

COGNEX CORP  
Form 10-Q  
October 29, 2012  
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**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 September 30, 2012**

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)

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**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

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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 September 30, 2012, there were 42,961,132 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                    |                    |
|---|--------------------------------------|--------------------|--------------------------------------|--------------------|
|   | September 30,<br>2012<br>(unaudited) | October 2,<br>2011 | September 30,<br>2012<br>(unaudited) | October 2,<br>2011 |
| Revenue   |                                      |                    |                                      |                    |
| Product   | \$ 72,437                            | \$ 74,165          | \$ 222,293                           | \$ 220,608         |
| Service   | 7,639                                | 5,920              | 19,818                               | 17,264             |
|   | <b>80,076</b>                        | 80,085             | <b>242,111</b>                       | 237,872            |
| Cost of revenue   |                                      |                    |                                      |                    |
| Product   | 15,863                               | 15,705             | 49,054                               | 47,258             |
| Service   | 3,643                                | 3,248              | 10,059                               | 9,457              |
|   | <b>19,506</b>                        | 18,953             | <b>59,113</b>                        | 56,715             |
| Gross margin  |                                      |                    |                                      |                    |
| Product   | 56,574                               | 58,460             | 173,239                              | 173,350            |
| Service   | 3,996                                | 2,672              | 9,759                                | 7,807              |
|   | <b>60,570</b>                        | 61,132             | <b>182,998</b>                       | 181,157            |
| Research, development, and engineering expenses                   | 10,002                               | 10,608             | 30,663                               | 30,596             |
| Selling, general, and administrative expenses                     | 28,765                               | 28,135             | 89,441                               | 86,762             |
| Operating income  | 21,803                               | 22,389             | 62,894                               | 63,799             |
| Foreign currency loss   | (409)                                | (231)              | (1,077)                              | (80)               |
| Investment income   | 823                                  | 917                | 3,596                                | 2,219              |
| Other expense   | (131)                                | (156)              | (227)                                | (509)              |
| Income before income tax expense                                  | 22,086                               | 22,919             | 65,186                               | 65,429             |
| Income tax expense  | 4,281                                | 4,882              | 13,332                               | 14,659             |
| Net income  | \$ 17,805                            | \$ 18,037          | \$ 51,854                            | \$ 50,770          |
| Earnings per weighted-average common and common-equivalent share: |                                      |                    |                                      |                    |
| Basic   | \$ 0.42                              | \$ 0.43            | \$ 1.21                              | \$ 1.22            |
| Diluted   | \$ 0.41                              | \$ 0.42            | \$ 1.19                              | \$ 1.19            |
| Weighted-average common and common-equivalent shares outstanding: |                                      |                    |                                      |                    |
| Basic   | 42,912                               | 42,128             | 42,777                               | 41,765             |
| Diluted   | 43,629                               | 42,976             | 43,610                               | 42,682             |
| Cash dividends per common share                                   | \$ 0.11                              | \$ 0.09            | \$ 0.32                              | \$ 0.26            |

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 |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30,      | October 2, | September 30,     | October 2, |
|   | 2012               | 2011       | 2012              | 2011       |
|   | (unaudited)        |            | (unaudited)       |            |
| Net income  | \$ 17,805          | \$ 18,037  | \$ 51,854         | \$ 50,770  |
| Other comprehensive income (loss), net of tax:  |                    |            |                   |            |
| Net unrealized gain on available-for-sale investments, net of tax of \$102 and \$27 in the three-month periods and net of tax of \$302 and \$62 in the nine-month periods, respectively | 201                | 225        | 730               | 48         |
| Foreign currency translation adjustments, net of tax of \$17 and (\$495) in the three-month periods and net of tax of (\$180) and (\$26) in the nine-month periods, respectively        | (2,905)            | (13,059)   | (12,086)          | 902        |
| Other comprehensive income (loss)   | (2,704)            | (12,834)   | (11,356)          | 950        |
| Comprehensive income  | \$ 15,101          | \$ 5,203   | \$ 40,498         | \$ 51,720  |

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

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**COGNEX CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**

(In thousands)

|   | September 30,<br>2012<br>(unaudited) | December 31,<br>2011 |
|---|--------------------------------------|----------------------|
| <b>ASSETS</b>   |                                      |                      |
| Current assets:   |                                      |                      |
| Cash and cash equivalents   | \$ 54,158                            | \$ 38,103            |
| Short-term investments  | 101,870                              | 144,431              |
| Accounts receivable, less reserves of \$1,130 and \$1,240 in 2012 and 2011, respectively    | 44,761                               | 48,206               |
| Inventories   | 24,995                               | 28,098               |
| Deferred income taxes   | 6,785                                | 6,880                |
| Prepaid expenses and other current assets   | 17,657                               | 19,628               |
| <b>Total current assets</b>   | <b>250,226</b>                       | <b>285,346</b>       |
| Long-term investments   | 259,910                              | 174,906              |
| Property, plant, and equipment, net   | 34,344                               | 31,744               |
| Deferred income taxes   | 17,378                               | 15,919               |
| Intangible assets, net  | 15,783                               | 18,910               |
| Goodwill  | 81,689                               | 82,029               |
| Other assets  | 2,785                                | 3,027                |
|   | <b>\$ 662,115</b>                    | <b>\$ 611,881</b>    |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>  |                                      |                      |
| Current liabilities:  |                                      |                      |
| Accounts payable  | \$ 7,567                             | \$ 7,098             |
| Accrued expenses  | 28,918                               | 32,290               |
| Accrued income taxes  | 3,583                                | 1,259                |
| Deferred revenue and customer deposits  | 11,755                               | 13,458               |
| <b>Total current liabilities</b>  | <b>51,823</b>                        | <b>54,105</b>        |
| Reserve for income taxes  | 4,890                                | 4,796                |
| Commitments and contingencies (Note 7)  |                                      |                      |
| Shareholders' equity:   |                                      |                      |
| Common stock, \$.002 par value  |                                      |                      |
| Authorized: 140,000 shares, issued: 42,961 and 42,223 shares in 2012 and 2011, respectively | 86                                   | 84                   |
| Additional paid-in capital  | 161,296                              | 135,668              |
| Retained earnings   | 472,729                              | 434,581              |
| Accumulated other comprehensive loss, net of tax  | (28,709)                             | (17,353)             |
| <b>Total shareholders' equity</b>   | <b>605,402</b>                       | <b>552,980</b>       |
|   | <b>\$ 662,115</b>                    | <b>\$ 611,881</b>    |

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           |                   | Loss               | Equity            |
| Balance as of December 31, 2011  | 42,223        | \$ 84        | \$ 135,668        | \$ 434,581        | \$ (17,353)        | \$ 552,980        |
| Issuance of common stock under stock option plans                          | 738           | 2            | 15,577            |                   |                    | 15,579            |
| Stock-based compensation expense   |               |              | 6,795             |                   |                    | 6,795             |
| Excess tax benefit from stock option exercises                             |               |              | 3,256             |                   |                    | 3,256             |
| Payment of dividends   |               |              |                   | (13,706)          |                    | (13,706)          |
| Net income   |               |              |                   | 51,854            |                    | 51,854            |
| Net unrealized gain on available-for-sale investments, net of tax of \$302 |               |              |                   |                   | 730                | 730               |
| Foreign currency translation adjustment, net of tax of \$180               |               |              |                   |                   | (12,086)           | (12,086)          |
| Balance as of September 30, 2012 (unaudited)                               | <b>42,961</b> | <b>\$ 86</b> | <b>\$ 161,296</b> | <b>\$ 472,729</b> | <b>\$ (28,709)</b> | <b>\$ 605,402</b> |

