

COGNEX CORP  
Form 10-Q  
November 02, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q  
(Mark One)

- Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended October 4, 2015 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 001-34218

COGNEX CORPORATION

(Exact name of registrant as specified in its charter)

Massachusetts

(State or other jurisdiction of  
incorporation or organization)

04-2713778

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

One Vision Drive

Natick, Massachusetts 01760-2059

(508) 650-3000

(Address, including zip code, and telephone number, including area code, of principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

|                         |                                     |                           |                          |
|-------------------------|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/>            | Smaller reporting company | <input type="checkbox"/> |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of October 4, 2015, there were 84,845,210 shares of Common Stock, \$.002 par value per share, of the registrant outstanding.

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COGNEX CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except per share amounts)

|   | Three-months Ended                |                       | Nine-months Ended                 |                       |
|---|-----------------------------------|-----------------------|-----------------------------------|-----------------------|
|   | October 4,<br>2015<br>(unaudited) | September 28,<br>2014 | October 4,<br>2015<br>(unaudited) | September 28,<br>2014 |
| Revenue   | \$107,587                         | \$154,356             | \$352,789                         | \$327,948             |
| Cost of revenue   | 26,319                            | 37,712                | 79,171                            | 72,455                |
| Gross margin  | 81,268                            | 116,644               | 273,618                           | 255,493               |
| Research, development, and engineering expenses                           | 16,977                            | 17,532                | 52,265                            | 41,625                |
| Selling, general, and administrative expenses                             | 35,806                            | 43,773                | 118,980                           | 111,103               |
| Operating income  | 28,485                            | 55,339                | 102,373                           | 102,765               |
| Foreign currency gain (loss)  | (40 )                             | 794                   | 580                               | 610                   |
| Investment income   | 841                               | 776                   | 2,648                             | 2,364                 |
| Other income (expense)  | (23 )                             | 202                   | (388 )                            | (146 )                |
| Income from continuing operations before income tax expense               | 29,263                            | 57,111                | 105,213                           | 105,593               |
| Income tax expense on continuing operations                               | 3,441                             | 9,430                 | 16,403                            | 17,422                |
| Income from continuing operations, net of tax                             | 25,822                            | 47,681                | 88,810                            | 88,171                |
| Income from discontinued operations, net of tax                           | —                                 | 2,719                 | 1,228                             | 6,683                 |
| Gain on sale of discontinued business, net of tax                         | 78,290                            | —                     | 78,290                            | —                     |
| Discontinued operations, net of tax (Note 15)                             | 78,290                            | 2,719                 | 79,518                            | 6,683                 |
| Net income  | \$104,112                         | \$50,400              | \$168,328                         | \$94,854              |
| Basic earnings per weighted-average common and common-equivalent share:   |                                   |                       |                                   |                       |
| Income from continuing operations   | \$0.30                            | \$0.55                | \$1.02                            | \$1.01                |
| Income from discontinued operations                                       | \$0.91                            | \$0.03                | \$0.92                            | \$0.08                |
| Net income  | \$1.21                            | \$0.58                | \$1.94                            | \$1.09                |
| Diluted earnings per weighted-average common and common-equivalent share: |                                   |                       |                                   |                       |
| Income from continuing operations   | \$0.29                            | \$0.53                | \$1.00                            | \$0.99                |
| Income from discontinued operations                                       | \$0.90                            | \$0.04                | \$0.90                            | \$0.07                |
| Net income  | \$1.19                            | \$0.57                | \$1.90                            | \$1.06                |
| Weighted-average common and common-equivalent shares outstanding:         |                                   |                       |                                   |                       |
| Basic   | 86,303                            | 86,963                | 86,756                            | 86,875                |
| Diluted   | 87,776                            | 89,167                | 88,559                            | 89,145                |
| Cash dividends per common share   | \$0.07                            | \$—                   | \$0.14                            | \$—                   |

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

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COGNEX CORPORATION  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(In thousands)

|  | Three-months Ended                |                       | Nine-months Ended                 |                       |
|--|-----------------------------------|-----------------------|-----------------------------------|-----------------------|
|  | October 4,<br>2015<br>(unaudited) | September 28,<br>2014 | October 4,<br>2015<br>(unaudited) | September 28,<br>2014 |
| Net income   | \$104,112                         | \$50,400              | \$168,328                         | \$94,854              |
| Other comprehensive income (loss), net of tax:   |                                   |                       |                                   |                       |
| Cash flow hedges:  |                                   |                       |                                   |                       |
| Change in net unrealized gain (loss), net of tax of (\$3) and \$4 in the three-month periods and net of tax of (\$28) and (\$2) in the nine-month periods, respectively            | (140                              | ) 62                  | (423                              | ) (173                |
| Reclassification of net realized loss into current operations  | 90                                | 44                    | 269                               | 101                   |
| Net change related to cash flow hedges   | (50                               | ) 106                 | (154                              | ) (72                 |
| Available-for-sale investments:  |                                   |                       |                                   |                       |
| Change in net unrealized gain (loss), net of tax of (\$61) and (\$49) in the three-month periods and net of tax of (\$55) and \$133 in the nine-month periods, respectively        | (666                              | ) (120                | ) (100                            | ) 1,441               |
| Reclassification of net realized gain into current operations  | (19                               | ) (45                 | ) (240                            | ) (651                |
| Net change related to available-for-sale investments   | (685                              | ) (165                | ) (340                            | ) 790                 |
| Foreign currency translation adjustments:  |                                   |                       |                                   |                       |
| Change in currency translation adjustments, net of tax of \$4 and (\$441) in the three-month periods and net of tax of (\$525) and (\$501) in the nine-month periods, respectively | 620                               | (4,540                | ) (7,620                          | ) (4,639              |
| Net change related to foreign currency translation adjustments   | 620                               | (4,540                | ) (7,620                          | ) (4,639              |
| Other comprehensive income (loss), net of tax  | (115                              | ) (4,599              | ) (8,114                          | ) (3,921              |
| Total comprehensive income   | \$103,997                         | \$45,801              | \$160,214                         | \$90,933              |

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

COGNEX CORPORATION  
CONSOLIDATED BALANCE SHEETS  
(In thousands)

|  | October 4, 2015<br>(unaudited) | December 31, 2014 |
|--|--------------------------------|-------------------|
| <b>ASSETS</b>  |                                |                   |
| Current assets:  |                                |                   |
| Cash and cash equivalents  | \$79,563                       | \$55,694          |
| Short-term investments   | 272,584                        | 90,456            |
| Accounts receivable, less reserves of \$747 and \$820 in 2015 and 2014, respectively   | 71,012                         | 40,053            |
| Inventories  | 39,841                         | 29,223            |
| Deferred income taxes  | 8,666                          | 8,985             |
| Prepaid expenses and other current assets  | 14,469                         | 17,686            |
| Held for sale assets (Note 15)   | —                              | 29,814            |
| Total current assets   | 486,135                        | 271,911           |
| Long-term investments  | 240,504                        | 400,845           |
| Property, plant, and equipment, net  | 51,105                         | 45,963            |
| Goodwill   | 81,448                         | 77,388            |
| Intangible assets, net   | 7,361                          | 9,670             |
| Deferred income taxes  | 18,069                         | 14,452            |
| Other assets   | 2,778                          | 1,505             |
| <b>Total assets</b>  | <b>\$887,400</b>               | <b>\$821,734</b>  |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                                |                   |
| Current liabilities:   |                                |                   |
| Accounts payable   | \$10,026                       | \$17,223          |
| Accrued expenses   | 32,871                         | 35,614            |
| Accrued income taxes   | 9,112                          | 1,048             |
| Deferred income taxes  | 502                            | —                 |
| Deferred revenue and customer deposits   | 15,311                         | 14,598            |
| Held for sale liabilities (Note 15)  | —                              | 12,191            |
| Total current liabilities  | 67,822                         | 80,674            |
| Reserve for income taxes   | 3,933                          | 4,623             |
| Other non-current liabilities  | 2,852                          | —                 |
| <b>Total liabilities</b>   | <b>74,607</b>                  | <b>85,297</b>     |
| Commitments and contingencies (Note 7)   |                                |                   |
| Shareholders' equity:  |                                |                   |
| Common stock, \$.002 par value – Authorized: 140,000 shares, issued and outstanding: 84,845 and 86,542 shares in 2015 and 2014, respectively | 170                            | 173               |
| Additional paid-in capital   | 306,344                        | 251,717           |
| Retained earnings  | 553,792                        | 523,946           |
| Accumulated other comprehensive loss, net of tax   | (47,513                        | ) (39,399         |
| Total shareholders' equity   | 812,793                        | 736,437           |
|  | <b>\$887,400</b>               | <b>\$821,734</b>  |

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

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COGNEX CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

|   | Nine-months Ended |                    |   |
|---|-------------------|--------------------|---|
|   | October 4, 2015   | September 28, 2014 |   |
|   | (unaudited)       |                    |   |
| Cash flows from operating activities:   |                   |                    |   |
| Net income  | \$ 168,328        | \$ 94,854          |   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                   |                    |   |
| Gain on sale of discontinued business   | (78,290           | ) —                |   |
| Stock-based compensation expense  | 15,964            | 11,258             |   |
| Depreciation of property, plant, and equipment                                    | 7,223             | 6,194              |   |
| Amortization of intangible assets   | 3,203             | 2,934              |   |
| Amortization of discounts or premiums on investments                              | 536               | 1,596              |   |
| Realized gain on sale of investments  | (240              | ) (651             | ) |
| Tax effect of stock option exercises  | (9,937            | ) (7,178           | ) |
| Change in deferred income taxes   | (2,134            | ) (2,959           | ) |
| Change in operating assets and liabilities:                                       |                   |                    |   |
| Accounts receivable   | (31,380           | ) (51,961          | ) |
| Inventories   | (11,363           | ) (6,555           | ) |
| Accounts payable  | (6,823            | ) 4,133            |   |
| Accrued expenses  | (4,010            | ) 6,221            |   |
| Accrued income taxes  | 18,032            | 7,331              |   |
| Deferred revenue  | 6,035             | 9,453              |   |
| Other   | (1,086            | ) (11,683          | ) |
| Net cash provided by operating activities   | 74,058            | 62,987             |   |
| Cash flows from investing activities:   |                   |                    |   |
| Purchases of investments  | (547,553          | ) (283,982         | ) |
| Maturities and sales of investments   | 521,464           | 239,396            |   |
| Purchases of property, plant, and equipment                                       | (13,017           | ) (9,078           | ) |
| Cash paid for acquisition of business   | (1,023            | ) —                |   |
| Cash paid for purchased technology  | (10,475           | ) —                |   |
| Net proceeds from sale of discontinued business                                   | 104,496           | —                  |   |
| Net cash provided by (used in) investing activities                               | 53,892            | (53,664            | ) |
| Cash flows from financing activities:   |                   |                    |   |
| Issuance of common stock under stock plans  | 27,440            | 15,651             |   |
| Repurchase of common stock  | (126,351          | ) (35,140          | ) |
| Payment of dividends  | (12,137           | ) —                |   |
| Tax effect of stock option exercises  | 9,937             | 7,178              |   |
| Net cash used in financing activities   | (101,111          | ) (12,311          | ) |
| Effect of foreign exchange rate changes on cash and cash equivalents              | (2,970            | ) 523              |   |
| Net change in cash and cash equivalents   | 23,869            | (2,465             | ) |
| Cash and cash equivalents at beginning of period                                  | 55,694            | 40,644             |   |
| Cash and cash equivalents at end of period  | \$ 79,563         | \$ 38,179          |   |
| Non-cash items related to discontinued operations:                                |                   |                    |   |
| Depreciation and amortization expense   | \$ 566            | \$ 866             |   |
| Capital expenditures  | 482               | 467                |   |
| Stock-based compensation expense  | 1,533             | 786                |   |



