2013 ANNUAL REPORT

This report was finalized on March 31, 2014 and speaks only as of such date or, with respect to historical information (including the financial data included herein), to such earlier date as may be expressly stated. Information contained herein has not been updated for the passage of time or otherwise from such dates.

With the exception of historical matters, this report also contains express or implied forward-looking information about the future plans, financial condition, and operating performance of Heska Corporation ("Heska") that are forward-looking statements within the meaning of the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations, and factors that could cause our actual business and financial results to differ materially from those expressed in Heska's forward-looking statements include the following: uncertainties related to using past results to predict future events; uncertainties related to Heska's ability to operate profitably in the future; uncertainties related to the integration of and expected benefits from the acquisition of a majority interest in Cuattro Veterinary USA, LLC; uncertainties related to reliance on third-parties to whom Heska is a supplier for commercial success; uncertainties related to Heska's reliance on third-party suppliers and on third parties for research and development activities, which are significant; uncertainties related to the performance of any product in field use; uncertainties related to the perception of any brand or product; uncertainties related to the productivity of Heska's and its subsidiaries' sales personnel, including the ability to increase or maintain such productivity; uncertainties related to the ultimate success of Heska's perceived innovations, or the ability of Heska to create comparable innovations in the future; uncertainties related to Heska's ability to successfully sell and market its products; uncertainties related to the performance and actions of any third-party to which Heska has granted significant marketing rights; uncertainties regarding Heska's ability to achieve any development milestone; uncertainties related to regulatory matters, including the risk a regulatory agency may require Heska to reduce the time to stated expiration of a product from time of manufacture; uncertainties related to competition and the impact of actions of competitors; uncertainties related to the operating performance and customer perception of a new product to be introduced into the veterinary market; uncertainties related to future customer placements and affiliated profitability of Element POC™ units; uncertainties related to the reputation of Heska's products and the impact of such perceptions on Heska's financial performance; uncertainties related to Heska's ability to negotiate any economically successful future agreement with a third party; competition; and the risks and uncertainties set forth in Heska's filings and future filings with the Securities and Exchange Commission, including those set forth in Heska's Quarterly Report on Form 10-Q for the nine month period ended September 30, 2013. Heska does not undertake to update any forward-looking statement.

Dear Fellow Shareholders:

This past year was strategically important, beginning with a transformative acquisition and ending with solid financial evidence that we are on the right path. We are quite pleased with the foundational strength of our business, and enter 2014 in much stronger position than we were early in 2013.

In early 2013, we told investors to expect to see the positive impacts associated with new commercial leadership, key changes in sales strategies, and the majority interest acquisition of Cuattro Veterinary USA. We also said we expected evidence of significant growth toward the end of the year. Our results were consistent with those expectations.

In addition, we announced two important relationships in 2013 that further bolster our foundation for growth. Elanco, the animal health division of Eli Lilly, has become our new partner for the cattle vaccines we manufacture in our Des Moines facility. Beyond their commitment to cattle vaccines, we expect to develop other areas of collaboration with Elanco. We also extended our relationship on the manufacture of Tri-Heart Plus with Merck Animal Health. We expect to see steady growth of that product over the 10 year extension. In both cases we have blue-chip, top five global animal health partners that are helping us grow our business outside our direct Heska sales force channel.

Thoughtful innovation continues to yield new opportunities, both within our product lines and our go-to-market strategies. The addition of digital imaging products through the Cuattro Veterinary USA transaction has produced strong growth and broadened our ability to serve customers. Beyond this addition of new products, the improvement in productivity of our outside sales force is striking. Furthermore, in September 2013, we obtained exclusive North American sales rights to the Element POC analyzer, a handheld instrument that delivers rapid blood gas, electrolyte and blood chemistry testing from BBI, a unit of Alere. This mobile device nicely complements our diagnostic lab suite. The leadership of President and COO, Kevin Wilson, has been key in these successes.

The foundation of our business has never been stronger and we remain committed to advancing veterinary medicine. We are redoubling our focus on growth opportunities. Accordingly, it is an ideal time to make a change in Heska's executive leadership. We have just announced the appointment of Kevin Wilson as Chief Executive Officer and President and my transition to Executive Chair. With Kevin's success in commercial execution, he is the clear choice to lead Heska into the future. We are confident Kevin will do a great job and I am pleased to help facilitate his success.

Thank you for your investment in Heska,

Robert B. Grieve
Chair and Chief Executive Officer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Heska Corporation and subsidiaries (the "Company") as of December 31, 2012 and 2013, and the related consolidated statements of operations, stockholders' equity, comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heska Corporation and subsidiaries as of December 31, 2012 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

EKS&H LLLP

March 31, 2014
Boulder, Colorado

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

	December 31, 2012	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,784	$ 6,016
Accounts receivable, net of allowance for doubtful accounts of $155 and $209, respectively	11,044	11,409
Due from - related party	—	1,200
Inventories, net	12,483	11,687
Deferred tax asset, current	1,130	2,156
Other current assets	2,514	1,443
Total current assets	32,955	33,911
Property and equipment, net	6,005	9,928
Note receivable – related party	—	1,407
Goodwill and other intangibles	1,120	21,571
Deferred tax asset, net of current portion	26,746	26,358
Other long-term assets	—	378
Total assets	$ 66,826	$ 93,553
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,298	$ 4,448
Accrued liabilities	4,132	4,420
Current portion of deferred revenue	2,407	3,908
Line of credit	2,552	4,798
Other short-term borrowings, including current portion of long-term note payable	—	132
Total current liabilities	14,389	17,706
Long-term note payable, net of current portion	—	369
Deferred revenue, net of current portion, and other	3,575	11,298
Total liabilities	17,964	29,373
Commitments and contingencies		
Non-Controlling Interest	—	13,659
Public Common Stock subject to redemption	—	3,405
Stockholders' equity:		
Preferred stock, $.01 par value, 2,500,000 shares authorized; none issued or outstanding	—	—
Common stock, $.01 par value, 7,500,000 shares authorized, none issued or outstanding	—	—
Public common stock, $.01 par value, 7,500,000 shares authorized, 5,372,336 and 5,845,931 shares issued and outstanding, respectively	54	58
Additional paid-in capital	218,544	217,588
Accumulated other comprehensive income	296	580
Accumulated deficit	(170,032)	(171,110)
Total stockholders' equity	48,862	47,116
Total liabilities and stockholders' equity	$ 66,826	$ 93,553