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



**Table of Contents****COGNEX CORPORATION****CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**

(In thousands)

|  | <b>Nine-months Ended</b> |                   |
|--|--------------------------|-------------------|
|  | <b>September 30,</b>     | <b>October 2,</b> |
|  | <b>2012</b>              | <b>2011</b>       |
|  | <b>(unaudited)</b>       |                   |
| <b>Cash flows from operating activities:</b>   |                          |                   |
| Net income   | <b>\$ 51,854</b>         | <b>\$ 50,770</b>  |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                          |                   |
| Stock-based compensation expense   | <b>6,795</b>             | 5,829             |
| Depreciation of property, plant, and equipment   | <b>4,977</b>             | 4,082             |
| Amortization of intangible assets  | <b>3,124</b>             | 3,181             |
| Amortization of discounts or premiums on investments                                     | <b>4,719</b>             | 4,675             |
| Realized gain on sale of investments   | <b>(1,411)</b>           | (33)              |
| Tax effect of stock option exercises   | <b>(3,256)</b>           | (3,624)           |
| Change in deferred income taxes  | <b>(1,509)</b>           | (359)             |
| Change in operating assets and liabilities   | <b>9,516</b>             | (2,184)           |
| <b>Net cash provided by operating activities</b>   | <b>74,809</b>            | 62,337            |
| <b>Cash flows from investing activities:</b>   |                          |                   |
| Purchases of investments   | <b>(355,351)</b>         | (288,045)         |
| Maturities and sales of investments  | <b>309,081</b>           | 217,528           |
| Purchases of property, plant, and equipment  | <b>(7,621)</b>           | (5,545)           |
| <b>Net cash used in investing activities</b>   | <b>(53,891)</b>          | (76,062)          |
| <b>Cash flows from financing activities:</b>   |                          |                   |
| Issuance of common stock under stock option plans  | <b>15,579</b>            | 27,837            |
| Repurchase of common stock   |                          | (10,000)          |
| Payment of dividends   | <b>(13,706)</b>          | (10,897)          |
| Tax effect of stock option exercises   | <b>3,256</b>             | 3,624             |
| <b>Net cash provided by financing activities</b>   | <b>5,129</b>             | 10,564            |
| Effect of foreign exchange rate changes on cash and cash equivalents                     | <b>(9,992)</b>           | 133               |
| <b>Net change in cash and cash equivalents</b>   | <b>16,055</b>            | (3,028)           |
| Cash and cash equivalents at beginning of period   | <b>38,103</b>            | 33,203            |
| <b>Cash and cash equivalents at end of period</b>  | <b>\$ 54,158</b>         | <b>\$ 30,175</b>  |

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

**Table of Contents****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, 2011.

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 necessary to present fairly the Company's financial position as of September 30, 2012, and the results of its operations for the three-month and nine-month periods ended September 30, 2012 and October 2, 2011, 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 September 30, 2012 are not necessarily indicative of the results to be expected for the full year.

**NOTE 2: 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 September 30, 2012 (in thousands):

|                            | Quoted Prices in<br>Active<br>Markets<br>for Identical<br>Assets (Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) |
|----------------------------|---|---|
| <b>Assets:</b>             |   |   |
| Cash equivalents           | \$ 6,799  | \$  |
| Money market instruments   | 4,099   |   |
| Corporate bonds            |   | 136,864   |
| Municipal bonds            |   | 83,843  |
| Asset-backed securities    |   | 47,202  |
| Treasury bills             |   | 46,032  |
| Agency bonds               |   | 27,023  |
| Sovereign bonds            |   | 7,833   |
| Covered bonds              |   | 7,421   |
| Currency forward contracts | 56  |   |
| <b>Liabilities:</b>        |   |   |
| Currency forward contracts | 18  |   |

The Company's cash equivalents and 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 investments. The Company's currency forward contracts are reported at fair value based upon quoted U.S. Dollar foreign currency exchange rates, and are therefore also classified as Level 1 investments.

The Company's debt securities 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, and are therefore classified as Level 2 investments. Management is responsible for estimating the fair value of these investments, and in doing so, considers valuations provided by a large, third-party pricing service. 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.



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**COGNEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The Company did not record an other-than-temporary impairment of these investments during the nine-month period ended September 30, 2012.

**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, 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 September 30, 2012.

**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 September 30, 2012.

A change to the level of an asset or liability within the fair value hierarchy is determined at the end of a reporting period. There were no changes to these levels during the nine-month period ended September 30, 2012.

**Table of Contents****COGNEX CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****NOTE 3: Cash, Cash Equivalents, and Investments**

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

|  | September 30,<br>2012 | December 31,<br>2011 |
|--|-----------------------|----------------------|
| Cash   | \$ 43,260             | \$ 36,404            |
| Cash equivalents   | 6,799                 |                      |
| Money market instruments                                       | 4,099                 | 1,699                |
| <br>Cash and cash equivalents                                  | <br>54,158            | <br>38,103           |
| Corporate bonds  | 45,025                | 55,570               |
| Municipal bonds  | 25,257                | 54,036               |
| Asset-backed securities  | 12,184                |                      |
| Treasury bills   | 10,043                | 1,945                |
| Covered bonds  | 4,664                 | 1,319                |
| Agency bonds   | 2,998                 | 27,545               |
| Sovereign bonds  | 1,699                 | 4,016                |
| <br>Short-term investments                                     | <br>101,870           | <br>144,431          |
| Corporate bonds  | 91,839                | 59,902               |
| Municipal bonds  | 58,586                | 69,680               |
| Treasury bills   | 35,989                |                      |
| Asset-backed securities  | 35,018                |                      |
| Agency bonds   | 24,025                | 12,335               |
| Sovereign bonds  | 6,134                 | 22,355               |
| Covered bonds  | 2,757                 | 4,701                |
| Limited partnership interest (accounted for using cost method) | 5,562                 | 5,933                |
| <br>Long-term investments                                      | <br>259,910           | <br>174,906          |
|  | <br>\$ 415,938        | <br>\$ 357,440       |

The Company's investment portfolio includes corporate bonds, municipal bonds, asset-backed securities, treasury bills, covered bonds, agency bonds, and sovereign bonds. Corporate bonds consist of debt securities issued by both domestic and foreign companies; municipal bonds consist of debt securities issued by state and local government entities; asset-backed securities consist of debt securities collateralized by pools of receivables or loans with credit enhancement; treasury bills consist of debt securities issued by both the U.S. and foreign governments; covered bonds consist of debt securities backed by governments, mortgages, or public sector loans; agency bonds consist of domestic or foreign obligations of government agencies and government sponsored enterprises that have government backing; and sovereign bonds consist of direct debt issued by foreign governments.

**Table of Contents****COGNEX CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The following tables summarize the Company's available-for-sale investments as of September 30, 2012 (in thousands):

|                         | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value     |
|-------------------------|-------------------|------------------------------|-------------------------------|-------------------|
| <b>Short-term:</b>      |                   |                              |                               |                   |
| Corporate bonds         | \$ 44,935         | \$ 94                        | \$ (4)                        | \$ 45,025         |
| Municipal bonds         | 25,241            | 17                           | (1)                           | 25,257            |
| Asset-backed securities | 12,192            | 5                            | (13)                          | 12,184            |
| Treasury bills          | 10,044            |                              | (1)                           | 10,043            |
| Covered bonds           | 4,679             |                              | (15)                          | 4,664             |
| Agency bonds            | 2,999             |                              | (1)                           | 2,998             |
| Sovereign bonds         | 1,699             |                              |                               | 1,699             |
| <b>Long-term:</b>       |                   |                              |                               |                   |
| Corporate bonds         | 91,131            | 723                          | (15)                          | 91,839            |
| Municipal bonds         | 58,246            | 341                          | (1)                           | 58,586            |
| Treasury bills          | 35,993            | 2                            | (6)                           | 35,989            |
| Asset-backed securities | 34,998            | 48                           | (28)                          | 35,018            |
| Agency bonds            | 24,001            | 43                           | (19)                          | 24,025            |
| Sovereign bonds         | 6,118             | 18                           | (2)                           | 6,134             |
| Covered bonds           | 2,753             | 4                            |                               | 2,757             |
|                         | <b>\$ 355,029</b> | <b>\$ 1,295</b>              | <b>\$ (106)</b>               | <b>\$ 356,218</b> |

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 September 30, 2012 (in thousands):

|                         | <b>Unrealized Loss Position For</b> |                              |
|-------------------------|-------------------------------------|------------------------------|
|                         | <b>Less than 12 Months</b>          |                              |
|                         | <b>Fair Value</b>                   | <b>Unrealized<br/>Losses</b> |
| Treasury bills          | \$ 38,529                           | \$ (7)                       |
| Asset-backed securities | 30,573                              | (41)                         |
| Corporate bonds         | 17,333                              | (19)                         |
| Agency bonds            | 12,558                              | (20)                         |
| Municipal bonds         | 4,828                               | (2)                          |
| Covered bonds           | 4,664                               | (15)                         |
| Sovereign bonds         | 2,464                               | (2)                          |
|                         | <b>\$ 110,949</b>                   | <b>\$ (106)</b>              |

As of September 30, 2012, 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.