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

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COGNEX CORPORATION  
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY  
(In thousands)

|   | Common Stock |           | Additional | Retained  | Accumulated   | Total         |
|---|--------------|-----------|------------|-----------|---------------|---------------|
|   | Shares       | Par Value | Paid-in    | Earnings  | Other         | Shareholders' |
|   |              |           | Capital    |           | Comprehensive | Equity        |
|   |              |           |            |           | Loss          |               |
| Balance as of December 31, 2014   | 86,542       | \$ 173    | \$251,717  | \$523,946 | \$(39,399)    | ) \$736,437   |
| Issuance of common stock under stock plans  | 1,509        | 3         | 27,437     |           |               | 27,440        |
| Repurchase of common stock  | (3,206)      | (6)       |            | (126,345) |               | (126,351)     |
| Stock-based compensation expense  |              |           | 17,070     |           |               | 17,070        |
| Excess tax benefit from stock option exercises                                      |              |           | 9,937      |           |               | 9,937         |
| Tax benefit for research and development credits as a result of stock options       |              |           | 183        |           |               | 183           |
| Payment of dividends  |              |           |            | (12,137)  |               | (12,137)      |
| Net income  |              |           |            | 168,328   |               | 168,328       |
| Net unrealized loss on cash flow hedges, net of tax of \$28                         |              |           |            |           | (423)         | (423)         |
| Reclassification of net realized loss on cash flow hedges                           |              |           |            |           | 269           | 269           |
| Net unrealized loss on available-for-sale investments, net of tax of \$55           |              |           |            |           | (100)         | (100)         |
| Reclassification of net realized gain on the sale of available-for-sale investments |              |           |            |           | (240)         | (240)         |
| Foreign currency translation adjustment, net of tax of \$525                        |              |           |            |           | (7,620)       | (7,620)       |
| Balance as of October 4, 2015 (unaudited)   | 84,845       | \$ 170    | \$306,344  | \$553,792 | \$(47,513)    | ) \$812,793   |

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



COGNEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1: Summary of Significant Accounting Policies

As permitted by the rules of the Securities and Exchange Commission applicable to Quarterly Reports on Form 10-Q, these notes are condensed and do not contain all disclosures required by generally accepted accounting principles (GAAP). Reference should be made to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

In the opinion of the management of Cognex Corporation (the "Company"), the accompanying consolidated unaudited financial statements contain all adjustments, consisting of normal, recurring adjustments and financial statement reclassifications, including those related to the disposition of a business (more fully described in Note 15), necessary to present fairly the Company's financial position as of October 4, 2015, and the results of its operations for the three-month and nine-month periods ended October 4, 2015 and September 28, 2014, and changes in shareholders' equity, comprehensive income, and cash flows for the periods presented.

The results disclosed in the Consolidated Statements of Operations for the three-month and nine-month periods ended October 4, 2015 are not necessarily indicative of the results to be expected for the full year.

On July 6, 2015, the Company completed the sale of its Surface Inspection Systems Division (SISD). The financial results of SISD are reported as a discontinued operation for all periods presented.

NOTE 2: New Pronouncements

Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers"

The amendments in ASU 2014-09 will supersede and replace all currently existing U.S. GAAP, including industry-specific revenue recognition guidance, with a single, principle-based revenue recognition framework. The concept guiding this new model is that revenue recognition will depict transfer of control to the customer in an amount that reflects consideration to which an entity expects to be entitled. The core principles supporting this framework include (1) identifying the contract with a customer, (2) identifying separate performance obligations within the contract, (3) determining the transaction price, (4) allocating the transaction price to the performance obligations, and (5) recognizing revenue. This new framework will require entities to apply significantly more judgment. This increase in management judgment will require expanded disclosure on estimation methods, inputs, and assumptions for revenue recognition. The Transition Resource Group (TRG) is evaluating the impact of this ASU and will release implementation guidance in future periods. ASU 2015-14, "Deferral of the effective date" amended the effective date of ASU 2014-09 for public companies to annual reporting periods beginning after December 15, 2017. Early adoption is permitted, but only beginning after December 15, 2016. Management will continue to evaluate the impact of this standard as it evolves.

Accounting Standards Update (ASU) 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software"

ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, then the customer should account for the arrangement as a service contract. For public companies, the guidance in ASU 2015-05 is effective for annual periods beginning after December 15, 2015, and interim periods thereafter. Early adoption is permitted. Management does not expect ASU 2015-05 to have a material impact on the Company's financial statements and disclosures.

Accounting Standards Update (ASU) 2015-11, "Inventory - Simplifying the Measurement of Inventory"

ASU 2015-11 requires companies to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which a company must measure inventory at the lower of cost or market. This ASU eliminates the need to determine replacement cost and evaluate whether said cost is within a quantitative range. This ASU also further aligns U.S. GAAP and international accounting standards. For public companies, the guidance in ASU 2015-11 is effective for annual periods beginning after December 15, 2016, and interim periods thereafter. Early adoption is permitted. Management does not expect ASU 2015-11 to have a material impact on the Company's financial statements and disclosures.

Accounting Standards Update (ASU) 2015-16, "Business Combinations - Simplifying the Accounting for Measurement-Period Adjustments"

ASU 2015-16 simplifies the requirements to retrospectively account for adjustments made to provisional amounts recognized in a business combination. This ASU applies to all entities that have reported provisional amounts for

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items in a business combination for which the accounting is incomplete by the end of the reporting period in which the combination occurs and that have recognized an adjustment to provisional amounts during the measurement period. For public companies, the guidance in ASU 2015-16 is effective for annual periods beginning after December 15, 2015, and interim periods thereafter. This ASU should be applied prospectively to adjustments to provisional amounts that occur after the effective date. Management does not expect ASU 2015-16 to have a material impact on the Company's financial statements and disclosures.

#### NOTE 3: Fair Value Measurements

##### Financial Assets and Liabilities that are Measured at Fair Value on a Recurring Basis

The following table summarizes the financial assets and liabilities required to be measured at fair value on a recurring basis as of October 4, 2015 (in thousands):

|                                   | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets (Level 1) | Significant Other<br>Observable<br>Inputs (Level 2) |
|-----------------------------------|---|---|
| Assets:                           |   |   |
| Money market instruments          | \$32,417  | \$—   |
| Corporate bonds                   | —   | 227,012   |
| Treasury bills                    | —   | 98,981  |
| Asset-backed securities           | —   | 89,246  |
| Euro liquidity fund               | —   | 63,672  |
| Agency bonds                      | —   | 14,280  |
| Sovereign bonds                   | —   | 12,270  |
| Municipal bonds                   | —   | 6,685   |
| Cash flow hedge forward contracts | —   | 82  |
| Economic hedge forward contracts  | —   | 32  |
| Liabilities:                      |   |   |
| Cash flow hedge forward contracts | —   | 227   |

The Company's money market instruments are reported at fair value based upon the daily market price for identical assets in active markets, and are therefore classified as Level 1.

The Company's debt securities and forward contracts are reported at fair value based upon model-driven valuations in which all significant inputs are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset or liability, and are therefore classified as Level 2. Management is responsible for estimating the fair value of these financial assets and liabilities, and in doing so, considers valuations provided by a large, third-party pricing service. For debt securities, this service maintains regular contact with market makers, brokers, dealers, and analysts to gather information on market movement, direction, trends, and other specific data. They use this information to structure yield curves for various types of debt securities and arrive at the daily valuations. The Company's forward contracts are typically traded or executed in over-the-counter markets with a high degree of pricing transparency. The market participants are generally large commercial banks.

The Company did not record an other-than-temporary impairment of these financial assets or liabilities during the nine-month period ended October 4, 2015.

##### Financial Assets that are Measured at Fair Value on a Non-recurring Basis

The Company has an interest in a limited partnership, which is accounted for using the cost method and is required to be measured at fair value on a non-recurring basis. Management is responsible for estimating the fair value of this investment, and in doing so, considers valuations of the partnership's investments as determined by the General Partner. Publicly-traded investments in active markets are reported at the market closing price less a discount, as appropriate, to reflect restricted marketability. Fair value for private investments for which observable market prices in active markets do not exist is based upon the best information available including the value of a recent financing, reference to observable valuation measures for comparable companies (such as revenue multiples), public or private transactions (such as the sale of a comparable company), and valuations for publicly-traded comparable companies.

The valuations also incorporate the General Partner's own judgment and close familiarity with the business activities of each portfolio company. Significant increases or decreases in any of these inputs in isolation may result in a significantly lower or higher fair value measurement. The portfolio consists of securities of public and private companies,

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## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

and consequently, inputs used in the fair value calculation are classified as Level 3. The Company did not record an other-than-temporary impairment of this asset during the nine-month period ended October 4, 2015.

## Non-financial Assets that are Measured at Fair Value on a Non-recurring Basis

Non-financial assets such as goodwill, intangible assets, and property, plant, and equipment are required to be measured at fair value only when an impairment loss is recognized. The Company did not record an impairment charge related to these assets during the nine-month period ended October 4, 2015.

