8 million for the six months ended June 28, 2019, primarily due to \$16.1 million of term loan payments, \$6.7 million of payroll tax payments upon vesting of stock-based compensation awards, and \$3.3 million of repurchases of common stock, partially offset by \$23.6 million of borrowings under our revolving credit facility used to fund the Ingenia and Med X Change acquisitions.

Off-Balance Sheet Arrangements, Contractual Obligations

Contractual Obligations

Our contractual obligations primarily consist of the principal and interest associated with our Senior Credit Facilities, operating and finance leases, purchase commitments, pension obligations, deferred cash considerations associated with acquisitions, contingent considerations and earn-outs. Such contractual obligations are described in our Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to Consolidated Financial Statements, each included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019. As of July 3, 2020, other than the First Amendment to the Third Amended and Restated Credit Agreement, we have not entered into any other material new or modified contractual obligations since the end of the fiscal year ended December 31, 2019.

Off-Balance Sheet Arrangements

Through July 3, 2020, we have not entered into any other off-balance sheet arrangements or material transactions with any unconsolidated entities or other persons.

Critical Accounting Policies and Estimates

The critical accounting policies that we believe impact significant judgments and estimates used in the preparation of our consolidated financial statements presented in this periodic report on Form 10-Q are described in our Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Notes to Consolidated Financial Statements, each included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019. There have been no material changes to our critical accounting policies and estimates through July 3, 2020 from those disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

Recent Accounting Pronouncements

See Note 1 to Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our primary market risk exposures are foreign currency exchange rate fluctuations and interest rate sensitivity. During the three months ended July 3, 2020, there have been no material changes to the information included under Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk," in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15(b) under the Securities and Exchange Act of 1934 (the "Exchange Act"), our management carried out an evaluation, with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) as of July 3, 2020, the end of the period covered by this report. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of July 3, 2020.

Changes in Internal Control over Financial Reporting

There has been no change to our internal control over financial reporting during the fiscal quarter ended July 3, 2020 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

The Company's risk factors are described in Part I, Item 1A, "Risk Factors", of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2019. Except as set forth below, there have been no material changes in our risk factors included in our Annual Report.

To the extent the COVID-19 pandemic adversely affects our business, results of operations, financial condition and cash flows, it may also heighten many of the risks described in the "Risk Factors" section of our Annual Report on Form 10-K for the fiscal year ended December 31, 2019. The ultimate impact of COVID-19 on our business, results of operations, financial condition and cash flows is dependent on future developments, including the duration of the pandemic and the related length of its impact on the global economy, which are uncertain and cannot be predicted at this time.

The COVID-19 pandemic has adversely impacted and is expected to further adversely impact our business and results of operations.

In 2020, a strain of novel coronavirus disease, COVID-19, was declared a pandemic and has spread across the world, including throughout the United States, Europe and Asia. The outbreak and government measures taken in response have also had a significant adverse impact, both direct and indirect, on our businesses and the economy. We have experienced weakened demand from certain customers in the advanced industrial and medical end-markets, which has adversely affected and is expected to continue to adversely affect our revenues. For example, healthcare providers have deferred elective medical procedures in order to focus on combatting the pandemic, which has significantly reduced demand for certain of our medical products. Certain other customers have delayed their research and development programs, which has negatively affected the demand for some of our products. If these trends continue, our revenues will continue to be negatively impacted.

We have also faced difficulty sourcing some materials and components necessary to fulfill production requirements and meeting scheduled shipments due to shipping and transportation disruptions. If these disruptions were to worsen, our ability to manufacture our products or meet our customers' schedules may be adversely affected and our business would be harmed. Even if we are able to find alternate sources of supply for such materials or components, they may cost more or be of lower quality, which could affect our profitability, financial condition and business. While the impact of the pandemic on our manufacturing capabilities has been limited to date, there can be no assurance that our ability to manufacture our products will not be disrupted in the future, due to sickness of employees, mandatory stay-at-home orders, travel restrictions, supply interruptions or other potential disruptions. We have also faced and may face in the future limitations on our employee resources as a results of various causes, including stay-at-home orders from local governments, mandatory furloughs for one week per quarter for substantially all non-manufacturing employees, sickness of employees or their families, or the desire of employees to avoid contact with large groups of people. The pandemic has also diverted management resources and the prolonged work-from-home arrangements have created business continuity and increased cybersecurity risks.

