

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark one)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE YEAR ENDING DECEMBER 31, 1997.
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO

Commission file number - 0-21918

FLIR SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

OREGON
(State or other jurisdiction of
incorporation or organization)

93-0708501
(I.R.S. Employer
Identification No.)

16505 S.W. 72ND AVENUE, PORTLAND, OREGON
(Address of principal executive offices)

97224
(Zip Code)

(503) 684-3731
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: NONE

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

Title of each class of Stock	Name of each exchange on which registered
Common Stock, \$0.01 par value	NASDAQ

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 X . NO .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K ((S)229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or amendment to this Form 10-K []

As of March 6, 1998, the aggregate market value of the shares of voting stock of the Registrant held by non-affiliates was \$189,138,843

As of March 6, 1998, there were 9,857,399 shares of the Registrant's common stock, \$0.01, par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

FLIR SYSTEMS, INC.

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ANNUAL REPORT
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PART I

ITEM 1. BUSINESS

GENERAL

FLIR Systems, Inc. ("FSI" or the "Company"), founded in 1978, designs, manufactures, and markets thermal imaging and broadcast camera systems worldwide for a wide variety of applications in the commercial and government markets. Thermal imaging systems detect infrared radiation, or heat, emitted directly by all objects and materials and enable the operator to see objects in total darkness, in adverse weather conditions and through obscurants such as smoke and haze. Government applications include public safety (law enforcement and drug interdiction, search and rescue, border patrol and maritime patrol, and environmental protection) and defense (surveillance, reconnaissance and navigation assistance). Commercial applications include electronic news-gathering, non-destructive testing and evaluation, research and development, manufacturing process control, condition monitoring and image analysis.

The Company was profitable in the year ended December 31, 1988 and has reported profitable results for each succeeding year except for 1997 in which the Company reported a loss of \$30.6 million due to a one-time \$52.5 million acquisition-related write-off. In June 1993, the Company completed an initial public offering of its stock, which is traded on the Nasdaq National Market System under the symbol "FLIR".

In December 1997, the Company continued to expand the market potential for the growing commercial market as well as the government market by acquiring AGEMA Infrared Systems AB, a corporation organized under the laws of Sweden ("AGEMA Sweden"); AGEMA Infrared Systems Limited, a corporation organized under the laws of the United Kingdom ("AGEMA UK"); AGEMA Infrared Systems Ltd., a corporation organized under the laws of Canada ("AGEMA Canada"); and AGEMA Infrared Systems, Inc., a Delaware corporation ("AGEMA USA") (collectively "AGEMA" or the "AGEMA entities"). AGEMA is a world leaders in the design, manufacture and marketing of handheld infrared cameras for detecting and mapping temperature differences and for non-contact temperature measurements for a wide variety of industrial and research applications. AGEMA's principal executive offices are located just outside Stockholm, Sweden. AGEMA Sweden has three subsidiaries which operate sales and service offices in France, Germany and Italy. Additionally, AGEMA Canada, AGEMA UK and AGEMA USA own and operate sales and service offices in Canada, Great Britain, and the United States, respectively.

The acquisition, which was effective December 1, 1997, was accomplished through the issuance of 4,162,000 shares of the Company's common stock to AGEMA's parent company, Spectra-Physics AB, also headquartered in Stockholm, in exchange for all the outstanding shares of AGEMA stock. The transaction was accounted for as a purchase and, accordingly, the results of operations of the AGEMA entities for the period from December 1, 1997 through December 31, 1997 are included in the consolidated results of operations.

The acquisition significantly diversifies the Company's product offerings by adding AGEMA's well-regarded commercial handheld thermal imaging products to

the Company's government and commercial product lines. The acquisition will allow the Company to reduce production costs by focusing commercial handheld product manufacturing at AGEMA's facilities in Stockholm and government and commercial broadcast product manufacturing at the Company's facilities in Portland. The combined entity will benefit from combining AGEMA's product design, packaging and thermographic experience with the Company's image analysis software and stabilized gimbal experience. Finally, the two organizations have highly complementary sales and marketing capabilities and advanced development programs, including the next generation of low cost, "uncooled" infrared technologies.

The year ended December 31, 1997, was also highlighted by new product introductions, including the introduction of the extremely lightweight UltraMedia-RS(TM), a compact camera system that gives small and weight-restricted aircraft the ability to gather high-quality video from long distances; the Tracer(TM), the first industrial imager capable of recording and analyzing long sequences of thermal activity on a real-time basis; the ULTRA 6000(TM), a gyro-stabilized dual sensor system that combines state-of-the-art infrared technology and a color video camera to deliver high resolution images under extreme conditions, day or night; and the AGEMA 570(TM), the worlds first handheld uncooled radiometric thermal imaging system.

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FORWARD-LOOKING STATEMENTS

This business discussion and other sections of this Annual Report contain forward-looking statements within the meaning of the Securities Litigation Reform Act of 1995 that are based on current expectations, estimates and projections about the Company's business, management's beliefs and assumptions made by management. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors, including, but not limited to, those discussed in this business section, as well as those discussed elsewhere in this Annual Report and from time to time in the Company's other Securities and Exchange Commission filings and reports. In addition, such statements could be affected by general industry and market conditions and growth rates, and general domestic and international economic conditions.

YEAR 2000 ISSUES

As the year 2000 approaches, the Company recognizes the need to ensure its operations and products will not be adversely impacted by Year 2000 software issues. The Company is addressing this via the use of both internal and external resources to conduct a comprehensive review of its computer systems and code internal to the Company products. The Company expects to complete the project on a timely basis to assure the availability and integrity of its financial system and the reliability of its operational systems by the end of 1999. Such work has not had and is not anticipated to have a material effect on the consolidated financial position of the Company.

INDUSTRY BACKGROUND

Infrared radiation is essentially light that is not visible because its wavelength is too long to be detected by the human eye. Unlike visible light, infrared radiation is emitted directly by all objects and materials. Thermal imaging systems are used to detect infrared radiation and convert it into an electronic signal, which is then formatted into a video scene and displayed on a monitor. Thermal imaging systems enable the operator to see objects in total darkness and through obscurants such as smoke, haze and many forms of fog. Unlike other night vision devices, such as night vision goggles, a thermal imaging system does not require any visible light to operate. Thermal imaging systems can also detect and measure temperature differences, which is important in a variety of industrial applications.

Early applications of thermal imaging primarily involved the use of very expensive high-resolution systems in military combat applications such as weapons targeting, where performance factors were far more important in the procurement decision than the system acquisition cost. A basic form of the technology was also employed in limited industrial applications such as

detection of heat loss from buildings, where system price was more important than sophisticated performance. Consequently, a large group of potential users in both the public safety sector and commercial markets did not use thermal imagers, since available systems either failed to meet their performance requirements or were too expensive. The Company was among the first to bridge the gap between high-cost, high-performance and low-cost, low-performance systems by developing thermal imaging products with a combination of price and performance suited to the needs of a broad range of customers in the government market. In addition, commercial applications and markets began to expand as thermal imaging companies developed products with enhanced performance characteristics.

The Company expects continued growth in the thermal imaging markets due primarily to the general improvements in the price and performance characteristics of imaging systems for the government and commercial markets. The Company believes the primary factors that will contribute to the growth in the government market are the increasing use of thermal imaging in public safety applications worldwide, the increasing emphasis of governments on public safety roles and the transition of defense procurement policies worldwide to favor cost-effective commercially developed technology. The Company believes that the use of thermal imaging and broadcast systems in commercial applications will increase, and the commercial imaging market will expand significantly, as high-performance industrial systems become more affordable, primarily due to the introduction of the uncooled technology, and industrial customers better understanding the improvements in quality and productivity that can be gained by the use of these systems and the related image analysis software. The Company's commercial products and image analysis software capabilities are designed to take advantage of these opportunities.

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MARKETS FOR THE COMPANY'S PRODUCTS

GOVERNMENT PRODUCTS

The worldwide government market consists of two segments: public safety and defense. The Company is a leader in the public safety segment, which is rapidly expanding but represents a small percentage of the total government market. The Company also sells its products for selected applications in the defense segment.

Public Safety

The Company is a worldwide leader in the emerging public safety market, which consists of products sold for a variety of uses in law enforcement and drug interdiction, search and rescue, border and maritime patrol, environmental protection and ground based surveillance and security. The Company has been instrumental in the development of this market worldwide, with systems operating in over 50 countries. During the last three years, the Company has sold into this market over 500 systems with a dollar value in excess of \$125 million. While no consistent data is available as to the size of this market, the Company believes this represents only a small percentage of the existing and potential global market.

Customers in the public safety market demand systems that are both affordable and capable of performing a variety of tasks requiring high resolution and image quality. The Company's products are well positioned to meet these customers' requirements for performance and affordability. Additionally, the Company's broad product range is well suited to the principal customer groups in the public safety market, each of which require different product configurations. The Company's products meet customer needs for systems that can be mounted on a variety of aircraft and ships, operate in different climatic conditions and accommodate changes in methods of operations. Installations for the Company's systems have been certified by the Federal Aviation Administration and equivalent authorities in foreign countries for most of the aircraft used in the market.

Law Enforcement and Drug Interdiction: Thermal imaging systems enable law enforcement agencies to expand their capabilities in activities ranging from routine patrol and surveillance to suspect apprehension and drug interdiction. There is a trend in law enforcement toward the use of aircraft, which have advantages over traditional ground operations in these activities. Airborne enforcement has historically been limited by an inability to perform effectively at night or under conditions of limited visibility -- precisely the conditions

under which significant criminal activity occurs. By providing night vision capability, thermal imaging systems significantly enhance the performance capabilities of airborne law enforcement.

The Company believes that law enforcement is an emerging market for its systems and that a relatively small percentage of law enforcement aircraft worldwide are presently equipped with thermal imaging systems. As various law enforcement agencies have gained familiarity with the uses and capabilities of these systems, the Company has expanded the applications for its products to meet the needs of a broader customer base. Over the past three years, demand for the Company's products has continued to be strong as a result of their effective use by customers in law enforcement and drug interdiction activities worldwide.

Law enforcement agencies are beginning to recognize the utility of thermal imaging systems in ground operations, an application in which cost, portability and image quality are key customer requirements. The Company has addressed these requirements with its line of handheld infrared cameras. See "Products."

Search and Rescue: Search and rescue operations include the traditional mission of rescuing boats and vehicles in distress, offshore oil platform safety and emergency response support for missing persons or accident victims. These operations are routinely conducted in most nations by military, governmental, or local entities in both coastal waters and inland areas. The range of the Company's customers in this market has expanded from initial coast guard sales to include military agencies, private contractors, oil companies and emergency response teams. The Company believes that this market will continue to grow, primarily due to the evolving need to maintain search and rescue capability on a 24-hour basis and under adverse weather conditions.

Border and Maritime Patrol: As the frequency of regional disputes throughout the world increases and concern over the effects of illegal immigration grows in most countries, the importance of border surveillance, particularly night time surveillance, has increased. The Company was among the first to demonstrate the effectiveness of thermal imaging systems for airborne operations in this market. Maritime patrol activities are performed by military or governmental agencies charged with maintaining the territorial integrity of coastal waters, monitoring national fishing boundaries and preventing smuggling.

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Environmental Protection: With the growing worldwide emphasis on the protection of natural resources, the Company expects the market for its systems in environmental protection activities to expand. The Company's thermal imaging systems have been effectively used in forest fire detection and extinguishment, oil spill detection and monitoring, and wildlife management. Potential additional applications include monitoring toxic waste sites, identifying sources of environmental contamination, and gas leak detection. In many cases, proper detection cannot be accomplished without thermal imaging. For example, heavy smoke inhibits the application of flame retardant while fighting forest fires; thermal imaging systems see through smoke and allow accurate airdrops of both retardant and water. The Company has successfully begun to market its systems for environmental protection applications in the United States and Canada, but this market is in its infancy and is expected to grow as users become increasingly aware of the applications and utility of thermal imaging systems.

Ground Based Security. As the concern over security of military bases and other sensitive installations throughout the world increases, the importance of ground-based surveillance and security, particularly at night, has increased. The Company was one of the first to provide a cost effective solution to this problem with the introduction of the AGEMA 1000(TM) in 1992. The Company believes that with the introduction of the uncooled technology and the resultant reduction in acquisition costs, the ground based surveillance and security market will expand significantly.

Defense

The defense market for thermal imaging systems, which consists primarily of sophisticated weapon systems, has historically constituted the largest segment of the market for night vision products. While the Company has purposely limited its participation in this market segment, due to the changing nature of defense priorities, the Company has begun to develop relationships with prime defense contractors that require cost-effective thermal imaging sensors for inclusion in their systems.

In addition to the traditional weapons systems applications, thermal imaging systems are increasingly being employed by the military for surveillance, reconnaissance, and navigation assistance as part of a larger trend toward expansion of night operations capability. As a result, night vision systems have been identified as a critical component of a more technology-based military. The Company believes that these trends will provide selected ongoing growth opportunities for the Company in the defense market.

COMMERCIAL PRODUCTS

The ability of thermal imaging systems to detect heat and measure temperature differences make them useful in a broad range of industrial applications. For example, thermal imaging systems can be used to observe the performance of heating and cooling devices, monitor the performance of electronic components or the movement of electrical current, detect water or moisture, identify leaks, locate bonding defects, detect cracks and voids in an object and determine surface uniformity. The Company believes that the increasing emphasis on improving manufacturing productivity and product quality, underscored by the growing importance of programs such as International Standards Organization (ISO) 9000 and the increasing complexity of high technology products and processes, creates an opportunity for a significant expansion of the industrial market. This market typically requires very high performance systems with extensive analytical software. The Company believes that growth of the commercial market will be further enhanced as thermal imaging systems achieve higher performance, the capabilities and benefits of thermal imaging are understood by a growing number of potential customers, the image analysis software capabilities continue to improve and systems become more affordable and easy to use.

The Company believes that its imaging systems and related software products will enable it to continue to capture market share and significantly expand applications in six principal areas: electronic news-gathering, non-destructive testing and evaluation, research and development, manufacturing process control, condition monitoring and image analysis.

Electronic news-gathering: The use of stabilized broadcast and thermal imaging systems is becoming a standard feature in today's news gathering markets. This market typically requires very high performance systems with extensive capabilities including state-of-the-art stabilization, the ability to provide jitter-free images from great distances and the ability to downlink the information on a real-time basis. The Company believes that this segment of the market will grow as a greater number of TV stations acquire helicopters to provide real-time reporting of news events and as system size and weight continue to decline which enable the use of such systems on small and weight restricted helicopters.

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Non-Destructive Testing and Evaluation ("NDT"): Non-destructive testing and evaluation is a market classification adopted by a broad group of users of various technologies for specialized testing. NDT in a broad sense applies to all testing and evaluation that is non-destructive in nature and is utilized in all industrial thermal imaging market segments. More specifically, the designation applies to a segment that focuses on the testing of composite materials or of products using composite materials. This is a relatively new thermal imaging market and has experienced strong growth. Many different types of products must be inspected to ensure they are properly constructed, meet acceptable quality standards, or have not been damaged. For many applications, technologies such as ultrasound and x-ray have not proven to be effective. Thermal imaging has proven to be non-destructive, effective, quick and affordable and is increasingly being used for this type of inspection.

Thermal imaging systems can also be used to evaluate, monitor and test composite material. For example, when two composite materials are bonded together, thermal imaging, unlike visual inspection, can be used to determine the quality of the bond. A similar inspection technique is used to inspect composite materials for damage after sustaining an impact. Additionally, during the production of solar cells, thermal imaging is used to verify the integrity of the bond between the various composition layers -- a factor critical to the cell's performance. For example, due to pressure and temperature differences experienced by an aircraft, water will collect in the internal honeycomb structure or insulation if there is a leak in the aircraft's outer skin; such leaks can be located through the use of thermal imaging.

Research and Development: Thermal imaging, due to its non-destructive analysis capability, is a new tool for use in research from automobiles to electronics. This market typically requires very high performance systems with extensive software capabilities and tools to analyze the thermal image. The Company believes that this segment of the commercial market will grow as system resolution and image analysis capabilities increase.

Because many component and product designs involve the use or control of heat, thermal imaging can be effectively used in the research and design of the component or product. For example, thermal imaging is used in laser design to determine the power distribution of the beam. Once the laser is in production, thermal imaging is used as a process and product specification monitoring system. In addition, thermal imaging is used in development of diesel engines using ceramic coated pistons to determine proper adhesion of the ceramic to the metal piston. During the design of a rubber tire, uniform heat distribution can be evaluated using thermal imaging.

Manufacturing Process Control: The ability to determine that a manufacturing process will produce unacceptable results at the earliest point in the production cycle is critical to quality improvement and cost reduction. Thermal imaging and image analysis allows for the monitoring and control of heat, which is used in most industrial processes. Depending on the process, too much, too little, or uneven heat can result in a defective product. The Company believes that, as all phases of the manufacturing process become increasingly competitive and quality standards increase, the use of thermal imaging and image analysis software in these applications will grow.

Potential thermal imaging applications for process monitoring are varied and extensive. For example, the quality of metal, plastic and glass cast parts is highly dependent upon the temperature distribution in the mold. The quality of paper is dependent upon proper and even moisture distribution during the drying process. Thermal imaging is used to monitor temperature and moisture distribution in these manufacturing processes. In addition, many products, such as rubber gloves, can be thermally examined to locate abnormally warm or cool spots, indicating non-uniform thickness which may result in a quality defect.

Condition Monitoring: Thermal imaging systems improve productivity by determining the location and detection of equipment faults so they can be corrected before they lead to catastrophic failure or major equipment damage. This allows companies to significantly reduce operating expenses by lowering repair costs and reducing downtime. Condition monitoring is currently the largest segment of the industrial market.

Specific condition monitoring applications are numerous. Utility companies utilize the Company's thermal imaging products to locate and repair defective power transmission components thereby significantly improving service reliability by reducing annual power outages per customer. The bearings of rotating machinery will operate at an increasingly warmer temperature as the end of their useful life approaches; thermal imaging surveys can predict the bearing's end of life, allowing planned maintenance to be performed before experiencing a plant shut-down or severe machinery damage. Thermal imaging is used to evaluate the integrity and amount of insulation in a building or container, providing substantial energy cost savings. Thermal imaging allows roof leaks and associated specific damaged areas to be located and repaired, avoiding the major expense of replacing the entire roof.

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Image Analysis: The acquisition of Optimas in early 1996, (Optimas is now know as FSI Automation, Inc.) coupled with the image analysis capability that the acquisition of AGEMA brought to the Company, has enabled the Company to greatly expand its image analysis capabilities. Image analysis is the extraction of specific quantitative information in an objective, repeatable fashion in order that such data can be more meaningfully employed or understood and used to make informed and better decisions. Image analysis incorporates image processing (improving or otherwise modifying the visual appearance of an image), but goes further to incorporate the identification of features of interest, extracting the desired measurements of those features and then making such measurements available for productive use.

Uses of image analysis software may include monitoring and controlling industrial processes, improving product quality, enhancing medical analysis or otherwise enabling or enhancing critical decision-making processes. For example,

in the manufacture of laser and ink jet printers, the precise alignment of thousands of tiny dots of ink and a minimization of scatter or excess ink spots in printing are critical quality concerns. Printer manufacturers examine a test sheet from each printer using the Company's image analysis software. The software can rapidly examine a digital scan of those pages and provide analysis of whether the printer is functioning within tolerances.

PRODUCTS

The following is a listing of the Company's main products and a brief description of such products:

Series 2000. The Series 2000(TM), first introduced in 1983, is a real-time analog TV-compatible thermal imaging system for use in applications such as military surveillance, narcotics interdiction, crime fighting, search and rescue and environmental protection.

SAFIRE. The SAFIRE(TM), first introduced in the second quarter of 1992, is a high-resolution digital thermal imaging system featuring gyro stabilization and image processing. SAFIRE systems are currently fielded by all branches of the U.S. military and are manufactured to meet the rigors of diverse missions from airborne and naval surveillance to search and rescue.

ULTRA 4000. The ULTRA 4000(TM), introduced in the third quarter of 1994, is a fully stabilized aerial camera system that couples a high-resolution infrared camera for low light or no light situations with an industry-standard broadcast camera for daylight coverage. The ULTRA 4000 provides the capability for long range airborne surveillance and broadcast video transmission in law enforcement, news gathering, and similar applications.