## NOTE 4: Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and investments consisted of the following (in thousands):

|                              | October 4, 2015 | December 31, 2014 |
|------------------------------|-----------------|-------------------|
| Cash                         | \$47,146        | \$54,917          |
| Money market instruments     | 32,417          | 777               |
| Cash and cash equivalents    | 79,563          | 55,694            |
| Treasury bills               | 82,401          | —                 |
| Euro liquidity fund          | 63,672          | 48,235            |
| Asset-backed securities      | 60,992          | 1,311             |
| Corporate bonds              | 45,170          | 30,889            |
| Agency bonds                 | 10,980          | 6,883             |
| Sovereign bonds              | 7,568           | —                 |
| Municipal bonds              | 1,801           | 1,237             |
| Supranational bonds          | —               | 1,901             |
| Short-term investments       | 272,584         | 90,456            |
| Corporate bonds              | 181,842         | 216,294           |
| Asset-backed securities      | 28,254          | 62,556            |
| Treasury bills               | 16,580          | 90,412            |
| Municipal bonds              | 4,884           | 6,600             |
| Sovereign bonds              | 4,702           | 13,461            |
| Agency bonds                 | 3,300           | 9,566             |
| Limited partnership interest | 942             | 1,956             |
| Long-term investments        | 240,504         | 400,845           |
|                              | \$592,651       | \$546,995         |

Corporate bonds consist of debt securities issued by both domestic and foreign companies; treasury bills consist of debt securities issued by both the U.S. and foreign governments; asset-backed securities consist of debt securities collateralized by pools of receivables or loans with credit enhancement; the Euro liquidity fund invests in a portfolio of investment-grade bonds; agency bonds consist of domestic or foreign obligations of government agencies and government sponsored enterprises that have government backing; sovereign bonds consist of direct debt issued by foreign governments; municipal bonds consist of debt securities issued by state and local government entities; and supranational bonds consist of direct debt issued by two or more foreign central governments. The Euro liquidity fund is denominated in Euros, and the remaining securities are denominated in U.S. Dollars.



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The following table summarizes the Company's available-for-sale investments as of October 4, 2015 (in thousands):

|                         | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value  |
|-------------------------|-------------------|------------------------------|-------------------------------|-------------|
| Short-term:             |                   |                              |                               |             |
| Treasury bills          | \$82,334          | \$67                         | \$—                           | \$82,401    |
| Euro liquidity fund     | 63,667            | 5                            | —                             | 63,672      |
| Asset-backed securities | 60,989            | 20                           | (17                           | ) 60,992    |
| Corporate bonds         | 45,182            | 56                           | (68                           | ) 45,170    |
| Agency bonds            | 10,979            | 1                            | —                             | 10,980      |
| Sovereign bonds         | 7,561             | 7                            | —                             | 7,568       |
| Municipal bonds         | 1,800             | 1                            | —                             | 1,801       |
| Long-term:              |                   |                              |                               |             |
| Corporate bonds         | 182,509           | 240                          | (907                          | ) 181,842   |
| Asset-backed securities | 28,257            | 31                           | (34                           | ) 28,254    |
| Treasury bills          | 16,521            | 59                           | —                             | 16,580      |
| Municipal bonds         | 4,851             | 33                           | —                             | 4,884       |
| Sovereign bonds         | 4,696             | 6                            | —                             | 4,702       |
| Agency bonds            | 3,299             | 1                            | —                             | 3,300       |
|                         | \$512,645         | \$527                        | \$(1,026                      | ) \$512,146 |

The following table summarizes the Company's gross unrealized losses and fair values for available-for-sale investments in an unrealized loss position as of October 4, 2015 (in thousands):

|                         | Unrealized Loss Position For: |                      |                      |                      |             |                      |   |
|-------------------------|-------------------------------|----------------------|----------------------|----------------------|-------------|----------------------|---|
|                         | Less than 12 Months           |                      | 12 Months or Greater |                      | Total       |                      |   |
|                         | Fair Value                    | Unrealized<br>Losses | Fair Value           | Unrealized<br>Losses | Fair Value  | Unrealized<br>Losses |   |
| Corporate bonds         | \$118,452                     | \$(879               | ) \$6,935            | \$(96                | ) \$125,387 | \$(975               | ) |
| Asset-backed securities | 48,781                        | (47                  | ) 2,334              | (4                   | ) 51,115    | (51                  | ) |
|                         | \$167,233                     | \$(926               | ) \$9,269            | \$(100               | ) \$176,502 | \$(1,026             | ) |

As of October 4, 2015, the Company did not recognize an other-than-temporary impairment of these investments. In its evaluation, management considered the type of security, the credit rating of the security, the length of time the security has been in a loss position, the size of the loss position, our intent and ability to hold the security to expected recovery of value, and other meaningful information. The Company does not intend to sell, and is unlikely to be required to sell, any of these available-for-sale investments before its effective maturity or market price recovery. The Company recorded gross realized gains and gross realized losses on the sale of debt securities totaling \$26,000 and \$7,000, respectively, during the three-month period ended October 4, 2015 and \$66,000 and \$21,000, respectively, during the three-month period ended September 28, 2014. The Company recorded gross realized gains and gross realized losses on the sale of debt securities totaling \$434,000 and \$194,000, respectively, during the nine-month period ended October 4, 2015 and \$695,000 and \$44,000, respectively, during the nine-month period ended September 28, 2014. These gains and losses are included in "Investment income" on the Consolidated Statement of Operations. Prior to the sale of these securities, unrealized gains and losses for these debt securities, net of tax, are recorded in shareholders' equity as other comprehensive income (loss).

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The following table presents the effective maturity dates of the Company's available-for-sale investments as of October 4, 2015 (in thousands):

|                         | 1<br>Year or Less | 1-2<br>Years | 2-3<br>Years | 3-4<br>Years | 4-5<br>Years | 5-8 Years | Total     |
|-------------------------|-------------------|--------------|--------------|--------------|--------------|-----------|-----------|
| Corporate bonds         | \$45,170          | \$95,528     | \$65,060     | \$17,922     | \$3,332      | \$—       | \$227,012 |
| Treasury bills          | 82,401            | 5,099        | 11,481       | —            | —            | —         | 98,981    |
| Asset-backed securities | 60,992            | 5,675        | 9,768        | 5,717        | 6,618        | 476       | 89,246    |
| Euro liquidity fund     | 63,672            | —            | —            | —            | —            | —         | 63,672    |
| Agency bonds            | 10,980            | —            | 3,300        | —            | —            | —         | 14,280    |
| Sovereign bonds         | 7,568             | 4,702        | —            | —            | —            | —         | 12,270    |
| Municipal bonds         | 1,801             | 4,884        | —            | —            | —            | —         | 6,685     |
|                         | \$272,584         | \$115,888    | \$89,609     | \$23,639     | \$9,950      | \$476     | \$512,146 |

The Company is a Limited Partner in Venrock Associates III, L.P. (Venrock), a venture capital fund. The Company has committed to a total investment in the limited partnership of up to \$20,500,000, with an expiration date of December 31, 2015. As of October 4, 2015, the Company contributed \$19,886,000 to the partnership. The remaining commitment of \$614,000 can be called by Venrock at any time before December 31, 2015. Distributions and contributions are at the discretion of Venrock's management. No contributions were made during the nine-month period ended October 4, 2015. The Company received a cash distribution of \$1,014,000 during the third quarter of 2015, which was accounted for as a return of capital.

NOTE 5: Inventories

Inventories consisted of the following (in thousands):

|                 | October 4, 2015 | December 31, 2014 |
|-----------------|-----------------|-------------------|
| Raw materials   | \$29,830        | \$18,223          |
| Work-in-process | 3,470           | 5,054             |
| Finished goods  | 6,541           | 5,946             |
|                 | \$39,841        | \$29,223          |

NOTE 6: Warranty Obligations

The Company records the estimated cost of fulfilling product warranties at the time of sale based upon historical costs to fulfill claims. Obligations may also be recorded subsequent to the time of sale whenever specific events or circumstances impacting product quality become known that would not have been taken into account using historical data. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers and third-party contract manufacturers, the Company's warranty obligation is affected by product failure rates, material usage, and service delivery costs incurred in correcting a product failure. An adverse change in any of these factors may result in the need for additional warranty provisions. Warranty obligations are included in "Accrued expenses" on the Consolidated Balance Sheets.

The changes in the warranty obligation was as follows (in thousands):

|  |         |
|--|---------|
| Balance as of December 31, 2014                    | \$4,086 |
| Provisions for warranties issued during the period | 3,709   |
| Fulfillment of warranty obligations                | (3,269) |
| Foreign exchange rate changes                      | (298)   |
| Balance as of October 4, 2015                      | \$4,228 |

NOTE 7: Contingencies

In March 2013, the Company filed a lawsuit against Microscan Systems, Inc. ("Microscan") and Code Corporation ("Code") in the United States District Court for the Southern District of New York alleging that Microscan's Mobile Hawk handheld imager infringes U.S. Patent 7,874,487 owned by the Company (the "487 patent"). The lawsuit sought to prohibit Code from manufacturing the product, and Microscan from selling and distributing the product.



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In August 2014, Microscan filed a lawsuit against the Company in the United States District Court for the Southern District of New York alleging that the Company's DataMan® 8500 handheld imager infringes U.S. Patent 6,352,204 owned by Microscan (the "204 patent"). The lawsuit sought to prohibit the Company from manufacturing, selling, and distributing the DataMan® 7500, 8500, 8600, and 9500 products.

In June 2015, the Company executed a settlement agreement with Microscan requiring a payment by the Company of \$3,500,000 which settles all outstanding litigation between the parties. The settlement included a patent license agreement valued at \$1,667,000 that allows the Company to continue producing current models of its handheld barcode readers, which was recorded as an asset and is being amortized to cost of revenue over the five year life of the patent starting in the third quarter of 2015. The remaining \$1,833,000 of the settlement was recorded as expense in the second quarter of 2015. All cases were dismissed by the end of July 2015. In July 2015, the Company also executed an immaterial settlement agreement with Code. This matter is now closed.

Various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened on behalf of or against the Company, including some pertaining to the Company's recently divested surface inspection business, which arose prior to the transaction closing date and for which the Company retains liability pursuant to the agreement governing such divestiture. While we cannot predict the outcome of these matters, we believe that any liability arising from them will not have a material adverse effect on our financial position, liquidity, or results of operations.

NOTE 8: Indemnification Provisions

Except as limited by Massachusetts law, the by-laws of the Company require it to indemnify certain current or former directors, officers, and employees of the Company against expenses incurred by them in connection with each proceeding in which he or she is involved as a result of serving or having served in certain capacities. Indemnification is not available with respect to a proceeding as to which it has been adjudicated that the person did not act in good faith in the reasonable belief that the action was in the best interests of the Company. The maximum potential amount of future payments the Company could be required to make under these provisions is unlimited. The Company has never incurred significant costs related to these indemnification provisions. As a result, the Company believes the estimated fair value of these provisions is minimal.

In the ordinary course of business, the Company may accept standard limited indemnification provisions in connection with the sale of its products, whereby it indemnifies its customers for certain direct damages incurred in connection with third-party patent or other intellectual property infringement claims with respect to the use of the Company's products. The term of these indemnification provisions generally coincides with the customer's use of the Company's products. The maximum potential amount of future payments the Company could be required to make under these provisions is generally subject to fixed monetary limits. The Company has never incurred significant costs to defend lawsuits or settle claims related to these indemnification provisions. As a result, the Company believes the estimated fair value of these provisions is minimal.