The COVID-19 pandemic continues to rapidly evolve. The extent to which the outbreak impacts our business, liquidity and financial results will depend on future developments, which are highly uncertain and cannot be predicted with confidence, such as the continued geographic spread of the disease, the duration of the pandemic, the location, duration and magnitude of future waves of infection, travel restrictions and social distancing in the United States, the European Union, China and other countries, the duration and extent of business closures or business disruptions and the effectiveness of actions taken to contain and treat the disease. If we or our customers experience prolonged shutdowns or other business disruptions beyond current expectations, our ability to conduct our business in the manner and within planned timelines could be materially adversely impacted, and our business and financial results may continue to be adversely affected.

Additionally, concerns over the economic impact of the COVID-19 pandemic have caused extreme volatility in financial and other capital markets, which adversely impacted and may continue to adversely impact our stock price and our ability to access capital markets.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed/ Furnished Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	Certificate and Articles of Continuance of the Registrant, dated March 22, 1999	S-3	333-202597	3.1	03/09/15	
3.2	By-Laws of the Registrant, as amended	10-Q	001-35083	3.2	05/12/20	
3.3	Articles of Reorganization of the Registrant, dated July 23, 2010	8-K	000-25705	3.1	07/23/10	
3.4	Articles of Amendment of the Registrant, dated December 29, 2010	8-K	000-25705	3.1	12/29/10	
3.5	Articles of Amendment of the Registrant, dated May 11, 2016	8-K	001-35083	10.1	05/12/16	
10.1	Second Amendment to Third Amended and Restated Credit Agreement, dated June 2, 2020					*
31.1	Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					*
31.2	Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					*
32.1	Chief Executive Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					**
32.2	Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					**
101.INS	Inline eXtensible Business Reporting Language (XBRL) Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.					
101.SCH	Inline XBRL Taxonomy Extension Schema Document					*
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document					*
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document					*
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document					*
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document					*
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)					*

* Filed herewith

** Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Novanta Inc. (Registrant)

<u>Name</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Matthijs Glastra</u> Matthijs Glastra	Director, Chief Executive Officer	August 6, 2020
<u>/s/ Robert J. Buckley</u> Robert J. Buckley	Chief Financial Officer	August 6, 2020

**SECOND AMENDMENT TO
THIRD AMENDED AND RESTATED CREDIT AGREEMENT**

This **SECOND AMENDMENT TO THIRD AMENDED AND RESTATED CREDIT AGREEMENT** dated as of June 2, 2020 (this “Amendment”) is made by and among NOVANTA CORPORATION, a Michigan corporation (the “Lead Borrower”), NOVANTA UK INVESTMENTS HOLDING LIMITED, a private limited company incorporated in England and Wales (the “U.K. Borrower”), Novanta Europe GmbH, a limited liability company (Gesellschaft mit beschränkter Haftung) formed and existing under the laws of Germany (the “German Borrower” and jointly and severally together with the Lead Borrower and the U.K. Borrower, collectively the “Borrowers”), NOVANTA INC., a company continued and existing under the laws of the Province of New Brunswick, Canada (“Holdings”), each of the Subsidiaries of Holdings listed under the caption “GUARANTORS” on the signature pages hereto (each a “Guarantor” and collectively the “Guarantors”), each lender party hereto and BANK OF AMERICA, N.A., as Administrative Agent (in such capacity, the “Administrative Agent”), Swing Line Lenders and L/C Issuer.