ULTRA 6000. The ULTRA 6000(TM), introduced in the third quarter of 1997, combines state-of-the-art infrared technology and a color video camera in a single compact system to deliver high-resolution images under extreme conditions, day or night.

UltraMedia. The UltraMedia(TM), introduced in the first quarter of 1996, is a compact daylight broadcast system that delivers a maximum of 72:1 magnification in a lightweight, low-profile package which is ideally suited for airborne broadcast teams. The UltraMedia breaks new ground by giving airborne broadcast teams hardware that delivers high-resolution images without high payload concerns.

UltraMedia RS. The UltraMedia RS(TM), introduced in the first quarter of 1997, combines many of the features of the larger UltraMedia system in a compact 35 pound configuration. The UltraMedia RS provides small and weight restricted aircraft the ability to gather high quality video footage from long distances.

AGEMA 1000. The ground-based AGEMA 1000(TM) series, first introduced in 1992, is a fixed or tripod mounted thermal imaging system which can detect small objects up to several kilometers away under extreme environmental conditions, day or night. Highly reliable and ready for 24-hour operation, these compact and versatile thermal imaging systems switch dual lenses at a touch of a button, optimize images automatically and offer remote control software.

AGEMA 900. The AGEMA 900(TM), first introduced in 1992, is a high resolution, handheld thermal imaging system available in both short and long wave versions. The AGEMA 900, with its wide range of lenses, filters and other accessories is ideally suited for the research and development market.

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AGEMA 550. The AGEMA 550(TM), introduced in the fourth quarter of 1996, is a handheld infrared camera developed for the condition monitoring market. The AGEMA 550 uses a stirling cooled PtSi focal plane array and, in its standard version is calibrated for temperature measurements up to 1500 degrees C. The AGEMA 550 has built-in digital recording. The AGEMA 550 is available with various lenses, for different fields of views, as well as filters and other accessories.

AGEMA 570. The AGEMA 570(TM), first introduced in the fourth quarter of 1997, is the world's first uncooled imaging radiometer. The AGEMA 570 provides lightweight (less than 5 lb.), instant-on convenience while delivering exceptional temperature measurement accuracy of objects from -20 degrees C to +2000 degrees C. Intelligent controls facilitate one-hand, point and shoot

operation of this self contained system. Image optimization is automatic and menu and data displays appear in any of 14 languages.

ThermoVision. The ThermoVision(TM), introduced in early 1998, is an uncooled infrared camera for the manufacturing process control market. Operating as a remotely controlled "smart" sensor, in supervised operation or integrated into a complete control system, the ThermoVision transmits data on a continuous real-time basis at 60 frames a second. Using built-in intelligence, ThermoVision can process multiple area of interest, trigger alarms or transmit control data. A variety of flexible, high-speed and reliable digital cable, fiber-optic and wireless transmission media allow for flexible system integration with controllers, computers and vision systems.

Thermoprofile 6. The Thermoprofile(TM) 6, is a line scanner developed originally to monitor the temperature on the surface of a rotating cement kiln. The line scanning technology has now expanded into other applications in the manufacturing process control market including hot and cold rolling steel mills, float glass manufacturing and metals refining.

Tracer. The Tracer(TM), introduced in the first quarter of 1997, is the first industrial imaging system capable of recording and analyzing long thermal event sequences at real-time frame rates on a Windows based PC. Tracer combines a high-resolution thermal imaging camera with a Pentium PC, digital recording system, and Windows-based analysis software.

IRwin Report. IRwin(TM) Software allows for review, analysis and processing of captured images and data. IRwin software is a Windows based program which provides for an ease of use and affordability that is unmatched in the industry. IRwin software is typically packaged with the AGEMA 500 series systems, though it is capable of operating with data gathered from other imaging modalities as well.

OPTIMAS. OPTIMAS(TM) software is a Windows based application designed to meet the needs of the advanced scientific and engineering markets. The OPTIMAS software package includes custom user interface tools which enable both novice and highly skilled users to efficiently and effectively solve their image analysis problems.

Xcaliper. Xcaliper(TM) software, introduced in the second quarter of 1995, is a high precision software product addressing certain industrial machine vision tasks such as gauging, part-presence or absence, edge detection and part alignment. Xcaliper software combines high speed with easy development using Visual Basic programming.

Sentinel. Sentinel(TM) software, introduced in the fourth quarter of 1995, is an image pattern and industrial OCR software application using neural network-based technology to perform fast pattern recognition on personal computers. Applications include form reading, package label identification, part orientation and inspection. Sentinel software employs a simple drag and drop interface to train patterns and build applications.

Library. Library(TM) software, introduced in the fourth quarter of 1995, is a flexible, multi-user image database with internal image management capabilities. Library software provides support for network and removable media and seamless links to OPTIMAS for one step archiving of images from OPTIMAS. Images can be retrieved and batch-analyzed using internal search features and automated field updates of analysis results. Library software utilizes a drag and drop interface to enable custom database and report development.

CUSTOMERS

The primary customers for the Company's products include instrumentalities of domestic and foreign governments, original equipment manufacturers, commercial manufacturers, research and development facilities, universities, utility companies, news-gathering agencies and various commercial enterprises.

A substantial portion of the Company's revenues is derived from sales to agencies and instrumentalities of the U.S. Government, which aggregated more than 10% of the Company's revenues in each of the last three years. For the year ended December 31, 1997, such sales represented 20.7% of the Company's total revenue. With the exception of the continuing sales to agencies and instrumentalities of the U.S. Government, the Company does not typically have

continuing customers whose purchases constitute more than 10% of revenues on a year to year basis. At any given time, however, the Company may have purchase commitments from customers which, if completed, would constitute more than 10% of revenues in any given year. The failure of any such customer to complete such purchases or the loss of the agencies and instrumentalities of the U.S. Government as a customer could have a material adverse effect on the Company's business, financial position and results of operations.

SALES, DISTRIBUTION AND CUSTOMER SERVICE

The Company markets its night vision products for the government market in the United States directly through a 12-person direct sales staff, and internationally through 50 independent representatives covering all major markets worldwide.

The Company sells its commercial products worldwide through a 40-person direct sales staff and a network of 90 distributors and representatives, each with an exclusive right to sell the Company's products in a defined geographic area. All distributors and representatives report to one of 15 regional sales managers employed by the Company. The Company sells its software products primarily through 35 authorized dealers, 15 of whom are located within the U.S. and Canada. Many of these dealers, particularly internationally, maintain their own network of subsidiary agents.

In support of both direct and distribution sales activities, the Company has a technical support group that provides installation, technical training and repair services. The Company maintains service facilities at its factories in Portland, Oregon, Sweden and the United Kingdom and at its subsidiaries in Seattle, Washington, Secaucus, New Jersey, Germany, Canada, France and Italy. The Company also maintains limited service capability in three foreign locations under the direction of its independent representatives.

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MANUFACTURING

The Company manufactures most critical components of its products, including detectors, optics and high speed motors. This allows the Company to minimize lead times, facilitate prompt delivery of its products, control costs and ensure that these components satisfy its quality standards. The Company purchases other parts pre-assembled, including coolers, circuit boards, cables and wiring harnesses. The interruption of certain sources of supply or the failure of suppliers of key components to adapt their products to the Company's changing technological requirements could disrupt the Company's ability to manufacture products or cause the Company to incur costs associated with the development of alternative sources, either of which could have an adverse effect on the Company's business, financial position, and financial results of operations. The Company has experienced delays in production due to its inability to timely obtain a necessary component from third-party supplier. No assurance can be given that similar delays will not be experienced in the future.

Certain critical components, such as detectors and optical systems, are made with special minerals, compounds or materials. The Company believes that all such materials are readily available and will continue to be available in the foreseeable future at costs that are not prohibitive or that would materially affect the Company's ability to manufacture such components.

The Company's manufacturing operations have been audited by its OEM customers, which include several major aircraft manufacturers, and were certified as meeting their quality standards. In addition, the Company has been certified for inclusion of its products in government systems after government audits of its manufacturing facilities.

COMPETITION

The Company's competitors are different in each market segment. In the public safety market, the Company competes with a variety of companies on a limited basis. For example, the Company competes with Inframetrics in the law enforcement segment and GEC and Wescam Ltd. in other public safety segments. In the commercial markets, the Company's principal competitors are Inframetrics and Avio and Wescam Ltd. in the electronic news-gathering market. In the image analysis market, the Company competes with Media Cybernetics and Noesis Vision, and to a lesser extent Data Translation, Jandel Scientific and Matrox Electronics Systems. In the manufacturing process control market, the Company

competes with Adept, Allen-Bradley Company, Cognex and Robotic Vision Systems. Competition in the defense market is more intense, and includes companies such as Lockheed Martin, Boeing, Thompson, GEC, and Thorn EMI. As the markets for the Company's products expand, the Company expects that additional competition will emerge and that existing competitors may commit more resources to the markets addressed by the Company. Most of the Company's competitors have substantially greater financial, technical and marketing resources than the Company. In addition, the Company's products compete indirectly with numerous other products, such as image intensifiers and low-light cameras, for limited military and governmental funds.

The Company believes that the principal competitive factors in its market are performance, cost, customer service, product reputation, and effectiveness of marketing and sales efforts. In addition, the Company believes that the speed with which companies can identify applications for thermal imaging, develop products to meet those needs and supply commercial quantities to the market are important competitive factors. The Company believes that it competes favorably with respect to each of these factors.

PROPRIETARY RIGHTS

The Company relies on intellectual property rights to protect its proprietary technology. The Company enters into confidentiality agreements with its employees and consultants and limits access to and distribution of its documentation and other proprietary information. There can be no assurance that the steps taken by the Company in this regard will be adequate to deter misappropriation of its technology or independent third-party development of competing technologies.

EMPLOYEES

As of December 31, 1997, the Company had 652 employees of whom 66 were in administration, 189 were in engineering, 8 were in quality assurance, 195 were in manufacturing, assembly and testing and 194 were in marketing and sales. The Company has been successful in attracting and retaining highly skilled technical, marketing and management personnel to date. None of the Company's employees in the United States are represented by a union or other bargaining group. Employees in Sweden and Italy are represented by a Union. The Company believes its relationship with its employees and the Unions are good.

ITEM 2. PROPERTIES.

The Company leases its facilities under various operating leases which expire in 1998 through 2003. The lease calls for fixed monthly payments over its term. The following summarized the primary facilities leased by the Company:

Location	Lease Expiration Date	Square Feet
-----	-----	-----
FLIR Systems, Inc. - Portland, Oregon	2000	85,000
FLIR Systems AB - Danderyd, Sweden	2001	63,000
FSI Automation, Inc. - Bothell, Washington	2000	9,600
FLIR Systems International Ltd. - West Malling, United Kingdom	2000	12,500
FLIR Systems Ltd. - Ontario, Canada	1998	4,200
FLIR Systems S.A.R.L. - France	1998	2,900
FLIR Systems GmbH - Germany	1998	2,200
FLIR Systems Limited - Leighton Buzzard, United Kingdom	1999	4,500
FLIR Systems s.r.l. - Italy	1998	2,200
FLIR Systems, Inc. - Secaucus, New Jersey	2003	8,000

ITEM 3. LEGAL PROCEEDINGS.

In the normal course of business, the Company is and has been involved in certain litigation, however, the Company is not the subject of or a party to any material legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

On December 1, 1997, a special meeting of Shareholders of the Company was held to vote upon the issuance of a total of 4,162,000 shares of the Company's common stock in exchange for all the outstanding share of capital of AGEMA Infrared Systems AB, a corporation organized under the laws of Sweden; AGEMA Infrared Systems Limited, a corporation organized under the laws of the United Kingdom; AGEMA Infrared Systems Ltd., a corporation organized under the laws of Canada; and AGEMA Infrared Systems, Inc., a Delaware corporation. At such meeting the shareholders approved the issuance by a vote of 3,501,830 for and 11,849 against with 4,175 abstentions. Information regarding this transaction is contained in the Company's definitive proxy statement dated November 10, 1997, for a special Meeting of Shareholders and is incorporated herein by reference.

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PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS.

The common stock of FLIR Systems, Inc. has been traded on the Nasdaq National Market System since June 22, 1993, under the symbol "FLIR". The following table sets forth, for the quarters indicated, the high and low sales price for Common Stock reported on the Nasdaq National Market System.

	1997		1996	
	HIGH	LOW	HIGH	LOW
First Quarter.....	17.75	13.25	14.38	10.00
Second Quarter.....	17.75	14.75	16.25	10.50
Third Quarter.....	22.00	15.75	15.25	11.75
Fourth Quarter.....	22.00	17.50	14.50	12.75

At December 31, 1997, there were approximately 400 holders of record of the Company's common stock and 9,756,458 shares outstanding. The Company has never paid cash dividends on its common stock. The Company intends to retain earnings for use in its business and, therefore, does not anticipate paying cash dividends in the foreseeable future.

During 1996, the Company sold securities without registration under the Securities Act of 1933, as amended (the "Securities Act") upon the exercise of certain stock options granted under the Company's 1984 Stock Incentive Plan. An aggregate of 76,367 shares of Common Stock were issued at exercise prices ranging from \$1.625 to \$5.225. These transactions were effected in reliance upon the exemption from registration under the Securities Act provided by Rule 701 promulgated by the Securities and Exchange Commission pursuant to authority granted under Section 3(b) of the Securities Act.

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ITEM 6. SELECTED FINANCIAL DATA.

	YEAR ENDED DECEMBER 31,				
	1997	1996	1995	1994	1993
	(In thousands, except per share data)				
STATEMENT OF OPERATIONS DATA					
Revenue:					
Government.....	\$ 48,483	\$42,958	\$33,575	\$35,805	\$31,051
Commercial.....	43,288	23,059	16,550	13,172	9,082
Total revenue.....	91,771	66,017	50,125	48,977	40,133
Cost of goods sold.....	58,507	30,415	22,724	23,813	19,103
Gross profit.....	33,264	35,602	27,401	25,164	21,030

Operating expenses:					
Research and development.....	11,814	9,485	7,786	7,588	7,044
Selling and other operating costs....	26,551	18,999	14,656	12,353	10,358
Combination costs.....	36,450	*	--	--	--
Total operating costs.....	74,815	28,484	22,442	19,941	17,402
(Loss) earnings from operations....	(41,551)	7,118	4,959	5,223	3,628
Interest income.....	182	44	226	705	138
Interest expense and other.....	(2,103)	(819)	(795)	(172)	(170)
(Loss) earnings before income taxes	(43,472)	6,343	4,390	5,756	3,596
Income tax (benefit) provision.....	(12,884)	1,251	523	570	405
Net (loss) earnings.....	\$ (30,588)	\$ 5,092	\$ 3,867	\$ 5,186	\$ 3,191
Net (loss) earnings per share:					
Basic.....	\$ (5.23)	\$0.95	\$0.74	\$1.01	\$0.69
Diluted.....	\$ (5.23)	\$0.91	\$0.70	\$0.95	\$0.66

BALANCE SHEET DATA:

Working capital.....	\$ 26,567	\$44,190	\$37,884	\$35,573	\$31,610
Total assets.....	153,857	75,104	56,918	49,269	40,385
Long-term debt, excluding current portion.....	1,679	5,173	1,175	1,209	1,167
Total shareholders' equity.....	\$ 75,189	\$49,971	\$43,470	\$39,162	\$33,046

* - In connection with the acquisition of AGMEA Infrared Systems AB, which was effective on December 1, 1997, the Company recorded a one-time charge of \$52.5 million. The write-off consisted of \$36.4 million of in-process research and development and acquisition-related costs, which are included as a separate line in operating expenses, and \$16.1 million of inventories due to the creation of duplicative product lines, which is included in cost of goods sold.

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

OVERVIEW

FLIR Systems, Inc. ("FSI" or the "Company"), founded in 1978, designs, manufactures, and markets thermal imaging and broadcast camera systems worldwide for a wide variety of applications in the commercial and government markets. Thermal imaging systems detect infrared radiation, or heat, emitted directly by all objects and materials and enable the operator to see objects in total darkness, in adverse weather conditions and through obscurants such as smoke and haze. Government applications include public safety (law enforcement and drug interdiction, search and rescue, border patrol and maritime patrol, and environmental protection) and defense (surveillance, reconnaissance and navigation assistance). Commercial applications include electronic news-gathering, non-destructive testing and evaluation, research and development, manufacturing process control, condition monitoring and image analysis.

The Company was profitable in the year ended December 31, 1988 and has reported profitable results for each succeeding year except for 1997 in which the Company reported a loss of \$30.6 million due to the inclusion of a one-time \$52.5 million acquisition related write-off. In June 1993, the Company completed an initial public offering of its stock, which is traded on the Nasdaq National Market System under the symbol "FLIR".

In December 1997, the Company continued to expand the market potential for the growing commercial market as well as the government market by acquiring AGEMA Infrared Systems AB, a corporation organized under the laws of Sweden ("AGEMA Sweden"); AGEMA Infrared Systems Limited, a corporation organized under the laws of the United Kingdom ("AGEMA UK"); AGEMA Infrared Systems Ltd., a corporation organized under the laws of Canada ("AGEMA Canada"); and AGEMA Infrared Systems, Inc., a Delaware corporation ("AGEMA USA") (collectively "AGEMA" or the "AGEMA entities"). AGEMA is one the world leaders in the design, manufacture and marketing of handheld infrared cameras for detecting and mapping temperature differences and for non-contact temperature measurements for a wide variety of industrial and research applications. AGEMA's principal executive offices are located just outside Stockholm, Sweden. AGEMA Sweden has three subsidiaries which operate sales and service offices in France, Germany and Italy. Additionally, AGEMA Canada, AGEMA UK and AGEMA USA own and operate sales and service offices in Canada, Great Britain, and the United States, respectively.

The acquisition, which was effective on December 1, 1997, was accomplished

through the issuance of 4,162,000 shares of the Company's common stock to AGEMA's parent company, Spectra-Physics AB, also headquartered in Stockholm, in exchange for all the outstanding shares of AGEMA stock. The transaction was accounted for as a purchase and, accordingly, the results of operations of the AGEMA entities for the period from December 1, 1997 through December 31, 1997 are included in the consolidated results of operations.

The acquisition significantly diversifies the Company's product offerings by adding AGEMA's well-regarded commercial handheld thermal imaging products to the Company government and commercial product lines. The acquisition will allow the Company to reduce production costs by focusing commercial handheld product manufacturing at AGEMA's facilities in Stockholm and government and commercial broadcast product manufacturing in the Company's facilities at Portland. The combined entity will benefit from combining AGEMA's product design, packaging and thermographic experience with the Company's image analysis software and stabilized gimbal experience. Finally, the two organizations have highly complementary sales and marketing capabilities and advanced development programs, including the next generation of low cost, "uncooled" infrared technologies.

The year ended December 31, 1997, was also highlighted by new product introductions, including the introduction of the extremely lightweight UltraMedia-RS(TM), a compact camera system that gives small and weight-restricted aircraft the ability to gather high-quality video from long distances; the Tracer(TM), the first industrial imager capable of recording and analyzing long sequences of thermal activity on a real-time basis; the ULTRA 6000(TM), a gyrostabilized dual sensor system that combines state-of-the-art infrared technology and a color video camera to deliver high resolution images under extreme conditions, day or night; and the AGEMA 570(TM), the worlds first handheld uncooled radiometric thermal imaging system.