In the ordinary course of business, the Company also accepts limited indemnification provisions from time to time, whereby it indemnifies customers for certain direct damages incurred in connection with bodily injury and property damage arising from the installation of the Company's products. The term of these indemnification provisions generally coincides with the period of installation. The maximum potential amount of future payments the Company could be required to make under these provisions is generally limited and is likely recoverable under the Company's insurance policies. As a result of this coverage, and the fact that the Company has never incurred significant costs to defend lawsuits or settle claims related to these indemnification provisions, the Company believes the estimated fair value of these provisions is minimal.

Under the terms of the Company's sale of its Surface Inspection Systems Division to AMETEK, Inc., the Company has agreed to retain certain liabilities in connection with its business dealings occurring prior to the transaction closing date of July 6, 2015, and to indemnify AMETEK, Inc. in connection with these retained liabilities and for any breach of the representations and warranties made by the Company to AMETEK, Inc. in connection with the sales agreement itself, as is usual and customary in such transactions. As of the date of this report, the Company believes the estimated fair value of these provisions is minimal.

NOTE 9: Derivative Instruments

The Company's foreign currency risk management strategy is principally designed to mitigate the potential financial impact of changes in the value of transactions and balances denominated in foreign currencies resulting from changes in foreign currency exchange rates. Currently, the Company enters into two types of hedges to manage this risk. The first are economic hedges which utilize foreign currency forward contracts with maturities of up to 45 days to manage

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the exposure to fluctuations in foreign currency exchange rates arising primarily from foreign-denominated receivables and payables. The gains and losses on these derivatives are intended to be offset by the changes in the fair value of the assets and liabilities being hedged. These economic hedges are not designated as hedging instruments for hedge accounting treatment. The second are cash flow hedges which utilize foreign currency forward contracts with maturities of up to 18 months to hedge specific forecasted transactions of the Company's foreign subsidiaries with the goal of protecting our budgeted revenues and expenses against foreign currency exchange rate changes compared to our budgeted rates. These cash flow hedges are designated as hedging instruments for hedge accounting treatment. The Company had the following outstanding forward contracts (in thousands):

| Currency  | October 4, 2015 |                | December 31, 2014 |                |
|---|-----------------|----------------|-------------------|----------------|
|   | Notional Value  | USD Equivalent | Notional Value    | USD Equivalent |
| <b>Derivatives Designated as Hedging Instruments:</b>     |                 |                |                   |                |
| Japanese Yen  | 1,000,000       | \$8,176        | 1,225,000         | \$10,211       |
| United States Dollar                                      | 7,870           | 7,870          | —                 | —              |
| Hungarian Forint  | 774,000         | 2,767          | 803,000           | 3,099          |
| Singapore Dollar  | 2,903           | 2,055          | 3,515             | 2,564          |
| Canadian Dollar   | 140             | 127            | 758               | 688            |
| British Pound   | 87              | 121            | 491               | 732            |
| <b>Derivatives Not Designated as Hedging Instruments:</b> |                 |                |                   |                |
| Japanese Yen  | 600,000         | \$4,993        | 345,000           | \$2,878        |
| British Pound   | 1,695           | 2,562          | 1,400             | 2,183          |
| Korean Won  | 1,440,000       | 1,206          | 940,000           | 858            |
| Singapore Dollar  | 1,700           | 1,176          | 1,225             | 922            |
| Taiwanese Dollar  | 31,250          | 941            | 28,000            | 883            |
| Hungarian Forint  | 220,000         | 786            | 410,000           | 1,569          |

Information regarding the fair value of the outstanding forward contracts was as follows (in thousands):

|   | Asset Derivatives                         |                            | Liability Derivatives |                        |                            |                   |
|---|---|----------------------------|-----------------------|------------------------|----------------------------|-------------------|
|   | Balance Sheet Location                    | Fair Value October 4, 2015 | December 31, 2014     | Balance Sheet Location | Fair Value October 4, 2015 | December 31, 2014 |
| <b>Derivatives Designated as Hedging Instruments:</b>     |   |                            |                       |                        |                            |                   |
| Cash flow hedge forward contracts                         | Prepaid expenses and other current assets | \$82                       | \$108                 | Accrued expenses       | \$227                      | \$84              |
| <b>Derivatives Not Designated as Hedging Instruments:</b> |   |                            |                       |                        |                            |                   |
| Economic hedge forward contracts                          | Prepaid expenses and other current assets | \$32                       | \$5                   | Accrued expenses       | \$—                        | \$13              |

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The table below details the gross activity for all derivative assets and liabilities which were presented on a net basis on the Consolidated Balance Sheets due to the right of offset with each counterparty (in thousands):

| Asset Derivatives                  | October 4,<br>2015 | December 31,<br>2014 | Liability Derivatives                   | October 4,<br>2015 | December 31,<br>2014 |
|------------------------------------|--------------------|----------------------|---|--------------------|----------------------|
| Gross amounts of recognized assets | \$ 118             | \$ 187               | Gross amounts of recognized liabilities | \$ 347             | \$ 149               |
| Gross amounts offset               | (4                 | ) (74                | Gross amounts offset                    | (120               | ) (52                |
| Net amount of assets presented     | \$ 114             | \$ 113               | Net amount of liabilities presented     | \$ 227             | \$ 97                |

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Information regarding the effect of derivative instruments, net of the underlying exposure, on the consolidated financial statements was as follows (in thousands):

|  | Location in Financial Statements   | Three-months Ended |                    | Nine-months Ended |                    |
|--|--|--------------------|--------------------|-------------------|--------------------|
|  |  | October 4, 2015    | September 28, 2014 | October 4, 2015   | September 28, 2014 |
| <b>Derivatives Designated as Hedging Instruments:</b>  |  |                    |                    |                   |                    |
| Gains (losses) recorded in shareholders' equity (effective portion)  | Accumulated other comprehensive income (loss), net of tax  | \$ (122            | ) \$ 32            | \$ (122           | ) \$ 32            |
| Gains (losses) reclassified from accumulated other comprehensive income (loss) into current operations (effective portion) | Product revenue  | \$ (125            | ) \$ (50           | ) \$ (436         | ) \$ (33           |
|  | Research, development, and engineering expenses  | (3                 | ) (15              | ) 16              | (40                |
|  | Selling, general, and administrative expenses  | 38                 | 21                 | 151               | (28                |
|  | Total gains (losses) reclassified from accumulated other comprehensive income (loss) into current operations | \$ (90             | ) \$ (44           | ) \$ (269         | ) \$ (101          |
| Gains (losses) recognized in current operations (ineffective portion and discontinued derivatives)                         | Foreign currency gain (loss)   | \$—                | \$—                | \$—               | \$—                |
| <b>Derivatives Not Designated as Hedging Instruments:</b>  |  |                    |                    |                   |                    |
| Gains (losses) recognized in current operations  | Foreign currency gain (loss)   | \$ (322            | ) \$ 197           | \$ 20             | \$ 59              |

The following table provides the changes in accumulated other comprehensive income (loss), net of tax, related to derivative instruments (in thousands):

|   |         |
|---|---------|
| Balance as of December 31, 2014   | \$ 32   |
| Reclassification of net realized loss on cash flow hedges into current operations | 269     |
| Net unrealized loss on cash flow hedges   | (423    |
| Balance as of October 4, 2015   | \$ (122 |

Net losses expected to be reclassified from accumulated other comprehensive income (loss), net of tax, into current operations within the next twelve months are \$124,000.

**NOTE 10: Stock-Based Compensation Expense**

The Company's share-based payments that result in compensation expense consist of stock option grants and restricted stock awards. As of October 4, 2015, the Company had 7,817,714 shares available for grant. Generally, stock options are granted with an exercise price equal to the market value of the Company's common stock at the grant date, vest over four years based upon continuous service, and expire ten years from the grant date. Restricted stock awards are granted with an exercise price equal to the market value of the Company's common stock at the time of grant. Conditions of the award may be based on continuing employment and/or achievement of pre-established performance



goals and objectives. Vesting for performance-based restricted stock awards and time-based restricted stock awards must be greater than one year and three years, respectively.

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The following table summarizes the Company's stock option activity for the nine-month period ended October 4, 2015:

|  | Shares<br>(in thousands) | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic<br>Value<br>(in thousands) |
|--|--------------------------|---|---|---|
| Outstanding as of December 31, 2014                          | 6,812                    | \$23.26                                   |   |   |
| Granted  | 1,458                    | 41.25                                     |   |   |
| Exercised  | (1,509)                  | ) 18.18                                   |   |   |
| Forfeited or expired   | (80)                     | ) 30.47                                   |   |   |
| Outstanding as of October 4, 2015                            | 6,681                    | \$28.25                                   | 7.3   | \$64,101  |
| Exercisable as of October 4, 2015                            | 2,517                    | \$17.02                                   | 5.5   | \$47,219  |
| Options vested or expected to vest as of October 4, 2015 (1) | 6,018                    | \$27.17                                   | 7.2   | \$62,906  |

(1) In addition to the vested options, the Company expects a portion of the unvested options to vest at some point in the future. Options expected to vest are calculated by applying an estimated forfeiture rate to the unvested options. The fair values of stock options granted in each period presented were estimated using the following weighted-average assumptions:

|                          | Three-months Ended |                    | Nine-months Ended |                    |   |
|--------------------------|--------------------|--------------------|-------------------|--------------------|---|
|                          | October 4, 2015    | September 28, 2014 | October 4, 2015   | September 28, 2014 |   |
| Risk-free rate           | 2.1                | % 2.7              | % 2.1             | % 2.7              | % |
| Expected dividend yield  | 1.25               | % —                | % 1.25            | % —                | % |
| Expected volatility      | 40                 | % 41               | % 40              | % 41               | % |
| Expected term (in years) | 5.4                | 5.4                | 5.4               | 5.4                |   |

## Risk-free rate

The risk-free rate was based upon a treasury instrument whose term was consistent with the contractual term of the option.

## Expected dividend yield

Generally, the current dividend yield is calculated by annualizing the cash dividend declared by the Company's Board of Directors and dividing that result by the closing stock price on the grant date. However, in the fourth quarter of 2012, the Company paid the full annual dividends for 2013 and 2014 in advance, and therefore, the dividend yield for those years has been adjusted to zero. A dividend yield of 1.25% was estimated for future periods from 2015 through the expected life of the option.

## Expected volatility

The expected volatility was based upon a combination of historical volatility of the Company's common stock over the contractual term of the option and implied volatility for traded options of the Company's stock.

## Expected term

The expected term was derived from the binomial lattice model from the impact of events that trigger exercises over time.

The Company stratifies its employee population into two groups: one consisting of senior management and another consisting of all other employees. The Company currently expects that approximately 74% of its stock options granted to senior management and 73% of its options granted to all other employees will actually vest. Therefore, the Company currently applies an estimated annual forfeiture rate of 10% to all unvested options for senior management and a rate of 11% for all other employees. The Company revised its estimated forfeiture rates in the first quarters of 2015 and 2014, resulting in an increase to compensation expense of \$461,000 and \$288,000, respectively.