WHEREAS, the Borrowers, the lenders from time to time party thereto (collectively, the “Lenders” and individually, a “Lender”) and the Administrative Agent are parties to that certain Third Amended and Restated Credit Agreement dated as of December 31, 2019, as amended by the First Amendment to Third Amended and Restated Credit Agreement dated as of March 27, 2020 (as further amended, restated, extended, supplemented or otherwise modified in writing from time to time, the “Credit Agreement”), pursuant to which the Lenders have agreed to make certain financial accommodations to the Borrowers; and

WHEREAS, the Borrowers, the Guarantors the Required Lenders and the Administrative Agent wish to amend the Credit Agreement in certain respects, all on the terms and conditions hereinafter set forth;

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties signatory hereto agree as follows:

1. Definitions. Except as otherwise defined in this Amendment, terms defined in the Credit Agreement are used herein as defined therein.

2. Amendments to Credit Agreement. Subject to the satisfaction of the conditions precedent specified in Section 3 below, the undersigned Lenders hereby agree that, effective as of the date hereof, the Credit Agreement shall be amended as follows:

Section 1.01 of the Credit Agreement is hereby amended by deleting the definition of “Consolidated Leverage Ratio” in its entirety and inserting the following definition in its stead:

“Consolidated Leverage Ratio” means, as of any date of determination, the ratio of (a)(i) Consolidated Funded Indebtedness as of such date minus (ii) an amount equal to the lesser of (x) \$25,000,000 and (y) the sum of the amount of (without duplication) (A) unrestricted cash and Cash Equivalents of the Loan Parties as of such date, (B) unrestricted cash and Cash Equivalents

of Holdings and its Subsidiaries held at deposit or securities accounts with the Administrative Agent or any Lender as of such date and (C) cash and Cash Equivalents of the Loan Parties held at deposit or securities accounts with the Administrative Agent or any Lender and restricted solely in favor of the Secured Parties as collateral security for the Obligations as of such date, to (b) Consolidated EBITDA of Holdings and its Subsidiaries on a consolidated basis for the most recently completed Measurement Period.

3. Conditions Precedent. The amendments to the Credit Agreement set forth in Section 2 hereof shall become effective, as of the date hereof, upon satisfaction of the following conditions precedent:

(a) the Lead Borrower shall have delivered to the Administrative Agent a counterpart of this Amendment executed by each Loan Party;

(b) the Lenders constituting Required Lenders and the Administrative Agent shall, in each case, have indicated their consent and agreement by executing this Amendment;

(c) the Borrowers shall have paid all fees and other amounts due and payable by them under the Credit Agreement, including to the extent invoiced the reasonable fees, costs and expenses owing to Choate, Hall & Stewart LLP;

(d) the representations and warranties made by each Loan Party in Section 4 hereof are true and correct as of the date hereof; and

(e) no Event of Default shall have occurred and be continuing.

4. Representations and Warranties. The Lead Borrower and the other Loan Parties each represents and warrants to the Lenders that the representations and warranties of the Loan Parties contained in Article V of the Credit Agreement or any other Loan Document, or which are contained in any document furnished at any time under or in connection herewith or therewith, are true and correct in all material respects on the date hereof, except that any representation and warranty that is qualified as to “materiality,” “Material Adverse Effect” or similar language shall be true and correct in all respects on the date hereof; provided that (a) to the extent that such representations and warranties specifically refer to an earlier date, in which case they shall be true and correct as of such earlier date, (b) the representations and warranties contained in Sections 5.05(a) and (b) of the Credit Agreement shall be deemed to refer to the most recent statements furnished pursuant to Sections 6.01(a) and (b) of the Credit Agreement, respectively and (c) each reference in the Credit Agreement to “this Agreement” or the “Credit Agreement” or the like shall include reference to this Amendment and the Credit Agreement as amended hereby.

5. Effect on Loan Documents. The Credit Agreement (as amended hereby) and the other Loan Documents shall be and remain in full force and effect in accordance with their terms and hereby are ratified and confirmed in all respects. Except as expressly set forth herein the execution, delivery, and performance of this Amendment shall not operate as a waiver or an amendment of any right, power, or remedy of the Administrative Agent or any Lender under the Credit Agreement or any other Loan Document, as in effect prior to the date hereof. Each of the

Loan Parties hereby ratifies and confirms in all respects all of its obligations under the Credit Agreement (as amended hereby) and the other Loan Documents to which it is a party.