In the third quarter of 2012, management changed the domicile of the subsidiary that held the Company's Euro-denominated investment portfolio and also changed that subsidiary's functional currency from the Euro to the U.S. Dollar. As a result of these changes, the investment portfolio was liquidated, primarily during the second quarter of 2012, and those funds were converted to U.S. Dollars. These funds were then used to purchase U.S. Dollar-denominated investments during the third quarter of 2012 once the change of domicile was complete.

**Table of Contents****COGNEX CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

The Company recorded gross realized gains and gross realized losses on the sale of investments totaling \$342,000 and \$1,000, respectively, during the three-month period ended September 30, 2012 and \$47,000 and \$28,000, respectively, during the three-month period ended October 2, 2011. The Company recorded gross realized gains and gross realized losses of \$1,669,000 and \$239,000, respectively, during the nine-month period ending September 30, 2012, and \$78,000 and \$45,000, respectively, during the nine-month period ended October 2, 2011.

The following table presents the effective maturity dates of the Company's available-for-sale investments as of September 30, 2012 (in thousands):

|                         | <1<br>Year        | 1-2<br>Years     | 2-3<br>Years      | 3-4<br>Years     | 4-5<br>Years    | 5-7<br>Years    | Total             |
|-------------------------|-------------------|------------------|-------------------|------------------|-----------------|-----------------|-------------------|
| Corporate bonds         | \$ 45,025         | \$ 19,494        | \$ 61,676         | \$ 8,456         | \$ 2,213        | \$              | \$ 136,864        |
| Municipal bonds         | 25,257            | 31,111           | 10,209            | 7,530            | 4,519           | 5,217           | 83,843            |
| Asset-backed securities | 12,184            | 17,388           | 12,595            | 4,530            |                 | 505             | 47,202            |
| Treasury bills          | 10,043            | 20,009           | 15,980            |                  |                 |                 | 46,032            |
| Covered bonds           | 4,664             | 961              |                   | 1,796            |                 |                 | 7,421             |
| Agency bonds            | 2,998             | 8,647            | 7,935             | 5,425            | 1,011           | 1,007           | 27,023            |
| Sovereign bonds         | 1,699             | 765              | 3,254             | 2,115            |                 |                 | 7,833             |
|                         | <b>\$ 101,870</b> | <b>\$ 98,375</b> | <b>\$ 111,649</b> | <b>\$ 29,852</b> | <b>\$ 7,743</b> | <b>\$ 6,729</b> | <b>\$ 356,218</b> |

In June 2000, the Company became a Limited Partner in Venrock Associates III, L.P. (Venrock), a venture capital fund. A Director of the Company was a General Partner of Venrock Associates through December 31, 2009. 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, 2013. As of September 30, 2012, 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, 2013. Distributions and contributions are at the discretion of Venrock's management. No contributions were made during the nine-month period ended September 30, 2012. During the second quarter of 2012, the Company received a stock distribution valued at \$371,000 resulting from a portfolio company's initial public offering. During the third quarter of 2012, the Company recorded a realized loss on this stock distribution of \$19,000 when the shares were sold for \$352,000.

**NOTE 4: Inventories**

Inventories consisted of the following (in thousands):

|                 | September 30,<br>2012 | December 31,<br>2011 |
|-----------------|-----------------------|----------------------|
| Raw materials   | \$ 13,800             | \$ 17,736            |
| Work-in-process | 1,896                 | 3,418                |
| Finished goods  | 9,299                 | 6,944                |
|                 | <b>\$ 24,995</b>      | <b>\$ 28,098</b>     |

**NOTE 5: Intangible Assets and Goodwill**

During the third quarter of 2012, the Company changed the domicile of the subsidiary that owns its international intellectual property. At that time, this entity changed its functional currency from the Euro to the U.S. Dollar. As of September 30, 2012, all goodwill is based in U.S.



Dollars. However, the change in the

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carrying value of goodwill noted on the Consolidated Balance Sheets during the nine-month period ended September 30, 2012 of \$340,000 is wholly attributable to fluctuations in foreign currency exchange rates, recorded prior to the change of domicile.

The Company evaluates the possible impairment of goodwill and other intangible assets whenever events or circumstances indicate that the carrying value of these assets may not be recoverable. No triggering event occurred in the nine-month period ended September 30, 2012 that would indicate a potential impairment of goodwill or other intangible assets. However, the Company continues to monitor a variety of factors that could result in an impairment of goodwill or other intangible assets in a future period.

**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 obligations are 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 obligations were as follows (in thousands):

|  |              |
|--|--------------|
| Balance as of December 31, 2011                    | \$ 2,097     |
| Provisions for warranties issued during the period | 1,344        |
| Fulfillment of warranty obligations                | (1,164)      |
| Foreign exchange rate changes                      | (6)          |
| <br>Balance as of September 30, 2012               | <br>\$ 2,271 |

**NOTE 7: Contingencies**

In May 2008, the Company filed a complaint against MvTec Software GmbH, MvTec LLC, and Fuji America Corporation in the United States District Court for the District of Massachusetts alleging infringement of certain patents owned by the Company. In April 2009 and again in June 2009, Defendant MvTec Software GmbH filed re-examination requests of the patents-at-issue with the United States Patent and Trademark Office. This matter is ongoing.

In May 2009, the Company pre-filed a complaint with the United States International Trade Commission (ITC) pursuant to Section 337 of the Tariff Act of 1930, as amended, 19 U.S.C. §1337, against MvTec Software GmbH, MvTec LLC, Fuji America, and several other respondents alleging unfair methods of competition and unfair acts in the unlawful importation into the United States, sale for importation, or sale within the United States after importation. By this filing, the Company requested the ITC to investigate the Company's contention that certain machine vision software, machine vision systems, and products containing the same infringe, and respondents directly infringe and/or actively induce and/or contribute to the infringement in the United States, of one or more of the Company's U.S. patents. In July 2009, the ITC issued an order that it would institute an investigation based upon the Company's assertions. In September 2009, the Company reached a settlement with two of the respondents, and in December 2009, the Company reached a settlement with five additional respondents. In March 2010, the Company reached a settlement with respondent Fuji Machine Manufacturing Co., Ltd. and its subsidiary Fuji America Corporation. These settlements did not have a material impact on the Company's financial results. An ITC hearing was held in May 2010. In July 2010, the Administrative Law Judge issued an initial determination finding two of the Company's patents invalid and that respondents did not infringe the patents-at-issue. In September 2010,



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**COGNEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

the ITC issued a notice that it would review the initial determination of the Administrative Law Judge. The ITC issued its Final Determination in November 2010 in which it determined to modify-in-part and affirm-in-part the Administrative Law Judge's determination, and terminate the investigation with a finding of no violation of Section 337 of the Tariff Act of 1930 (as amended 19 U.S.C. §1337). The Company has filed an appeal of the decision with the United States Court of Appeals for the Federal Circuit. An oral hearing before the United States Court of Appeals occurred in February 2012. This matter is ongoing.