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The weighted-average grant-date fair values of stock options granted during the three-month periods ended October 4, 2015 and September 28, 2014 were \$14.36 and \$15.45, respectively. The weighted-average grant-date fair values of stock options granted during the nine-month periods ended October 4, 2015 and September 28, 2014 were \$14.35 and \$15.35, respectively.

The total intrinsic values of stock options exercised for the three-month periods ended October 4, 2015 and September 28, 2014 were \$4,506,000 and \$14,461,000, respectively. The total intrinsic values of stock options exercised for the nine-month periods ended October 4, 2015 and September 28, 2014 were \$43,737,000 and \$29,104,000, respectively. The total fair values of stock options vested for the three-month periods ended October 4, 2015 and September 28, 2014 were \$565,000 and \$268,000, respectively. The total fair values of stock options vested for the nine-month periods ended October 4, 2015 and September 28, 2014 were \$14,984,000 and \$11,251,000, respectively.

As of October 4, 2015, total unrecognized compensation expense related to non-vested stock options was \$22,169,000, which is expected to be recognized over a weighted-average period of 1.71 years.

The following table summarizes the Company's restricted stock award activity:

|                                    | Shares (in<br>thousands) | Weighted-Average<br>Exercise Price | Aggregate<br>Intrinsic Value (in<br>thousands) |
|------------------------------------|--------------------------|------------------------------------|--|
| Non-vested as of December 31, 2014 | 20                       | 34.05                              |  |
| Granted                            | —                        | —                                  |  |
| Vested                             | —                        | —                                  |  |
| Forfeited or expired               | —                        | —                                  |  |
| Non-vested as of October 4, 2015   | 20                       | \$34.05                            | \$27   |

The fair values of restricted stock awards granted were determined based upon the market value of the Company's common stock at the time of grant. The initial cost is then amortized over the period of vesting until the restrictions lapse. These restricted shares will be fully vested in 2018. Participants are entitled to dividends on restricted stock awards, but only receive those amounts if the shares vest. The sale or transfer of these shares is restricted during the vesting period.

The total stock-based compensation expense and the related income tax benefit recognized for the three-month period ended October 4, 2015 were \$5,493,000 and \$1,865,000, respectively, and for the three-month period ended September 28, 2014 were \$3,298,000 and \$1,098,000, respectively. The total stock-based compensation expense and the related income tax benefit recognized for the nine-month period ended October 4, 2015 were \$17,070,000 and \$5,734,000, respectively, and for the nine-month period ended September 28, 2014 were \$11,258,000 and \$3,670,000, respectively. No compensation expense was capitalized as of October 4, 2015 or December 31, 2014.

The following table details the stock-based compensation expense by caption for each period presented on the Consolidated Statements of Operations (in thousands):

|  | Three-months Ended |                       | Nine-months Ended |                       |
|--|--------------------|-----------------------|-------------------|-----------------------|
|  | October 4, 2015    | September 28,<br>2014 | October 4, 2015   | September 28,<br>2014 |
| Cost of revenue                        | \$351              | \$253                 | \$1,167           | \$866                 |
| Research, development, and engineering | 1,130              | 836                   | 4,097             | 2,803                 |
| Selling, general, and administrative   | 2,906              | 1,978                 | 10,273            | 6,803                 |
| Discontinued operations                | 1,106              | 231                   | 1,533             | 786                   |
|  | \$5,493            | \$3,298               | \$17,070          | \$11,258              |

Upon the sale of the Company's Surface Inspection Systems Division, completed on July 6, 2015, the Company accelerated the vesting of stock options with respect to 190,000 underlying shares, resulting in an additional \$1,106,000 of stock option expense recorded in the third quarter of 2015.



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## NOTE 11: Stock Repurchase Program

In November 2011, the Company's Board of Directors authorized the repurchase of up to \$80,000,000 of the Company's common stock. Purchases under this 2011 program were completed in 2014. In April 2014, the Company's Board of Directors authorized the repurchase of an additional \$50,000,000 of the Company's common stock. Purchases under this 2014 program began in 2014 upon completion of the 2011 program. As of October 4, 2015, the Company repurchased 1,079,000 shares at a cost of \$50,000,000 under this 2014 program, including 895,000 shares at a cost of \$42,415,000 in 2015. Stock repurchases under this program are now complete. In August 2015, the Company's Board of Directors authorized the repurchase of an additional \$100,000,000 of the Company's common stock. Purchases under this 2015 program began in the third quarter of 2015 upon completion of the 2014 program. As of October 4, 2015, the Company repurchased 2,311,000 shares at a cost of \$83,936,000 under this 2015 program. On November 1, 2015, the Company's Board of Directors authorized the repurchase of an additional \$100,000,000 of the Company's common stock. This new authorization will commence once the Company completes the August 2015 program. The Company may repurchase shares under these programs in future periods depending upon a variety of factors, including, among other things, the impact of dilution from employee stock options, stock price, share availability, and cash requirements.

## NOTE 12: Taxes

A reconciliation of the United States federal statutory corporate tax rate to the Company's effective tax rate, or income tax provision, was as follows:

|   | Three-months Ended |                       | Nine-months Ended  |                       |    |
|---|--------------------|-----------------------|--------------------|-----------------------|----|
|   | October 4,<br>2015 | September 28,<br>2014 | October 4,<br>2015 | September 28,<br>2014 |    |
| Continuing operations:                                |                    |                       |                    |                       |    |
| Income tax provision at federal statutory rate        | 35                 | % 35                  | % 35               | % 35                  | %  |
| State income taxes, net of federal benefit            | 1                  | % 1                   | % 1                | % 1                   | %  |
| Foreign tax rate differential                         | (19)               | )% (19)               | )% (19)            | )% (19)               | )% |
| Discrete tax events                                   | (5)                | )% (1)                | )% (2)             | )% (1)                | )% |
| Income tax provision related to continuing operations | 12                 | % 16                  | % 15               | % 16                  | %  |

The effective tax rate for 2015 included the impact of the following discrete tax events: (1) a decrease in tax expense of \$364,000 recorded in the first quarter of 2015 from the expiration of statutes of limitations for certain reserves for income tax uncertainties, (2) a decrease in tax expense of \$112,000 recorded in the second quarter of 2015 from the final true-up of the prior year's tax accrual upon filing the actual tax returns, (3) an increase in tax expense of \$65,000 recorded in the second quarter of 2015 from the write down of a deferred tax asset, (4) a decrease in tax expense of \$993,000 recorded in the third quarter of 2015 for the final true-up of the prior year's tax accrual upon filing the actual tax returns, and (5) a decrease in tax expense of \$611,000 recorded in the third quarter of 2015 from the expiration of statutes of limitations for certain reserves for income tax uncertainties.

The effective tax rate for 2014 included the impact of the following discrete tax events: (1) a decrease in tax expense of \$418,000 recorded in the second quarter of 2014 from the closing of the Internal Revenue Service audit of the Company for tax years 2010 and 2011, (2) a decrease in tax expense of \$652,000 recorded in the third quarter of 2014 from the final true-up of the prior year's tax accrual upon filing the actual tax returns, and (3) a decrease in tax expense of \$217,000 recorded in the third quarter of 2014 from the expiration of the statutes of limitations for certain reserves for income tax uncertainties.

During the nine-month period ended October 4, 2015, the Company recorded a \$635,000 decrease in reserves for income taxes, net of deferred tax benefit, including an increase to additional paid in capital of \$157,000 and a reduction in income tax expense of \$478,000. Included in this net decrease are the discrete events noted above.

Estimated interest and penalties included in these amounts totaled \$5,000 for the nine-month period ended October 4, 2015.

The Company's reserve for income taxes, including gross interest and penalties, was \$4,961,000 as of October 4, 2015, which included \$3,933,000 classified as a non-current liability and \$1,028,000 recorded as a reduction to non-current deferred tax assets. The amount of gross interest and penalties included in these balances was \$507,000. If the Company's tax positions were sustained or the statutes of limitations related to certain positions expired, these reserves would be released and income tax expense would be reduced in a future period, less \$507,000 that would be recorded through additional paid-in capital. As a result of the expiration of certain statutes of limitations and the

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

conclusion of the IRS examination, there is a potential that a portion of these reserves could be released, which would decrease income tax expense by approximately \$750,000 to \$850,000 over the next twelve months.

On July 6, 2015, the Company completed the sale of its Surface Inspection Systems Division. A pre-tax gain of \$125,465,000 and associated income tax expense of \$47,175,000 was recorded in the third quarter of 2015.

The Company has defined its major tax jurisdictions as the United States, Ireland, China, and Japan, and within the United States, Massachusetts and California. Within the United States, the tax years 2012 through 2014 remain open to examination by the Internal Revenue Service, while the tax years 2011 through 2014 remain open to various state taxing authorities, and the tax years 2010 through 2014 remain open to examination by various taxing authorities in other jurisdictions in which the Company operates.

## NOTE 13: Weighted-Average Shares

Weighted-average shares were calculated as follows (in thousands):

|  | Three-months Ended |                       | Nine-months Ended  |                       |
|--|--------------------|-----------------------|--------------------|-----------------------|
|  | October 4,<br>2015 | September 28,<br>2014 | October 4,<br>2015 | September 28,<br>2014 |
| Basic weighted-average common shares outstanding                 | 86,303             | 86,963                | 86,756             | 86,875                |
| Effect of dilutive stock options                                 | 1,473              | 2,204                 | 1,803              | 2,270                 |
| Weighted-average common and common-equivalent shares outstanding | 87,776             | 89,167                | 88,559             | 89,145                |

Stock options to purchase 3,251,000 and 2,049,000 shares of common stock, on a weighted-average basis, were outstanding during the three-month and nine-month periods ended October 4, 2015, respectively, and 1,351,000 and 1,090,000 for the same periods in 2014, but were not included in the calculation of dilutive net income per share because they were anti-dilutive.

## NOTE 14: Segment Information

On July 6, 2015, the Company completed the sale of its Surface Inspection Systems Division (SISD). Prior to this date, the Company had reported SISD as one of its two segments. Given the disposition of the SISD segment, management reviewed its segment reporting and concluded that the Company now operates in one segment, machine vision technology. Operating segments were not aggregated in reaching this conclusion. The Company's chief operating decision maker is the chief executive officer, who makes decisions to allocate resources and assesses performance at the corporate level. The Company offers a variety of machine vision products that have similar economic characteristics, have the same production processes, and are distributed by the same sales channels to the same types of customers.

## NOTE 15: Discontinued Operations

On July 6, 2015 (the first day of the Company's third quarter), the Company completed the sale of its Surface Inspection Systems Division (SISD) to AMETEK, Inc. (AMETEK) for \$155,655,000 in cash. Transaction costs totaled \$5,090,000 and included \$1,106,000 of stock option expense from the accelerated vesting of stock options triggered by the sale.