See accompanying notes to consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	Year Ended December 31,		
	2011	**2012**	**2013**
Revenue:			
Core companion animal health	$ 57,481	$ 61,502	$ 66,404
Other vaccines, pharmaceuticals and products	12,584	11,303	11,935
Total revenue, net	70,065	72,805	78,339
Cost of revenue	40,878	41,704	47,707
Gross profit	29,187	31,101	30,632
Operating expenses:			
Selling and marketing	15,167	18,339	19,428
Research and development	1,650	958	1,500
General and administrative	9,121	9,646	11,134
Total operating expenses	25,938	28,943	32,062
Operating income (loss)	3,249	2,158	(1,430)
Interest and other (income) expense, net	(117)	135	(37)
Income (loss) before income taxes	3,366	2,023	(1,393)
Income tax expense:			
Current income tax expense	165	214	183
Deferred income tax expense (benefit)	1,056	606	(637)
Total income tax expense (benefit)	1,221	820	(454)
Net income (loss)	$ 2,145	$ 1,203	$ (939)
Net income (loss) attributable to non-controlling interest	—	—	257
Net income (loss) attributable to Heska Corporation	2,145	1,203	(1,196)
Basic net income (loss) per share attributable to Heska Corporation	$ 0.41	$ 0.23	$ (0.21)
Diluted net income (loss) per share attributable to Heska Corporation	$ 0.40	$ 0.22	$ (0.21)
Weighted average outstanding shares used to compute basic net income (loss) per share attributable to Heska Corporation	5,237	5,326	5,755
Weighted average outstanding shares used to compute diluted net income (loss) per share attributable to Heska Corporation	5,338	5,489	5,755

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2011	2012	2013
Net income (loss)	$ 2,145	$ 1,203	$ (939)
Other comprehensive income (expense):			
Minimum pension liability	(20)	(20)	182
Unrealized gain (loss) on available for sale investments	(8)	—	30
Foreign currency translation	(14)	74	72
Comprehensive income (loss)	$ 2,103	$ 1,257	$ (655)
Comprehensive income (loss) attributable to non-controlling interest	$ —	$ —	$ 257
Comprehensive income (loss) attributable to Heska Corporation	$ 2,103	$ 1,257	$ (912)

See accompanying notes to consolidated financial statements.

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

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balances, January 1, 2011	5,231	$ 52	$ 217,240	$ 284	$ (171,778)	$ 45,798
Net income (loss)	—	—	—	—	2,145	2,145
Issuance of common stock related to options, ESPP and other	19	—	124	—	—	124
Recognition of stock based compensation	—	—	414	—	—	414
Minimum pension liability adjustments	—	—	—	(20)	—	(20)
Unrealized gain (loss) on available for sale investments	—	—	—	(8)	—	(8)
Foreign currency translation adjustments	—	—	—	(14)	—	(14)
Balances, December 31, 2011	5,250	52	217,778	242	(169,633)	48,439
Net income	—	—	—	—	1,203	1,203
Issuance of common stock related to options, ESPP and other	122	2	388	—	—	390
Recognition of stock based compensation	—	—	378	—	—	378
Dividends paid	—	—	—	—	(1,602)	(1,602)
Minimum pension liability adjustments	—	—	—	(20)	—	(20)
Foreign currency translation adjustments	—	—	—	74	—	74
Balances, December 31, 2012	5,372	54	218,544	296	(170,032)	48,862
Net income (loss)	—	—	—	—	(939)	(939)
Issuance of common stock related to options, ESPP and other	55	—	323	—	—	323
Recognition of stock based compensation	—	—	423	—	—	423
Stock issued for Heska Imaging	419	4	3,571	—	—	3,575
Stock issued for Heska Imaging Mark to Market	—	—	(3,405)	—	—	(3,405)
Accretion of non-controlling interest	—	—	(1,868)	—	—	(1,868)
Accrued distribution for Heska Imaging minority	—	—	—	—	(139)	(139)
Minimum pension liability adjustments	—	—	—	182	—	182
Unrealized gain on available for sale investments	—	—	—	30	—	30
Foreign currency translation adjustments	—	—	—	72	—	72
Balances, December 31, 2013	5,846	$ 58	$ 217,588	$ 580	$ (171,110)	$ 47,116

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31, 2011	2012	2013
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES:			
Net income (loss)	$ 2,145	$ 1,203	$ (939)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:			
Depreciation and amortization	2,052	1,699	2,497
Deferred tax (benefit) expense	1,056	606	(637)
Stock based compensation	414	378	423
Unrealized (gain) loss on foreign currency translation	10	46	20
Changes in operating assets and liabilities:			
Accounts receivable	929	(3,099)	(159)
Inventories	(850)	(1,405)	(1,687)
Other current assets	(93)	(1,551)	(642)
Accounts payable	(164)	1,298	(2,276)
Accrued liabilities and other	(259)	741	(130)
Other non-current assets	—	—	(179)
Deferred revenue and other	(352)	(285)	2,312
Net cash provided by (used in) operating activities	4,888	(369)	(1,397)
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:			
Investment in subsidiary	—	—	(3,019)
Purchases of property and equipment	(1,084)	(1,509)	(1,930)
Proceeds from disposition of property and equipment	—	—	5,020
Net cash provided by (used in) investing activities	(1,084)	(1,509)	71
CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES:			
Proceeds from issuance of common stock	124	390	323
Proceeds from (repayments of) line of credit borrowings, net	(3,079)	2,552	2,246
Proceeds from (repayments of) other debt	—	—	(1,025)
Dividends paid to stockholders	—	(1,602)	—
Net cash provided by (used in) financing activities	(2,955)	1,340	1,544
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(9)	(10)	14
INCREASE IN CASH AND CASH EQUIVALENTS	840	(548)	232
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	5,492	6,332	5,784
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 6,332	$ 5,784	$ 6,016
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid for interest	$ 28	$ 77	$ 78
Cash paid for income taxes	$ 214	$ 153	$ 84
Non-cash transfer of inventory to property and equipment and other long-term assets	$ 351	$ 1,327	$ 3,950
Prepaid applied to acquisition of Heska Imaging	$ —	$ —	$ 1,000
Issuance of stock for investment in subsidiary	$ —	$ —	$ 3,571
Accretion of non-controlling interest	$ —	$ —	$ 1,867

See accompanying notes to consolidated financial statements.

HESKA CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BUSINESS

Heska Corporation ("Heska" or the "Company") develops, manufactures, markets, sells and supports veterinary products. Heska's core focus is on the canine and feline companion animal health markets.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and its majority-owned subsidiaries since their respective dates of acquisitions. All material intercompany transactions and balances have been eliminated in consolidation. Where the Company's ownership of a subsidiary is less than 100%, the non-controlling interest is reported on the Company's consolidated balance sheets. The non-controlling interest in the Company's consolidated net income is reported as "Net income (loss) attributable to non-controlling interest" on the Company's consolidated statements of operations.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates are required when establishing the allowance for doubtful accounts and the provision for excess/obsolete inventory, in determining the period over which the Company's obligations are fulfilled under agreements to license product rights and/or technology rights, evaluating long-lived and intangible assets for impairment, determining the allocation of purchase price under purchase accounting, estimating the expense associated with the granting of stock options and in determining the need for, and the amount of, a valuation allowance on deferred tax assets.

Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on historical write-off experience. The Company reviews its allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectability. Account balances are charged against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its customers.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to a concentration of credit risk consist of cash and cash equivalents and accounts receivable. The Company maintains the majority of its cash and cash equivalents with financial institutions that management believes are creditworthy in the form of demand deposits. The Company has no significant off-balance-sheet concentrations of credit risk such as foreign exchange contracts, options contracts or other foreign currency hedging arrangements. Its accounts receivable balances are due primarily from domestic veterinary clinics and individual veterinarians, and both domestic and international corporations.

Cash and Cash Equivalents

Cash and cash equivalents are stated at cost, which approximates market, and include short-term, highly liquid investments with original maturities of less than three months. The Company valued its Euro and Japanese Yen cash accounts at the spot market foreign exchange rate as of each balance sheet date, with changes due to foreign exchange fluctuations recorded in current earnings. The Company held 332,888 and 321,411 Euros at December 31, 2012 and 2013, respectively. The Company held 3,406,393 and 1,252,220 Yen at December 31, 2012 and 2013, respectively. The Company held 65,472 and 209,486 Swiss Francs at December 31, 2012 and 2013, respectively. The majority of the Company's cash and cash equivalents are held at U.S.-based or Swiss-based financial institutions in accounts not insured by governmental entities.

Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, short-term trade receivables and payables and the Company's revolving line of credit. The carrying values of cash and cash equivalents and short-term trade receivables and payables approximate fair value. The fair value of the Company's line of credit balance is estimated based on current rates available for similar debt with similar maturities and collateral, and at December 31, 2012 and 2013, approximates the carrying value due primarily to the floating rate of interest on such debt instruments.

Inventories

Inventories are stated at the lower of cost or market using the first-in, first-out method. Inventory manufactured by the Company includes the cost of material, labor and overhead. If the cost of inventories exceeds estimated fair value, provisions are made to reduce the carrying value to estimated fair value.

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

	December 31,	
	2012	**2013**
Raw materials	$ 5,275	$ 5,787
Work in process	3,342	2,920
Finished goods	4,671	4,784
Allowance for excess or obsolete inventory	(805)	(1,804)
	$ 12,483	$ 11,687

Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful lives of the related assets. Leasehold improvements are amortized over the applicable lease period or their estimated useful lives, whichever is shorter. Maintenance and repairs are charged to expense when incurred, and major renewals and improvements are capitalized.

Property and equipment consist of the following (in thousands):

	Estimated Useful Life	December 31, 2012	December 31, 2013
Land	N/A	$ 377	$ 377
Building	10 to 20 years	2,678	2,868
Machinery and equipment	3 to 15 years	30,346	36,107
Leasehold and building improvements	7 to 15 years	5,429	5,838
Construction in progress		1,091	753
		39,921	45,943
Less accumulated depreciation and amortization		(33,916)	(36,015)
		$ 6,005	$ 9,928

From time to time, the Company utilizes marketing programs whereby its instruments in inventory may be placed in a customer's location on a rental basis. The cost of these instruments is transferred to machinery and equipment or other long-term assets and depreciated, typically over a five to seven year period depending on the circumstance under which the instrument is placed with the customer. During 2011, 2012 and 2013, total costs transferred from inventory were approximately $351 thousand, $1.3 million and $3.9 million, respectively.

Depreciation and amortization expense for property and equipment was $2.1 million, $1.7 million and $2.5 million for the years ended December 31, 2011, 2012 and 2013, respectively.

Capitalized Software

The Company capitalizes third-party software costs, where appropriate, and reports such capitalized costs, net of accumulated amortization, on the "property and equipment" line of its consolidated balance sheets. The Company had $83 thousand and $791 thousand of such capitalized costs, net of accumulated amortization, on the "property and equipment" line of its consolidated balance sheets as of December 31, 2012 and December 31, 2013, respectively. Capitalized software costs in a given year are reported on the "purchases of property and equipment" line item of the Company's consolidated statements of cash flows. The Company had $121 thousand, $11 thousand and $809 thousand of capitalized software costs reported on the "purchases of property and equipment" line item of its consolidated statements of cash flows for the years ended December 31, 2011, 2012 and 2013, respectively.

Realizability of Long-Lived Assets

The Company continually evaluates whether events and circumstances have occurred that indicate the remaining estimated useful life of long-lived assets may warrant revision, or that the remaining balance of these assets may not be recoverable. When deemed necessary, the Company completes this evaluation by comparing the carrying amount of the assets with the estimated undiscounted future cash flows associated with them. If such evaluations indicate that the future undiscounted cash flows of amortizable long-lived assets are not sufficient to recover the carrying value of such assets, the assets are adjusted to their estimated fair values.

Goodwill

Goodwill is subject to an annual assessment for impairment or sooner if there is an indication of impairment. Impairment is indicated when the carrying amount of the related reporting unit is greater than its estimated fair value.

The Company's recorded goodwill relates to the February 2013 acquisition of a majority interest in Cuattro Veterinary USA, LLC and the 1997 acquisition of Heska AG, the Company's Swiss subsidiary. This goodwill is reviewed at least annually for impairment. This impairment assessment is completed at the reporting unit level. The Company completed its annual analysis of the Company's Swiss subsidiary estimating that the fair value of the reporting unit exceeds the carrying value of the reporting unit including goodwill at December 31, 2013 and determined there was no indicated impairment. The key inputs to the estimated fair value included estimates of future profitability for the reporting unit as well as discount rate and operating income terminal multiple. The Company determined there is no indication of impairment for goodwill related to the acquisition of Cuattro Veterinary USA, LLC at December 31, 2013. As this acquisition closed in February 2013, annual goodwill assessment is required to begin in 2014. At December 31, 2012 and 2013, goodwill was approximately $1.0 million and $21.0 million, respectively, and was included in the assets of the Core Companion Animal Health segment. There can be no assurance that future goodwill impairments will not occur if projected financial results are not met, or otherwise.