The Company cannot predict the outcome of the above-referenced pending matters and an adverse resolution of these lawsuits could have a material adverse effect on the Company's financial position, liquidity, results of operations, and/or indemnification obligations. In addition, 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. While we cannot predict the outcome of these incidental 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.

**NOTE 9: Derivative Instruments**

The Company is exposed to certain risks relating to its ongoing business operations including foreign currency exchange rate risk and interest rate risk. The Company currently mitigates certain foreign currency exchange rate risks with derivative instruments. The Company does not currently manage its interest rate risk with derivative instruments.

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The Company faces exposure to foreign currency exchange rate fluctuations, as a significant portion of its revenues, expenses, assets, and liabilities are denominated in currencies other than the functional currencies of the Company's subsidiaries or the reporting currency of the Company, which is the U.S. Dollar. The Company faces two types of foreign currency exchange rate exposures:

transactional currency/functional currency exchange rate exposures from transactions that are denominated in currencies other than the functional currency of the subsidiary (for example, a U.S. Dollar receivable on the Company's Irish subsidiary's books for which the functional currency is the Euro), and

functional currency/reporting currency exchange rate exposures from transactions that are denominated in currencies other than the U.S. Dollar, which is the reporting currency of the Company.

The Company currently uses derivative instruments to provide an economic hedge against its transactional currency/functional currency exchange rate exposures. Forward contracts on currencies are entered into to manage the transactional currency/functional currency exposure of the Company's Irish subsidiary's accounts receivable denominated in U.S. dollars and intercompany receivables denominated in Japanese Yen. These forward contracts are used to minimize foreign currency gains or losses, as the gains or losses on these contracts are intended to offset the losses or gains on the underlying exposures. In addition, during the third quarter of 2012, the Company entered into forward contracts to exchange Euros for U.S. Dollars at fixed exchange rates to protect against a potential devaluation of the Euro as it was converting a large amount of Euro-denominated cash into U.S. Dollars.

These forward contracts do not qualify for hedge accounting. Both the underlying exposures and the forward contracts are recorded at fair value on the Consolidated Balance Sheets and changes in fair value are reported as Foreign currency loss on the Consolidated Statements of Operations. The Company recorded net foreign currency losses of \$409,000 and \$1,077,000 in the three-month and nine-month periods ended September 30, 2012, respectively, and net foreign currency losses of \$231,000 and \$80,000 in the three-month and nine-month periods ended October 2, 2011, respectively.

As of September 30, 2012, the Company had the following outstanding forward contracts that were entered into to mitigate foreign currency exchange rate risk:

| Currency          | Amount                   |
|-------------------|--------------------------|
| Japanese Yen/Euro | 212,000,000 Japanese Yen |
| U.S. Dollar/Euro  | 3,385,000 U.S. Dollars   |

Information regarding the fair value of the forward contracts outstanding as of September 30, 2012 and December 31, 2011 was as follows (in thousands):

|                            | Asset Derivatives                  |                    |                   | Liability Derivatives  |                    |                   |
|----------------------------|------------------------------------|--------------------|-------------------|------------------------|--------------------|-------------------|
|                            | Balance Sheet Location             | Fair Value         |                   | Balance Sheet Location | Fair Value         |                   |
|                            |                                    | September 30, 2012 | December 31, 2011 |                        | September 30, 2012 | December 31, 2011 |
| Currency forward contracts | Prepaid expenses and other current | \$ 56              | \$ 14             | Accrued expenses       | \$ 18              | \$ 165            |

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assets

Information regarding the effect of the forward contracts, net of the underlying exposure, on the Consolidated Statements of Operations for the three-month and nine-month periods ended September 30, 2012 and October 2, 2011 was as follows (in thousands):

|                            | Location of      | Amount of Loss Recognized in |            | Location of | Amount of Loss |            |
|----------------------------|------------------|------------------------------|------------|-------------|----------------|------------|
|                            | Loss             | Income on Derivatives        |            | Loss        | Recognized in  |            |
|                            | Recognized       | Three-months ended           |            | Recognized  | Income on      |            |
|                            | in Income        |                              |            | in Income   | Derivatives    |            |
|                            | on               | September 30,                | October 2, | on          | September 30,  | October 2, |
|                            | Derivatives      | 2012                         | 2011       | Derivatives | 2012           | 2011       |
| Currency forward contracts |                  |                              |            | Foreign     |                |            |
|                            | Foreign currency |                              |            | currency    |                |            |
|                            | loss             | \$ (546)                     | \$ (171)   | loss        | \$ (637)       | \$ (43)    |

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## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

The Company's share-based payments that result in compensation expense consist solely of stock option grants. As of September 30, 2012, the Company had 6,306,506 shares available for grant under two stock option plans: the 2001 General Stock Option Plan (4,940,521) and the 2007 Stock Option and Incentive Plan (1,365,985). Each of these plans expires ten years from the date the plan was approved. In December 2011, the 2001 General Stock Option Plan received shareholder approval for an amendment and restatement of the plan, extending the plan until September 2021. Stock options are granted with an exercise price equal to the market value of the Company's common stock at the grant date. Generally, stock options vest over four years based upon continuous service and expire ten years from the grant date.

The following table summarizes the Company's stock option activity for the nine-month period ended September 30, 2012:

|                                      | Shares<br>(in<br>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, 2011  | 4,473                       | \$ 24.48                                  |   |   |
| Granted                              | 34                          | 37.24                                     |   |   |
| Exercised                            | (745)                       | 20.89                                     |   |   |
| Forfeited or expired                 | (87)                        | 22.77                                     |   |   |
| Outstanding as of September 30, 2012 | <b>3,675</b>                | <b>\$ 25.37</b>                           | <b>7.3</b>  | <b>\$ 34,143</b>                                  |
| Exercisable as of September 30, 2012 | <b>1,265</b>                | <b>\$ 21.12</b>                           | <b>5.6</b>  | <b>\$ 17,123</b>                                  |

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     |                    |
|--------------------------|-----------------------|--------------------|-----------------------|--------------------|
|                          | September 30,<br>2012 | October 2,<br>2011 | September 30,<br>2012 | October 2,<br>2011 |
| Risk-free rate           | <b>2.0%</b>           | 3.6%               | <b>2.0%</b>           | 3.6%               |
| Expected dividend yield  | <b>1.2%</b>           | 1.0%               | <b>1.2%</b>           | 1.0%               |
| Expected volatility      | <b>44%</b>            | 42%                | <b>44%</b>            | 42%                |
| Expected term (in years) | <b>5.6</b>            | 5.2                | <b>5.6</b>            | 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

The current dividend yield was calculated by annualizing the cash dividend declared by the Company's Board of Directors for the current quarter and dividing that result by the closing stock price on the grant date. The current dividend yield was then adjusted to reflect the Company's expectations relative to future dividend declarations.





**Table of Contents****COGNEX CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****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 weighted-average grant-date fair values of stock options granted during the three-month periods ended September 30, 2012 and October 2, 2011 were \$12.96 and \$11.89, respectively. The weighted-average grant-date fair values of stock options granted during the nine-month periods ended September 30, 2012 and October 2, 2011 were \$13.16 and \$11.78, respectively.

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 67% of its stock options granted to senior management and 66% of its options granted to all other employees will actually vest. Therefore, the Company currently applies an estimated annual forfeiture rate of 12% to all unvested options for senior management and a rate of 14% for all other employees.