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Carrying amounts of major assets and liabilities included as part of the disposal group were as follows (in thousands):

|   | December 31, 2014 |
|---|-------------------|
| Accounts receivable, net                  | \$10,885          |
| Inventories, net                          | 6,313             |
| Unbilled revenue                          | 2,356             |
| Prepaid expenses and other current assets | 2,955             |
| Property, plant, and equipment, net       | 1,944             |
| Intangible assets, net                    | 1,029             |
| Goodwill                                  | 4,301             |
| Other assets                              | 31                |
| Held for sale assets                      | \$29,814          |
| Accounts payable                          | 1,891             |
| Accrued expenses                          | 4,335             |
| Deferred revenue                          | 5,965             |
| Held for sale liabilities                 | \$12,191          |

The financial results of SISD are reported as a discontinued operation for all periods presented. The pretax gain associated with this sale was \$125,465,000 and was recorded in the third quarter of 2015 in "Gain on sale of discontinued business, net of tax" on the Consolidated Statements of Operations.

The major classes of revenue and expense included in discontinued operations were as follows (in thousands):

|   | Three-months Ended |                       | Nine-months Ended  |                       |
|---|--------------------|-----------------------|--------------------|-----------------------|
|   | October 4,<br>2015 | September 28,<br>2014 | October 4,<br>2015 | September 28,<br>2014 |
| Revenue   | \$—                | \$15,000              | \$23,248           | \$41,139              |
| Cost of revenue                                 | —                  | (6,514)               | (11,291)           | (18,462)              |
| Research, development, and engineering expenses | —                  | (1,033)               | (2,126)            | (3,101)               |
| Selling, general, and administrative expenses   | —                  | (3,364)               | (7,800)            | (9,748)               |
| Foreign currency gain (loss)                    | —                  | (78)                  | (177)              | (100)                 |
| Pretax income from discontinued operations      | —                  | 4,011                 | 1,854              | 9,728                 |
| Pretax gain on sale of discontinued business    | 125,465            | —                     | 125,465            | —                     |
| Discontinued operations, pretax                 | 125,465            | 4,011                 | 127,319            | 9,728                 |
| Income tax expense                              | 47,175             | 1,292                 | 47,801             | 3,045                 |
| Discontinued operations, net of tax             | \$78,290           | \$2,719               | \$79,518           | \$6,683               |

Significant non-cash items related to the discontinued business were as follows (in thousands):

|                                  | Three-months Ended |                       | Nine-months Ended |                       |
|----------------------------------|--------------------|-----------------------|-------------------|-----------------------|
|                                  | October 4, 2015    | September 28,<br>2014 | October 4, 2015   | September 28,<br>2014 |
| Stock-based compensation expense | \$1,106            | \$231                 | \$1,533           | \$786                 |
| Depreciation expense             | —                  | 196                   | 401               | 584                   |
| Amortization expense             | —                  | 94                    | 165               | 282                   |
| Capital expenditures             | —                  | 206                   | 482               | 467                   |

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Company also entered into a Transition Services Agreement (TSA) with AMETEK to ensure an orderly and effective transition of SISD. Under the terms of the TSA, the Company agreed to continue to perform certain administrative activities related to SISD; however, AMETEK is responsible for monitoring the business and making all strategic decisions. Activities under this TSA were completed in October 2015. The income associated with this TSA was immaterial to the three-month and nine-month periods ended October 4, 2015.

## NOTE 16: Acquisition of Selected Assets of Manatee Works, Inc.

On August 21, 2015, the Company acquired selected assets of Manatee Works, Inc. (Manatee), a privately-held U.S.-based developer of barcode scanning software development kits (SDKs). Under this transaction, the Company acquired technology and a product for use in mobile devices.

The Company paid \$1,023,000 in cash upon closing and may pay additional contingent consideration over the next three years based upon milestone revenue levels. The undiscounted potential outcomes related to the contingent consideration range from \$0 to approximately \$5,000,000. The fair value of the contingent consideration as of the acquisition date was \$3,790,000, resulting in a total purchase price of \$4,813,000. The contingent consideration will be remeasured each reporting period with changes in fair value recorded in current operations. The fair value as of October 4, 2015 did not change from the August 21, 2015 acquisition date. As of October 4, 2015, the current portion of contingent consideration expected to be paid within the next year was \$938,000 and was recorded in "Accrued expenses," and the non-current portion expected to be paid beyond one year was \$2,852,000 and was recorded in "Other non-current liabilities" on the Consolidated Balance Sheets.

The purchase price was allocated as follows (in thousands):

|                      |         |
|----------------------|---------|
| Prepaid expenses     | \$23    |
| Developer network    | 140     |
| Completed technology | 590     |
| Goodwill             | 4,060   |
| Purchase price       | \$4,813 |

The developer network and completed technology are included in "Intangible assets" on the Consolidated Balance Sheets. The developer network will be amortized on a straight-line basis to selling, general, and administrative expenses over five years. The completed technology will be amortized on a straight-line basis to cost of revenue over five years. The goodwill is expected to be deductible for tax purposes. Transactions costs were immaterial and were expensed as incurred in the third quarter of 2015.

Manatee financial results are immaterial with respect to the inclusion of supplemental pro-forma information.

## NOTE 17: Subsequent Events

On November 1, 2015, the Company's Board of Directors authorized the repurchase of an additional \$100,000,000 of the Company's common stock. This new authorization will commence once the Company completes the August 2015 program.

In addition, on November 1, 2015, the Company's Board of Directors declared a cash dividend of \$0.07 per share. The dividend is payable December 18, 2015 to all shareholders of record as of the close of business on December 4, 2015.

## ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Forward-Looking Statements

Certain statements made in this report, as well as oral statements made by the Company from time to time, constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Readers can identify these forward-looking statements by our use of the words “expects,” “anticipates,” “estimates,” “believes,” “projects,” “intends,” “plans,” “will,” “may,” “could,” “should,” and similar words and other statements of a similar sense. These statements are based upon our current estimates and expectations as to prospective events and circumstances, which may or may not be in our control and as to which there can be no firm assurances given. These forward-looking statements, which include statements regarding business and market trends, future financial performance, customer order rates, expected areas of growth, future product and customer mix, research and development activities, investments, and strategic plans, involve known and unknown risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include: (1) the loss of a large customer; (2) current and future conditions in the global economy; (3) the reliance on revenue from the consumer electronics or automotive industries; (4) the inability to penetrate new markets; (5) the cyclicity of the semiconductor and electronics industries; (6) the inability to achieve significant international revenue; (7) fluctuations in foreign currency exchange rates and the use of derivative instruments; (8) the inability to attract and retain skilled employees; (9) the reliance upon key suppliers to manufacture and deliver critical components for our products; (10) the failure to effectively manage product transitions or accurately forecast customer demand; (11) the inability to design and manufacture high-quality products; (12) the technological obsolescence of current products and the inability to develop new products; (13) the failure to properly manage the distribution of products and services; (14) the inability to protect our proprietary technology and intellectual property; (15) our involvement in time-consuming and costly litigation; (16) the impact of competitive pressures; (17) the challenges in integrating and achieving expected results from acquired businesses; (18) potential impairment charges with respect to our investments or for acquired intangible assets or goodwill; (19) exposure to additional tax liabilities; and (20) information security breaches or business system disruptions. The foregoing list should not be construed as exhaustive and we encourage readers to refer to the detailed discussion of risk factors included in Part I-Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014. The Company cautions readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. The Company disclaims any obligation to subsequently revise forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date such statements are made.

### Executive Overview

Cognex Corporation is a leading worldwide provider of machine vision products that capture and analyze visual information in order to automate tasks, primarily in manufacturing processes, where vision is required. On July 6, 2015 (the first day of the fiscal third quarter), the Company completed the sale of its Surface Inspection Systems Division (SISD) that specialized in machine vision products that are used to inspect the surfaces of materials processed in a continuous fashion. The financial results of SISD are reported as a discontinued operation for all periods presented.

In addition to product revenue derived from the sale of machine vision products, the Company also generates revenue by providing maintenance and support, consulting, and training services to its customers; however, service revenue accounted for less than 10% of total revenue for all periods presented.

The Company's customers are predominantly in the factory automation market. Factory automation customers purchase Cognex products and incorporate them into their manufacturing processes. Virtually every manufacturer can achieve better quality and manufacturing efficiency by using machine vision, and therefore, this market includes a broad base of customers across a variety of industries, including consumer electronics, automotive, consumer

products, food and beverage, medical devices, and pharmaceuticals. Factory automation customers also purchase Cognex products for use outside of the manufacturing process, such as using ID products in logistics automation for package sorting and distribution. Sales to factory automation customers represented 95% of total revenue for both the three-month and nine-month periods in 2015, compared to 95% and 93% of total revenue for the same periods in 2014.

A small percentage of the Company's customers are in the semiconductor and electronics capital equipment market. These customers purchase Cognex products and integrate them into the automation equipment that they manufacture and then sell to their customers to either make semiconductor chips or assemble printed circuit boards. Demand from these customers has been relatively flat on an annual basis for the past several years. Sales to semiconductor and electronics capital equipment manufacturers represented only 5% of total revenue for both the three-month and nine-month periods in 2015, compared to 5% and 7% of total revenue for the same periods in 2014.

Revenue for the third quarter of 2015 totaled \$107,587,000, representing a decrease of \$46,769,000, or 30%, from the prior year due primarily to the timing of revenue from large orders in the consumer electronics industry. Gross margin was consistent at 76% of revenue for both the third quarters of 2015 and 2014. Operating expenses decreased by \$8,522,000, or 14%, from the third quarter of 2014 due primarily to lower accruals related to incentive compensation plans, the favorable impact of foreign currency exchange rate changes on expenses, and lower spending in discretionary areas to bring expenses more in line with the lower revenue level. These expense reductions were not large enough, however, to offset the decline in revenue compared to the prior year, and as a result, operating income decreased by \$26,854,000, or 49%, from the third quarter of 2014. Operating income was \$28,485,000, or 26% of revenue, in the third quarter of 2015 compared to \$55,339,000, or 36% of revenue, in the third quarter of 2014; income from continuing operations was \$25,822,000, or 24% of revenue, in the third quarter of 2015 compared to \$47,681,000, or 31% of revenue, in the third quarter of 2014; and income from continuing operations per diluted share was \$0.29 in the third quarter of 2015 compared to \$0.53 in the third quarter of 2014.

#### Results of Operations

As foreign currency exchange rates are a factor in understanding period-to-period comparisons, we believe the presentation of results on a constant-currency basis in addition to reported results helps improve investors' ability to understand our operating results and evaluate our performance in comparison to prior periods. We also use results on a constant-currency basis as one measure to evaluate our performance. Constant-currency information compares results between periods as if exchange rates had remained constant period-over-period. We generally refer to such amounts calculated on a constant-currency basis as excluding the impact of foreign currency exchange rate changes. Results on a constant-currency basis are not in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and should be considered in addition to, and not as a substitute for, results prepared in accordance with U.S. GAAP.