RESULTS OF OPERATIONS

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

	Year Ended December 31,		
	1997	1996	1995
Revenue:			
Government.....	52.8 %	65.1%	67.0%
Commercial.....	47.2	34.9	33.0
Total revenue.....	100.0	100.0	100.0
Cost of goods sold.....	63.8	46.1	45.3
Gross profit.....	36.2	53.9	54.7
Operating expenses:			
Research and development.....	12.9	14.4	15.5
Selling and other operating costs.....	28.9	28.8	29.3
Combination costs.....	39.7	--	--
Total operating expenses.....	81.5	43.2	44.8
(Loss) earnings from operations.....	(45.3)	10.7	9.9
Interest income.....	0.2	0.1	0.5
Interest expense and other.....	(2.3)	(1.2)	(1.6)
(Loss) earnings before income taxes.....	(47.4)	9.6	8.8
Income tax (benefit) provision.....	(14.0)	1.9	1.0
Net (loss) earnings.....	(33.4) %	7.7%	7.8%

YEARS ENDED DECEMBER 31, 1997, 1996 AND 1995

OVERALL. The Company's revenue increased 39.0%, from \$66.0 million in 1996 to \$91.8 million in 1997. Net earnings, before non-recurring charges associated with the AGEMA acquisition, increased 34.6%, from \$5.1 million (or \$0.91 per diluted share) in 1996 to \$6.9 million (or \$1.10 per diluted share) in 1997. After recording the one-time, charge of \$52.5 million for costs associated with the AGEMA acquisition, the net loss for 1997 was \$30.6 million (or \$5.23 per diluted share). The increase in overall revenue and net income, prior to acquisition related write-offs, was primarily due to the continued sales growth of the UltraMedia(TM) for the electronic news-gathering market, continued strong sales of the SAFIRE(TM) night vision system for the government market, continued

production and deliveries of handheld thermal imaging systems, higher international sales and a partial-month of contribution from AGEMA operations. These increases were offset in part by an increase in interest expense related to increased short and long-term borrowings, an increase in the effective tax rate and an increase in shares outstanding due to the AGEMA acquisition.

During 1996, the Company's overall revenue increased 31.7%, from \$50.1 million in 1995 to \$66.0 million in 1996. Net earnings increased 31.7%, from \$3.9 million (or \$0.70 per diluted share) in 1995 to \$5.1 million (or \$0.91 per diluted share) in 1996. The increase in overall revenue and net income was primarily due to the inclusion of revenue from the sale of the Company's commercial broadcast products, principally the UltraMedia(TM) which was introduced in April 1996, as well as to increased deliveries of the SAFIRE(TM) night vision system to the federal government, particularly to the U.S. Marine Corps and the U.S. Air Force. Further, the increase in revenue and net income was due to the fact that 1995 government revenue was constrained due to delays in the finalization of several international and domestic contracts and the inclusion, in 1995, of the significant one-time transaction costs associated with the acquisition of Optimas Corporation ("Optimas") in early 1996.

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REVENUE. Revenue from the sale of night vision systems to the government market increased 12.9%, from \$43.0 million in 1996 to \$48.5 million in 1997. This increase was primarily attributable to continued robust sales of the SAFIRE(TM) night vision system and increased deliveries to international customers, which typically have a higher sales price than domestic orders. Additionally, revenue from the sale of products manufactured by the Company's United Kingdom subsidiary increased during 1997. Commercial revenue increased 87.7%, from \$23.1 million in 1996 to \$43.3 million in 1997. This improvement was principally attributable to increased sales of the UltraMedia(TM), the Company's airborne camera system for the electronic news-gathering market, which aggregated \$12.2 million in 1997 compared to \$6.3 million in 1996; further production and deliveries of the Company's handheld imaging systems, which aggregated \$10.9 million in 1997 compared to \$4.7 million in 1996; higher international sales; and the partial-month contribution from AGEMA's operations which aggregated \$9.4 million.

Revenue in 1996 from the sale of night vision systems to the government market increased 27.9%, from \$33.6 million in 1995 to \$43.0 million in 1996. This increase was primarily due to increased sales of the SAFIRE(TM) night vision system, principally to the U.S. Marine Corps and the U.S. Air Force. Commercial revenue increased 39.3%, from \$16.6 million in 1995 to \$23.1 million in 1996. This improvement was principally attributable to the inclusion of revenue from sales of the Company's commercial broadcast products, primarily the UltraMedia(TM) which was introduced in April 1996.

The Company has continued to benefit from its significant investment in developing worldwide sales and distribution channels. The majority of the Company's revenue outside the United States is from Europe. International revenue increased from \$21.2 million in 1996 to \$43.3 million in 1997 and accounted for approximately 47.2% of the Company's revenue in 1997. This represents an increase from the 32.0% experienced in 1996 and the 46.0% experienced in 1995. The increase in absolute dollars and as a percentage of revenue in 1997 was primarily due to increased shipments under the terms of existing international contracts, decreased shipments to U.S. government customers, principally the U.S. Marine Corps, and the inclusion of a partial month of AGEMA revenue which are primarily international. The Company anticipates that revenue from international sales as a percentage of total revenue will continue to comprise a significant percentage of revenue but may vary modestly from year to year.

GROSS PROFIT. As a percentage of revenue, gross profit decreased from 53.9% in 1996 to 36.2% in 1997, primarily due to the \$16.1 million write-off of duplicative inventories related to the AGEMA acquisition which was included in cost of goods sold in 1997. Exclusive of this write-off, gross margin remained relatively consistent at 53.8% for 1997 compared to 53.9% in 1996. The gross margin remained relatively consistent due to an increase in higher margin international sales and a decrease in sales to the U.S. Government which aggregated \$19.0 million in 1997 compared to \$26.5 million in 1996 and typically have lower margins than other sales to the government market. This increase was mitigated by the increased proportion of sales of the Company's commercial products which typically have slightly lower margins than government products. Gross profit decreased as a percentage of revenue from 54.7% in 1995

to 53.9% in 1996, primarily due to the lower percentage of higher margin international sales in 1996 and increased sales to the U.S. Government.

Gross profit percentages are affected by a variety of factors, including the mix of domestic and international government and commercial sales, the more competitive nature of the commercial market and the impact of competitive bids for significant government contracts.

RESEARCH AND DEVELOPMENT. Research and development expense increased 24.6%, from \$9.5 million in 1996 to \$11.8 million in 1997, and increased 21.8%, from \$7.8 million in 1995 to \$9.5 million in 1996. As a percentage of revenue, research and development expense decreased from 14.4% in 1996 to 12.9% in 1997 and decreased from 15.5% in 1995 to 14.4% in 1996. The increase in research and development expense, in absolute dollar terms, was attributable to increased research and development activities related to the introduction of the UltraMedia-RS(TM), the ULTRA 6000(TM) and the Tracer(TM), as well as to on-going product enhancements. Further impacting research and development expense was the reclassification of development costs directly associated with engineering revenue as cost of goods sold rather than research and development expenses. Such costs amounted to \$800,000, \$200,000 and \$425,000 in 1997, 1996 and 1995, respectively. Without these reclassifications, research and development expense as a percentage of revenue would be 13.7%, 14.7% and 16.4% in 1997, 1996 and 1995, respectively, reflecting the fact that a large percentage of research and development expense is fixed in nature.

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The general trend in research and development expense reflects the Company's continuing emphasis on product development and new product introductions. With the acquisition of AGEMA, the engineering efforts for handheld thermographic products will be concentrated at AGEMA's Stockholm facility and the engineering efforts for government products and airborne broadcast cameras will be concentrated at the Company's facilities in Portland. The Company expects that research and development expense, in absolute dollars, will increase in 1998 as a result of the inclusion of a full year of AGEMA operations. However, as the Company's revenues increase, and given the large percentage of research and development expense that is fixed in nature, such expenses should continue to decline slightly as a percentage of revenue.

SELLING AND OTHER OPERATING COSTS. Selling and other operating costs increased 39.7% in 1997 compared to 1996 and increased 29.6% in 1996 compared to 1995, primarily due to costs associated with increased revenue, particularly the increase in international sales, expenses related to the expanded operations of the Company's United Kingdom facility and to increased personnel. Further, the Company has continued to expand and strengthen the direct sales and marketing staff. Selling and other operating costs as a percentage of revenue remained relatively consistent at 28.8% in 1996 and 28.9% in 1997, and decreased slightly from 29.3% in 1995 to 28.8% in 1996. The Company expects that selling and other operating costs will continue to grow in absolute dollar terms in 1998 as a result of the inclusion of a full year of AGEMA operations, further planned sales force increases and anticipated increased marketing efforts and related expenses.

INTEREST EXPENSE AND OTHER. Interest expense and other includes costs related to short-term and long-term debt, capital lease obligations and miscellaneous bank charges and expenses. The increase from \$819,000 in 1996 to \$2.1 million in 1997 was primarily due to increased short-term and long-term debt as a result of increased working capital needs discussed below. The increase from \$795,000 in 1995 (\$195,000 exclusive of the one-time costs associated with the acquisition of Optimas) to \$819,000 in 1996 was due to the one-time costs associated with the acquisition of Optimas. Such acquisition expenses aggregated approximately \$600,000.

INCOME TAXES. The Company's effective income tax rates for 1997, 1996 and 1995 were 29.6%, 19.7% and 11.9%, respectively. The effective tax rates were substantially below the statutory rate as the Company was able to realize the benefits of a portion of its net operating loss carryforwards and existing tax credits. Additionally, the Company recognized a net deferred tax asset of \$14.7 million, \$400,000 and \$950,000 in 1997, 1996 and 1995, respectively, under the recognition criteria of Statement of Financial Accounting Standards No. 109 (SFAS 109), "Accounting for Income Taxes." The \$14.7 million deferred tax asset recognized in 1997 relates primarily to the \$52.5 million write-off in conjunction with the AGEMA acquisition. The current portion of income tax expense consists of state, federal and foreign income

taxes, as the utilization of net operating loss carryforwards and existing tax credits was limited.

At December 31, 1997, the Company had net operating loss carryforwards aggregating \$9.3 million, which expire in the years 1998 through 2012. Utilization of the Company's acquired net operating loss carryforwards from Optimas is limited to future earnings of Optimas and further limited to approximately \$350,000 per year, as Optimas experienced a cumulative change in ownership of more than 50% within a three-year period. Additionally, the Company has various tax credits available aggregating \$1.3 million which expire in the years 1999 through 2012.

AGEMA ACQUISITION

Effective December 1, 1997, the Company acquired all of the outstanding shares of AGEMA in exchange for 4,162,000 shares of the Company's common stock with a value of \$54.1 million and an additional \$1.6 million of direct acquisition costs. AGEMA designs, manufactures and markets handheld infrared imaging systems for the commercial market. The results of AGEMA's operations have been combined with those of the Company since the date of acquisition.

In conjunction with the acquisition, during the quarter ended December 31, 1997, the Company recognized a one-time charge of \$52.5 million. The write-off consisted of \$36.4 million of in-process research and development and acquisition-related costs, which are included as a separate line in operating expenses, and \$16.1 million of inventories due to the creation of duplicative product lines, which is included in cost of goods sold.

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LIQUIDITY AND CAPITAL RESOURCES

At December 31, 1997, the Company had cash and cash equivalents on hand of \$5.9 million compared with \$775,000 at December 31, 1996. Additionally, at December 31, 1997, the Company had \$26.6 million drawn on its lines of credit. Working capital decreased to \$26.6 million at December 31, 1997, from \$44.2 million at December 31, 1996. The decrease in working capital was primarily due to the increased utilization of the lines of credit due to increases in accounts receivable discussed below, increase in liabilities assumed related to the AGEMA acquisition and cash required for the expanded operations.

At December 31, 1997, the Company had \$55.5 million in accounts receivable outstanding compared to \$28.3 million at December 31, 1996. The increase in accounts receivable was primarily due to the addition of receivables related to AGEMA operations and the 39.0% increase in revenue. Days sales outstanding increased from 157 days at December 31, 1996 to 221 days at December 31, 1997. This increase was primarily a result of the acquisition of AGEMA, as the Company acquired all the receivables of AGEMA but has only included its operations from December 1, 1997, through December 31, 1997. Had the Company included the operations of AGEMA for all of 1997, days sales outstanding would have decreased to 150 days. The Company generally experiences long collection cycles due to a variety of factors, including payment terms required by foreign governmental customers as well as payment terms for companies that integrate the Company's products into aircraft for sale to ultimate users. The Company believes that with the inclusion of AGEMA's operations and ongoing collection efforts, days sales outstanding will continue to decline as revenue increases and as commercial revenue, which generally have a shorter collection cycle, continues to become a larger percentage of overall revenue.

At December 31, 1997, the Company had inventories on hand aggregating \$34.7 million compared to \$33.5 million at December 31, 1996. The slight increase in the inventory level was principally due to the inclusion of inventory of AGEMA, an increase in components related to anticipated deliveries of SAFIRE(TM) systems to the U.S. Government and international customers, and an increase in inventories to support deliveries of new products including the UltraMedia(TM), the UltraMedia RS(TM) and the Tracer(TM). These increases were somewhat offset as a result of the \$16.1 million write-off of duplicative inventories discussed above. Additionally, inventory levels at the Company's United Kingdom manufacturing operation continue to increase in anticipation of future deliveries under existing contracts. Because of the extremely long lead times for many of the Company's most expensive components, it is necessary to have inventory on hand to meet the required delivery schedule. The Company maintains levels of inventory sufficient to satisfy backlog which the Company considers to be firm and to respond to short term delivery requirements for a majority of its

products. Management believes its ability to provide prompt deliveries gives the Company a competitive advantage for certain sales. It is expected that the current inventory levels will be maintained or decrease slightly.

The Company has available approximately \$35.1 million in lines of credit which bear interest at rates from 4.70% to 7.75% and are collateralized by all assets of the Company. At December 31, 1997, the Company had a balance of \$26.6 million drawn on these lines of credit compared to a \$6.4 million balance on these lines at December 31, 1996.

The Company believes that its existing cash, cash generated from operations, and available credit facilities together with scheduled collections on existing receivable balances will be sufficient to meet its cash requirements for the foreseeable future.

FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Annual Report contain forward-looking statements within the meaning of the Securities Litigation Reform Act of 1995 that are based on current expectations, estimates and projections about the Company's business, management's beliefs and assumptions made by management. Words such as "expect," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors, including, but not limited to, those discussed in this Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as

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those discussed elsewhere in this Annual Report and from time to time in the Company's other Securities and Exchange Commission filings and reports. In addition, such statements could be affected by general industry and market conditions and growth rates, and general domestic and international economic conditions.

YEAR 2000 ISSUES

As the year 2000 approaches, the Company recognizes the need to ensure its operations and products will not be adversely impacted by Year 2000 software issues. The Company is addressing this via the use of both internal and external resources to conduct a comprehensive review of its computer systems and code internal to the Company products. The Company expects to complete the project on a timely basis to assure the availability and integrity of its financial system and the reliability of its operational systems by the end of 1999. Such work has not had and is not anticipated to have a material effect on the consolidated financial position of the Company.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

This item includes the following financial information:

STATEMENT	Page
Report of Price Waterhouse LLP, Independent Accountants.....	19
Consolidated Statement of Operations for the Years Ended December 31, 1997, 1996 and 1995..	20
Consolidated Balance Sheet as of December 31, 1997 and 1996.....	21
Consolidated Statement of Shareholders' Equity for the Years Ended	
December 31, 1997, 1996 and 1995.....	22
Consolidated Statement of Cash Flows for the Years Ended December 31, 1997, 1996 and 1995...	23
Notes to the Consolidated Financial Statements.....	24
Quarterly Financial Data (Unaudited).....	36

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To the Board of Directors and
Shareholders of FLIR Systems, Inc.

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, of shareholders' equity, and of cash flows present fairly, in all material respects, the financial position of FLIR Systems, Inc. and its subsidiaries at December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PRICE WATERHOUSE LLP

Portland, Oregon
March 9, 1998

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FLIR SYSTEMS, INC.

CONSOLIDATED STATEMENT OF OPERATIONS
(in thousands, except per share amounts)

	Year Ended December 31,		
	1997	1996	1995
Revenue:			
Government.....	\$ 48,483	\$42,958	\$33,575
Commercial.....	43,288	23,059	16,550
Total revenue.....	91,771	66,017	50,125
Cost of goods sold.....	58,507	30,415	22,724
Research and development.....	11,814	9,485	7,786
Selling and other operating costs.....	26,551	18,999	14,656
Combination costs.....	36,450	--	--
(Loss) earnings from operations.....	133,322	58,899	45,166
Interest income.....	(41,551)	7,118	4,959
Interest expense and other.....	182	44	226
	(2,103)	(819)	(795)
(Loss) earnings before income taxes.....	(43,472)	6,343	4,390
Income tax (benefit) provision.....	(12,884)	1,251	523
Net (loss) earnings.....	\$ (30,588)	\$ 5,092	\$ 3,867
Net (loss) earnings per share:			
Basic.....	\$ (5.23)	\$ 0.95	\$ 0.74
Diluted.....	\$ (5.23)	\$ 0.91	\$ 0.70

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

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FLIR SYSTEMS, INC.

CONSOLIDATED BALANCE SHEET
(in thousands, except for share data)

ASSETS

	December 31,	
	1997	1996
Current assets:		
Cash and cash equivalents.....	\$ 5,884	\$ 775
Accounts receivable, net.....	55,463	28,311
Inventories.....	34,724	33,513
Prepaid expenses.....	3,516	1,551
Total current assets.....	99,587	64,150
Property and equipment, net.....	18,423	7,137
Software development costs, net.....	1,043	799
Deferred income taxes, net.....	16,873	2,200
Intangible assets, net.....	14,013	--
Other assets.....	3,918	818
	\$153,857	\$75,104

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Notes payable.....	\$ 26,558	\$ 6,365
Accounts payable.....	15,493	7,628
Accounts payable to related parties.....	6,228	128
Accrued payroll and other liabilities.....	19,105	3,389
Accrued income taxes.....	363	1,073
Current portion of long-term debt.....	5,273	1,377
Total current liabilities.....	73,020	19,960
Long-term debt.....	1,679	5,173
Pension liability.....	3,969	--
Commitments and contingencies.....	--	--
Shareholders' equity:		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized; no shares issued at December 31, 1997 or 1996.....	--	--
Common stock, \$0.01 par value, 30,000,000 shares authorized, 9,756,458 and 5,387,483 shares issued at December 31, 1997 and 1996, respectively.....	98	54
Additional paid-in capital.....	97,684	41,833
(Accumulated deficit) retained earnings.....	(22,331)	8,257
Cumulative foreign translation adjustment.....	(262)	(173)
Total shareholders' equity.....	75,189	49,971
	\$153,857	\$75,104

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

FLIR SYSTEMS, INC.

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(in thousands, except for share data)

	Preferred Stock		Common Stock	
	Shares	Amount	Shares	Amount
Authorized.....	10,000,000	\$0.01 par value	30,000,000	\$0.01 par value
Balance, December 31, 1994.....	--	\$ --	5,187,804	\$ 52
Net earnings for the year.....	--	--	--	--
Common stock options exercised...	--	--	79,275	1
Common shares issued.....	--	--	16,286	--
Balance, December 31, 1995.....	--	--	5,283,365	53
Net earnings for the year.....	--	--	--	--
Common stock options exercised...	--	--	70,788	1
Common shares issued pursuant to stock option plans.....	--	--	33,330	--
Income tax benefit from stock options exercised.....	--	--	--	--
Foreign translation adjustment...	--	--	--	--

Balance, December 31, 1996.....	--	--	5,387,483	54
Net loss for the year.....	--	--	--	--
Common stock options excised....	--	--	206,975	2
Common stock issued for acquisitions.....	--	--	4,162,000	42
Income tax benefit from stock options exercised.....	--	--	--	--
Foreign translation adjustment...	--	--	--	--
Balance, December 31, 1997.....	--	\$ --	9,756,458	\$ 98

	Additional Paid-in Capital	Retained Earnings (Deficit)	Cumulative Foreign Translation Adjustment	Total
Authorized.....				
Balance, December 31, 1994.....	\$39,812	\$ (702)	\$ --	\$ 39,162
Net earnings for the year.....	--	3,867	--	3,867
Common stock options exercised...	363	--	--	364
Common shares issued.....	77	--	--	77
Balance, December 31, 1995.....	40,252	3,165	--	43,470
Net earnings for the year.....	--	5,092	--	5,092
Common stock options exercised...	587	--	--	588
Common shares issued pursuant to stock option plans.....	398	--	--	398
Income tax benefit from stock options exercised.....	596	--	--	596
Foreign translation adjustment...	--	--	(173)	(173)
Balance, December 31, 1996.....	41,833	8,257	(173)	49,971
Net loss for the year.....	--	(30,588)	--	(30,588)
Common stock options excised....	1,460	--	--	1,462
Common stock issued for acquisitions.....	54,064	--	--	54,106
Income tax benefit from stock options exercised.....	327	--	--	327
Foreign translation adjustment...	--	--	(89)	(89)
Balance, December 31, 1997.....	\$97,684	\$ (22,331)	\$ (262)	\$75,189

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

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FLIR SYSTEMS, INC.

CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	1997	1996	1995
Cash (used) provided by operating activities:			
Net (loss) earnings.....	\$ (30,588)	\$ 5,092	\$ 3,867
Income charges not affecting cash:			
In-process research and development write-off.....	33,600	--	--
Depreciation.....	2,689	1,972	1,854
Amortization.....	680	481	506
Disposal and write-offs of property and equipment.....	333	239	104
Deferred income taxes.....	(13,796)	(400)	(950)
Changes in certain working capital components, net of effects of acquisition:			
Increase in accounts receivable.....	(18,210)	(3,413)	(3,847)

Decrease (increase) in inventories.....	8,966	(9,847)	(6,762)
Increase in prepaid expenses.....	(35)	(1,112)	(106)
Decrease (increase) in other assets.....	609	(329)	109
Increase in accounts payable.....	4,981	2,151	1,843
Increase (decrease) in accounts payable to related parties...	976	(145)	(51)
Increase (decrease) in accrued payroll and other liabilities.	4,446	(58)	(604)
(Decrease) increase in accrued income taxes.....	(767)	488	133
	-----	-----	-----
Cash used by operating activities.....	(6,116)	(4,881)	(3,904)
	-----	-----	-----
Cash used by investing activities:			
Additions to property and equipment.....	(10,843)	(5,526)	(2,987)
Net cash acquired from Agema.....	805	--	--
Software development costs.....	(703)	(630)	(599)
	-----	-----	-----
Cash used by investing activities.....	(10,741)	(6,156)	(3,586)
	-----	-----	-----
Cash provided by financing activities:			
Net increase in notes payable.....	19,971	4,309	2,056
Proceeds from long-term debt.....	995	5,817	572
Repayments of long-term debt including current portion.....	(593)	(877)	(608)
Common stock issued.....	--	--	77
Reduction of pension liability.....	(107)	--	--
Proceeds from exercise of stock options and shares issued pursuant to incentive stock option plans, including tax benefit.....	1,789	1,582	364
	-----	-----	-----
Cash provided by financing activities.....	22,055	10,831	2,461
	-----	-----	-----
Effect of exchange rate changes on cash.....	(89)	(173)	--
	-----	-----	-----
Net increase (decrease) in cash.....	5,109	(379)	(5,029)
Cash and cash equivalents, beginning of year.....	775	1,154	6,183
	-----	-----	-----
Cash and cash equivalents, end of year.....	\$ 5,884	\$ 775	\$ 1,154
	=====	=====	=====

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

FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES:

The Company designs, manufactures, and markets thermal imaging and broadcast camera systems worldwide for a wide variety of applications in the government and commercial markets. Thermal imaging systems detect infrared radiation, or heat, emitted directly by all objects and materials and enable the operator to see objects in total darkness, in adverse weather conditions and through obscurants such as smoke and haze. Government applications include public safety (law enforcement and drug interdiction, search and rescue, border patrol and maritime patrol, and environmental protection) and defense (surveillance, reconnaissance and navigation assistance). Commercial applications include electronic news-gathering, non-destructive testing and evaluation, research and development, manufacturing process control, condition monitoring and image analysis.

Principles of consolidation

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

Recognition of revenue

Revenue is recognized when products are shipped or when services are performed, except for certain long-term contracts, which are recorded on the percentage-of-completion method. The percentage-of-completion method is used for research and development contracts and for production contracts that require significant amounts of initial engineering and development costs. The percentage-of-completion is determined by relating the actual costs incurred to date to the total costs to complete the respective contract.

Foreign currency translation

The financial statements of subsidiaries outside the United States are generally measured using the local currency as the functional currency. Assets and liabilities of these subsidiaries are translated at the rates of exchange at the balance sheet date. Income and expense items are translated at the average monthly rates of exchange. The resultant translation adjustments are included in the cumulative foreign translation adjustment, a separate component of shareholders' equity. Gains and losses from foreign currency transactions of these subsidiaries are included in net earnings.

Cash and cash equivalents
- -----

The Company considers short-term investments which are highly liquid, readily convertible into cash and have original maturities of less than three months to be cash equivalents for purposes of the statement of cash flows. The Company generally invests its excess cash in investment grade, short-term commercial paper which is held to maturity. At December 31, 1997, the Company did not hold any short-term investments.

Inventories
- -----

Inventories are stated at the lower of average cost or market.

NOTE 1 - NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued):
- -----

Property and equipment
- -----

Property and equipment are stated at cost and are depreciated using a straight-line methodology over their estimated useful lives. Such lives range from two to ten years.

Repairs and maintenance are charged to operations as incurred.

Software development costs
- -----

The Company capitalizes software development costs when a project reaches technological feasibility and ceases capitalization once the related product is ready for release. Research and development costs related to software development that has not reached technological feasibility are expensed as incurred. Software development costs are amortized at the greater of (a) the ratio of number of units shipped to the current and anticipated future units to be shipped or (b) the straight-line method over the remaining estimated economic life of the product. Generally, the estimated economic life is three years.

Income taxes
- -----

The Company utilizes the liability method as set forth in Statement of Financial Accounting Standards No. 109 (SFAS 109), "Accounting for Income Taxes" (see Note 3).

Earnings per share
- -----

Earnings per share are based on the weighted average number of shares of common stock and common stock equivalents outstanding during the periods, computed using the treasury stock method for stock options. In 1997, the Company adopted Statement of Financial Accounting Standards No. 128, "Earnings per Share." The following table sets forth the reconciliation of the denominator utilized in the computation of basic and diluted (loss) earnings per share (in thousands):

December 31,		
1997	1996	1995
-----	-----	-----

Weighted average number of common shares outstanding.....	5,843	5,361	5,246
Assumed exercise of stock options net of shares assumed reacquired under the treasury stock method.....	--	263	277
Diluted shares outstanding.....	5,843	5,624	5,523

The effect of stock options in 1997 of 388,000 shares was excluded for purposes of diluted earnings per share since the effect would have been anti-dilutive.

Reclassifications

- - - - -

Certain reclassifications have been made to prior years' data to conform with the current year's presentation. These reclassifications had no impact on previously reported results of operations or shareholders' equity.

NOTE 1 - NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued):

- - - - -

Statement of cash flows

- - - - -

Cash paid for interest and income taxes amounted to the following (in thousands):

	Year ended December 31,		
	1997	1996	1995
Cash paid for:			
Interest.....	\$1,508	\$ 782	\$ 133
Taxes.....	\$1,549	\$ 763	\$1,340

The non-cash portion of the AGEMA acquisition was excluded from the statement of cash flows. (see Note 17).

Fair value of financial assets and liabilities

- - - - -

The Company estimates the fair value of its monetary assets and liabilities based upon comparison of such assets and liabilities to the current market values for instruments of a similar nature and degree of risk. The Company estimates that the recorded value of all of its monetary assets and liabilities approximates fair value as of December 31, 1997, except for the patent note described in Note 9. Interest has been imputed on the patent note at 14% which exceeds the current market rate for this type of note. Therefore, the fair value of this note is estimated to be approximately \$16,000 in excess of its recorded value at December 31, 1997.

Stock-based compensation

- - - - -

The Company adopted the disclosure only provisions of Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock-Based Compensation", effective January 1, 1996. SFAS 123 allows companies to choose whether to account for stock-based compensation under the method prescribed in Accounting Principles Board Opinion No. 25 (APB 25) or use the fair value method described in SFAS 123. The Company elected to continue to follow the provisions of APB 25 (see Note 13).

Concentration of credit risk

- - - - -

Financial instruments that potentially subject the Company to concentration of

credit risk consist primarily of trade receivables. Concentration of credit risk with respect to trade receivables is limited because a relatively large number of geographically diverse customers make up the Company's customer base, thus diversifying the trade credit risk. The Company controls credit risk through credit approvals, credit limits and monitoring procedures. The Company performs in-depth credit evaluations for all new customers and requires letters of credit, bank guarantees and advanced payments, if deemed necessary.

Certain risks and uncertainties

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 and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Significant estimates and judgments made by management of the Company include matters such as collectibility of accounts receivable, realizability of inventories and recoverability of capitalized software and deferred tax assets. Actual results could differ from those estimates.

NOTE 1 - NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued):

Recent accounting pronouncements

In 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 130 (SFAS 130), "Reporting of Comprehensive Income." Additionally in 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 131 (SFAS 131), "Disclosure about Segments of an Enterprise and Related Information." Both these items require certain additional disclosures about the Company's operations and historical operations. The Company plans to adopt SFAS 130 and SFAS 131 in 1998, however, management believes that the impact of adoption will not have a significant effect on the Company's financial position or results of operations.

NOTE 2 - OTHER OPERATING COSTS:

Selling and other operating costs consist of the following (in thousands):

	Year ended December 31,		
	1997	1996	1995
Representative commissions.....	\$ 3,371	\$ 1,587	\$ 2,390
Allowance for doubtful accounts.....	839	1,260	55
Other selling, general and administrative expenses....	22,341	16,152	12,211
	-----	-----	-----
	\$26,551	\$18,999	\$14,656
	=====	=====	=====

NOTE 3 - INCOME TAXES:

SFAS 109 requires the Company to recognize deferred tax liabilities and assets for the expected future tax consequences of events and basis differences that have been recognized in the Company's financial statements and tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement carrying amount and the tax basis of assets and liabilities using the enacted tax rates in effect in the years in which the differences are expected to reverse.

The (benefit) provision for income taxes is as follows (in thousands):

	Year ended December 31,		
	1997	1996	1995
Current tax expense:			
Federal.....	\$ 377	\$ 1,361	\$1,210
State.....	--	290	263
Foreign.....	538	--	--
	915	1,651	1,473
Deferred tax (benefit) expense:			
Federal.....	(16,566)	675	(146)
State.....	(1,817)	144	(15)
Foreign.....	478	--	--
	(17,905)	819	(161)
Increase (decrease) in valuation allowance.....	4,106	(1,219)	(789)
Total (benefit) provision.....	<u>\$ (12,884)</u>	<u>\$ 1,251</u>	<u>\$ 523</u>

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NOTE 3 - INCOME TAXES - (Continued):

Deferred tax assets are composed of the following components (in thousands):

	December 31,	
	1997	1996
Allowance for doubtful accounts.....	\$ 759	\$ 679
Warranty reserve.....	392	347
Inventory basis differences.....	2,841	665
Accrued liabilities.....	1,841	324
Acquired in-process research and development.....	12,768	--
Depreciation.....	(196)	75
Software development costs.....	(396)	(325)
Net operating loss carryforwards.....	3,358	1,870
Credit carryforwards.....	1,334	771
Other.....	1,061	577
Gross deferred tax asset.....	23,762	4,983
Deferred tax asset valuation allowance.....	(6,889)	(2,783)
	<u>\$16,873</u>	<u>\$ 2,200</u>

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

	Year ended December 31,		
	1997	1996	1995
Statutory federal tax rate.....	(34.0)%	34.0%	34.0%
Increase (decrease) in rates resulting from:			
State taxes.....	(4.2)	4.5	6.0
Utilization of net operating loss carryforwards.....	--	--	(15.0)
Foreign sales corporation benefit.....	(2.7)	(3.2)	(7.6)
Utilization of research and development credits.....	--	(11.3)	(0.8)
Increase in valuation allowance.....	9.5	(6.3)	(21.6)
Alternative minimum tax.....	--	--	16.1
Other.....	1.8	2.0	0.8
Effective tax rate.....	<u>(29.6)%</u>	<u>19.7%</u>	<u>11.9%</u>

As of December 31, 1997, the Company's net operating loss carryforwards aggregated \$9,267,000 and expire in the years 1998 through 2012. Utilization of the Company's acquired net operating loss carryforwards from Optimas is limited to future earnings of Optimas and are further limited to approximately \$350,000 per year, as Optimas has experienced a cumulative change in ownership of more than 50% within a three-year period. In addition, the Company has various tax credits available aggregating \$1,334,000 at December 31, 1997, which expire in

the years 1999 through 2012.

NOTE 4 - ACCOUNTS RECEIVABLE:
 - -----

Accounts receivable are net of an allowance for doubtful accounts of \$2,483,000 and \$1,671,000 at December 31, 1997 and 1996, respectively.

NOTE 5 - INVENTORIES:
 - -----

Inventories consist of the following (in thousands):

	December 31,	
	1997	1996
Raw material and subassemblies.....	\$26,631	\$23,855
Work-in-progress.....	9,995	8,171
Finished goods.....	894	1,494
	37,520	33,520
Less - progress payments received from customers.....	(2,796)	(7)
	\$34,724	\$33,513

NOTE 6 - PROPERTY AND EQUIPMENT:
 - -----

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

	December 31,	
	1997	1996
Land and building.....	\$ 464	\$ --
Machinery and equipment.....	24,859	8,445
Office equipment and other.....	9,672	5,382
	34,995	13,827
Less - accumulated depreciation.....	(16,572)	(6,690)
	\$18,423	\$ 7,137

Property and equipment include the cost of equipment held by the Company under capital lease agreements. Such cost and related accumulated depreciation aggregated \$3,674,000 and \$1,939,000, respectively, at December 31, 1997, and \$2,724,000 and \$1,336,000, respectively, at December 31, 1996.

NOTE 7 - SOFTWARE DEVELOPMENT COSTS:
 - -----

Software development costs are summarized as follows (in thousands):

	December 31,	
	1997	1996
Software development costs.....	\$ 2,236	\$1,533
Less - accumulated amortization.....	(1,193)	(734)

----- \$ 1,043 =====	----- \$ 799 =====
----------------------------	--------------------------

Amortization of capitalized software costs aggregated \$459,000, \$300,000 and \$393,000 for the years ended December 31, 1997, 1996 and 1995, respectively.

NOTE 8 - NOTES PAYABLE:

The Company has a \$30,000,000 line of credit bearing interest at the IBOR plus 1.75% (7.75% at December 31, 1997) secured by all assets of the Company. Additionally, the Company, through one of its subsidiaries, has a 40,000,000 Swedish Kroner (approximately \$5,040,000) line of credit at 4.70% at December 31, 1997. At December 31, 1997 and 1996, the Company had \$26,558,000 and \$6,365,000, respectively, outstanding against these lines.

NOTE 9 - LONG-TERM DEBT:

Long-term debt at December 31 is summarized as follows (in thousands):

	December 31,	
	----- 1997 -----	----- 1996 -----
Note payable - patent.....	\$ 206	\$ 294
Note payable to bank; 7.75% interest rate. Payable in monthly installments of \$123, due June 1, 1998, secured by all assets of the Company.....	4,609	4,663
Capital leases.....	2,137	1,593
	-----	-----
	6,952	6,550
Less - current portion.....	(5,273)	(1,377)
	-----	-----
	\$ 1,679	\$ 5,173
	=====	=====

The patent note calls for annual payments through 1999 of \$70,000 plus an adjustment for changes in the Consumer Price Index. Because the note did not include a stated interest rate, interest has been imputed at a rate of 14%. The Consumer Price Index was estimated assuming an average increase of 5% per year. Payments of \$116,000, \$115,000 and \$112,000 were made in the years ended December 31, 1997, 1996 and 1995, respectively. The related patent was capitalized based on the present value, at inception, of the patent note of \$683,000. The patent was fully amortized as of December 31, 1990.

NOTE 10 - PENSION PLANS:

As a result of the AGEMA acquisition (See Note 17), the Company now offers most of the employees outside the United States participation in defined benefit pension plans.

A summary of the components of the net periodic pension expense for the defined benefit plan for employees in Sweden was as follows (in thousands):

	----- 1997 -----
Service costs benefit earned for December 1997.....	\$ --
Interest cost on projected benefit obligation.....	17
Amortization of actuarial gain.....	--
Amortization of remaining transition obligation.....	(3)

Net pension costs..... \$ 14
=====

NOTE 10 PENSION PLANS (Continued):

A summary of the funded status of the pension plan in Sweden and the net pension liability is as follows (in thousands):

	December 31
	----- 1997 -----
Accumulated vested benefit obligations.....	\$3,421
Projected benefit obligation.....	3,421
Plan assets at fair value.....	--
Projected benefit obligation in excess of plan assets.....	3,421
Unrecognized actuarial gain.....	90
Unrecognized transition obligation.....	458
Pension liability.....	\$3,969 =====

Assumptions used for the defined benefit pension plans were as follows:

	1997

Weighted average discount rate.....	6.00%
Rates of increase in compensation levels.....	3.00%
Inflation rate.....	2.00%

NOTE 11 COMMITMENTS AND CONTINGENCIES:

The Company leases its primary facilities under various operating leases which expire in 1998 through 2003. Total rent expense for the years ended December 31, 1997, 1996 and 1995 amounted to \$1,940,000, \$1,471,000 and \$871,000, respectively.

Minimum rental payments required under all non-cancelable leases for equipment and facilities at December 31, 1997 are as follows (in thousands):

	Capital leases	Operating leases
	-----	-----
1998.....	\$ 732	\$2,520
1999.....	610	2,302
2000.....	499	1,937
2001.....	427	892
2002.....	197	37
Total minimum lease payments.....	2,465	\$7,688 =====
Less amount representing interest.....	(328)	
Present value of lease payments.....	\$2,137 =====	

The Company has a 401(k) Savings and Retirement Plan (the "Plan") to provide for voluntary salary deferral contributions on a pre-tax basis for employees within the United States in accordance with Section 401(k) of the Internal Revenue Code of 1986, as amended. The Plan allows for contributions by the Company. The Company recorded matching contributions of \$511,000, \$533,000 and \$0 for the years ended December 31, 1997, 1996 and 1995, respectively.

NOTE 12 - CAPITAL STOCK:

In 1996, the Company increased the number of shares of common stock reserved for future issuance pursuant to its incentive stock plans to 2,769,400. Under the plans, restricted stock, incentive stock options or non-qualified stock options may be granted to employees, consultants or non-employee directors of the Company with an exercise price of not less than the fair market value of the stock on the date of grant. Options granted pursuant to the plans expire ten years from date of grant and the plan terminates in 2003.

Under the 1992 incentive stock plan, 430,000 shares of common stock were reserved for restricted stock awards. Shares awarded are earned ratably over the term of the restricted stock agreement, based upon achievement of specified performance goals. Shares granted in 1997 and 1996 aggregated 115,000 and 100,000 shares, respectively. Of the shares granted, 115,000 and 33,330 shares were earned in 1997 and 1996, respectively, based upon achievement of specified performance goals. Shares granted which are not issued lapse and cease to be subject to the award. Compensation expense related to these awards, in the amounts of \$1,747,000 and \$398,000 was recorded in 1997 and 1996, respectively, and is included in selling and other operating costs. At December 31, 1997, there were 215,000 shares available for future awards.

NOTE 13 STOCK OPTIONS:

The Company has elected to account for its stock based compensation under APB 25; however, as required by SFAS 123, the Company has computed for pro forma disclosure purposes the value of options granted during 1997, 1996 and 1995 using the Black-Scholes option pricing model. The weighted average assumptions used for stock option grants for 1997, 1996 and 1995 were a risk-free interest rate of 6.0%, 5.2% and 7.7%, respectively, an expected dividend yield of 0%, 0% and 0%, respectively, an expected life of three years, and an expected volatility of 40.2%, 22.7% and 23.9%, respectively.

Options were assumed to be exercised upon vesting for purposes of this valuation. Adjustments are made for options forfeited prior to vesting. For the years ended December 31, 1997, 1996 and 1995, the total value of the options granted was computed to be \$1,879,000, \$819,000 and \$1,200,000, respectively, which would be amortized on a straight-line basis over the vesting period of the options.