The total stock-based compensation expense and the related income tax benefit recognized for the three-month period ended September 30, 2012 were \$1,492,000 and \$478,000, respectively, and for the three-month period ended October 2, 2011 were \$1,520,000 and \$502,000, respectively. The total stock-based compensation expense and the related income tax benefit recognized for the nine-month period ended September 30, 2012 were \$6,795,000 and \$2,212,000, respectively, and for the nine-month period ended October 2, 2011 were \$5,829,000 and \$1,947,000, respectively. No compensation expense was capitalized as of September 30, 2012 or December 31, 2011.

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

|  | <b>Three-months Ended</b>     |                            | <b>Nine-months Ended</b>      |                            |
|--|-------------------------------|----------------------------|-------------------------------|----------------------------|
|  | <b>September 30,<br/>2012</b> | <b>October 2,<br/>2011</b> | <b>September 30,<br/>2012</b> | <b>October 2,<br/>2011</b> |
| Product cost of revenue                | \$ 99                         | \$ 80                      | \$ 474                        | \$ 350                     |
| Service cost of revenue                | 26                            | 27                         | 134                           | 136                        |
| Research, development, and engineering | 385                           | 394                        | 1,735                         | 1,732                      |
| Selling, general, and administrative   | 982                           | 1,019                      | 4,452                         | 3,611                      |
|  | <b>\$ 1,492</b>               | <b>\$ 1,520</b>            | <b>\$ 6,795</b>               | <b>\$ 5,829</b>            |

The total intrinsic values of stock options exercised for the three-month periods ended September 30, 2012 and October 2, 2011 were \$1,436,000 and \$5,254,000, respectively. The total intrinsic values of stock options exercised for the nine-month periods ended September 30, 2012 and October 2, 2011 were \$14,744,000 and \$17,808,000, respectively.

As of September 30, 2012, total unrecognized compensation expense related to non-vested stock options was \$8,273,000, which is expected to be recognized over a weighted-average period of 1.5 years.

**NOTE 11: Stock Repurchase Program**

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In April 2008, the Company's Board of Directors authorized the repurchase of up to \$50,000,000 of the Company's common stock. As of September 30, 2012, the Company had repurchased a total of 1,375,875 shares at a cost of \$30,000,000 under this 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 to help reduce share dilution associated with equity incentive plans. This new authorization will commence once the Company

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## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

completes the \$50,000,000 program noted above. The Company did not purchase any additional shares under these programs during the nine-month period ended September 30, 2012. The Company may repurchase shares under these programs in future periods depending upon a variety of factors, including, among other things, stock price levels, share availability, and cash reserve 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 |                 |
|--|--------------------|-----------------|-------------------|-----------------|
|  | Sept. 30,<br>2012  | Oct. 2,<br>2011 | Sept. 30,<br>2012 | Oct. 2,<br>2011 |
| Income tax at federal statutory rate       | 35%                | 35%             | 35%               | 35%             |
| State income taxes, net of federal benefit | 1                  | 1               | 1                 | 1               |
| Foreign tax rate differential              | (15)               | (13)            | (15)              | (13)            |
| Discrete tax events                        | (2)                | (2)             | (1)               | (1)             |
| Income tax provision                       | 19%                | 21%             | 20%               | 22%             |

The Company's effective tax rate for the third quarter of 2012 included a decrease in tax expense of \$441,000 due to the expiration of statutes of limitations for certain reserves for income tax uncertainties. This reduction in tax expense was partially offset by the final true-up of the prior year's tax accrual upon filing the actual tax returns, which increased tax expense by \$84,000. These discrete tax events decreased the effective tax rate from a provision of 21% to a provision of 19% for the three-month period in 2012 and decreased the effective tax rate from a provision of 21% to a provision of 20% for the nine-month period in 2012. Included in the effective tax rate is the reversal of a \$2,457,000 valuation allowance against foreign tax credits recorded in the prior year. Management believes that the Company will have sufficient foreign source earnings taxable in the United States to allow for full realization of these credits in 2012.

The Company's effective tax rate for the third quarter of 2011 included a decrease in tax expense of \$808,000 due to the expiration of statutes of limitations for certain reserves for income tax uncertainties, along with a decrease in tax expense of \$155,000 resulting from the Company's settlement of its Advanced Pricing Agreement between Japan and Ireland. These reductions in tax expense were partially offset by the final true-up of the prior year's tax accrual upon filing the actual tax returns, which increased tax expense by \$574,000. In addition, a deferred tax asset and a related valuation allowance of \$2,457,000 were recognized for incremental foreign tax credits in the United States generated in 2010. These discrete tax events decreased the effective tax rate from a provision of 23% to a provision of 21% for the three-month period in 2011 and decreased the effective tax rate from a provision of 23% to a provision of 22% for the nine-month period in 2011.

During the nine-month period ended September 30, 2012, the Company recorded a \$428,000 increase in liabilities, net of deferred tax benefit, for uncertain tax positions that were recorded as income tax expense, of which \$206,000 was recorded in the three-month period ended September 30, 2012. Estimated interest and penalties included in these amounts totaled \$95,000 for the nine-month period ended September 30, 2012, of which \$32,000 was recorded in the three-month period ended September 30, 2012.

The Company's reserve for income taxes, including gross interest and penalties, was \$4,890,000 as of September 30, 2012, all of which was classified as noncurrent. The amount of gross interest and penalties included in these balances was \$1,149,000. 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 \$311,000 that would be recorded as Additional Paid in Capital. As a result of the expiration of certain statutes of limitations, there is a potential that a portion of these reserves could be released, which would decrease income tax expense by approximately \$1,500,000 to \$1,800,000 over the next twelve months.



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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 2006 through 2011 remain open to examination by various taxing authorities due to a 2009 carryback claim, while the tax years 2007 through 2011 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  |                 |
|--|--------------------|-----------------|--------------------|-----------------|
|  | September 30, 2012 | October 2, 2011 | September 30, 2012 | October 2, 2011 |
| Basic weighted-average common shares outstanding                 | 42,912             | 42,128          | 42,777             | 41,765          |
| Effect of dilutive stock options                                 | 717                | 848             | 833                | 917             |
| Weighted-average common and common-equivalent shares outstanding | 43,629             | 42,976          | 43,610             | 42,682          |

Stock options to purchase 935,342 and 892,349 shares of common stock, on a weighted-average basis, were outstanding during the three-month and nine-month periods ended September 30, 2012, respectively, and 1,007,991 and 821,035 for the same periods in 2011, but were not included in the calculation of dilutive net income per share because they were anti-dilutive.

**NOTE 14: Segment Information**

The Company has two reportable segments: the Modular Vision Systems Division (MVSD) and the Surface Inspection Systems Division (SISD). MVSD develops, manufactures, and markets modular vision systems that are used to control the manufacture of discrete items by locating, identifying, inspecting, and measuring them during the manufacturing process. SISD develops, manufactures, and markets surface inspection vision systems that are used to inspect surfaces of materials processed in a continuous fashion, such as metals, paper, nonwoven, plastics, and glass, to ensure there are no flaws or defects on the surfaces. Segments are determined based upon the way that management organizes its business for making operating decisions and assessing performance. The Company evaluates segment performance based upon income or loss from operations, excluding stock-based compensation expense.