Revenue Recognition

The Company generates its revenues through sale of products and services, licensing and sale of product and technology rights, and research and development services. Revenue is accounted for in accordance with the guidelines provided by SEC Codification of Staff Accounting Bulletins, Topic 13: Revenue Recognition. The Company's policy is to recognize revenue when the applicable revenue recognition criteria have been met, which generally include the following:

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

Revenue from the sale of products is generally recognized after both the goods are shipped to the customer and acceptance has been received, if required, with an appropriate provision for estimated returns and other allowances. The terms of the customer arrangements generally pass title and risk of ownership to the customer at the time of shipment. Certain customer arrangements provide for acceptance provisions. Revenue for these arrangements is not recognized until the acceptance has been received or the acceptance period has lapsed. The Company maintains an allowance for sales returns based upon its customer policies and historical experience. Shipping and handling costs charged to customers are included as revenue, and the related costs are recorded as a component of cost of products sold.

In addition to its direct sales force, the Company utilizes distributors to sell its products. Distributors purchase goods from the Company, take title to those goods and resell them to their customers in the distributors' territory.

Upfront payments received by the Company under arrangements for product, patent or technology rights in which the Company retains an interest in the underlying product, patent or technology are initially deferred, and revenue is subsequently recognized over the estimated life of the agreement, product, patent or technology. Similarly, upfront payments received by the Company under agreements where the Company is obligated to maintain a product or technology sold to a third party and/or transfer know-how or technology to a third party are initially deferred and revenue is subsequently recognized over the estimated life of the agreement. The Company received upfront payments totaling $0, $0 and $7 million in 2011, 2012 and 2013, respectively. Revenue from royalties is recognized as the Company is informed of sales on which it is entitled to royalties.

For multiple-element arrangements that are not subject to a higher level of authoritative literature, the Company follows the authoritative guidance for accounting for revenue arrangements with multiple deliverables in determining the separate units of accounting. For those arrangements subject to appropriate separation criteria, the Company must determine whether the various elements meet the criteria to be accounted for as separate elements. If the elements cannot be separated, revenue is recognized once revenue recognition criteria for the entire arrangement have been met or over the period that the Company's obligations to the customer are fulfilled, as appropriate. If the elements are determined to be separable, the revenue is allocated to the separate elements based on relative fair value and recognized separately for each element when the applicable revenue recognition criteria have been met, subject to revenue deferred estimated to be sufficient to cover the cost of servicing such revenue. In accounting for these multiple element arrangements, the Company must make determinations about whether elements can be accounted for separately and make estimates regarding their relative fair values.

Cost of Products Sold

Royalties payable in connection with certain licensing agreements (see Note 9) are reflected in cost of products sold as incurred.

Stock-Based Compensation

During the years ended December 31, 2011, 2012 and 2013, the Company's income from operations and income before income taxes were reduced by $414 thousand, $378 thousand and $423 thousand, respectively, and net income was reduced by $348 thousand, $219 thousand and $380 thousand, respectively, for compensation related to stock options issued and shares issued under our employee stock purchase plan. Basic and diluted earnings per share were reduced by $0.07 and $0.07 in 2011, $0.04 and $0.04 in 2012 and $0.07 and $0.07 in 2013. For all years presented, there was no material impact on cash flow from operations and cash flow from financing activities. At December 31, 2013, the Company had two stock-based compensation plans. See Note 7 for a description of these plans and additional disclosures regarding the plans.

Advertising Costs

The Company expenses advertising costs as incurred. Advertising expenses were $621 thousand, $701 thousand and $386 thousand for the years ended December 31, 2011, 2012 and 2013, respectively.

Income Taxes

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

Basic and Diluted Net Income (Loss) Per Share

Basic net income (loss) per common share is computed using the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed using the sum of the weighted average number of shares of common stock outstanding, and, if not anti-dilutive, the effect of outstanding common stock equivalents (such as stock options and warrants) determined using the treasury stock method.

For the twelve months ended December 31, 2011 and 2012, the Company reported net income attributable to Heska Corporation and therefore, dilutive common stock equivalent securities, as computed using the treasury method (but excluding options to purchase fractional shares resulting from the Company's December 2010 1-for-10 reverse stock split), were added to basic weighted average shares outstanding for the period to derive the weighted average shares for diluted earnings per share calculation. Common stock equivalent securities other than options to purchase fractional shares that were anti-dilutive for the twelve months ended December 31, 2011 and 2012, and therefore excluded, were outstanding options to purchase 1,029,151 and 643,094 shares of common stock, respectively. These securities are anti-dilutive primarily due to exercise prices greater than the average trading price of the Company's common stock during the twelve months ended December 31, 2011 and 2012.

For the twelve months ended December 31, 2013, the Company reported a net loss attributable to Heska Corporation and therefore all common stock equivalent securities would be anti-dilutive and were not included in the diluted earnings per share calculation for the period. Common stock equivalent securities other than options to purchase fractional shares that were anti-dilutive for the twelve months ended December 31, 2013, and therefore excluded, were outstanding options to purchase 1,321,232 shares of common stock.

Comprehensive Income (Loss)

Comprehensive income (loss) includes net income adjusted for the results of certain stockholders' equity changes. Such changes include foreign currency items and minimum pension liability adjustments. At December 31, 2011, Accumulated Other Comprehensive Income (Loss) consists of $838 thousand gain for cumulative translation adjustments, $609 thousand loss for unrealized pension liability and $13 thousand of unrealized gain on available for sale investments. At December 31, 2012, Accumulated Other Comprehensive Income (Loss) consists of $912 thousand gain for cumulative translation adjustments, $629 thousand loss for unrealized pension liability and $13 thousand of unrealized gain on available for sale investments. At December 31, 2013, Accumulated Other Comprehensive Income (Loss) consists of $984 thousand gain for cumulative translation adjustments, $447 thousand loss for unrealized pension liability and $43 thousand of unrealized gain on available for sale investments.

Foreign Currency Translation

The functional currency of the Company's Swiss subsidiary is the Swiss Franc. Assets and liabilities of the Company's Swiss subsidiary are translated using the exchange rate in effect at the balance sheet date. Revenue and expense accounts and cash flows are translated using an average of exchange rates in effect during the period. Cumulative translation gains and losses are shown in the consolidated balance sheets as a separate component of stockholders' equity. Exchange gains and losses arising from transactions denominated in foreign currencies (i.e., transaction gains and losses) are recognized as a component of other income (expense) in current operations, as are exchange gains and losses on intercompany transactions expected to be settled in the near term.

Recent Accounting Pronouncements

Management has evaluated recent accounting pronouncements and determined none would have a material impact on the Company's financial statements.