If the Company had accounted for these plans in accordance with SFAS 123, the Company's net earnings and pro forma net earnings per share would have been as follows (in thousands, except per share data):

	Year Ended December 31,		
	1997	1996	1995
Net (loss) earnings - as reported.....	\$ (30,588)	\$ 5,092	\$ 3,867
Net (loss) earnings - pro forma.....	\$ (31,353)	\$ 4,593	\$ 3,578
(Loss) earnings per share:			
Basic - as reported.....	\$ (5.23)	\$ 0.95	\$ 0.74
Diluted - as reported.....	\$ (5.23)	\$ 0.91	\$ 0.70
(Loss) earnings per share:			
Basic - pro forma.....	\$ (5.37)	\$ 0.86	\$ 0.68
Diluted - pro forma.....	\$ (5.37)	\$ 0.82	\$ 0.65

The effects of applying SFAS 123 for providing pro forma disclosure for 1997, 1996 and 1995 are not likely to be representative of the effects on reported net earnings and earnings per share for future years since options vest over several

years and additional awards may be made.

NOTE 13 STOCK OPTIONS (Continued):

The table below summarizes the Company's stock option activity:

	Shares	Weighted Average Exercise Price
Balance at December 31, 1994.....	611,413	\$ 7.16
Granted.....	361,500	12.76
Exercised.....	(79,275)	5.85
Terminated.....	(65,067)	11.25
Balance at December 31, 1995.....	828,571	9.41
Granted.....	331,000	11.07
Exercised.....	(70,788)	8.41
Terminated.....	(27,757)	11.56
Balance at December 31, 1996.....	1,061,026	9.94
Granted.....	361,500	15.38
Exercised.....	(206,975)	7.97
Terminated.....	(92,378)	11.41
Balance at December 31, 1997.....	1,123,173	\$11.96

The following table sets forth the exercise price range, number of shares, weighted average exercise price, and the remaining contractual lives by group of similar price and grant dates:

Exercise Price Range	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
\$1.63 - \$5.23	145,349	\$ 4.76	3.3
\$9.13 - \$13.75	799,824	12.07	7.7
\$14.00 - \$20.63	178,000	17.31	9.2
	1,123,173	\$11.96	7.4

Options exercisable at December 31, 1997, totaled 565,547 shares at a weighted average exercise price of \$10.10. Options available for grant at December 31, 1997 totaled 1,021,322 shares.

NOTE 14 LONG-TERM CONTRACTS:

During 1994, the Company entered into a long-term research and development contract with a consortium of companies to develop an Autonomous Landing Guidance System for commercial and military aircraft as part of the U.S. Government's Technology Reinvestment Program. The Company's portion of this contract aggregated \$650,000. In April 1995, the Company was awarded an additional \$900,000 under this contract for the second phase of the development. Revenue from this contract aggregated \$0, \$416,000 and \$896,000 during the years ended December 31, 1997, 1996 and 1995, respectively, and are included in revenue. Costs associated with this contract aggregated \$0, \$200,000 and \$425,000 in 1997, 1996 and 1995, respectively, and are included in cost of goods sold. Outstanding billings at December 31, 1997 and 1996 aggregated \$0 and \$35,000, respectively, and were included in accounts receivable.

NOTE 15 - RELATED PARTY TRANSACTIONS:

The Company and Hughes Aircraft Company are related parties resulting from Hughes' stock interest in the Company. The Company purchases inventory parts from Hughes and its subsidiaries. During the years ended December 31, 1997, 1996 and 1995, the Company purchased parts aggregating \$2,243,000, \$1,670,000 and \$1,320,000, respectively, from Hughes and its subsidiaries. As of December 31, 1997 and 1996, the Company owed Hughes \$1,243,000 and \$128,000, respectively. Sales of the Company's products to Hughes and its affiliates amounted to \$34,000, \$103,000 and \$320,000 for the years ended December 31, 1997, 1996 and 1995, respectively.

As a result of the AGEMA acquisition (see Note 17), Spectra-Physics AB and subsidiaries ("Spectra") are related parties as a result of Spectra's stock interest in the Company. At December 31, 1997, the Company owed Spectra \$4,985,000 which is payable in full on June 30, 1998.

NOTE 16 - EXPORT SALES AND MAJOR CUSTOMERS:

Export sales and sales to major customers are as follows (in thousands):

	Year ended December 31,		
	1997	1996	1995
United States.....	\$48,462	\$44,865	\$27,062
Europe.....	24,008	14,883	15,872
Other foreign.....	19,301	6,269	7,191
	\$91,771	\$66,017	\$50,125
Major Customers:			
U.S. Government.....	\$18,983	\$26,469	\$15,686

NOTE 17 AGEMA ACQUISITION:

Effective December 1, 1997, the Company acquired all of the outstanding shares of AGEMA Infrared Systems AB, a corporation organized under the laws of Sweden, AGEMA Infrared Systems Limited, a corporation organized under the laws of the United Kingdom, AGEMA Infrared Systems Ltd., a corporation organized under the laws of Canada and AGEMA Infrared Systems, Inc., a Delaware corporation ("AGEMA") in exchange for 4,162,000 shares of the Company's common stock with a value of \$54,106,000. An additional \$1,559,000 of direct acquisition costs were also incurred and included in the purchase prices. AGEMA designs, manufactures and markets handheld infrared imaging systems for the commercial market. The results of AGEMA's operations have been combined with those of the Company since the date of acquisition.

NOTE 17 AGEMA ACQUISITION- (Continued):

The acquisition was accounted for using the purchase method of accounting. Accordingly, a portion of the purchase price was allocated to the net assets acquired based upon their estimated fair values as follows (in thousands):

	Balance at December 1, 1997
Current assets.....	\$ 23,413
Property and equipment.....	3,590
Other long-term assets.....	1,599
In process research and development.....	33,600
Intangibles.....	3,600
Excess of purchase price over net assets acquired.....	14,092

Current liabilities.....	(20,153)
Long-term liabilities.....	(4,076)

	\$ 55,665
	=====

The excess of purchase price over net assets acquired is being amortized on a straight-line basis over 15 years. Amortization of such excess of purchase price over the net assets acquired aggregated \$79,000 for 1997 and is included in selling and other operating costs.

The consolidated, unaudited results of operations, on a pro forma basis, are presented as though the acquisition of AGEMA had occurred on January 1, 1996, excluding one-time charges for acquired in-process research and development, acquisition related costs and duplicative inventories (in thousands, except per share data).

	1997	1996

	(Unaudited)	
Revenue.....	\$134,825	\$114,418
Net earnings.....	\$ 7,122	\$ 1,888
Earnings per share:		
Basic.....	\$ 0.74	\$ 0.20
Diluted.....	\$ 0.71	\$ 0.19

These unaudited pro forma results have been prepared for comparative purposes only and include certain adjustments, such as additional amortization expense of the excess of purchase price over net assets acquired and other intangible assets. They do not purport to be indicative of the results of operations which actually would have resulted had the combination been in effect on January 1, 1996, or of future results of operations of the consolidated entities.

For the purposes of this pro-forma presentation, amounts were translated at an average rate of 7.60 and 6.71 Swedish Kroner to the U.S. dollar for 1997 and 1996, respectively.

In conjunction with the acquisition, during the quarter ended December 31, 1997, the Company recognized a one-time charge of \$52,549,000. The write-off consisted of \$36,450,000 of acquired in-process research and development and acquisition-related costs, which are included as a separate line in operating expenses, and \$16,099,000 of inventories due to the creation of duplicative product lines, which is included in cost of goods sold.

QUARTERLY FINANCIAL DATA (UNAUDITED)

FLIR Systems, Inc.

	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER	YEAR

	(In thousands, except per share data)				
1997					

Revenue:					
Government.....	\$ 8,403	\$10,976	\$12,946	\$ 16,158	\$ 48,483
Commercial.....	7,418	8,963	10,969	15,938	43,288
Total revenue.....	15,821	19,939	23,915	32,096	91,771
Gross profit.....	8,292	10,944	12,785	1,243	33,264
Net (loss) earnings.....	91	1,450	2,437	(34,566)	(30,588)
Net (loss) earnings per share:					
Basic.....	\$ 0.02	\$ 0.26	\$ 0.44	\$ (4.96)	\$ (5.23)*
Diluted.....	\$ 0.02	\$ 0.25	\$ 0.41	\$ (4.96)	\$ (5.23)*
1996					

Revenue:					
Government.....	\$ 6,479	\$ 9,991	\$11,913	\$ 14,575	\$ 42,958
Commercial.....	4,757	5,138	6,025	7,139	23,059
Total revenue.....	11,236	15,129	17,938	21,714	66,017
Gross profit.....	5,992	7,743	9,626	12,241	35,602
Net earnings.....	56	1,106	2,121	1,809	5,092

Net earnings per share:					
Basic.....	\$ 0.01	\$ 0.21	\$ 0.39	\$ 0.34	\$ 0.95
Diluted.....	\$ 0.01	\$ 0.20	\$ 0.38	\$ 0.32	\$ 0.91

* - The sum of the quarterly (loss) earnings per share does not equal annual loss per share as a result of the computation of quarterly versus annual average shares outstanding primarily related to the shares issued on December 1, 1997, related to the Agema acquisition.

SIGNIFICANT FOURTH QUARTER ADJUSTMENT:

During the quarter ended December 31, 1997, the Company increased the reserve for doubtful accounts by \$800,000 primarily related to commercial customers in Southeast Asia.

Additionally, during the quarter ended December 31, 1997, the Company recorded a one-time charge of \$52.5 million associated with the acquisition of AGEMA which was effective December 1, 1997. The write-off consisted of \$36.4 million of in-process research and development and merger-related costs, which are included as a separate line in operating expense, and \$16.1 million of inventories due to the creation of duplicative product lines, which is included in cost of goods sold.

Item 9. CHANGES IN AND DISAGREEMENT WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES.

Not Applicable

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

Information with respect to directors and executive officers of the Company is included under "Election of Directors," "Management -- Executive Officers" and "Section 16 Reports" in the Company's definitive proxy statement for its 1998 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION.

Information with respect to executive compensation is included under "Executive Compensation" in the Company's definitive proxy statement for its 1998 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

Information with respect to security ownership of certain beneficial owners and management is included under "Stock Owned by Management and Principal Shareholders" in the Company's definitive proxy statement for its 1998 Annual Meeting of Shareholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The Company purchases inventory parts from Hughes and its subsidiaries. During the years ended December 31, 1997, 1996 and 1995, the Company purchased parts aggregating \$2,243,000, \$1,670,000 and \$1,320,000, respectively, from Hughes and its subsidiaries. As of December 31, 1997 and 1996, the Company owed Hughes \$1,243,000 and \$128,000, respectively. Sales of the Company's products to Hughes and its affiliates amounted to \$34,000, \$103,000 and \$320,000 for the years ended December 31, 1997, 1996 and 1995, respectively.

As a result of the AGEMA acquisition, Spectra-Physics AB and subsidiaries ("Spectra") are related parties as a result of Spectra's stock interest in the Company. At December 31, 1997, the Company owed Spectra \$4,985,000 which is payable in full on June 30, 1998.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENTS AND SCHEDULES.

(a) (1) FINANCIAL STATEMENTS

The financial statements are included in Item 8 above.

(a) (2) FINANCIAL STATEMENT SCHEDULES

The following schedule is filed as part of this Report:

Schedule II -- Valuation and Qualifying Accounts
Report of Independent Accountants on Financial Statement Schedule

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

(a) (3) EXHIBITS

Number	Description
3.1	Second Restated Articles of Incorporation of FLIR Systems, Inc. (incorporated by reference to Exhibit 3.1 to Registration Statement on Form S-1 (File No. 33-62582))
3.2	First Restated Bylaws of FLIR Systems, Inc. (incorporated by reference to Exhibit 3.2 to Registration Statement on Form S-1 (File No. 33-62582))
10.1	Form of Indemnity Agreement between FLIR Systems, Inc. and each member of its Board of Directors (incorporated by reference to Exhibit 10.1 to Registration Statement on Form S-1 (File No. 33-62582))
10.2	1984 Incentive Stock Option Plan and Amendments (incorporated by reference to Exhibit 10.2 to Registration Statement on Form S-1 (File No. 33-62582))
10.3	1992 Stock Incentive Plan (incorporated by reference to Exhibit 10.3 to Registration Statement on Form S-1 (File No. 33-62582))
10.4	1993 Stock Option Plan for Non-employee Directors (incorporated by reference to Exhibit 10.4 to Registration Statement on Form S-1 (File No. 33-62582))
10.5	Description of Management Bonus Plan (incorporated by reference to Exhibit 10.5 to Registration Statement on Form S-1 (File No. 33-62582))
10.6	Lease Dated February 11, 1985, as amended, by and among FLIR Systems, Inc. and Pacific Realty Association, L.P. (incorporated by reference to Exhibit 10.6 to Registration Statement on Form S-1 (File No. 33-62582))
10.7	Form of Registration Rights Agreement dated as of May 12, 1993 by and among FLIR Systems, Inc., Louisiana Pacific Venture Corp. and Hughes Aircraft Company (incorporated by reference to Exhibit 10.8 to Registration on Form S-1 (File No. 33-62582))
10.8	Amendments to the Lease dated February 11, 1985, by and among FLIR Systems, Inc. and Pacific Realty Association, L.P.
10.9	Business Loan Agreement with Bank of America NT & SA
10.10	Amendment No. 2 to Business Loan Agreement with Bank of America NT & SA
10.11	Security Agreement with Bank of America NT & SA
10.12	Combination Agreement, Dated October 6, 1997, Among FLIR Systems, Inc., Spectra-Physics AB, Spectra-Physics Holding S.A., Spectra-Physics Holdings GmbH, Spectra-Physics Holdings PLC, and Pharos Holdings, Inc. (incorporated by reference to Exhibit 2.0 to Current Report on Form 8-K filed on October 24, 1997)
10.13	Form of Executive Employment Agreement dated as of May 5, 1997 (Robert P. Daltry and J. Kenneth Stringer III) (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed on October 24, 1997)
10.14	Form of Executive Employment Agreement dated as of May 5, 1997 (James A. Fitzhenry, J. Mark Samper, William N. Martin and Steven R. Palmquist) (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed on October 24, 1997)
10.15	Form of Agreement Amending Executive Employment Agreement dated as of December 1, 1997 for Robert P. Daltry, J. Kenneth Stringer III, James A. Fitzhenry, J. Mark Samper, William N. Martin and Steven R. Palmquist (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed on December 15, 1997)
10.16	Registration Rights Agreement dated as of December 1, 1997 by and among FLIR Systems, Inc., Spectra-Physics AB, Spectra Physics Holdings PLC and Pharos Holdings (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed on December 15, 1997)
10.17	Amendment to Registration Rights Agreement dated as of December 1, 1997 by and among

Leif Bergstrom

/s/ J. KENNETH STRINGER III

Director, President and Chief
Operating Officer

J. Kenneth Stringer III

Vice President of Finance and Chief
Financial Officer (Principal
Accounting and Financial Officer)

/s/ J. MARK SAMPER

J. Mark Samper

/s/ PATRICK L. EDELL

Patrick L. Edsell

Director

/s/ JOHN C. HART

John C. Hart

Director

/s/ EGON LINDEROTH

Egon Linderoth

Director

/s/ W. ALLEN REED

W. Allen Reed

Director

/s/ LARS SPONGBERG

Lars Spongberg

Director

/s/ RONALD L. TURNER

Ronald L. Turner

Director

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SCHEDULE II

FLIR SYSTEMS, INC.

VALUATION AND QUALIFYING ACCOUNTS
(In thousands)

COLUMN A	COLUMN B	COLUMN C	COLUMN D	COLUMN E	
		Additions			
	Balance at Beginning of the Year	Charges to Costs and Expense	Charged To Other Accounts Described	Write-offs Net of Recoveries	Balance at the End Of the Year
Year ended December 31, 1997					
Allowance for Doubtful Accounts	\$1,671	\$ 839	\$434	\$ (461)	\$2,483
Allowance for Deferred Tax Assets	\$2,783	\$ 4,106	\$0	\$ 0	\$6,889
Year ended December 31, 1996					
Allowance for Doubtful Accounts	\$ 743	\$ 1,260	\$0	\$ (332)	\$1,671
Allowance for Deferred Tax Assets	\$4,002	\$ (1,219)	\$0	\$ 0	\$2,783
Year ended December 31, 1995					
Allowance for Doubtful Accounts	\$ 800	\$ 55	\$0	\$ (112)	\$ 743
Allowance for Deferred Tax Assets	\$4,791	\$ (789)	\$0	\$ 0	\$4,002

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REPORT OF INDEPENDENT ACCOUNTANTS ON
FINANCIAL STATEMENT SCHEDULE

To the Board of Directors of

FLIR Systems, Inc.

Our audits of the consolidated financial statements referred to in our report dated March 9, 1998 appearing on page 19 on this Form 10-K also included an audit of the Financial Statement Schedule listed in Item 14 (a) of this Form 10-K. In our opinion, this Financial Statement Schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PRICE WATERHOUSE LLP
Portland, Oregon
March 9, 1998

LEASE AMENDMENT

DATED: January 28, 1997

BETWEEN: PACIFIC REALTY ASSOCIATES, LP.,
a Delaware limited partnership LANDLORD

AND: FLIR SYSTEMS, INC.,
an Oregon corporation TENANT

By written Lease dated February 11, 1985, Tenant Leased from Landlord approximately 20,118 square feet of office, production and storage space located in Building F, PacTrust Business Center, 16505 S.W. 72nd Avenue, Portland, Oregon 97224. By Lease Amendment dated May 19, 1986, the lease was amended and the term extended. By Lease Amendment dated March 6, 1989, Tenant Leased an additional approximately 24,650 square feet of warehouse and office space and the term of the Lease was extended. By Lease Amendment dated February 28, 1990, the lease was amended. By Lease Amendment dated July 31, 1990, Tenant Leased an additional approximately 2,656 square feet of office and storage space. By Lease Amendment dated August 29, 1991, the Lease was amended. Tenant's Leased area within Building F now totals approximately 47,424 square feet of office, production, warehouse and storage space. By Lease Amendment dated June 24, 1992, Tenant Leased an additional approximately 5,400 square feet of office and warehouse space located in Building D PacTrust Business Center, 16195 S.W. 72nd Avenue, Portland, Oregon 97224. By Lease Amendment dated January 21, 1993, Tenant leased an additional approximately 3,850 square feet of warehouse and office space in Building D and the term of the Lease was extended. By Lease Amendment dated August 26, 1993, Tenant leased an additional approximately 6,590 square feet of warehouse and office space in Building D and the Lease was amended. By Lease Amendment dated November 22, 1993, the Lease was amended. By Lease Amendment dated September 5, 1995, Tenant leased an additional approximately 9,160 square feet of office and warehouse space in Building D and the Lease was amended and extended. Tenant's Leased area within Building D now totals approximately 25,000 square feet of office space. Tenant's Leased area within Buildings F and D totals approximately 72,424 square feet of office, production, warehouse and storage space ("hereinafter referred to as the Premises"). By Lease Amendment dated April 15, 1996, the Lease was amended. Such documents are hereinafter jointly referred to as "the Lease". The Lease expires September 30, 2000.

Tenant now wishes to lease an additional approximately 12,415 square feet of offices and warehouse space located in Building E, PacTrust Business Center, 16280 S.W. Upper Boones Ferry Road, Portland, Oregon 97224 (herein referred to as the "Seventh Additional Space") and as further described on The attached Exhibits A and B.

NOW, THEREFORE, the parties agree as follows:

1. The Seventh Additional Space shall become subject to the terms of the Lease upon occupancy by Tenant, which is estimated to be by March 1, 1997. Tenant's total leased area shall increase from 72,424 square feet of office, production, warehouse and storage space to 84,839 square feet of office, production, warehouse and storage space. Tenant may occupy the Seventh Additional Space prior to such commencement date on a rent-free basis and compliance with all terms of the Lease.
2. Base rent shall be according to the following schedule:

Period	7th Add'l Sp	Premises	Total
	-----	-----	-----
March 1, 1997 through March 31, 1998	\$9,932.00	\$60,840.00	\$70,772.00
April 1, 1998 through September 30, 2000	\$9,932.00	\$62,922.00	\$72,854.00

3. Landlord shall, at its sole cost and expense, service and make any necessary repairs to the heating, ventilation and air conditioning ("HVAC") system. Landlord shall grant Tenant a one year warranty for the HVAC system, provided that Tenant contracts with a reputable service contractor to provide proper maintenance for the system. Such warranty shall be in effect for one year from March 1, 1997.
4. A tenant improvement allowance of \$5.00 per square foot (hereinafter referred to as "The Allowance") has been provided. A final space plan will be completed upon which Landlord and Tenant agree. If landlord cannot construct the required improvements within the \$5.00 per square foot allowance, Tenant agrees to pay to Landlord the amount by which this cost exceeds the Allowance, adjusted by any reductions or increases in costs initiated by Tenant after a final plan and specifications have been signed off by both parties with such amounts to be paid upon occupancy. If the tenant improvements, including tenant-initiated adjustments, are less the Allowance, Landlord shall credit Tenant a like amount in the form of a moving allowance payable upon occupancy of the Premises or by providing Tenant with a like amount in the form of free base rent.
5. Notwithstanding the foregoing, the Premises shall be taken by Tenant in "as-is" condition with existing improvements configured generally as shown in the attached Exhibit B.
6. Except as expressly modified hereby, all terms of the Lease shall remain in full force and effect and shall continue through the existing term.