#### Revenue

Revenue decreased by \$46,769,000, or 30%, for the three-month period and increased by \$24,841,000, or 8%, for the nine-month period. Excluding the impact of foreign currency exchange rate changes, revenue decreased by \$41,213,000, or 27%, for the three-month period, and increased by \$42,337,000, or 13%, for the nine-month period, as sales denominated in foreign currencies, primarily the Euro, were translated into U.S. Dollars at a lower rate. The decrease for the three-month period was primarily due to the timing of revenue from large orders in the consumer electronics industry. The new product introduction cycles of customers in this industry result in cyclical ordering patterns. During 2014, large consumer electronics orders were recognized as revenue predominantly in the third quarter, while during 2015, large consumer electronics orders were recognized as revenue in each of the first three quarters of the year, with the highest level being recognized in the second quarter. Excluding these large consumer electronics orders, revenue from factory automation customers increased for both the three-month and nine-month periods on a constant-currency basis, with the highest growth coming from Greater China and Europe. Revenue from semiconductor and electronics capital equipment manufacturers decreased for both the three-month and nine-month period on a constant-currency basis.

#### Gross Margin

Gross margin was consistent at 76% of revenue for the three-month periods in both 2015 and 2014, and 78% of revenue for the nine-month periods in both 2015 and 2014. Changes in foreign currency exchange rates had a negative impact on gross margin, as a significant amount of revenue is denominated in Euros while inventories are predominantly purchased in U.S. Dollars. A shift in revenue mix to relatively-lower margin products and higher new product introduction costs also had a negative impact on gross margin. These gross margin decreases were offset, however, by manufacturing efficiencies achieved from higher revenue levels as fixed manufacturing costs were spread over a larger revenue base, as well as lower inventory charges in 2015 as compared to 2014.

### Research, Development, and Engineering Expenses

Research, development, and engineering (RD&E) expenses decreased by \$555,000, or 3%, for the three-month period and increased by \$10,640,000, or 26%, for the nine-month period as detailed in the table below (in thousands).

|  | Three-month Period | Nine-month Period |
|--|--------------------|-------------------|
| RD&E expenses in 2014                  | \$17,532           | \$41,625          |
| Personnel-related costs                | 1,390              | 5,213             |
| Outsourced engineering costs           | 694                | 5,135             |
| Stock-based compensation expense       | 313                | 1,368             |
| Incentive compensation accruals        | (1,316             | ) (862            |
| Foreign currency exchange rate changes | (739               | ) (1,765          |
| Other                                  | (897               | ) 1,551           |
| RD&E expenses in 2015                  | \$16,977           | \$52,265          |

RD&E expenses increased due to higher personnel-related costs resulting from headcount additions, such as salaries and fringe benefits, as well as modest salary increases granted early in 2015. The Company also incurred higher spending on outsourced engineering costs. In addition, stock-based compensation expense increased due to a higher stock price valuation for options granted in the previous four years. Offsetting these increases were lower accruals related to incentive compensation plans, such as company bonuses, resulting from lower achievement levels on plans that were set at the beginning of the year. In addition, changes in foreign currency exchange rates resulted in lower U.S. Dollar expenses when expenses denominated in foreign currencies, primarily the Euro, were translated into U.S. Dollars.

RD&E expenses as a percentage of revenue was 16% and 15% for the three-month and nine-month periods in 2015, respectively, compared to 11% and 13% for the same periods in 2014. We believe that a continued commitment to RD&E activities is essential in order to maintain or achieve product leadership with our existing products and to provide innovative new product offerings. In addition, we consider our ability to accelerate time to market for new products to be critical to our revenue growth. Therefore, we expect to continue to make significant RD&E investments in the future, and we target our RD&E spending to be between 10% and 15% of revenue. This percentage is impacted by revenue levels and investing cycles.

### Selling, General, and Administrative Expenses

Selling, general, and administrative (SG&A) expenses decreased by \$7,967,000, or 18%, for the three-month period and increased by \$7,877,000, or 7%, for the nine-month period as detailed in the table below (in thousands).

|  | Three-month Period | Nine-month Period |
|--|--------------------|-------------------|
| SG&A expenses in 2014                  | \$43,773           | \$111,103         |
| Personnel-related costs                | 3,591              | 12,945            |
| Stock-based compensation expense       | 971                | 3,703             |
| Microscan settlement and legal fees    | (201               | ) 3,143           |
| Incentive compensation accruals        | (4,985             | ) (4,785          |
| Marketing programs                     | (1,131             | ) (1,158          |
| Sales demonstration equipment          | (1,273             | ) (211            |
| Foreign currency exchange rate changes | (2,537             | ) (6,284          |
| Other                                  | (2,402             | ) 524             |
| SG&A expenses in 2015                  | \$35,806           | \$118,980         |

SG&A expenses increased due to higher personnel-related costs resulting from headcount additions, such as salaries, fringe benefits, sales commissions, and travel expenses, as well as modest salary increases granted early in 2015. In addition, stock-based compensation expense increased due to a higher stock price valuation for options granted in the previous four years. Offsetting these increases were lower accruals related to incentive compensation plans, such as company bonuses and sales commissions, resulting from lower achievement levels on plans that were set at the beginning of the year, as well as lower spending on marketing programs and sales demonstration equipment. In addition, changes in foreign currency exchange rates resulted in lower U.S. Dollar expenses when expenses

denominated in foreign currencies, primarily the Euro, were translated into U.S. Dollars.

In the second quarter of 2015, the Company reached a settlement of outstanding patent litigation with Microscan Systems, Inc., for \$3,500,000. The settlement included a patent license agreement valued at \$1,667,000 that allows the Company to continue producing current models of its handheld barcode readers, which was recorded as an asset and is being amortized to cost of revenue over the five year life of the patent starting in the third quarter of 2015. The remaining \$1,833,000 of the settlement was recorded as SG&A expense in the second quarter of 2015. The Company incurred legal fees related to this litigation of \$201,000 in the third quarter of 2014 and legal fees were \$1,310,000 higher for the nine-month period in 2015 compared to the nine-month period in 2014.

#### Non-operating Income (Expense)

The Company recorded foreign currency losses of \$40,000 and foreign currency gains of \$580,000 for the three-month and nine-month periods in 2015, respectively, compared to foreign currency gains of \$794,000 and \$610,000 for the same periods in 2014. The foreign currency gains and losses in each period resulted primarily from the revaluation and settlement of accounts receivable, accounts payable, and intercompany balances that are reported in one currency and collected in another. As of October 4, 2015, the Company had approximately \$31m of U.S. Dollar-denominated accounts receivable on the books of its Irish subsidiary, for which the functional currency is the Euro, which it expects to collect in the fourth quarter of 2015. These accounts receivable are subject to revaluation until they are collected.

Investment income increased by \$65,000, or 8%, for the three-month period and increased by \$284,000, or 12%, for the nine-month period due to increased funds available for investment.

The Company recorded other expense of \$23,000 and \$388,000 for the three-month and nine-month periods in 2015, respectively, compared to other income of \$202,000 and other expense of \$146,000 for the same periods in 2014.

Other income (expense) primarily includes rental income, net of associated expenses, from leasing buildings adjacent to the Company's corporate headquarters.

#### Income Tax Expense

The Company's effective tax rate was 12% and 15% for the three-month and nine-month periods in 2015, compared to 16% for the same periods in 2014.

The effective tax rate for 2015 included the impact of the following discrete tax events: (1) a decrease in tax expense of \$364,000 recorded in the first quarter of 2015 from the expiration of statutes of limitations for certain reserves for income tax uncertainties, (2) a decrease in tax expense of \$112,000 recorded in the second quarter of 2015 from the final true-up of the prior year's tax accrual upon filing the actual tax returns, (3) an increase in tax expense of \$65,000 recorded in the second quarter of 2015 from the write down of a deferred tax asset, (4) a decrease in tax expense of \$993,000 recorded in the third quarter of 2015 for the final true-up of the prior year's tax accrual upon filing the actual tax returns, and (5) a decrease in tax expense of \$611,000 recorded in the third quarter of 2015 from the expiration of statutes of limitations for certain reserves for income tax uncertainties.

The effective tax rate for 2014 included the impact of the following discrete tax events: (1) a decrease in tax expense of \$418,000 recorded in the second quarter of 2014 from the closing of the Internal Revenue Service audit of the Company for tax years 2010 and 2011, (2) a decrease in tax expense of \$652,000 recorded in the third quarter of 2014 from the final true-up on the prior year's tax accrual upon filing the actual tax returns, and (3) a decrease in tax expense of \$217,000 recorded in the third quarter of 2014 from the expiration of the statutes of limitations for certain reserves for income tax uncertainties.

Excluding the impact of these discrete tax events, the Company's effective tax rate was relatively consistent for all periods presented at approximately 17.5%.

#### Discontinued Operations

On July 6, 2015 (the first day of the fiscal third quarter), the Company completed the sale of its Surface Inspection Systems Division (SISD) that specialized in machine vision products that are used to inspect the surfaces of materials processed in a continuous fashion. The financial results of SISD are reported as a discontinued operation for all periods presented. Income from discontinued operations, net of tax, was \$1,228,000 for the six-month period ended July 5, 2015 and was \$6,683,000 for the nine-month period ended September 28, 2014, including \$2,719,000 recorded in the third quarter of 2014. The gain on the sale of SISD, net of tax, recorded in the third quarter of 2015 was \$78,290,000. Refer to Note 15 to the Consolidated Financial Statements in Part I - Item 1 of this Quarterly Report on



Form 10-Q for further information.

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### Liquidity and Capital Resources

The Company has historically been able to generate positive cash flow from operations, which has funded its operating activities and other cash requirements and has resulted in an accumulated cash, cash equivalent, and investment balance of \$592,651,000 as of October 4, 2015. The Company has established guidelines relative to credit ratings, diversification, and maturities of its investments that maintain liquidity.

The Company's cash requirements during the nine-months ended October 4, 2015 were met with positive cash flows from operations, investment maturities, and the proceeds from stock option exercises, as well as the net proceeds from the sale of the Company's Surface Inspection Systems Division. Cash requirements consisted of operating activities, investment purchases, cash paid for business and technology acquisitions, the repurchase of common stock, the payment of dividends, and capital expenditures. Capital expenditures for the nine-month period ended October 4, 2015 totaled \$13,017,000 and consisted primarily of expenditures for building improvements at the Company's headquarters and adjacent buildings in Natick, Massachusetts, as well as computer hardware, computer software, and manufacturing test equipment related to new product introductions.

In the third quarter of 2015, the Company completed the sale of its Surface Inspection Systems Division that specialized in machine vision products that are used to inspect the surfaces of materials processed in a continuous fashion. The Company received net proceeds of \$104,496,000 from this sale during the third quarter of 2015, representing the sale price less associated income taxes and transaction costs.