3. ACQUISITION AND RELATED PARTY ITEMS

On February 24, 2013, the Company acquired a 54.6% interest in Cuattro Veterinary USA, LLC ("Cuattro Vet USA") for approximately $7.6 million in cash and stock, including more than $4 million in cash and over 400 thousand shares of Heska stock (the "Acquisition"). Immediately following and as a result of the transaction, former Cuattro Vet USA unit holders owned approximately 7.2% of the Company's Public Common Stock. The remaining minority position (45.4%) in Cuattro Vet USA is subject to purchase by Heska under performance-based puts and calls following calendar year 2015, 2016 and 2017. Should Heska undergo a change in control, as defined, prior to the end of 2017, Cuattro Vet USA minority unit holders will be entitled to sell their Cuattro Vet USA units to Heska at the highest call value they could have otherwise obtained. The Company's position in Cuattro Vet USA is subject to premium repurchase or discounted sale under calls and puts expiring 18 months following the closing of the transaction.

The Company accounted for the acquisition pursuant to ASC No. 805, "Business Combinations." Accordingly, it recorded assets acquired, liabilities assumed and non-controlling interests at their estimated fair values. The intangible assets and non-controlling interest were valued based on a report from an independent third party. The following summarizes the aggregate consideration paid by the Company and the allocation of the purchase price based on current estimates as the Company continues to gather information to evaluate the appropriate accounting result (in thousands):

Consideration		
Cash	$	4,073
Stock		3,571
Total	$	7,644
Inventories	$	1,466
Note from Cuattro Veterinary, LLC, due March 15, 2016		1,360
Other tangible assets		1,278
Intangible assets		688
Goodwill		19,994
Notes payable and other borrowings		(1,527)
Accounts payable		(1,424)
Other assumed liabilities		(2,399)
Total Net Assets Acquired	$	19,436
Non-controlling interest		(11,792)
Total	$	7,644

Intangible assets and their amortization periods are as follows:

	Useful Life (in years)	Fair Value
Trade name	2.75	$ 688
		$ 688

The Company believes goodwill is a function of several factors. Cuattro Vet USA had assembled a workforce highly knowledgeable in the veterinary imaging area. These individuals had acquired the training necessary to identify opportunities for the Cuattro Vet USA to sell products, including training related to which components from existing systems could be utilized within the Cuattro Vet USA's solution to minimize the out-of-pocket cost to the customer. Cuattro Vet USA had demonstrated an ability to combine disparate assets including but not limited to digital radiography detectors, positioning aides such as tunnels and tables, viewing computers and other accessories along with embedded software and support, data hosting and other services to provide customers with a simple, efficient and convenient experience in utilizing advanced data imaging technology far in excess of what a typical customer could have created individually with similar but separately purchased assets and services. The Company anticipated bundling and cross promotion programs, including potentially in one customer contract, could enhance the revenue of both the Company and Cuattro Vet USA following the Acquisition. The ability of Cuattro Vet USA to generate estimated future cash flows due to these factors supports the goodwill calculated at the closing of the Acquisition and the current carrying value of the goodwill on the Company's consolidated balance sheets. The Company estimates it had approximately $6.9 million in tax deductible goodwill from the Acquisition at the closing of the Acquisition.

Cuattro Vet USA was subsequently renamed Heska Imaging US, LLC ("Heska Imaging") and markets, sells and supports digital radiography and ultrasound products along with embedded software and support, data hosting and other services.

Shawna M. Wilson, Clint Roth, DVM, Steven M. Asakowicz, Rodney A. Lippincott, Kevin S. Wilson and Cuattro, LLC own approximately 29.75%, 8.39%, 4.09%, 3.07%, 0.05% and 0.05% of Heska Imaging, respectively. Kevin S. Wilson is the President and Chief Operating Officer of the Company and the spouse of Shawna M. Wilson. Steven M. Asakowicz serves as Executive Vice President, Companion Animal Health Sales for the Company. Rodney A. Lippincott serves as Executive Vice President, Companion Animal Health Sales for the Company. Mr. Wilson, Mrs. Wilson and trusts for their children and family own a 100% interest in Cuattro, LLC. Cuattro, LLC owns a 100% interest in Cuattro Software, LLC. Mr. Wilson, Mrs. Wilson and trusts for their children and family own a majority interest in Cuattro Veterinary, LLC and Cuattro Medical, LLC.

Since the Acquisition closed, Cuattro, LLC charged Heska Imaging $6.8 million, primarily related to digital imaging products, for which there is an underlying supply contract with minimum purchase obligations, software and services as well as other operating expenses; Heska Corporation charged Heska Imaging $2.2 million, primarily related to sales expenses; Heska Corporation net charged Cuattro, LLC $140 thousand, primarily related to facility usage and other services.

At December 31, 2013, Heska Imaging had a $1.4 million note receivable, including accrued interest, from Cuattro Veterinary, LLC, which is due on March 15, 2016 and which is listed as "Note receivable – related party" on the Company's consolidated balance sheets; Heska Imaging has accounts receivable from Cuattro Software, LLC of $892 thousand, which is included in "Due from - related party" on the Company's consolidated balance sheets; Heska Corporation had net accounts receivable from Cuattro, LLC of $110 thousand which is included in "Due from - related party" on the Company's consolidated balance sheets; Heska Imaging had net accounts receivable from Cuattro, LLC of $198 thousand which is included in "Due from - related party" on the Company's consolidated balance sheets; Heska Corporation had accounts receivable from Heska Imaging of $3.3 million, including accrued interest, which eliminated in consolidation of the Company's financial statements; all monies owed accrue interest at the same interest rate Heska Corporation pays under its credit and security agreement with Wells Fargo Bank, National Association ("Wells Fargo") once past due with the exception of the note receivable, which accrues at this rate to its maturity date.

The aggregate position in Heska Imaging of the unit holders who hold the 45.4% of Heska Imaging that Heska Corporation does not own (the "Put Value") is being accreted to its estimated redemption value in accordance with Heska Imaging's Operating Agreement. Since the Operating Agreement contains certain put rights that are out of the control of the Company, authoritative guidance requires the non-controlling interest, which includes the estimated value of such put rights, to be displayed outside of the equity section of the consolidated balance sheets. The adjustment to increase or decrease the Put Value to its expected redemption value and to estimate any distributions required under Heska Imaging's Operating Agreement to the unit holders who hold the 45.4% of Heska Imaging that Heska Corporation does not own (the "Imaging Minority") each reporting period is recorded to stockholders' equity in accordance with United States Generally Accepted Accounting Principles.

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

Beginning balance at closing date of February 24, 2013	$	11,792
Accretion of Put Value	$	1,867
Balance at December 31, 2013	$	13,659

In addition, the Company recorded an estimated distribution to the Imaging Minority the Company believes is contractually required under Heska Imaging's Operating Agreement of $139 thousand, which effected the Company's accumulated deficit and accrued liabilities at December 31, 2013.