The following table summarizes information about the segments (in thousands):

| Three-months Ended |            | Reconciling |         |              |
|--------------------|------------|-------------|---------|--------------|
| September 30, 2012 | MVSD       | SISD        | Items   | Consolidated |
| Product revenue    | \$ 64,971  | \$ 7,466    | \$      | \$ 72,437    |
| Service revenue    | 3,291      | 4,348       |         | 7,639        |
| Operating income   | 22,664     | 2,724       | (3,585) | 21,803       |
| Nine-months Ended  |            | Reconciling |         |              |
| September 30, 2012 | MVSD       | SISD        | Items   | Consolidated |
| Product revenue    | \$ 198,935 | \$ 23,358   | \$      | \$ 222,293   |

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|                  |        |        |          |        |
|------------------|--------|--------|----------|--------|
| Service revenue  | 6,989  | 12,829 |          | 19,818 |
| Operating income | 68,843 | 7,964  | (13,913) | 62,894 |

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| <b>October 2, 2011</b> | <b>MVSD</b> | <b>SISD</b> | <b>Reconciling<br/>Items</b> | <b>Consolidated</b> |
|------------------------|-------------|-------------|------------------------------|---------------------|
| Product revenue        | \$ 66,404   | \$ 7,761    | \$                           | \$ 74,165           |
| Service revenue        | 1,771       | 4,149       |                              | 5,920               |
| Operating income       | 23,422      | 2,891       | (3,924)                      | 22,389              |

**Nine-months Ended**

| <b>October 2, 2011</b> | <b>MVSD</b> | <b>SISD</b> | <b>Reconciling<br/>Items</b> | <b>Consolidated</b> |
|------------------------|-------------|-------------|------------------------------|---------------------|
| Product revenue        | \$ 200,163  | \$ 20,445   | \$                           | \$ 220,608          |
| Service revenue        | 5,574       | 11,690      |                              | 17,264              |
| Operating income       | 72,036      | 5,910       | (14,147)                     | 63,799              |

Reconciling items consist of stock-based compensation expense and unallocated corporate expenses, which primarily include corporate headquarters costs, professional fees, and patent infringement litigation. Additional asset information by segment is not produced internally for use by the chief operating decision maker, and therefore, is not presented. Additional asset information is not provided because cash and investments are commingled and the segments share assets and resources in a number of locations around the world.

**NOTE 15: Dividends**

On July 30, 2012, the Company's Board of Directors declared a cash dividend of \$0.11 per share. The dividend was paid on September 14, 2012 to all shareholders of record at the close of business on August 31, 2012.

On October 29, 2012, the Company's Board of Directors declared a cash dividend of \$0.11 per share. The dividend is payable on December 14, 2012 to all shareholders of record at the close of business on November 30, 2012.

**Table of Contents****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, shall, could, should, and similar words and other statements of a similar sense. These statements are based upon 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, research and development activities, 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) current and future conditions in the global economy; (2) the cyclical nature of the semiconductor and electronics industries; (3) the inability to penetrate new markets; (4) the inability to achieve significant international revenue; (5) fluctuations in foreign currency exchange rates; (6) the loss of a large customer; (7) the inability to attract and retain skilled employees; (8) the reliance upon key suppliers to manufacture and deliver critical components for our products; (9) the failure to effectively manage product transitions or accurately forecast customer demand; (10) the inability to design and manufacture high-quality products; (11) the technological obsolescence of current products and the inability to develop new products; (12) the failure to properly manage the distribution of products and services; (13) the inability to protect our proprietary technology and intellectual property; (14) our involvement in time-consuming and costly litigation; (15) the impact of competitive pressures; (16) the challenges in integrating and achieving expected results from acquired businesses; (17) potential impairment charges with respect to our investments or for acquired intangible assets or goodwill; (18) exposure to additional tax liabilities; and (19) 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, 2011. 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. Our Modular Vision Systems Division (MVSD) specializes in machine vision systems that are used to automate the manufacture of discrete items, while our Surface Inspection Systems Division (SISD) specializes in machine vision systems that are used to inspect the surfaces of materials processed in a continuous fashion.

In addition to product revenue derived from the sale of machine vision systems, the Company also generates revenue by providing maintenance and support, training, consulting, and installation services to its customers. Our customers can be classified into three primary markets: factory automation, semiconductor and electronics capital equipment, and surface inspection.

Factory automation customers, who are included in the Company's MVSD segment, purchase Cognex vision 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 automotive, consumer electronics, food and beverage, health and beauty, pharmaceutical, medical devices, and solar. The factory automation market also includes customers who purchase Cognex vision products for use outside of the assembly process, such as using ID products in logistics automation for package sorting and distribution. Sales to factory automation customers represented 77% of total revenue in the third quarter of 2012.



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Semiconductor and electronics capital equipment manufacturers, who are included in the Company's MVSD segment, purchase Cognex vision 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 capital equipment manufacturers has historically been highly cyclical, with periods of investment followed by downturn. Sales to semiconductor and electronics capital equipment manufacturers represented 8% of total revenue in the third quarter of 2012.

Surface inspection customers, who comprise the Company's SISD segment, are manufacturers of materials processed in a continuous fashion, such as metals, paper, nonwoven, plastics, and glass. These customers need sophisticated machine vision to detect, classify, and analyze defects on the surfaces of those materials as they are being processed at high speeds. Surface inspection sales represented 15% of total revenue in the third quarter of 2012.

Revenue for the third quarter of 2012 totaled \$80,076,000. Revenue for the current quarter was relatively flat with the third quarter of 2011, as higher sales in the factory automation market were offset by lower sales in the cyclical semiconductor and electronics capital equipment market. Although the gross margin percentage rounded to 76% in both the third quarter of 2012 and 2011, the gross margin contribution was slightly lower in the third quarter of 2012 due primarily to higher new product introduction costs. Operating expenses were relatively flat with the third quarter of 2011 due principally to expenses associated with increased headcount in strategic areas, offset by lower company bonus accruals and the favorable impact of foreign currency exchange rates on operating expenses. The Company recorded operating income of \$21,803,000, or 27% of revenue, in the third quarter of 2012, compared to \$22,389,000, or 28% of revenue, in the third quarter of 2011. Net income was \$17,805,000, or 22% of revenue, in the third quarter of 2012, compared to \$18,037,000, or 23% of revenue, in the third quarter of 2011.

**Results of Operations****Revenue**

Revenue was relatively flat for the three-month period in 2012 compared to the same period in 2011, and increased by \$4,239,000, or 2%, for the nine-month period in 2012 compared to the same period in 2011. In the three-month period, higher sales to factory automation customers were offset by lower sales to semiconductor and electronics capital equipment customers. Sales to customers in the surface inspection market were relatively flat in the three-month period. In the nine-month period, the increase was due to higher sales to factory automation and surface inspection customers, partially offset by lower sales to semiconductor and electronics capital equipment customers.

*Factory Automation Market*

Sales to customers in the factory automation market represented 77% and 75% of total revenue for the three-month and nine-month periods in 2012, respectively, compared to 74% and 73% for the same periods in 2011. Sales to these customers increased by \$2,147,000, or 4%, for the three-month period and increased by \$9,643,000, or 6%, for the nine-month period. A weaker Euro in 2012 compared to the prior year had a negative impact on reported factory automation revenue, as sales denominated in Euros were translated to U.S. Dollars at a lower rate. Excluding the impact of foreign currency exchange rate changes on revenue, sales to factory automation customers increased by \$5,209,000, or 9%, for the three-month period and increased by \$15,127,000, or 9%, for the nine-month period.

Geographically, increases from the prior year in factory automation revenue excluding the impact of foreign currency exchange rate changes were noted in the Americas, Europe, and, most notably, in Asia, where the Company has made significant investments, particularly in China, to expand its sales and support infrastructure in order to access more of the machine vision market in this high-potential growth region. By product, the largest increase in factory automation revenue in the nine-month period came from sales of the Company's ID Products, which are used in manufacturing applications as well as in the logistics industry for

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package sorting and distribution. Although revenue from ID Products increased in the three-month period as well, the largest increase came from the Vision Software business, which included \$1,300,000 related to an arrangement with a single customer for which the work was performed over the prior two years, but revenue was deferred until the final software obligation was completed in the third quarter of 2012.

On a sequential basis, sales to factory automation customers were relatively flat compared to the second quarter of 2012. Although sales in this market increased from the prior quarter in the Americas and Asia, this increase was offset by typical seasonal softness in Europe.