IN WITNESS WHEREOF, the parties hereto have executed this agreement on the respective dates set opposite their signature below, but this Agreement on behalf of such parties shall be deemed to have been as of the day first written.

LANDLORD:

PACIFIC REALTY ASSOCIATES, LP.,
A Delaware limited partnership

By PacTrust Realty, Inc.,
A Delaware corporation,
Its General Partner

By /s/ David G. Hicks Date: 1-29-97

David G. Hicks
Vice President

TENANT:

FLIR SYSTEMS, INC.,
A Oregon corporation

By /s/ James A. Fitzhenry Date: 1-29-97

James A. Fitzhenry
Vice President and General Counsel

BANK OF AMERICA NT & SA BUSINESS LOAN AGREEMENT

This Agreement dated as of August 2, 1997 is between Bank of America NT & SA (the "Bank") and FLIR Systems, Inc. (the "Borrower").

1. FACILITY NO.1: LINE OF CREDIT AMOUNT AND TERMS

1.1 LINE OF CREDIT AMOUNT.

(a) During the availability period described below, the Bank will provide a line of credit to the Borrower. The amount of the line of credit (the "Facility No.1 Commitment") is Twenty Five Million Dollars (\$25,000,000).

(b) This is a revolving line of credit. During the availability period, the Borrower may repay principal amounts and reborrow them.

(c) The Borrower agrees not to permit the outstanding principal balance of the line of credit to exceed the Facility No.1 Commitment.

1.2 AVAILABILITY PERIOD.

The line of credit is available between the date of this Agreement and June 1, 1998 (the "Facility No.1 Expiration Date") unless the Borrower is in default.

1.3 INTEREST RATE.

(a) Unless the Borrower elects an optional interest rate as described below, the interest rate is the Reference Rate.

(b) The Reference Rate is the rate of interest publicly announced from time to time by Bank as its Reference Rate. The Reference Rate is set based on various factors, including Bank's costs and desired return, general economic conditions and other factors, and is used as a reference point for pricing some loans. The Bank may price loans to its customers at, above, or below the Reference Rate. Any change in the Reference Rate shall take effect at the opening of business on the day specified in the public announcement of a change in the Reference Rate.

1.4 REPAYMENT TERMS.

(a) The Borrower will pay interest on October 1, 1997, and then monthly thereafter until payment in full of any principal outstanding under this line of credit.

(b) The Borrower will repay in full all principal and any unpaid interest or other charges outstanding under this line of credit no later than the Facility No.1 Expiration Date.

(c) Any amount bearing interest at an optional interest rate (as described below) may be repaid at the end of the applicable interest period, which shall be no later than the Facility No.1 Expiration Date.

(d) The Borrower may prepay the loan in full or in part at any time. The prepayment will be applied to the most remote installment of principal due under this Agreement.

1.5 OPTIONAL INTEREST RATES. Instead of the interest rate based on the Reference Rate, the Borrower may elect to have all or portions of the line of credit (during the availability period) bear interest at the rate(s) described below during an interest period agreed to by the Bank and the Borrower. Each interest rate is a rate per year. Interest will be paid on the first day of every month and on the last day of each interest period. At the end of any interest period, the interest rate will revert to the rate based on the Reference Rate, unless the Borrower has designated another optional interest rate for the portion.

1.6 FIXED RATE. The Borrower may elect to have all or portions of the principal balance of the line of credit bear interest at the Fixed Rate, subject to the following requirements:

- (a) The "Fixed Rate" means the fixed interest rate the Bank and the Borrower agree will apply to the portion during the applicable interest period.
- (b) The interest period during which the Fixed Rate will be in effect will be no shorter than 30 days and no longer than one year.
- (c) Each Fixed Rate portion will be for an amount not less than Five Hundred Thousand Dollars (\$500,000).
- (d) The Borrower may not elect a Fixed Rate with respect to any portion of the principal balance of the line of credit which is scheduled to be repaid before the last day of the applicable interest period.
- (e) Any portion of the principal balance of the line of credit already bearing interest at the Fixed Rate will not be converted to a different rate during its interest period.
- (f) Each prepayment of a Fixed Rate portion, whether voluntary, by reason of acceleration or otherwise, will be accompanied by the amount of accrued interest on the amount prepaid, and a prepayment fee equal to the amount (if any) by which:
 - (i) the additional interest which would have been payable on the amount prepaid had it not been paid until the last day of the interest period, exceeds
 - (ii) the interest which would have been recoverable by the Bank by placing the amount prepaid on deposit in the certificate of deposit market for a period starting on the date on which it was prepaid and ending on the last day of the interest period for such portion.

1.7 OFFSHORE RATE. The Borrower may elect to have all or portions of the principal balance of the line of credit bear interest at the Offshore Rate plus 1.75 percentage points.

Designation of an Offshore Rate portion is subject to the following requirements:

- (a) The interest period during which the Offshore Rate will be in effect will be no shorter than 30 days and no longer than 180 days. The last day of the interest period will be determined by the Bank using the practices of the offshore dollar inter-bank market.
- (b) Each Offshore Rate portion will be for an amount not less than Five Hundred Thousand Dollars (\$500,000) for interest periods of 30 days or longer.
- (c) The "Offshore Rate" means the interest rate determined by the following formula, rounded upward to the nearest 1/100 of one percent. (All amounts in the calculation will be determined by the Bank as of the first day of the interest period.)

$$\text{Offshore Rate} = \frac{\text{Grand Cayman Rate}}{(1.00 - \text{Reserve Percentage})}$$

Where,

- (i) "Grand Cayman Rate" means the interest rate (rounded upward to the nearest 1/16th of one percent) at which the Bank's Grand Cayman Branch, Grand Cayman, British West Indies, would offer U.S. dollar deposits for the applicable interest period to other major banks in the offshore dollar inter-bank market.
- (ii) "Reserve Percentage" means the total of the maximum reserve percentages for determining the reserves to be maintained by member banks of the Federal Reserve System for Eurocurrency Liabilities, as defined in the Federal Reserve Board Regulation D, rounded upward to the nearest 1/100 of one percent. The percentage will be expressed as

a decimal, and will include, but not be limited to, marginal, emergency, supplemental, special, and other reserve percentages.

(d) The Borrower may not elect an Offshore Rate with respect to any portion of the principal balance of the line of credit which is scheduled to be repaid before the last day of the applicable interest period.

(e) Any portion of the principal balance of the line of credit already bearing interest at the Offshore Rate will not be converted to a different rate during its interest period.

(f) Each prepayment of an Offshore Rate portion, whether voluntary, by reason of acceleration or otherwise, will be accompanied by the amount of accrued interest on the amount prepaid, and a prepayment fee equal to the amount (if any) by which

(i) the additional interest which would have been payable on the amount prepaid had it not been paid until the last day of the interest period, exceeds

(ii) the interest which would have been recoverable by the Bank by placing the amount prepaid on deposit in the offshore dollar market for a period starting on the date on which it was prepaid and ending on the last day of the interest period for such portion.

(g) The Bank will have no obligation to accept an election for an Offshore Rate portion if any of the following described events has occurred and is continuing:

(i) Dollar deposits in the principal amount, and for periods equal to the interest period, of an Offshore Rate portion are not available in the offshore Dollar inter-bank market; or

(ii) the Offshore Rate does not accurately reflect the cost of an Offshore Rate portion.

1.8 LIBOR RATE. The Borrower may elect to have all or portions of the principal balance of the line of credit bear interest at the LIBOR Rate plus 1.75 percentage points.

Designation of a LIBOR Rate portion is subject to the following requirements:

(a) The interest period during which the LIBOR Rate will be in effect will be 30 to 180 days. The last day of the interest period will be determined by the Bank using the practices of the London inter-bank market.

(b) Each LIBOR Rate portion will be an amount not less than Five Hundred Thousand Dollars (\$500,000).

(c) The Borrower shall irrevocably request a LIBOR Rate portion no later than 9:00 a. m. San Francisco time three (3) banking days before the commencement of the interest period.

(d) The "LIBOR Rate" means the interest rate determined by the following formula, rounded upward to the nearest 1/100 of one percent. (All amounts in the calculation will be determined by the Bank as of the first day of the interest period.)

$$\text{LIBOR Rate} = \frac{\text{London Rate}}{(1.00 - \text{Reserve Percentage})}$$

Where,

(i) "London Rate" means the interest rate (rounded upward to the nearest 1/16th of one percent) at which the Bank's London Branch, London, Great Britain, would offer U.S. dollar deposits for the applicable interest period to other major banks in the London inter-bank market at approximately 11:00a.m. London time two (2) banking days before the commencement of the interest period.

(ii) "Reserve Percentage" means the total of the maximum reserve percentages for determining the reserves to be maintained by the member banks of the Federal Reserve System for Eurocurrency

Liabilities, as defined in the Federal Reserve Board Regulation D, rounded upward to the nearest 1/100 of one percent. The percentage will be expressed as a decimal, and will include, but not be limited to, marginal, emergency, supplemental, special, and other reserve percentages.

(e) The Borrower may not elect a LIBOR Rate with respect to any portion of the principal balance of the line of credit which is scheduled to be repaid before the last day of the applicable interest period.

(f) Any portion of the principal balance of the line of credit already bearing interest at the LIBOR Rate will not be converted to a different rate during its interest period.

(g) Each prepayment of a LIBOR Rate portion, whether voluntary, by reason of acceleration or otherwise, will be accompanied by the amount of accrued interest on the amount prepaid, and a prepayment fee equal to the amount (if any) by which:

(i) the additional interest which would have been payable on the amount prepaid had it not been paid until the last day of the interest period, exceeds

(ii) the interest which would have been recoverable by the Bank by placing the amount prepaid on deposit in the London inter-bank market for a period starting on the date on which it was prepaid and ending on the last day of the interest period for such portion.

(h) The Bank will have no obligation to accept an election for LIBOR Rate portion if any of the following described events has occurred and is continuing:

(i) Dollar deposits in the principal amount, and for periods equal to the interest period, of a LIBOR Rate portion are not available in the London inter-bank market; or

(ii) the LIBOR Rate does not accurately reflect the cost of a LIBOR Rate portion.

2. FACILITY NO.2: LINE OF CREDIT AMOUNT AND TERMS

2.1 LINE OF CREDIT AMOUNT.

(a) During the availability period described below, the Bank will provide a line of credit to the Borrower. The amount of the line of credit (the "Facility No.2 Commitment") is Five Million Dollars (\$5,000,000).

(b) This is a non-revolving line of credit with a term repayment option. Any amount borrowed, even if repaid before the end of the availability period, permanently reduces the remaining available line of credit.

(c) The Borrower agrees not to permit the outstanding principal balance of the line of credit to exceed the Facility No.2 Commitment.

2.2 AVAILABILITY PERIOD.

The line of credit is available between the date of this Agreement and June 1, 1998 (the "Facility No.2 Expiration Date") unless the Borrower is in default.

2.3 INTEREST RATE.

(a) Unless the Borrower elects an optional interest rate as described below, the interest rate is the Reference Rate.

2.4 REPAYMENT TERMS.

(a) The Borrower will repay principal and interest beginning September 1, 1997 in 9 successive equal installments which would fully amortize the outstanding principal balance over 48 months. On June 1, 1998 the Borrower will repay the remaining principal balance plus any interest then due. Each installment, when paid, will be applied first to the payment of interest accrued. The amount of interest due, and the portion of each installment which is applied to interest, will change from time to time if there are

changes in the Interest Rate. The balance, if any, of each installment will be applied to the repayment of principal. If the accrued interest owing exceeds the amount of any installment, the Borrower will pay the excess in addition to the installment. The excess accrued interest will be paid on the due date of the installment.

2.5 OPTIONAL INTEREST RATES. Instead of the interest rate based on the Reference Rate, the Borrower may elect to have all or portions of the line of credit (during the availability period and during the term repayment period) bear interest at the rate(s) described below during an interest period agreed to by the Bank and the Borrower. Each interest rate is a rate per year. Interest will be paid on the first day of every month and on the last day of each interest period. At the end of any interest period, the interest rate will revert to the rate based on the Reference Rate, unless the Borrower has designated another optional interest rate for the portion.

2.6 FIXED RATE. The Borrower may elect to have all or portions of the principal balance of the line of credit bear interest at the Fixed Rate, subject to the following requirements:

(a) The "Fixed Rate" means the fixed interest rate the Bank and the Borrower agree will apply to the portion during the applicable interest period.

(b) The interest period during which the Fixed Rate will be in effect will be no shorter than 30 days and no longer than one year.

(c) Each Fixed Rate portion will be for an amount not less than Five Hundred Thousand Dollars (\$500,000).

(d) The Borrower may not elect a Fixed Rate with respect to any portion of the principal balance of the line of credit which is scheduled to be repaid before the last day of the applicable interest period.

(e) Any portion of the principal balance of the line of credit already bearing interest at the Fixed Rate will not be converted to a different rate during its interest period.

(f) Each prepayment of a Fixed Rate portion, whether voluntary, by reason of acceleration or otherwise, will be accompanied by the amount of accrued interest on the amount prepaid, and a prepayment fee equal to the amount (if any) by which:

(i) the additional interest which would have been payable on the amount prepaid had it not been paid until the last day of the interest period, exceeds

(ii) the interest which would have been recoverable by the Bank by placing the amount prepaid on deposit in the certificate of deposit market for a period starting on the date on which it was prepaid and ending on the last day of the interest period for such portion.

2.7 OFFSHORE RATE. The Borrower may elect to have all or portions of the principal balance of the line of credit bear interest at the Offshore Rate plus 1.75 percentage points.

Designation of an Offshore Rate portion is subject to the following requirements:

(a) The interest period during which the Offshore Rate will be in effect will be no shorter than 30 days and no longer than 180 days. The last day of the interest period will be determined by the Bank using the practices of the offshore dollar inter-bank market.

(b) Each Offshore Rate portion will be for an amount not less than Five Hundred Thousand Dollars (\$500,000) for interest periods of 30 days or longer.

(c) The "Offshore Rate" means the interest rate determined by the following formula, rounded upward to the nearest 1/100 of one percent. (All amounts in the calculation will be determined by the Bank as of the first day of the interest period.)

$$\text{Offshore Rate} = \frac{\text{Grand Cayman Rate}}{\text{-----}} \\ \text{(1.00- Reserve Percentage)}$$

Where,

- (i) "Grand Cayman Rate" means the interest rate (rounded upward to the nearest 1/16th of one percent) at which the Bank's Grand Cayman Branch, Grand Cayman, British West Indies, would offer U.S. dollar deposits for the applicable interest period to other major banks in the offshore dollar inter-bank market.
 - (ii) "Reserve Percentage" means the total of the maximum reserve percentages for determining the reserves to be maintained by member banks of the Federal Reserve System for Eurocurrency Liabilities, as defined in the Federal Reserve Board Regulation D, rounded upward to the nearest 1/100 of one percent. The percentage will be expressed as a decimal, and will include, but not be limited to, marginal, emergency, supplemental, special, and other reserve percentages.
- (d) The Borrower may not elect an Offshore Rate with respect to any portion of the principal balance of the line of credit which is scheduled to be repaid before the last day of the applicable interest period.
- (e) Any portion of the principal balance of the line of credit already bearing interest at the Offshore Rate will not be converted to a different rate during its interest period.
- (f) Each prepayment of an Offshore Rate portion, whether voluntary, by reason of acceleration or otherwise, will be accompanied by the amount of accrued interest on the amount prepaid, and a prepayment fee equal to the amount (if any) by which
- (i) the additional interest which would have been payable on the amount prepaid had it not been paid until the last day of the interest period, exceeds
 - (ii) the interest which would have been recoverable by the Bank by placing the amount prepaid on deposit in the offshore dollar market for a period starting on the date on which it was prepaid and ending on the last day of the interest period for such portion.
- (g) The Bank will have no obligation to accept an election for an Offshore Rate portion if any of the following described events has occurred and is continuing:
- (i) Dollar deposits in the principal amount, and for periods equal to the interest period, of an Offshore Rate portion are not available in the offshore Dollar inter-bank market; or
 - (ii) the Offshore Rate does not accurately reflect the cost of an Offshore Rate portion.

2.8. LIBOR RATE. The Borrower may elect to have all or portions of the principal balance of the line of credit bear interest at the LIBOR Rate plus 1.75 percentage points.

Designation of a LIBOR Rate portion is subject to the following requirements:

- (a) The interest period during which the LIBOR Rate will be in effect will be 30 to 180 days. The last day of the interest period will be determined by the Bank using the practices of the London inter-bank market.
- (b) Each LIBOR Rate portion will be an amount not less than Five Hundred Thousand Dollars (\$500,000).
- (c) The Borrower shall irrevocably request a LIBOR Rate portion no later than 9:00 a. m. San Francisco time three (3) banking days before the commencement of the interest period.
- (d) The "LIBOR Rate" means the interest rate determined by the following formula, rounded upward to the nearest 1/100 of one percent. (All amounts in the calculation will be determined by the Bank as of the first day of the interest period.)

$$\text{LIBOR Rate} = \frac{\text{London Rate}}{(1.00 - \text{Reserve Percentage})}$$

Where,

- (i) "London Rate" means the interest rate (rounded upward to the nearest 1/16th of one percent) at which the Bank's London Branch, London, Great Britain, would offer U.S. dollar deposits for the applicable interest period to other major banks in the London inter-bank market at approximately 11:00a.m. London time two (2) banking days before the commencement of the interest period.
- (ii) "Reserve Percentage" means the total of the maximum reserve percentages for determining the reserves to be maintained by the member banks of the Federal Reserve System for Eurocurrency Liabilities, as defined in the Federal Reserve Board Regulation D, rounded upward to the nearest 1/100 of one percent. The percentage will be expressed as a decimal, and will include, but not be limited to, marginal, emergency, supplemental, special, and other reserve percentages.
- (e) The Borrower may not elect a LIBOR Rate with respect to any portion of the principal balance of the line of credit which is scheduled to be repaid before the last day of the applicable interest period.
- (f) Any portion of the principal balance of the line of credit already bearing interest at the LIBOR Rate will not be converted to a different rate during its interest period.
- (g) Each prepayment of a LIBOR Rate portion, whether voluntary, by reason of acceleration or otherwise, will be accompanied by the amount of accrued interest on the amount prepaid, and a prepayment fee equal to the amount (if any) by which:
 - (i) the additional interest which would have been payable on the amount prepaid had it not been paid until the last day of the interest period, exceeds
 - (ii) the interest which would have been recoverable by the Bank by placing the amount prepaid on deposit in the London inter-bank market for a period starting on the date on which it was prepaid and ending on the last day of the interest period for such portion.
- (h) The Bank will have no obligation to accept an election for LIBOR Rate portion if any of the following described events has occurred and is continuing:
 - (i) Dollar deposits in the principal amount, and for periods equal to the interest period, of a LIBOR Rate portion are not available in the London inter-bank market; or
 - (ii) the LIBOR Rate does not accurately reflect the cost of a LIBOR Rate portion.

3. FEES AND EXPENSES

3.1 LOAN FEE. The Borrower agrees to pay a loan fee of Thirty Seven Thousand Five Hundred Dollars (\$37,500) equal to 0.125% of the Facility No.1 and Facility No.2 Commitments due upon execution of this Agreement.