Cuattro Vet USA generated net revenue of $12.7 million and net income of $566 thousand, inclusive of net income of $257 thousand attributable to non-controlling interest, for the period from February 24, 2013 to December 31, 2013. The following unaudited pro forma financial information presents the combined results of the Company and Cuattro Vet USA, in thousands, as if the Acquisition had closed on January 1, 2012.

	Year Ended December 31,			
	2012		2013	
Revenue, net	$	83,122	$	79,239
Net income (loss) attributable to Heska Corporation		1,132		(1,948)
Basic earnings (loss) per share attributable to Heska Corporation	$	0.20	$	(0.34)
Diluted earnings (loss) per share attributable to Heska Corporation		0.19		(0.34)

4. CREDIT FACILITY AND LONG-TERM DEBT

The Company has a credit and security agreement with Wells Fargo Bank, National Association which expires December 31, 2015. The agreement includes a $15.0 million asset-based revolving line of credit with a stated interest rate at December 31, 2013 of LIBOR plus 3.75% (4.00%). There is an annual minimum interest charge of $100 thousand under the agreement. Amounts due under the credit facility are secured by a first security interest in essentially all of the Company's assets excluding assets securing the term debt referenced below, which is an obligation of Heska Imaging and which was outstanding when the Company acquired a majority interest in Heska Imaging. Under the agreement, the Company is required to comply with certain financial and non-financial covenants. Among the financial covenants are requirements for minimum capital monthly, minimum net income quarterly and capital expenditures monthly. The amount available for borrowings under the line of credit varies based upon available cash, eligible accounts receivable and eligible inventory. As of December 31, 2013, there was $4.8 million of borrowings outstanding and there was approximately $3.8 million available capacity for borrowings under the line of credit agreement.

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

	December 31, 2012	December 31, 2013
Term loan with a financial entity, secured by demo equipment, due in monthly installments beginning July 2012 with the balance paid in full in June 2017 and a stated interest rate of 6.0%.	$ —	$ 501
Less current portion of long-term debt	—	132
Long-term debt, net of current portion	$ —	$ 369

Maturities of long-term debt as of December 31, 2013 were as follows (in thousands):

Year Ending December 31,	
2014	$ 132
2015	141
2016	149
2017	78
	$ 501

5. SUPPLEMENTAL DISCLOSURE OF INTEREST AND OTHER EXPENSE (INCOME) INFORMATION

	Year Ended December 31, 2011	2012	2013
		(in thousands)	
Interest and other expense (income):			
Interest income	$ (268)	$ (95)	$ (127)
Interest expense	124	117	74
Other, net	27	113	16
	$ (117)	$ 135	$ (37)

6. INCOME TAXES

As of December 31, 2013, the Company had a domestic net operating loss carryforward ("NOL"), of approximately $109.0 million, a domestic alternative minimum tax credit of approximately $297 thousand and a domestic research and development tax credit carryforward of approximately $598 thousand for federal tax purposes. The Company's federal NOL is expected to expire as follows if unused: $103.1 million in 2018 through 2022, $5.5 million in 2024 and 2025 and $385 thousand in 2027. The NOL and tax credit carryforwards are subject to alternative minimum tax limitations and to examination by the tax authorities. In addition, the Company had a "change of ownership" as defined under the provisions of Section 382 of the Internal Revenue Code of 1986, as amended (an "Ownership Change"). The Company does not believe this Ownership Change will place a significant restriction on its ability to utilize its NOL in the future. The Company has established a valuation allowance against those NOL's for which it is more likely than not that they will expire unutilized. There can be no assurance that valuation allowance adjustments will not occur if projected financial results are not met, or otherwise. On September 13, 2013, the IRS released the final tangible property regulations under section 162 and 263, which generally apply to taxable years beginning on or after January 1, 2014. The company has reviewed the final regulations, and does not anticipate any material financial statement impact resulting from these final regulations.

The Company is subject to income taxes in the U.S. federal jurisdiction, and various foreign, state and local jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. In the United States, the tax years 2010 – 2012 remain open to examination by the federal Internal Revenue Service and the tax years 2009 – 2012 remain open for various state taxing authorities.

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

	Year Ended December 31,		
	2011	2012	2013
Domestic	$ 3,189	$ 1,869	$ (1,508)
Foreign	177	154	115
	$ 3,366	$ 2,023	$ (1,393)

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

	December 31,	
	2012	2013
Current deferred tax assets:		
Inventory	$ 323	$ 692
Accrued compensation	251	131
Net operating loss carryforwards – domestic	45	1,589
Stock Options	463	443
Other	789	695
	1,871	3,550
Valuation allowance	(741)	(1,394)
Total current deferred tax assets	$ 1,130	$ 2,156
Noncurrent deferred tax assets:		
Research and development tax credit	$ 526	$ 598
Alternative minimum tax credit	233	297
Deferred revenue	1,884	3,978
Property and equipment	2,059	2,006
Net operating loss carryforwards – domestic	39,541	36,445
Other	—	60
	44,243	43,384
Valuation allowance	(17,497)	(17,026)
Total noncurrent deferred tax assets	$ 26,746	$ 26,358

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

	Year Ended December 31,		
	2011	2012	2013
Current income tax expense (benefit):			
Federal	$ 37	$ 41	$ 95
State	90	140	62
Foreign	38	33	26
Total current expense (benefit)	165	214	183
Deferred income tax expense (benefit):			
Federal	977	560	(583)
State	79	46	(54)
Foreign	—	—	—
Total deferred expense (benefit)	1,056	606	(637)
Total income tax expense (benefit)	$ 1,221	$ 820	$ (454)

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

	Year Ended December 31,		
	2011	2012	2013
Statutory federal tax rate	34 %	34 %	34 %
State income taxes, net of federal benefit	3 %	4 %	3 %
Non-controlling interest in Heska Imaging US, LLC	—	—	6 %
Other permanent differences	3 %	6 %	(10) %
Change in tax rate	(4) %	(1) %	— %
Foreign rate difference	(1) %	(1) %	(1) %
Change in valuation allowance	(137) %	(638) %	(13) %
Other	138 %	637 %	13 %
Effective income tax rate	36 %	41 %	33 %

ASC 740 provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in the financial statements. Tax positions must meet a "more-likely-than-not" recognition threshold before a benefit is recognized in the financial statements. As of December 31, 2013, the Company has not recorded a liability for uncertain tax positions. The Company would recognize interest and penalties related to uncertain tax positions in income tax (benefit)/expense. No interest and penalties related to uncertain tax positions were accrued at December 31, 2013.