### *Semiconductor and Electronics Capital Equipment Market*

Sales to customers who make automation equipment for the semiconductor and electronics industries represented 8% and 10% of total revenue for the three-month and nine-month periods in 2012, respectively, compared to 11% and 14% for the same periods in 2011. Sales to these customers decreased by \$2,060,000, or 23%, for the three-month period and decreased by \$9,456,000, or 29%, for the nine-month period. Furthermore, sales to these customers decreased by \$2,982,000, or 30%, from the second quarter of 2012. The semiconductor and electronics capital equipment market has historically been highly cyclical and management has limited visibility regarding future order levels from these customers.

### *Surface Inspection Market*

Sales to customers in the surface inspection market represented 15% of total revenue for both the three-month and nine-month periods in 2012, compared to 15% and 13% for the three-month and nine-month periods in 2011, respectively. Revenue from these customers was relatively flat for the three-month period and increased by \$4,052,000, or 13%, for the nine-month period due to higher product revenue, primarily from metals customers in Asia, as well as higher service revenue from training services and spare part sales. Revenue from the surface inspection market decreased by \$991,000, or 8%, from the second quarter of 2012. The revenue reported each quarter can vary significantly depending upon the timing of customer orders, system deliveries, and installations, as well as the impact of revenue deferrals.

### *Product Revenue*

Product revenue decreased by \$1,728,000, or 2%, for the three-month period and increased by \$1,685,000, or 1%, for the nine-month period. Although the Company has sold a higher volume of modular vision systems than the prior year, the average selling price has declined in part due to a shift in revenue mix to ID Products, which have relatively lower average selling prices.

### *Service Revenue*

Service revenue, which is derived from the sale of maintenance and support, training, consulting, and installation services, increased by \$1,719,000, or 29%, for the three-month period and increased by \$2,554,000, or 15%, for the nine-month period. For the three-month period, service revenue included \$1,300,000 related to a custom software development arrangement with an MVSD customer for which the work was performed over the prior two years, but revenue was deferred until the final software obligation was completed in the third quarter of 2012. For the nine-month period, the increase was also due to higher revenue from SISD training services and spare part sales. Service revenue as a percentage of total revenue was 10% and 8% for the three-month and nine-month periods in 2012, respectively, compared to 7% for both the three-month and nine-month periods in 2011.

### **Gross Margin**

Gross margin as a percentage of revenue was 76% for all periods presented.

### *MVSD Margin*

MVSD gross margin as a percentage of revenue was 79% and 80% for the three-month and nine-month periods in 2012, respectively, compared to 80% for both the three-month and nine-month periods in 2011. The decrease in MVSD margin for the three-month period was due primarily to the impact of higher new product introduction costs while MVSD revenue was relatively flat.

**Table of Contents***SISD Margin*

SISD gross margin as a percentage of revenue was 54% and 53% for the three-month and nine-month periods in 2012, respectively, compared to 53% and 51% for the same periods in 2011. The increase in SISD margin for both periods was due to improvements in both product and service margins. Product margins improved primarily due to manufacturing efficiencies, as SISD manufacturing costs were lower in 2012 than the prior year. Service margins improved due to a shift in revenue mix to relatively higher margin training services and spare part sales.

*Product Margin*

Product gross margin as a percentage of revenue was 78% for both the three-month and nine-month periods in 2012, compared to 79% for both the three-month and nine-month periods in 2011. The decrease in product margin was principally due to a decline in MVSD product margins resulting from higher new product introduction costs. For the nine-month period, the decrease was also due to a higher percentage of total revenue from SISD products that have relatively lower margins.

*Service Margin*

Service gross margin as a percentage of revenue was 52% and 49% for the three-month and nine-month periods in 2012, respectively, compared to 45% for both of the same periods in 2011. The increase in service margin was primarily due to higher margins from consulting services, which included the \$1,300,000 revenue arrangement at a 58% margin recorded in the third quarter of 2012 as further discussed above. In addition, the increase in the nine-month period was due to an increase in relatively higher margin training services and spare part sales.

*Research, Development, and Engineering Expenses*

Research, development, and engineering (RD&E) expenses decreased by \$606,000, or 6%, for the three-month period in 2012 compared to the same period in 2011, and were relatively flat for the nine-month period in 2012 compared to the same period in 2011. MVSD RD&E expenses decreased by \$697,000, or 7%, for the three-month period and decreased by \$360,000, or 1%, for the nine-month period, while SISD RD&E expenses increased by \$91,000, or 11%, for the three-month period and increased by \$427,000, or 18%, for the nine-month period.

The table below details the \$697,000 and the \$360,000 net decreases in MVSD RD&E for the three-month and nine-month periods, respectively:

|  | <b>Three-Month<br/>Period</b> | <b>Nine-Month<br/>Period</b> |
|--|-------------------------------|------------------------------|
| MVSD RD&E expenses in 2011             | \$ 9,747                      | \$ 28,173                    |
| Personnel-related costs                | 295                           | 900                          |
| Company bonus accruals                 | (373)                         | (853)                        |
| Foreign currency exchange rate changes | (305)                         | (645)                        |
| Other                                  | (314)                         | 238                          |
| <br>MVSD RD&E expenses in 2012         | <br><b>\$ 9,050</b>           | <br><b>\$ 27,813</b>         |

Personnel-related costs have increased from the prior year due to additional headcount, partially offset by lower average costs per head. Over the past year, the Company has continued to increase headcount to support strategic initiatives, resulting in higher personnel-related costs, such as salaries and fringe benefits. Many of these heads have been added in Budapest, Hungary, which has resulted in a decrease in the average costs per head. These investments were offset by lower company bonus accruals based on the Company's operating income margin. In addition, a weaker Euro in 2012 compared to the prior year resulted in lower RD&E costs when expenses of the Company's foreign operations were translated to U.S. Dollars.

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The increase in SISD RD&E expenses was primarily due to increased salaries and fringe benefits expenses (\$58,000 for the three-month period and \$278,000 for the nine-month period). In the nine-month period, higher outsourced engineering services (\$81,000) also contributed to the increase.

RD&E expenses as a percentage of revenue were 12% and 13% for the three-month and nine-month periods in 2012, respectively, compared to 13% for both of the same periods in 2011. 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. Although we target our RD&E spending to be between 10% and 15% of revenue, this percentage is impacted by revenue levels.

*Selling, General, and Administrative Expenses*

Selling, general, and administrative (SG&A) expenses increased by \$630,000, or 2%, for the three-month period in 2012 compared to the same period in 2011, and increased by \$2,679,000, or 3%, for the nine-month period in 2012 compared to the same period in 2011. MVSD SG&A expenses increased by \$904,000, or 4%, for the three-month period and increased by \$3,420,000, or 5%, for the nine-month period, while SISD SG&A expenses increased by \$53,000, or 2%, for the three-month period and increased by \$251,000, or 3%, for the nine-month period. Corporate expenses that are not allocated to either division decreased by \$327,000, or 12%, for the three-month period and decreased by \$992,000, or 10%, for the nine-month period.