3.2 EXPENSES.

- (a) The Borrower agrees to immediately repay the Bank for expenses that include, but are not limited to, filing, recording and search fees, appraisal fees, title report fees, and documentation fees.
- (b) The Borrower agrees to reimburse the Bank for any expenses it incurs in the preparation of this Agreement and any agreement or instrument required by this Agreement. Expenses include, but are not limited to, reasonable

attorneys' fees, including any allocated costs of the Bank's in-house counsel.

4. COLLATERAL

4.1 PERSONAL PROPERTY. The Borrower's obligations to the Bank under this Agreement will be secured by personal property the Borrower now owns or will own in the future as listed below. The collateral is further defined in security agreement(s) executed by the Borrower. In addition, all personal property collateral securing this Agreement shall also secure all other present and future obligations of the Borrower to the Bank (excluding any consumer credit covered by the Federal Truth in Lending law, unless the Borrower has otherwise agreed in writing). All personal property collateral securing any other present or future obligations of the Borrower to the Bank shall also secure this Agreement.

- (a) Machinery and equipment.
- (b) Inventory.
- (c) Receivables.

5. DISBURSEMENTS, PAYMENTS AND COSTS

5.1 REQUESTS FOR CREDIT. Each request for an extension of credit will be made in writing in a manner acceptable to the Bank, or by another means acceptable to the Bank.

5.2 DISBURSEMENTS AND PAYMENTS. Each disbursement by the Bank and each payment by the Borrower will be:

- (a) made at the Bank's branch (or other location) selected by the Bank from time to time;
- (b) made for the account of the Bank's branch selected by the Bank from time to time;
- (c) made in immediately available funds, or such other type of funds selected by the Bank;
- (d) evidenced by records kept by the Bank. In addition, the Bank may, at its discretion, require the Borrower to sign one or more promissory notes.

5.3 TELEPHONE AUTHORIZATION.

- (a) The Bank may honor telephone instructions for advances or repayments or for the designation of optional interest rates given by the individual signer(s) of this Agreement or a person or persons authorized by the signer(s) of this Agreement.
- (b) Advances will be deposited in and repayments will be withdrawn from the Borrower's account number 28018-00865, or such other accounts with the Bank as designated in writing by the Borrower.
- (c) The Borrower indemnifies and excuses the Bank (including its officers, employees, and agents) for, from and against all liability, loss, and costs in connection with any act resulting from telephone instructions it reasonably believes are made by a signer of this Agreement or a person authorized by a signer. This indemnity and excuse will survive this Agreement's termination.

5.4 DIRECT DEBIT (PRE-BILLING)

(a) The Borrower agrees that the Bank will debit the Borrower's deposit account number 28018-00865 (the "Designated Account") on the date each payment of principal and interest and any fees from the Borrower becomes due (the "Due Date"). If the Due Date is not a banking day, the Designated Account will be debited on the next banking day.

(b) Approximately 10 days prior to each Due Date, the Bank will mail to the Borrower a statement of the amounts that will be due on that Due Date (the "Billed Amount"). The calculation will be made on the assumption that no new extensions of credit or payments will be made between the date of the

billing statement and the Due Date, and that there will be no changes in the applicable interest rate.

(c) The Bank will debit the Designated Account for the Billed Amount, regardless of the actual amount of principal due and interest accrued (collectively, the "Accrued Amount").

If the Billed Amount debited to the Designated Account differs from the Accrued Amount, the discrepancy will be treated as follows:

- (i) If the Billed Amount is less than the Accrued Amount, the Billed Amount for the following Due Date will be increased by the amount of the discrepancy. The Borrower will not be in default by reason of any such discrepancy.
- (ii) If the Billed Amount is more than the Accrued Amount, the Billed Amount for the following Due Date will be decreased by the amount of the discrepancy.

Regardless of any such discrepancy, interest will continue to accrue based on the actual amount of principal outstanding without compounding. The Bank will not pay the Borrower interest on any overpayment.

(d) The Borrower will maintain sufficient funds in the Designated Account to cover each debit. If there are insufficient funds in the Designated Account on the date the Bank enters any debit authorized by this Agreement, the debit will be reversed.

5.5 BANKING DAYS. Unless otherwise provided in this Agreement, a banking day is a day other than a Saturday or a Sunday on which the Bank is open for business in Oregon and banks are open for business in California. For amounts bearing interest at an offshore rate (if any), a banking day is a day other than a Saturday or a Sunday on which the Bank is open for business in Oregon and the Bank is dealing in offshore dollars. All payments and disbursements which would be due on a day which is not a banking day will be due on the next banking day. All payments received on a day which is not a banking day will be applied to the credit on the next banking day.

5.6 TAXES. The Borrower will not deduct any taxes from any payments it makes to the Bank. If any government authority imposes any taxes or charges on any payments made by the Borrower, the Borrower will pay the taxes or charges. Upon request by the Bank, the Borrower will confirm that it has paid the taxes by giving the Bank official tax receipts (or notarized copies) within 30 days after the due date. However, the Borrower will not pay the Bank's net income taxes.

5.7 ADDITIONAL COSTS. The Borrower will pay the Bank, on demand, for the Bank's costs or losses arising from any statute or regulation, or any request or requirement of a regulatory agency. The costs and losses will be allocated to the loan in a manner determined by the Bank, using any reasonable method. The costs include the following:

(a) any reserve or deposit requirements; and

(b) any capital requirements relating to the Bank's assets and commitments for credit.

5.8 INTEREST CALCULATION. Except as otherwise stated in this Agreement, all interest and fees, if any, will be computed on the basis of a 360-day year and the actual number of days elapsed. This results in more interest or a higher fee than if a 365-day year is used.

5.9 INTEREST ON LATE PAYMENTS. At the Bank's sole option in each instance, any amount not paid when due under this Agreement (including interest) shall bear interest from the due date at the Reference Rate. This may result in compounding of interest.

5.10 DEFAULT RATE. Upon the occurrence and during the continuation of any default under this Agreement, advances under this Agreement will at the option of the Bank bear interest at a rate per annum which is 2.00 percentage points higher than the rate of interest otherwise provided under this Agreement. This will not constitute a waiver of any event of default.

6. CONDITIONS

The Bank must receive the following items, in form and content acceptable to the Bank, before it is required to extend any credit to the Borrower under this Agreement:

6.1 AUTHORIZATIONS. Evidence that the execution, delivery and performance by the Borrower of this Agreement and any instrument or agreement required under this Agreement have been duly authorized.

6.2 SECURITY AGREEMENTS. Signed original security agreements, financing statements and fixture filings (together with collateral in which the Bank requires a possessory security interest), which the Bank requires.

6.3 EVIDENCE OF PRIORITY. Evidence that security interests and liens in favor of the Bank are valid, enforceable, and prior to all others' rights and interests, except those the Bank consents to in writing.

6.4 INSURANCE. Evidence of insurance coverage, as required in the "Covenants" section of this Agreement.

6.5 OTHER ITEMS. Any other items that the Bank reasonably requires.

7. REPRESENTATIONS AND WARRANTIES

When the Borrower signs this Agreement, and until the Bank is repaid in full, the Borrower makes the following representations and warranties. Each request for an extension of credit constitutes a renewed representation:

7.1 ORGANIZATION OF BORROWER. The Borrower is a corporation duly formed and existing under the laws of the state where organized.

7.2 AUTHORIZATION. This Agreement, and any instrument or agreement required hereunder, are within the Borrower's powers, have been duly authorized, and do not conflict with any of its organizational papers.

7.3 ENFORCEABLE AGREEMENT. This Agreement is a legal, valid and binding agreement of the Borrower, enforceable against the Borrower in accordance with its terms, and any instrument or agreement required hereunder, when executed and delivered, will be similarly legal, valid, binding and enforceable.

7.4 GOOD STANDING. In each state in which the Borrower does business, it is properly licensed, in existence and in good standing, and, where required, in compliance with fictitious name statutes.

7.5 NO CONFLICTS. This Agreement does not conflict with any law, agreement, or obligation by which the Borrower is bound.

7.6 FINANCIAL INFORMATION. All financial and other information that has been or will be supplied to the Bank, including the Borrower's financial statement dated as of June 30, 1997, is:

- (a) sufficiently complete to give the Bank accurate knowledge of the Borrower's financial condition.
- (b) in form and content required by the Bank.
- (c) in compliance with all government regulations that apply.

Since the date of the financial statement specified above, there has been no material adverse change in the assets or the financial condition of the Borrower.

7.7 LAWSUITS. There is no lawsuit, tax claim or other dispute pending or threatened against the Borrower which, if lost, would impair the Borrower's financial condition or ability to repay the loan, except as have been disclosed in writing to the Bank.

7.8 COLLATERAL. All collateral required in this Agreement is owned by the grantor of the security interest free of any title defects or any liens or interests of others.

7.9 PERMITS, Franchises. The Borrower possesses all permits, memberships, franchises, contracts and licenses required and all trademark rights, trade name

rights, patent rights and fictitious name rights necessary to enable it to conduct the business in which it is now engaged without conflict with the rights of others.

7.10 OTHER OBLIGATIONS. The Borrower is not in default on any obligation for borrowed money, any purchase money obligation or any other material lease, commitment, contract, instrument or obligation.

7.11 INCOME TAX RETURNS. The Borrower has no knowledge of any pending assessments or adjustments of its income tax for any year, except as have been disclosed in writing to the Bank.

7.12 NO EVENT OF DEFAULT. There is no event which is, or with notice or lapse of time or both would be, a default under this Agreement.

7.13 ERISA PLANS.

- (a) The Borrower has fulfilled its obligations, if any, under the minimum funding standards of ERISA and the Code with respect to each Plan and is in compliance in all material respects with the presently applicable provisions of ERISA and the Code, and has not incurred any liability with respect to any Plan under Title IV of ERISA
- (b) No reportable event has occurred under Section 4043(b) of ERISA for which the PBGC requires 30 day notice.
- (c) No action by the Borrower to terminate or withdraw from any Plan has been taken and no notice of intent to terminate a Plan has been filed under Section 4041 of ERISA
- (d) No proceeding has been commenced with respect to a Plan under Section 4042 of ERISA, and no event has occurred or condition exists which might constitute grounds for the commencement of such a proceeding.
- (e) The following terms have the meanings indicated for purposes of this Agreement:
 - (i) "Code" means the Internal Revenue Code of 1986, as amended from time to time.
 - (ii) "ERISA" means the Employee Retirement Income Act of 1974, as amended from time to time.
 - (iii) "PBGC" means the Pension Benefit Guaranty Corporation established pursuant to Subtitle A of Title IV of ERISA
 - (iv) "Plan" means any employee pension benefit plan maintained or contributed to by the Borrower and insured by the Pension Benefit Guaranty Corporation under Title IV of ERISA

8. COVENANTS

The Borrower agrees, so long as credit is available under this Agreement and until the Bank is repaid in full:

8.1 USE OF PROCEEDS.

- (a) To use the proceeds of Facility No.1 only for working capital.
- (b) To use the proceeds of Facility No.2 only for refinancing existing U.S. National Bank debt.

8.2 FINANCIAL INFORMATION. To provide the following financial information and statements and such additional information as requested by the Bank from time to time:

- (a) Within 120 days of the Borrower's fiscal year end, the Borrower's annual financial statements. These financial statements must be audited by a Certified Public Accountant ("CPA") acceptable to the Bank. The statements shall be prepared on a consolidated basis. This annual financial statement to be accompanied by the Borrower's fiscal year end compliance certificate.
- (b) Within 120 days of the Borrower's fiscal year end, the Borrower's annual

balance sheet and income statement forecast including capital expenditure budget.

- (c) Within 45 days of the period's end, the Borrower's quarterly financial statements. These financial statements may be Borrower prepared. The statements shall be prepared on a consolidated basis.
- (d) Within 45 days of the period's end of the first through third accounting periods, the Borrower's quarterly compliance certificate.

8.3 MINIMUM FIXED CHARGE COVERAGE. To maintain quarterly on a consolidated basis a minimum fixed charge coverage of at least 1.75:1.0

Minimum Fixed Charge Coverage is defined as the sum of EBIT (Earnings Before Interest and Taxes) plus Rents (or Lease Payments) divided by the sum of Interest plus Rents (or Lease Payments).

8.4 MAXIMUM FUNDED DEBT TO TOTAL CAPITALIZATION. To maintain quarterly on a consolidated basis a maximum Funded Debt to Total Capitalization of no more than 45%.

"Funded Debt" defined as the sum of all Bank Debt plus Capital Leases plus Other Long Term Debt.

"Total Capitalization" is defined as the sum of Funded Debt plus Consolidated Net Worth.

8.5 MINIMUM NET WORTH. To maintain quarterly on a consolidated basis a minimum net worth equal to Forty Five Million Dollars (\$45,000,000) as of fiscal year end December 31, 1996, plus 30% of future net income.

8.6 OTHER DEBTS. Not to have outstanding or incur any direct or contingent debts or lease obligations (other than those to the Bank and its affiliates), or become liable for the debts of others without the Bank's written consent. This does not prohibit:

- (a) Acquiring goods, supplies, or merchandise on normal trade credit.
- (b) Endorsing negotiable instruments received in the usual course of business.
- (c) Obtaining surety bonds in the usual course of business.
- (d) Additional debts and lease obligations for business purposes in relation only to additional purchase money security interests allowed in Paragraph 8.7(d).

8.7 OTHER LIENS. Not to create, assume, or allow any security interest or lien (including judicial liens) on property the Borrower now or later owns, except:

- (a) Deeds of trust and security agreements in favor of the Bank and its affiliates.
- (b) Liens for taxes not yet due.
- (c) Liens outstanding on the date of this Agreement disclosed in writing to the Bank.
- (d) Additional purchase money security interests in personal or real property acquired after the date of this Agreement if the aggregate principal amount of debts secured by such liens does not exceed 5% of Consolidated Net Worth at any one time.

8.8 NOTICES TO BANK. To promptly notify the Bank in writing of:

- (a) any lawsuit over One Million Dollars (\$1,000,000) against the Borrower.
- (b) any substantial dispute between the Borrower and any government authority.
- (c) any failure to comply with this Agreement.
- (d) any material adverse change in the Borrower's financial condition or operations.

(e) any change in the Borrower's name, address or legal structure.

8.9 BOOKS AND RECORDS. To maintain adequate books and records.

8.10 AUDITS. To allow the Bank and its agents to inspect the Borrower's properties and examine, audit and make copies of books and records at any reasonable time. If any of the Borrower's properties, books or records are in the possession of a third party, the Borrower authorizes that third party to permit the Bank or its agents to have access to perform inspections or audits and to respond to the Bank's requests for information concerning such properties, books and records.

8.11 COMPLIANCE WITH LAWS. To comply with the laws (including any fictitious name statute), regulations and orders of any government body with authority over the Borrower's business.

8.12 PRESERVATION OF RIGHTS. To maintain and preserve all rights, privileges, and franchises the Borrower now has.

8.13 MAINTENANCE OF PROPERTIES. To make any repairs, renewals, or replacements to keep the Borrower's properties in good working condition.

8.14 PERFECTION OF LIENS. To help the Bank perfect and protect its security interests and liens, and reimburse it for related costs it incurs to protect its security interests and liens.

8.15 COOPERATION. To take any action requested by the Bank to carry out the intent of this Agreement.

8.16 INSURANCE.

(a) INSURANCE COVERING COLLATERAL. To maintain all risk property damage insurance policies covering the tangible property comprising the collateral. Each insurance policy must be in an amount acceptable to the Bank. The insurance must be issued by an insurance company acceptable to the Bank and must include a lender's loss payable endorsement in favor of the Bank in a form acceptable to the Bank.

(b) GENERAL BUSINESS INSURANCE. To maintain insurance as is usual for the business it is in.

(c) EVIDENCE OF INSURANCE. Upon the request of the Bank, to deliver to the Bank a copy of each insurance policy, or, if permitted by the Bank, a certificate of insurance listing all insurance in force.

8.17 ADDITIONAL NEGATIVE COVENANTS. Not to, without the Bank's written consent:

(a) engage in any business activities substantially different from the Borrower's present business.

(b) liquidate or dissolve the Borrower's business.

(c) enter into any consolidation, merger, pool, joint venture, syndicate, or other combination.

(d) lease, or dispose of all or a substantial part of the Borrower's business or the Borrower's assets.

(e) acquire or purchase a business or its assets.

(f) sell or otherwise dispose of any assets for less than fair market value, or enter into any sale and leaseback agreement covering any of its fixed or capital assets.

8.18 NEGATIVE PLEDGE. Not to sell, refinance or allow liens on the Borrower's unencumbered assets.

8.19 MERGER. Borrower to remain successor and/or parent to any merger.

8.20 ERISA PLANS. To give prompt written notice to the Bank of:

(a) The occurrence of any reportable event under Section 4043(b) of ERISA for which the PBGC requires 30 day notice.

- (b) Any action by the Borrower to terminate or withdraw from a Plan or the filing of any notice of intent to terminate under Section 4041 of ERISA
- (c) Any notice of noncompliance made with respect to a Plan under Section 4041(b) of ERISA
- (d) The commencement of any proceeding with respect to a Plan under Section 4042 of ERISA

9. HAZARDOUS WASTE INDEMNIFICATION

The Borrower will indemnify and hold harmless the Bank for, from, and against any loss or liability directly or indirectly arising out of the use, generation, manufacture, production, storage, release, threatened release, discharge, disposal or presence of a hazardous substance. This indemnity will apply whether the hazardous substance is on, under or about the Borrower's property or operations or property leased to the Borrower. The indemnity includes but is not limited to attorneys' fees (including the reasonable estimate of the allocated cost of in-house counsel and staff). The indemnity extends to the Bank, its parent, subsidiaries and all of their directors, officers, employees, agents, successors, attorneys and assigns. For these purposes, the term "hazardous substances" means any substance which is or becomes designated as "hazardous" or "toxic" under any federal, state or local law, or any petroleum products, including crude oil and any product derived directly or indirectly from, or any fraction or distillate of, crude oil. This indemnity will survive repayment of the Borrower's obligations to the Bank.

10. DEFAULT

If any of the following events occur, the Bank may do one or more of the following: declare the Borrower in default, stop making any additional credit available to the Borrower, and require the Borrower to repay its entire debt immediately and without prior notice. If a bankruptcy petition is filed with respect to the Borrower, the entire debt outstanding under this Agreement will automatically become due immediately.

10.1 FAILURE TO PAY. The Borrower fails to make a payment under this Agreement when due.

10.2 NON-COMPLIANCE. The Borrower fails to meet the conditions of, or fails to perform any obligation under:

- (a) this Agreement,
- (b) any other agreement made in connection with this loan, or
- (c) any other agreement the Borrower has with the Bank or any affiliate of the Bank.

10.3 CROSS-DEFAULT. Any default occurs under any agreement in connection with any credit the Borrower has obtained from anyone else or which the Borrower has guaranteed.

10.4 LIEN PRIORITY. The Bank fails to have an enforceable first lien (except for any prior liens to which the Bank has consented in writing) on or security interest in any property given as security for this loan.

10.5 FALSE INFORMATION. The Borrower has given the Bank false or misleading information or representations.

10.6 BANKRUPTCY. The Borrower files a bankruptcy petition, a bankruptcy petition is filed against the Borrower, or the Borrower makes a general assignment for the benefit of creditors.

10.7 RECEIVERS. A receiver or similar official is appointed for the Borrower's business, or the business is terminated.

10.8 LAWSUITS. Any lawsuit or lawsuits are filed on behalf of one or more trade creditors against the Borrower in an aggregate amount of One Million Dollars (\$1,000,000) or more in excess of any insurance coverage.

10.9 JUDGMENTS. Any judgments or arbitration awards are entered against the Borrower; or the Borrower enters into any settlement agreements with respect to any litigation or arbitration, in an aggregate amount of One Million Dollars (\$1,000,000) or more in excess of any insurance coverage.

10.10 GOVERNMENT ACTION. Any government authority takes action that the Bank believes materially adversely affects the Borrower's financial condition or ability to repay.

10.11 DEFAULT UNDER GUARANTY OR SUBORDINATION AGREEMENT. Any guaranty, subordination agreement, security agreement, deed of trust, or other document required by this Agreement is violated or no longer in effect.

10.12 MATERIAL ADVERSE CHANGE. A material adverse change occurs in the Borrower's financial condition, properties or prospects, or ability to repay the loan.