6. No Novation; Entire Agreement. This Amendment evidences solely the amendment of the terms and provisions of the obligations of the Lead Borrower and the other Loan Parties under the Loan Documents and is not a novation or discharge thereof. There are no other understandings, express or implied, among the Lead Borrower, the other Loan Parties, the Administrative Agent and the Lenders regarding the subject matter hereof or thereof.

7. Choice of Law. This Amendment shall be governed by, and construed in accordance with, the laws of the State of New York.

8. Electronic Signatures; Counterparts. This Amendment and any document, amendment, approval, consent, information, notice, certificate, request, statement, disclosure or authorization related to this Amendment (each a "Communication"), including Communications required to be in writing, may be in the form of an Electronic Record and may be executed using Electronic Signatures. Each of the Loan Parties agrees that any Electronic Signature on or associated with any Communication shall be valid and binding on each of the Loan Parties to the same extent as a manual, original signature, and that any Communication entered into by Electronic Signature, will constitute the legal, valid and binding obligation of each of the Loan Parties enforceable against such in accordance with the terms thereof to the same extent as if a manually executed original signature was delivered. Any Communication may be executed in as many counterparts as necessary or convenient, including both paper and electronic counterparts, but all such counterparts are one and the same Communication. For the avoidance of doubt, the authorization under this paragraph may include, without limitation, use or acceptance by the Administrative Agent and each of the Lenders of a manually signed paper Communication which has been converted into electronic form (such as scanned into PDF format), or an electronically signed Communication converted into another format, for transmission, delivery and/or retention. The Administrative Agent and each of the Lenders may, at its option, create one or more copies of any Communication in the form of an imaged Electronic Record ("Electronic Copy"), which shall be deemed created in the ordinary course of such Person's business, and destroy the original paper document. All Communications in the form of an Electronic Record, including an Electronic Copy, shall be considered an original for all purposes, and shall have the same legal effect, validity and enforceability as a paper record. Notwithstanding anything contained herein to the contrary, the Administrative Agent is under no obligation to accept an Electronic Signature in any form or in any format unless expressly agreed to by the Administrative Agent pursuant to procedures approved by it; provided, further, without limiting the foregoing, (a) to the extent the Administrative Agent has agreed to accept such Electronic Signature, the Administrative Agent and each of the Lenders shall be entitled to rely on any such Electronic Signature purportedly given by or on behalf of any Loan Party without further verification and (b) upon the request of the Administrative Agent or any Lender, any Electronic Signature shall be promptly followed by such manually executed counterpart. For purposes hereof, "Electronic Record" and "Electronic Signature" shall have the meanings assigned to them, respectively, by 15 USC §7006, as it may be amended from time to time. For the avoidance of doubt, upon the request of the Administrative Agent, each Loan Party and each Lender party hereto hereby agrees to deliver a manually signed original counterpart of each

Communication to the Administrative Agent within a reasonable time after the effectiveness of this Amendment.

9. Construction. This Amendment is a Loan Document. This Amendment and the Credit Agreement shall be construed collectively and in the event that any term, provision or condition of any of such documents is inconsistent with or contradictory to any term, provision or condition of any other such document, the terms, provisions and conditions of this Amendment shall supersede and control the terms, provisions and conditions of the Credit Agreement. Upon and after the effectiveness of this Amendment, each reference in the Credit Agreement to “this Agreement”, “hereunder”, “herein”, “hereof” or words of like import referring to the Credit Agreement, and each reference in the other Loan Documents to “the Credit Agreement”, “thereunder”, “therein”, “thereof” or words of like import referring to the Credit Agreement, shall mean and be a reference to the Credit Agreement as modified and amended hereby.

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IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed as of the date first above written.

BORROWERS:

NOVANTA CORPORATION

By: /s/ Robert Buckley

Name: Robert Buckley

Title: Chief Financial Officer

NOVANTA UK INVESTMENTS HOLDING LIMITED

By: /s/ Robert Buckley

Name: Robert Buckley

Title: Director

NOVANTA EUROPE GmbH

By: /s/ Robert Buckley

Name: Robert Buckley

Title: Managing Director

[Second Amendment to Third A&R Credit Agreement]

HOLDINGS:
NOVANTA INC.