In the third quarter of 2015, the Company acquired selected assets of Manatee Works, a privately-held US developer of barcode scanning software development kits (SDKs). Cognex paid \$1,023,000 in cash upon closing and may pay additional consideration contingent over the next three years based on milestone revenue levels. The amounts of contingent consideration are not expected to be material to the Company's liquidity in future periods. In the second quarter of 2015, the Company paid \$10,475,000 in cash to purchase technology that was subsequently transferred as part of the sale of the Surface Inspections Systems Division.

The Company is a Limited Partner in Venrock Associates III, L.P. (Venrock), a venture capital fund. The Company has committed to a total investment in the limited partnership of up to \$20,500,000, with the commitment period expiring on December 31, 2015. The Company does not have the right to withdraw from the partnership prior to this date. As of October 4, 2015, the Company had contributed \$19,886,000 to the partnership. The remaining commitment of \$614,000 can be called by Venrock in any period through December 31, 2015. Distributions and contributions are at the discretion of Venrock's management. No contributions were made during the nine-month period ended October 4, 2015. The Company received a cash distribution of \$1,014,000 during the third quarter of 2015, which was accounted for as a return of capital.

The Company's Board of Directors declared and paid a cash dividend of \$0.07 per share during the second quarter of 2015 totaling \$6,110,000. The Company's Board of Directors also declared and paid a cash dividend of \$0.07 per share during the third quarter of 2015 totaling \$6,027,000. Total dividends paid during the nine-month period ended October 4, 2015 amounted to \$12,137,000. On November 1, 2015, the Company's Board of Directors declared a cash dividend of \$0.07 per share payable in the fourth quarter of 2015. Future dividends will be declared at the discretion of the Company's Board of Directors and will depend upon such factors as the Board deems relevant including, among other things, the Company's ability to generate positive cash flows from operations.

In the second quarter of 2014, the Company's Board of Directors authorized the repurchase of \$50,000,000 of the Company's common stock. As of October 4, 2015, the Company repurchased 1,079,000 shares at a cost of \$50,000,000 under this 2014 program, including 895,000 shares at a cost of \$42,415,000 in 2015. Stock repurchases under this program are now complete. In the third quarter of 2015, the Company's Board of Directors authorized the repurchase of an additional \$100,000,000 of the Company's common stock. Purchases under this 2015 program began in the third quarter of 2015 upon completion of the 2014 program. As of October 4, 2015, the Company repurchased 2,311,000 shares at a cost of \$83,936,000 under this 2015 program. Total stock repurchases during the nine-month period ended October 4, 2015 amounted to \$126,351,000. On November 1, 2015, the Company's Board of Directors authorized the repurchase of an additional \$100,000,000 of the Company's common stock. The Company may repurchase shares under these programs in future periods depending upon a variety of factors, including, among other

things, the impact of dilution from employee stock options, stock price, share availability, and cash requirements. The Company believes that its existing cash, cash equivalent, and investment balances, together with cash flow from operations, will be sufficient to meet its operating, investing, and financing activities for the next twelve months. As of October 4, 2015, the Company had approximately \$592 million in cash, cash equivalents, and debt securities that could be converted into cash. In addition, the Company has no debt and does not anticipate needing debt financing

in the near future. We believe that our strong cash position has put us in a relatively good position with respect to our longer-term liquidity needs.

#### New Pronouncements

##### Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers"

The amendments in ASU 2014-09 will supersede and replace all currently existing U.S. GAAP, including industry-specific revenue recognition guidance, with a single, principle-based revenue recognition framework. The concept guiding this new model is that revenue recognition will depict transfer of control to the customer in an amount that reflects consideration to which an entity expects to be entitled. The core principles supporting this framework include (1) identifying the contract with a customer, (2) identifying separate performance obligations within the contract, (3) determining the transaction price, (4) allocating the transaction price to the performance obligations, and (5) recognizing revenue. This new framework will require entities to apply significantly more judgment. This increase in management judgment will require expanded disclosure on estimation methods, inputs, and assumptions for revenue recognition. The Transition Resource Group (TRG) is evaluating the impact of this ASU and will release implementation guidance in future periods. ASU 2015-14, "Deferral of the effective date" amended the effective date of ASU 2014-09 for public companies to annual reporting periods beginning after December 15, 2017. Early adoption is permitted, but only beginning after December 15, 2016. Management will continue to evaluate the impact of this standard as it evolves.

##### Accounting Standards Update (ASU) 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software"

ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, then the customer should account for the arrangement as a service contract. For public companies, the guidance in ASU 2015-05 is effective for annual periods beginning after December 15, 2015, and interim periods thereafter. Early adoption is permitted. Management does not expect ASU 2015-05 to have a material impact on the Company's financial statements and disclosures.

##### Accounting Standards Update (ASU) 2015-11, "Inventory - Simplifying the Measurement of Inventory"

ASU 2015-11 requires companies to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which a company must measure inventory at the lower of cost or market. This ASU eliminates the need to determine replacement cost and evaluate whether said cost is within a quantitative range. This ASU also further aligns U.S. GAAP and international accounting standards. For public companies, the guidance in ASU 2015-11 is effective for annual periods beginning after December 15, 2016, and interim periods thereafter. Early adoption is permitted. Management does not expect ASU 2015-11 to have a material impact on the Company's financial statements and disclosures.

##### Accounting Standards Update (ASU) 2015-16, "Business Combinations - Simplifying the Accounting for Measurement-Period Adjustments"

ASU 2015-16 simplifies the requirements to retrospectively account for adjustments made to provisional amounts recognized in a business combination. This ASU applies to all entities that have reported provisional amounts for items in a business combination for which the accounting is incomplete by the end of the reporting period in which the combination occurs and that have recognized an adjustment to provisional amounts during the measurement period. For public companies, the guidance in ASU 2015-16 is effective for annual periods beginning after December 15, 2015, and interim periods thereafter. This ASU should be applied prospectively to adjustments to provisional amounts that occur after the effective date. Management does not expect ASU 2015-16 to have a material impact on the Company's financial statements and disclosures.

#### ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to the Company's exposures to market risk since December 31, 2014.

#### ITEM 4: CONTROLS AND PROCEDURES

As required by Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934, the Company has evaluated, with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, the effectiveness

of its disclosure controls and procedures (as defined in such rules) as of the end of the period covered by this report. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer concluded that such disclosure controls and procedures were effective as of that date. From time to time, the Company reviews its disclosure controls and procedures, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that the Company's systems evolve with its business. There was no change in the Company's internal control over financial

reporting that occurred during the quarter ended October 4, 2015 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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## PART II: OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

In March 2013, the Company filed a lawsuit against Microscan Systems, Inc. ("Microscan") and Code Corporation ("Code") in the United States District Court for the Southern District of New York alleging that Microscan's Mobile Hawk handheld imager infringes U.S. Patent 7,874,487 owned by the Company (the "487 patent"). The lawsuit sought to prohibit Code from manufacturing the product, and Microscan from selling and distributing the product.

In August 2014, Microscan filed a lawsuit against the Company in the United States District Court for the Southern District of New York alleging that the Company's DataMan® 8500 handheld imager infringes U.S. Patent 6,352,204 owned by Microscan (the "204 patent"). The lawsuit sought to prohibit the Company from manufacturing, selling, and distributing the DataMan® 7500, 8500, 8600, and 9500 products.

In June 2015, the Company executed a settlement agreement with Microscan requiring a payment by the Company of \$3,500,000 which settles all outstanding litigation between the parties. The settlement included a patent license agreement valued at \$1,667,000 that allows the Company to continue producing current models of its handheld barcode readers, which was recorded as an asset and is being amortized to cost of revenue over the five year life of the patent starting in the third quarter of 2015. The remaining \$1,833,000 of the settlement was recorded as expense in the second quarter of 2015. All cases were dismissed by the end of July 2015. In July 2015, the Company also executed an immaterial settlement agreement with Code. This matter is now closed.

Various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened on behalf of or against the Company, including some pertaining to the Company's recently divested surface inspection business, which arose prior to the transaction closing date and for which the Company retains liability pursuant to the agreement governing such divestiture. While we cannot predict the outcome of these matters, we believe that any liability arising from them will not have a material adverse effect on our financial position, liquidity, or results of operations.

## ITEM 1A. RISK FACTORS

For a complete list of factors that could affect the Company's business, results of operations, and financial condition, see the risk factors discussion provided in Part I—Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table sets forth information with respect to purchases by the Company of shares of its Common Stock during the periods indicated.

|                             | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total Number of<br>Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans or<br>Programs (1) | Approximate<br>Dollar Value<br>of Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|-----------------------------|---|------------------------------------|--|---|
| July 6 - August 2, 2015     | —   | —                                  | —  | \$6,574,000   |
| August 3 - August 30, 2015  | 1,100,000                                 | 36.41                              | 1,100,000  | \$66,517,000  |
| August 31 - October 4, 2015 | 1,386,000                                 | 36.40                              | 1,386,000  | \$16,064,000  |
| Total                       | 2,486,000                                 | 36.41                              | 2,486,000  | \$16,064,000  |

(1) In April 2014, the Company's Board of Directors authorized the repurchase of \$50,000,000 of the Company's common stock. In August 2015, the Company's Board of Directors authorized the repurchase of an additional \$100,000,000 of the Company's common stock. Purchases under this 2015 program commenced in the third quarter of 2015 upon completion of the 2014 program. In November 2015, the Company's Board of Directors authorized the repurchase of an additional \$100,000,000 of the Company's common stock. Purchases under this program will commence once the August 2015 program is complete.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit Number

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934\*
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934\*
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*\*
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002\*\*
- 101 xBRL (Extensible Business Reporting Language)  
The following materials from Cognex Corporation's Quarterly Report on Form 10-Q for the period ended October 4, 2015, formatted in xBRL: (i) Consolidated Statements of Operations for the three-month and nine-month periods ended October 4, 2015 and September 28, 2014; (ii) Consolidated Statements of Comprehensive Income for the three-month and nine-month periods ended October 4, 2015 and September 28, 2014; (iii) Consolidated Balance Sheets as of October 4, 2015 and December 31, 2014; (iv) Consolidated Statements of Cash Flows for the nine-month periods ended October 4, 2015 and September 28, 2014; (v) Consolidated Statement of Shareholders' Equity for the nine-month period ended October 4, 2015; and (vi) Notes to Consolidated Financial Statements.
- \* Filed herewith
- \*\* Furnished herewith

SIGNATURES

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

Date: November 2, 2015

COGNEX CORPORATION

By: /s/ Robert J. Willett  
Robert J. Willett  
President and Chief Executive Officer  
(principal executive officer)

By: /s/ Richard A. Morin  
Richard A. Morin  
Executive Vice President of Finance and Administration  
and Chief Financial Officer  
(principal financial and accounting officer)