10.13 ERISA PLANS. The occurrence of any one or more of the following events with respect to the Borrower, provided such event or events could reasonably be expected, in the judgment of the Bank, to subject the Borrower to any tax, penalty or liability (or any combination of the foregoing) which, in the aggregate, could have a material adverse effect on the financial condition of the Borrower with respect to a Plan:

- (a) A reportable event shall occur with respect to a Plan which is, in the reasonable judgment of the Bank likely to result in the termination of such Plan for purposes of Title IV of ERISA
- (b) Any Plan termination (or commencement of proceedings to terminate a Plan) or the Borrower's full or partial withdrawal from a Plan.

11. ENFORCING THIS AGREEMENT; MISCELLANEOUS

11.1 GAAP. Except as otherwise stated in this Agreement, all financial information provided to the Bank and all financial covenants will be made under generally accepted accounting principles, consistently applied.

11.2 OREGON LAW. This Agreement is governed by Oregon law.

11.3 SUCCESSORS AND ASSIGNS. This Agreement is binding on the Borrower's and the Bank's successors and assignees. The Borrower agrees that it may not assign this Agreement without the Bank's prior consent. The Bank may sell participations in or assign this loan, and may exchange financial information about the Borrower with actual or potential participants or assignees. If a participation is sold or the loan is assigned, the purchaser will have the right of set-off against the Borrower.

11.4 ARBITRATION.

- (a) This paragraph concerns the resolution of any controversies or claims between the Borrower and the Bank, including but not limited to those that arise from:
 - (i) This Agreement (including any renewals, extensions or modifications of this Agreement);
 - (ii) Any document, agreement or procedure related to or delivered in connection with this Agreement;
 - (iii) Any violation of this Agreement; or
 - (iv) Any claims for damages resulting from any business conducted between the Borrower and the Bank, including claims for injury to persons, property or business interests (torts).
- (b) At the request of the Borrower or the Bank, any such controversies or claims will be settled by arbitration in accordance with the United States Arbitration Act. The United States Arbitration Act will apply even though this Agreement provides that it is governed by Oregon law.
- (c) Arbitration proceedings will be administered by the American Arbitration Association and will be subject to its commercial rules of arbitration.

- (d) For purposes of the application of the statute of limitations, the filing of an arbitration pursuant to this paragraph is the equivalent of the filing of a lawsuit, and any claim or controversy which may be arbitrated under this paragraph is subject to any applicable statute of limitations. The arbitrators will have the authority to decide whether any such claim or controversy is barred by the statute of limitations and, if so, to dismiss the arbitration on that basis.
- (e) If there is a dispute as to whether an issue is arbitrable, the arbitrators will have the authority to resolve any such dispute.
- (f) The decision that results from an arbitration proceeding may be submitted to any authorized court of law to be confirmed and enforced.
- (g) This provision does not limit the right of the Borrower or the Bank to:
 - (i) exercise self-help remedies such as setoff;
 - (ii) foreclose against or sell any real or personal property collateral;
or
 - (iii) act in a court of law, before, during or after the arbitration proceeding to obtain:
 - (A) a provisional or interim remedy; and/or
 - (B) additional or supplementary remedies.
- (h) The pursuit of or a successful action for provisional, interim, additional or supplementary remedies, or the filing of a court action, does not constitute a waiver of the right of the Borrower or the Bank, including the suing party, to submit the controversy or claim to arbitration if the other party contests the lawsuit.
- (i) If the Bank forecloses against any real property securing this Agreement, the Bank has the option to exercise the power of sale under the deed of trust or mortgage, or to proceed by judicial foreclosure.

11.5 SEVERABILITY; WAIVERS. If any part of this Agreement is not enforceable, the rest of the Agreement may be enforced. The Bank retains all rights, even if it makes a loan after default. If the Bank waives a default, it may enforce a later default. Any consent or waiver under this Agreement must be in writing.

11.6 COSTS. If the Bank incurs any expenses in connection with enforcing this Agreement or administering this Agreement (including in connection with extending, amending, renewing or modifying this Agreement), or if the Bank takes collection action under this Agreement, it is entitled to costs and reasonable attorneys' fees, including any allocated costs of in-house counsel.

11.7 ATTORNEYS' FEES. In the event of a lawsuit or arbitration proceeding, the prevailing party is entitled to recover costs and reasonable attorneys' fees (including any allocated costs of in-house counsel) incurred in connection with the lawsuit or arbitration proceeding, as determined by the court or arbitrator (and not by a jury). Such costs and attorneys' fees shall include, without limitation, those incurred on any appeal, as determined by the appellate court, and any anticipated costs and attorneys' fees to pursue or collect any judgement.

11.8 ONE AGREEMENT. This Agreement and any related security or other agreements required by this Agreement, collectively:

- (a) represent the sum of the understandings and agreements between the Bank and the Borrower concerning this credit; and
- (b) replace any prior oral or written agreements between the Bank and the Borrower concerning this credit; and
- (c) are intended by the Bank and the Borrower as the final, complete and exclusive statement of the terms agreed to by them.

In the event of any conflict between this Agreement and any other agreements

required by this Agreement, this Agreement will prevail.

11.9 EXCHANGE OF INFORMATION. The Borrower agrees that the Bank may exchange financial information about the Borrower with Bank America Corporation affiliates and other related entities.

11.10 NOTICES. All notices required under this Agreement shall be personally delivered or sent by first class mail, postage prepaid, to the addresses on the signature page of this Agreement, or to such other addresses as the Bank and the Borrower may specify from time to time in writing.

11.11 HEADINGS. ARTICLE AND PARAGRAPH headings are for reference only and shall not affect the interpretation or meaning of any provisions of this Agreement.

11.12 COUNTERPARTS. This Agreement may be executed in as many counterparts as necessary or convenient, and by the different parties on separate counterparts each of which, when so executed, shall be deemed an original but all such counterparts shall constitute but one and the same agreement.

11.13 WRITTEN AGREEMENTS. UNDER OREGON LAW, MOST AGREEMENTS, PROMISES AND COMMITMENTS MADE BY THE BANK AFTER OCTOBER 3, 1989. CONCERNING LOANS AND OTHER CREDIT EXTENSIONS WHICH ARE NOT FOR PERSONAL, FAMILY OR HOUSEHOLD PURPOSES OR SECURED SOLELY BY THE BORROWER'S RESIDENCE MUST BE IN WRITING, EXPRESS CONSIDERATION AND BE SIGNED BY THAT BANK TO BE ENFORCEABLE.

This Agreement is executed as of the date stated at the top of the first page.

Bank of America NT & SA

FLIR SYSTEMS, INC.

X /s/ Marie-Lou A. Godinez

X /s/ J. Mark Samper

By: Marie-Lou A. Godinez
Title: Vice President

By: J. Mark Samper
Title: Vice President-Finance and C.F.O.

ADDRESS WHERE NOTICES TO THE BANK
ARE TO BE SENT:
Oregon Commercial Banking #2090
P.O. Box 6400
Portland, OR 97228

ADDRESS WHERE NOTICES TO THE BORROWER
ARE TO BE SENT:
16505 S.W. 72nd Avenue
Portland, OR 97224

BANK OF AMERICA

AMENDMENT TO DOCUMENTS

AMENDMENT NO.2 TO BUSINESS LOAN AGREEMENT

This Amendment No.2 (the "Amendment") dated as of December 3,1997, is between Bank of America NT & SA (the "Bank") and FLIR Systems, Inc. (the "Borrower").

RECITALS

A. The Bank and the Borrower entered into a certain Business Loan Agreement dated as of August 21, 1997 (the "Agreement").

B. The Bank and the Borrower desire to amend the Agreement.

AGREEMENT

1. Definitions. Capitalized terms used but not defined in this Amendment shall have the meaning given to them in the Agreement.

2. Amendments. The Agreement is hereby amended as follows:

2.1 In Subparagraph 1.1(a) of the Agreement, the amount "Thirty Million Dollars (\$30,000,000)" is substituted for the amount "Twenty Five Million Three Hundred Thousand Dollars (\$25,300,000)".

2.2 In Paragraph 1.9 of the Agreement, the amount "Three Million Dollars (\$3,000,000)" is substituted for the amount "Three Hundred Thousand Dollars (\$300,000)".

3. Conditions. This Amendment will be effective when the Bank receives the following items, in form and content acceptable to the Bank:

3.1 The Borrower agrees to pay a Six Thousand Two Hundred Fifty Dollars (\$6,250) fee, or .125% of the increase in the Facility No.1 Commitment amount, due upon execution of this Amendment.

4. Effect of Amendment. Except as provided in this Amendment, all of the terms and conditions of the Agreement shall remain in full force and effect.

This Amendment is executed as of the date stated at the beginning of this Amendment.

BANK OF AMERICA NT & SA

FLIR SYSTEMS, INC.

X /s/ Robert Countryman

X /S/ J. Mark Samper

By: Robert Countryman
Title: Vice President

By: J. Mark Samper
Title: Vice President-Finance and C.F.O.

SECURITY AGREEMENT

BANK OF AMERICA NT & SA

(RECEIVABLES, INVENTORY' AND EQUIPMENT)

1. THE SECURITY. The undersigned FLIR Systems, Inc. ("Borrower") hereby assigns and grants to Bank of America NT & SA ("Bank") a security interest in the following described property ("Collateral"):
 - A. All of the following, whether now owned or hereafter acquired by Borrower: accounts, contract rights, chattel paper, instruments, deposit accounts and general intangibles.
 - B. All inventory now owned or hereafter acquired by Borrower.
 - C. All machinery, furniture and other equipment of every type now owned or hereafter acquired by Borrower (including, but not limited to, the equipment described in the attached Equipment Description, if any).
 - D. All negotiable and nonnegotiable documents of title now owned or hereafter acquired by Borrower covering any of the above-described property.
 - E. All rights under contracts of insurance now owned or hereafter acquired by Borrower covering any of the above-described property.
 - F. All proceeds now owned or hereafter acquired by Borrower of any of the above-described property.
 - G. All books and records now owned or hereafter acquired by Borrower pertaining to any of the above-described property, including but not limited to any computer-readable memory and any computer hardware or software necessary to process such memory ("Books and Records").
2. THE INDEBTEDNESS. The Collateral secures and will secure all Indebtedness of Borrower to Bank. For the purposes of this Agreement, "Indebtedness" means all loans and advances made by Bank to Borrower and all other obligations and liabilities of Borrower to Bank, whether now existing or hereafter incurred or created, whether voluntary or involuntary, whether due or not due, whether absolute or contingent, or whether incurred directly or acquired by Bank by assignment or otherwise. Unless Borrower shall have otherwise agreed in writing, Indebtedness, for the purposes of this Agreement, shall not include "consumer credit" subject to the disclosure requirements of the Federal Truth in Lending Act or any regulations promulgated thereunder.
3. BORROWER'S COVENANTS. Borrower covenants and warrants that unless compliance is waived by Bank in writing:
 - A. Borrower will properly preserve the Collateral; defend the Collateral against any adverse claims and demands; and keep accurate Books and Records.
 - B. Borrower has notified Bank in writing of, and will notify Bank in writing prior to any change in, the locations of (i) Borrower's place of business or Borrower's chief executive office if Borrower has more than one place of business, and (ii) any Collateral, including the Books and Records.
 - C. Borrower will notify Bank in writing prior to any change in Borrower's name, identity or business structure.
 - D. Borrower will maintain and keep in force insurance covering Collateral designated by Bank against fire and extended coverages. Such insurance shall require losses to be paid on a replacement cost basis, be issued by insurance companies acceptable to Bank and include a loss payable endorsement in favor of Bank in a form acceptable to Bank.
 - E. Borrower has not granted and will not grant any security interest in any of the Collateral except to Bank, and will keep the Collateral free of all liens, claims, security interests and encumbrances of any kind or nature except the security interest of Bank.

- F. Borrower will not sell, lease, agree to sell or lease, or otherwise dispose of; or remove from Borrower's place of business (i) any inventory except in the ordinary course of business as heretofore conducted by Borrower, or (ii) any other Collateral except with the prior written consent of Bank.
- G. Borrower will promptly notify Bank in writing of any event which affects the value of the Collateral, the ability of Borrower or Bank to dispose of the Collateral, or the rights and remedies of Bank in relation thereto, including, but not limited to, the levy of any legal process against any Collateral and the adoption of any marketing order, arrangement or procedure affecting the Collateral, whether governmental or otherwise.
- H. If any Collateral is or becomes the subject of any registration certificate or negotiable document of title, including any warehouse receipt or bill of lading, Borrower shall immediately deliver such document to Bank.
- I. Borrower will not attach any Collateral to any real property or fixture in a manner which might cause such Collateral to become a part thereof unless Borrower first obtains the written consent of any owner, holder of any lien on the real property or fixture, or other person having an interest in such property to the removal by Bank of the Collateral from such real property or fixture. Such written consent shall be in form and substance acceptable to Bank and shall provide that Bank has no liability to such owner, holder of any lien, or any other person.
- J. Until Bank exercises its rights to make collection, Borrower will diligently collect all Collateral.

4. ADDITIONAL OPTIONAL REQUIREMENTS. Borrower agrees that Bank may at its option at any time, whether or not Borrower is in default:

- A. Require Borrower to segregate all collections and proceeds of the Collateral so that they are capable of identification and deliver daily such collections and proceeds to Bank in kind.
- B. Require Borrower to deliver to Bank (i) copies of or extracts from the Books and Records, and (ii) information on any contracts or other matters affecting the Collateral.
- C. Examine the Collateral, including the Books and Records, and make copies of or extracts from the Books and Records, and for such purposes enter at any reasonable time upon the property where any Collateral or any Books and Records are located.
- D. Require Borrower to deliver to Bank any instruments or chattel paper.
- E. Require Borrower to obtain Bank's prior written consent to any sale, lease, agreement to sell or lease, or other disposition of any inventory.
- F. Notify any account debtors, any buyers of the Collateral, or any other persons of Bank's interest in the Collateral.
- G. Require Borrower to direct all account debtors to forward all payments and proceeds of the Collateral to a post office box under Bank's exclusive control.
- H. Demand and collect any payments and proceeds of the Collateral. In connection therewith Borrower irrevocably authorizes Bank to endorse or sign Borrower's name on all checks, drafts, collections, receipts and other documents, and to take possession of and open the mail addressed to Borrower and remove therefrom any payments and proceeds of the Collateral.

5. DEFAULTS. Any one or more of the following shall be a default hereunder:

- A. Borrower fails to pay any Indebtedness when due.
- B. Borrower breaches any term, provision, warranty or representation under

this Agreement, or under any other obligation of Borrower to Bank.

- C. Any custodian, receiver or trustee is appointed to take possession, custody or control of all or a substantial portion of the property of Borrower or of any guarantor of any Indebtedness.
- D. Borrower or any guarantor of any Indebtedness becomes insolvent, or is generally not paying or admits in writing its inability to pay its debts as they become due, fails in business, makes a general assignment for the benefit of creditors, dies or commences any case, proceeding or other action under any bankruptcy or other law for the relief of, or relating to, debtors.
- E. Any case, proceeding or other action is commenced against Borrower or any guarantor of any Indebtedness under any bankruptcy or other law for the relief of, or relating to, debtors.
- F. Any involuntary lien of any kind or character attaches to any Collateral.
- G. Any financial statements, certificates, schedules or other information now or hereafter furnished by Borrower to Bank proves false or incorrect in any material respect.

6. BANK'S REMEDIES AFTER DEFAULT. In the event of any default Bank may do any one or more of the following:

- A. Declare any Indebtedness immediately due and payable, without notice or demand.
- B. Enforce the security interest given hereunder pursuant to the Uniform Commercial Code and any other applicable law.
- C. Enforce the security interest of Bank in any deposit account of Borrower maintained with Bank by applying such account to the Indebtedness.
- D. Require Borrower to assemble the Collateral, including the Books and Records, and make them available to Bank at a place designated by Bank.
- E. Enter upon the property where any Collateral, including any Books and Records, are located and take possession of such Collateral and such Books and Records, and use such property (including any buildings and facilities) and any of Borrower's equipment, if Bank deems such use necessary or advisable in order to take possession of, hold, preserve, process, assemble, prepare for sale or lease, market for sale or lease, sell or lease, or otherwise dispose of, any Collateral.
- F. Grant extensions and compromise or settle claims with respect to the Collateral for less than face value, all without prior notice to Borrower.
- G. Use or transfer any of Borrower's rights and interests in any Intellectual Property now owned or hereafter acquired by Borrower, if Bank deems such use or transfer necessary or advisable in order to take possession of, hold, preserve, process, assemble, prepare for sale or lease, market for sale or lease, sell or lease, or otherwise dispose of; any Collateral. Borrower agrees that any such use or transfer shall be without any additional consideration to Borrower. As used in this paragraph, "Intellectual Property" includes, but is not limited to, all trade secrets, computer software, service marks, trademarks, trade names, trade styles, copyrights, patents, applications for any of the foregoing, customer lists, working drawings, instructional manuals, and rights in processes for technical manufacturing, packaging and labelling, in which Borrower has any right or interest, whether by ownership, license, contract or otherwise.
- H. Have a receiver appointed by any court of competent jurisdiction to take possession of the Collateral.
- L. Take such measures as Bank may deem necessary or advisable to take possession of, hold, preserve, process, assemble, insure, prepare for

sale or lease, market for sale or lease, sell or lease, or otherwise dispose of, any Collateral, and Borrower hereby irrevocably constitutes and appoints Bank as Borrower's attorney-in-fact to perform all acts and execute all documents in connection therewith.

7. MISCELLANEOUS.

- A. Any waiver, express or implied, of any provision hereunder and any delay or failure by Bank to enforce any provision shall not preclude Bank from enforcing any such provision thereafter.
- B. Borrower shall, at the request of Bank, execute such other agreements, documents, instruments, or financing statements in connection with this Agreement as Bank may reasonably deem necessary.
- C. All notes, security agreements, subordination agreements and other documents executed by Borrower or furnished to Bank in connection with this Agreement must be in form and substance satisfactory to Bank.
- D. This Agreement shall be governed by and construed according to the laws of the State of Oregon, to the jurisdiction of which the parties hereto submit.
- E. All rights and remedies herein provided are cumulative and not exclusive of any rights or remedies otherwise provided by law. Any single or partial exercise of any right or remedy shall not preclude the further exercise thereof or the exercise of any other right or remedy.
- F. All terms not defined herein are used as set forth in the Uniform Commercial Code.
- G. In the event of any action by Bank to enforce this Agreement or to protect the security interest of Bank in the Collateral, or to take possession of; hold, preserve, process, assemble, insure, prepare for sale or lease, market for sale or lease, sell or lease, or otherwise dispose of; any Collateral, Borrower agrees to pay immediately the costs and expenses thereof, together with reasonable attorney's fees and allocated costs for in-house legal services.
- H. Any Borrower who is married agrees that such Borrower's separate property shall be liable for payment of the Indebtedness if such Borrower is personally liable for the Indebtedness.

Dated: August 21, 1997

Borrower:
FLIR Systems, Inc.

Bank of America NT & SA

An Oregon Corporation

X /s/ Marie-Lou A. Godinez

Marie-Lou A. Godinez, Vice President

/s/ J. Mark Samper

J. Mark Samper, Vice President-Finance
and C.F.O.

SUBSIDIARIES OF FLIR SYSTEMS, INC.

-
- . FSI International, Inc., a Barbados Corporation
 - . Hoeger Optical Co., Inc., a California Corporation
 - . FLIR Systems International Ltd., a United Kingdom Corporation
 - . FSI Automation, Inc., a Washington Corporation
 - . FLIR Systems AB, a Swedish Corporation
 - . FLIR Systems Limited., a United Kingdom Corporation
 - . FLIR Systems Ltd., a Canadian Corporation
 - . FLIR Systems Secaucus, a Delaware Corporation

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 33-82676, 33-82194 and 33-95248) of FLIR Systems, Inc. of our report dated March 9, 1998, which appears on page 19 of this Form 10-K. We also consent to the incorporation by reference of our report on the Financial Statement Schedule which appears on page 42 of this Form 10-K.

PRICE WATERHOUSE LLP
Portland, Oregon
March 31, 1998

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