7. CAPITAL STOCK

Stock Option Plans

The Company has two stock option plans which authorize granting of stock options and stock purchase rights to employees, officers, directors and consultants of the Company to purchase shares of common stock. In 1997, the board of directors adopted the 1997 Stock Incentive Plan (the "1997 Plan") and terminated two prior option plans. All shares that remained available for grant under the terminated plans were incorporated into the 1997 Plan, including shares subsequently cancelled under prior plans. In May 2012, the stockholders approved an amendment to the 1997 Plan allowing for an increase of 250,000 shares and an annual increase through 2016 based on the number of non-employee directors serving as of the Company's Annual Meeting of Stockholders, subject to a maximum of 45,000 shares per year. In May 2003, the stockholders approved a new plan, the 2003 Equity Incentive Plan, which allows for the granting of options for up to 239,050 shares of the Company's common stock. The number of shares reserved for issuance under both plans as of January 1, 2014 was 276,507.

The stock options granted by the board of directors may be either incentive stock options ("ISOs") or non-qualified stock options ("NQs"). The exercise price for options under all of the plans may be no less than 100% of the fair value of the underlying common stock for ISOs or 85% of fair value for NQs. Options granted will expire no later than the tenth anniversary subsequent to the date of grant or three months following termination of employment, except in cases of death or disability, in which case the options will remain exercisable for up to twelve months. Under the terms of the 1997 Plan, in the event the Company is sold or merged, outstanding options will either be assumed by the surviving corporation or vest immediately.

There are four key inputs to the Black-Scholes model which the Company uses to estimate fair value for options which it issues: expected term, expected volatility, risk-free interest rate and expected dividends, all of which require the Company to make estimates. The Company's estimates for these inputs may not be indicative of actual future performance and changes to any of these inputs can have a material impact on the resulting estimated fair value calculated for the option. The Company's expected term input was estimated based on the Company's historical experience for time from option grant to option exercise for all employees in 2011, 2012 and 2013; the Company treated all employees in one grouping in all three years. The Company's expected volatility input was estimated based on the Company's historical stock price volatility in 2011, 2012 and 2013. The Company's risk-free interest rate input was determined based on the U.S. Treasury yield curve at the time of option issuance in 2011, 2012 and 2013. The Company's expected dividends input were zero in 2011, 4.3% in 2012 and zero in 2013. Weighted average assumptions used in 2011, 2012 and 2013 for each of these four key inputs are listed in the following table:

	2011	**2012**	**2013**
Risk-free interest rate	0.64%	0.38%	0.75%
Expected lives	3.0 years	3.0 years	3.4 years
Expected volatility	70%	57%	46%
Expected dividend yield	0%	4.3%	0%

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

	Year Ended December 31,					
	2011		**2012**		**2013**	
	Options	**Weighted Average Exercise Price**	**Options**	**Weighted Average Exercise Price**	**Options**	**Weighted Average Exercise Price**
Outstanding at beginning of period	1,341,876	$ 11.003	1,448,675	$ 10.425	1,245,161	$ 11.054
Granted at Market	187,750	$ 6.962	137,950	$ 9.534	275,654	$ 7.532
Cancelled	(73,871)	$ 12.684	(118,330)	$ 11.373	(166,286)	$ 11.437
Exercised	(7,080)	$ 4.564	(223,134)	$ 5.863	(33,297)	$ 6.488
Outstanding at end of period	1,448,675	$ 10.425	1,245,161	$ 11.054	1,321,232	$ 10.386
Exercisable at end of period	1,175,731	$ 11.427	971,029	$ 12.129	939,458	$ 11.556

The total estimated fair value of stock options granted during the years ended December 31, 2011, 2012 and 2013 were computed to be approximately $602 thousand, $402 thousand and $701 thousand, respectively. The amounts are amortized ratably over the vesting periods of the options. The weighted average estimated fair value of options granted during the years ended December 31, 2011, 2012 and 2013 was computed to be approximately $3.21, $2.92 and $2.54, respectively. The total intrinsic value of options exercised during the years ended December 31, 2011, 2012 and 2013 was $10 thousand, $1.1 million and

$42 thousand, respectively. The cash proceeds from options exercised during the years ended December 31, 2011, 2012 and 2013 was $32 thousand, $263 thousand and $161 thousand.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2013, excluding outstanding options to purchase an aggregate of 74.1 fractional shares resulting from the Company's December 2010 1-for-10 reverse stock split with a weighted average remaining contractual life of 1.24 years, a weighted average exercise price of $13.72 and exercise prices ranging from $4.40 to $30.20. The Company intends to issue whole shares only from option exercises.

	Options Outstanding			Options Exercisable	
Exercise Prices	Number of Options Outstanding at December 31, 2013	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Number of Options Exercisable at December 31, 2013	Weighted Average Exercise Price
$ 2.70 - $ 6.76	231,048	5.38	$ 5.030	203,010	$ 4.974
$ 6.77 - $ 7.36	302,667	8.69	$ 7.214	55,838	$ 6.941
$ 7.37 - $ 8.76	203,314	7.47	$ 8.446	104,266	$ 8.408
$ 8.77 - $12.50	293,193	2.43	$ 10.764	285,334	$ 10.789
$12.51 - $30.20	291,010	1.80	$ 18.912	291,010	$ 18.912
$ 2.70 - $30.20	1,321,232	5.02	$ 10.386	939,458	$ 11.556

As of December 31, 2013, there was $935 thousand of total unrecognized compensation expense related to outstanding stock options. That cost is expected to be recognized over a weighted-average period of 2.2 years with all cost to be recognized by the end of November 2017, assuming all options vest according to the vesting schedules in place at December 31, 2013. As of December 31, 2013, the aggregate intrinsic value of outstanding options was $1.4 million and the aggregate intrinsic value of exercisable options was $892 thousand.

Employee Stock Purchase Plan (the "ESPP")

Under the 1997 Employee Stock Purchase Plan, the Company is authorized to issue up to 375,000 shares of common stock to its employees, of which 344,322 had been issued as of December 31, 2013. Employees of the Company who are expected to work at least 20 hours per week and five months per year are eligible to participate. Under the terms of the plan, employees can choose to have up to 10% of their annual base earnings withheld to purchase the Company's common stock. During the period from January 1, 2011 to June 30, 2013, the Company's ESPP had a five-year offering period and six-month accumulation periods ending on each June 30 and December 31. The purchase price of stock on June 30 and December 31 was 85% of the fair market value at purchase.

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

Since July 1, 2013, the Company has estimated the fair values of stock purchase rights granted under the ESPP in 2013 using the Black-Scholes pricing model and the following weighted average assumptions:

	2013
Risk-free interest rate	0.21%
Expected lives	1.3 years
Expected volatility	34%
Expected dividend yield	0%

For the years ended December 31, 2011, 2012 and 2013, the weighted-average fair value of the purchase rights granted was $1.09, $1.45 and $1.28 per share, respectively.