By: /s/ Robert Buckley
Name: Robert Buckley
Title: Chief Financial Officer

[Second Amendment to Third A&R Credit Agreement]

OTHER GUARANTORS:

NOVANTA TECHNOLOGIES UK LIMITED

By: /s/ Robert Buckley
Name: Robert Buckley
Title: Director

NDS SURGICAL IMAGING LLC

By: /s/ Robert Buckley
Name: Robert Buckley
Title: President

MED X CHANGE, INC.

By: /s/ Robert Buckley
Name: Robert Buckley
Title: President

NOVANTA MEDICAL TECHNOLOGIES CORP.

By: /s/ Robert Buckley
Name: Robert Buckley
Title: President

W.O.M. WORLD OF MEDICINE USA, INC.

By: /s/ Timothy Spinella
Name: Timothy Spinella
Title: Treasurer

BANK OF AMERICA, N.A., as
Administrative Agent

By: /s/ Melissa Mullis
Name: Melissa Mullis
Title: Assistant Vice President

[Second Amendment to Third A&R Credit Agreement]

BANK OF AMERICA, N.A., as a Lender

By: /s/ John F. Lynch
Name: John F. Lynch
Title: Senior Vice President

[Second Amendment to Third A&R Credit Agreement]

JPMORGAN CHASE BANK, N.A., as a Lender

By: /s/ Maria Riaz
Name: MARIA RIAZ
Title: VICE PRESIDENT

[Second Amendment to Third A&R Credit Agreement]

WELLS FARGO BANK, NATIONAL ASSOCIATION, as a Lender

By: /s/ Cody King
Name: Cody King
Title: Vice President

[Second Amendment to Third A&R Credit Agreement]

SILICON VALLEY BANK, as a Lender

By: /s/ Michael Shuhy
Name: Michael Shuhy
Title: Managing Director

[Second Amendment to Third A&R Credit Agreement]

TD BANK, N.A., as a Lender

By: /s/ Leonid Batsevitsky

Name: Leonid Batsevitsky

Title: Vice President

[Second Amendment to Third A&R Credit Agreement]

BANK OF MONTREAL, as a Lender

By: /s/ Anne Robles

Name: Anne Robles

Title: Vice President

[Second Amendment to Third A&R Credit Agreement]

BANK OF MONTREAL, London Branch, as a Lender

By: /s/ Tom Woolgar
Name: Tom Woolgar
Title: Managing Director

By: /s/ Scott Matthews
Name: Scott Matthews
Title: Managing Director

[Second Amendment to Third A&R Credit Agreement]

HSBC BANK USA, NATIONAL ASSOCIATION, as a Lender

By: /s/ Shaun R. Kleinman
Name: Shaun R. Kleinman
Title: Senior vice President

[Second Amendment to Third A&R Credit Agreement]

HSBC UK BANK PLC, as a Lender

By: /s/ Rachel Shatliff

Name: Rachel Shatliff

Title: Managing Director and Head of International Subsidiary Banking

[Second Amendment to Third A&R Credit Agreement]

PNC BANK, NATIONAL ASSOCIATION, as a Lender

By: /s/ Eileen P. Murphy
Name: Eileen P. Murphy
Title: Vice
President

[Second Amendment to Third A&R Credit Agreement]

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
CERTIFICATIONS**

I, Matthijs Glastra, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Novanta Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 6, 2020

/s/ Matthijs Glastra

Matthijs Glastra

Chief Executive Officer

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

CERTIFICATION

I, Robert J. Buckley, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Novanta Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 6, 2020

/s/ Robert J. Buckley

Robert J. Buckley

Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Novanta Inc. (the “Company”) on Form 10-Q for the period ended July 3, 2020 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Matthijs Glastra, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) the Report fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Matthijs Glastra

Matthijs Glastra

Chief Executive Officer

August 6, 2020

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Novanta Inc. (the "Company") on Form 10-Q for the period ended July 3, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert J. Buckley, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) the Report fully complies with the requirements of section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Robert J. Buckley

Robert J. Buckley

Chief Financial Officer

August 6, 2020