8. MAJOR CUSTOMERS

One customer represented approximately 13% of the Company's 2011 revenue. One customer represented approximately 13% of the Company's 2013 revenue. One customer represented approximately 29% of the Company's accounts receivable at December 31, 2012. One customer represented approximately 16%, and another customer represented 12% of the Company's accounts receivable at December 31, 2013. No other customers represented 10% or more of revenue for 2011, 2012 or 2013 nor 10% or more of accounts receivable at December 31, 2012 or December 31, 2013.

9. COMMITMENTS AND CONTINGENCIES

The Company holds certain rights to market and manufacture all products developed or created under certain research, development and licensing agreements with various entities. In connection with such agreements, the Company has agreed to pay the entities royalties on net product sales. In the years ended December 31, 2011, 2012 and 2013, royalties of $513 thousand, $503 thousand and $391 thousand became payable under these agreements, respectively.

The Company has contracts with suppliers for unconditional annual minimum inventory purchases and milestone obligations to third parties the Company believes are likely to be triggered currently totaling approximately $8.0 million for fiscal 2014, $1.5 million for fiscal 2015, $1.6 million for fiscal 2016 and $1.6 million for fiscal 2017.

The Company has entered into operating leases for its office and research facilities and certain equipment with future minimum payments as of December 31, 2013 as follows (in thousands):

Year Ending December 31,		
2014	$	1,760
2015		1,619
2016		1,594
2017		1,571
2018		1,457
Thereafter		7,240
	$	15,241

The Company had rent expense of $1.8 million, $1.8 million and $1.8 million in 2011, 2012 and 2013, respectively.

From time to time, the Company may be involved in litigation relating to claims arising out of its operations. At December 31, 2013, the Company was not a party to any legal proceedings that were expected, individually or in the aggregate, to have a material adverse effect on our business, financial condition or operating results.

The Company's current terms and conditions of sale include a limited warranty that its products and services will conform to published specifications at the time of shipment and a more extensive warranty related to certain of its products. The Company also sells a renewal warranty for certain of its products. The typical remedy for breach of warranty is to correct or replace any defective product, and if not possible or practical, the Company will accept the return of the defective product and refund the amount paid. Historically, the Company has incurred minimal warranty costs. The Company's warranty reserve on December 31, 2013 was $451 thousand.

10. SEGMENT REPORTING

The Company is comprised of two reportable segments, Core Companion Animal Health ("CCA") and Other Vaccines, Pharmaceuticals and Products ("OVP"). The Core Companion Animal Health segment includes diagnostic instruments and supplies, as well as single use diagnostic and other tests, pharmaceuticals and vaccines, primarily for canine and feline use. The CCA segment also includes digital radiography and ultrasound products along with embedded software and support, data hosting and other services from Heska Imaging after February 24, 2013. These products are sold directly by the Company as well as through independent third-party distributors and through other distribution relationships. CCA segment products manufactured at the Des Moines, Iowa production facility included in the OVP segment's assets are transferred at cost and are not recorded as revenue for the OVP segment. The Other Vaccines, Pharmaceuticals and Products segment includes private label vaccine and pharmaceutical production, primarily for cattle, but also for other animals including small mammals. All OVP products are sold by third parties under third-party labels.

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

	Core Companion Animal Health	Other Vaccines, Pharmaceuticals and Products	Total
2011:			
Total revenue	$ 57,481	$ 12,584	$ 70,065
Operating income	1,564	1,685	3,249
Interest expense	107	17	124
Total assets	51,172	10,722	61,894
Net assets	40,435	8,004	48,439
Capital expenditures	495	589	1,084
Depreciation and amortization	1,192	860	2,052

	Core Companion Animal Health	Other Vaccines, Pharmaceuticals and Products	Total
2012:			
Total revenue	$ 61,502	$ 11,303	$ 72,805
Operating income	1,160	998	2,158
Interest expense	91	26	117
Total assets	55,071	11,755	66,826
Net assets	39,726	9,136	48,862
Capital expenditures	634	875	1,509
Depreciation and amortization	862	837	1,699

	Core Companion Animal Health	Other Vaccines, Pharmaceuticals and Products	Total
2013:			
Total revenue	$ 66,404	$ 11,935	$ 78,339
Operating income (loss)	(2,295)	865	(1,430)
Interest expense	45	29	74
Total assets	81,041	12,512	93,553
Net assets	37,732	9,384	47,116
Capital expenditures	512	1,418	1,930
Depreciation and amortization	1,691	806	2,497

Total revenue by principal geographic area was as follows (in thousands):

	For the Years Ended December 31,		
	2011	2012	2013
United States	$ 60,383	$ 64,552	$ 71,713
Europe	3,408	2,996	2,738
Other International	6,274	5,257	3,888
Total	$ 70,065	$ 72,805	$ 78,339

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

	December 31, 2011	December 31, 2012	December 31, 2013
United States	$ 58,984	$ 63,980	$ 90,572
Europe	2,910	2,846	2,981
Other International	—	—	—
Total	$ 61,894	$ 66,826	$ 93,553

11. QUARTERLY FINANCIAL INFORMATION (unaudited)

The following summarizes selected quarterly financial information for each of the two years in the periods ended December 31, 2012 and 2013 (amounts in thousands, except per share data).

	Q1	Q2	Q3	Q4	Total
2012:					
Total revenue	$ 19,175	$ 18,271	$ 16,906	$ 18,453	$ 72,805
Gross profit	8,923	8,048	6,726	7,404	31,101
Operating income (loss)	1,082	383	(27)	720	2,158
Net income (loss)	584	262	(32)	389	1,203
Net income (loss) attributable to Heska Corporation	584	262	(32)	389	1,203
Basic net income (loss) per share attributable to Heska Corporation	0.11	0.05	(0.01)	0.07	0.23
Diluted net income (loss) per share attributable to Heska Corporation	0.11	0.05	(0.01)	0.07	0.22
2013:					
Total revenue	$ 18,979	$ 18,261	$ 17,595	$ 23,504	$ 78,339
Gross profit	7,802	5,020	7,406	10,404	30,632
Operating income (loss)	(682)	(3,578)	75	2,755	(1,430)
Net income (loss)	(352)	(2,467)	(18)	1,898	(939)
Net income (loss) attributable to Heska Corporation	(386)	(2,228)	241	1,177	(1,196)
Basic net income (loss) per share attributable to Heska Corporation	(0.07)	(0.38)	0.04	0.20	(0.21)
Diluted net income (loss) per share attributable to Heska Corporation	(0.07)	(0.38)	0.04	0.20	(0.21)

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Heska seeks to impact the lives of millions of pets and people by protecting and supporting the bond we share with animals. We accomplish this through thoughtful innovation and a desire to solve important problems for animal health.

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