The table below details the \$904,000 and the \$3,420,000 net increases in MVSD SG&A for the three-month and nine-month periods, respectively:

|  | <b>Three-Month<br/>Period</b> | <b>Nine-Month<br/>Period</b> |
|--|-------------------------------|------------------------------|
| MVSD SG&A expenses in 2011             | \$ 22,622                     | \$ 68,456                    |
| Personnel-related costs                | 1,273                         | 4,045                        |
| Stock-based compensation expense       | 19                            | 730                          |
| Sales demonstration equipment          | 330                           | 485                          |
| Depreciation expense                   | 152                           | 440                          |
| China long-term incentive plan         | 164                           | 363                          |
| Company bonus accruals                 | (376)                         | (744)                        |
| Sales commissions                      | (114)                         | (945)                        |
| Foreign currency exchange rate changes | (924)                         | (1,426)                      |
| Other                                  | 380                           | 472                          |
| <b>MVSD SG&amp;A expenses in 2012</b>  | <b>\$ 23,526</b>              | <b>\$ 71,876</b>             |

Personnel-related costs have increased from the prior year due to additional headcount, and to a lesser extent, higher average costs per head. Over the past year, the Company has continued to increase headcount in strategic areas, principally Sales, resulting in higher personnel-related costs, such as salaries, fringe benefits, commissions, and travel expenses. Average costs per head have increased over the prior year due primarily to modest wage increases granted early in 2012 and higher fringe benefits, such as health care costs. The Company also recorded increased stock-based compensation expense due to a higher valuation of stock options granted in the fourth quarter of 2011 and a lower level of credits related to forfeited options, increased spending on sales demonstration equipment, and higher depreciation expense related principally to business system upgrades and leasehold improvements. In addition, the Company began to accrue expenses in 2012 associated with a long-term incentive plan implemented in China in lieu of granting stock options in this region. These increases were offset by lower sales commissions as a result of fewer sales employees exceeding their bookings quotas compared to the prior year and lower company bonus accruals based upon the Company's operating income margin. In addition, a weaker Euro in 2012 compared to the prior year resulted in lower SG&A costs when expenses of the Company's foreign operations were translated to U.S. Dollars.

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The increase in SISD SG&A expenses was primarily due to increased salaries and fringe benefits expenses (\$72,000 for the three-month period and \$258,000 for the nine-month period).

The decrease in corporate expenses was primarily due to lower company bonus accruals (\$475,000 for the three-month period and \$824,000 for the nine-month period).

**Nonoperating Income (Expense)**

The Company recorded foreign currency losses of \$409,000 and \$1,077,000 for the three-month and nine-month periods in 2012, respectively, compared to foreign currency losses of \$231,000 and \$80,000 for the same periods in 2011. In the third quarter of 2012, management changed the domicile of the subsidiary that held the Company's Euro-denominated investment portfolio and also changed that subsidiary's functional currency from the Euro to the U.S. Dollar. As a result of these changes, the investment portfolio was liquidated, primarily during the second quarter of 2012, and those funds were converted into U.S. Dollars when the change in domicile was completed. To protect against a potential devaluation in the Euro, the Company entered into forward contracts to exchange Euros for U.S. Dollars at fixed exchange rates. The settlement of these forward contracts resulted in a foreign currency loss of \$504,000 recorded in the third quarter of 2012. In addition, the foreign currency losses in each period resulted from the revaluation and settlement of accounts receivable and intercompany balances that are reported in one currency and collected in another. Although a portion of the Company's foreign currency exposure of accounts receivable is mitigated through the use of forward contracts, this program depends upon forecasts of sales and collections, and therefore, gains or losses on the underlying receivables may not perfectly offset losses or gains on the contracts.

Investment income decreased by \$94,000, or 10%, for the three-month period in 2012 compared to the same period in 2011, and increased by \$1,377,000, or 62%, for the nine-month period in 2012 compared to the same period in 2011. The increase in the nine-month period was primarily due to gains recognized on the sale of Euro-denominated investments, as well as an increase in cash that was available for investment.

The Company recorded other expense of \$131,000 and \$227,000 for the three-month and nine-month periods in 2012, respectively, compared to other expense of \$156,000 and \$509,000 for the same periods in 2011. The Company recorded \$141,000 of other income in the first quarter of 2012 upon the expiration of the statute of limitations relating to a tax holiday, during which time the Company collected value-added taxes from customers that were not required to be remitted to the government authority. Other income (expense) also includes rental income, net of associated expenses, from leasing buildings adjacent to the Company's corporate headquarters. A portion of this space is currently unoccupied.

**Income Tax Expense**

The Company's effective tax rates were provisions of 19% and 20% for the three-month and nine-month periods ended September 30, 2012 respectively, compared to provisions of 21% and 22% for the same periods in 2011.

The Company's effective tax rate for the third quarter of 2012 included a decrease in tax expense of \$441,000 due to the expiration of statutes of limitations for certain reserves for income tax uncertainties. This reduction in tax expense was partially offset by the final true-up of the prior year's tax accrual upon filing the actual tax returns, which increased tax expense by \$84,000. These discrete tax events decreased the effective tax rate from a provision of 21% to a provision of 19% for the three-month period in 2012 and decreased the effective tax rate from a provision of 21% to a provision of 20% for the nine-month period in 2012. Included in the effective tax rate is the reversal of a \$2,457,000 valuation allowance against foreign tax credits recorded in the prior year. Management believes that the Company will have sufficient foreign source earnings taxable in the United States to allow for full realization of these credits in 2012.

The Company's effective tax rate for the third quarter of 2011 included a decrease in tax expense of \$808,000 due to the expiration of statutes of limitations for certain reserves for income tax uncertainties,

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along with a decrease in tax expense of \$155,000 resulting from the Company's settlement of its Advanced Pricing Agreement between Japan and Ireland. These reductions in tax expense were partially offset by the final true-up of the prior year's tax accrual upon filing the actual tax returns, which increased tax expense by \$574,000. In addition, a deferred tax asset and a related valuation allowance of \$2,457,000 were recognized for incremental foreign tax credits in the United States generated in 2010. These discrete tax events decreased the effective tax rate from a provision of 23% to a provision of 21% for the three-month period in 2011 and decreased the effective tax rate from a provision of 23% to a provision of 22% for the nine-month period in 2011.

Excluding these discrete tax events, the Company's effective tax rate would be 21% of the Company's pretax income for both periods in 2012, compared to 23% of the Company's pretax income for both periods in 2011. The decrease in the effective tax rate was primarily due to a higher proportion of the Company's pre-tax income being earned in relatively low tax jurisdictions.

## **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 \$415,938,000 as of September 30, 2012. 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 September 30, 2012 were met with its existing cash balances, cash from investment sales and maturities, positive cash flows from operations, and the proceeds from stock option exercises. Cash requirements primarily consisted of operating activities, purchases of investments, capital expenditures, and the payment of dividends. Capital expenditures for the nine months ended September 30, 2012 totaled \$7,621,000 and consisted primarily of expenditures for computer hardware and software, as well as manufacturing test equipment.

In the third quarter of 2012, management changed the domicile of the subsidiary that held the Company's Euro-denominated investment portfolio and also changed that subsidiary's functional currency from the Euro to the U.S. Dollar. As a result of these changes, the investment portfolio was liquidated, primarily during the second quarter of 2012, and those funds were converted into U.S. Dollars. These funds were then used to purchase U.S. Dollar-denominated investments during the third quarter of 2012 once the change in domicile was completed. At September 30, 2012, the Company's investment portfolio consisted predominantly of U.S. Dollar-denominated securities.

In June 2000, the Company became 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, 2013. The Company does not have the right to withdraw from the partnership prior to December 31, 2013. As of September 30, 2012, the Company had contributed \$19,886,000 to the partnership. No contributions were made during the nine months ended September 30, 2012. The remaining commitment of \$614,000 can be called by Venrock in any period through December 31, 2013. The Company received a stock distribution valued at \$371,000 on June 26, 2012 resulting from a portfolio company's initial public offering. These shares were sold for \$352,000 on July 2, 2012.

Beginning in the third quarter of 2003, the Company's Board of Directors has declared and paid a cash dividend in each quarter, including a dividend of \$0.10 per share during the first quarter of 2012 and dividends of \$0.11 per share during the second and third quarters of 2012, totaling \$13,706,000 for the nine months ended September 30, 2012. 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 April 2008, the Company's Board of Directors authorized the repurchase of up to \$50,000,000 of the Company's common stock, primarily as a means to reduce the dilutive effect of employee stock options. As of September 30, 2012, the Company had repurchased 1,375,875 shares at a cost of \$30,000,000 under this 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 to help reduce share dilution associated with equity incentive

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plans. This new authorization will commence once the Company completes the \$50,000,000 program noted above. The Company did not purchase any shares under these programs during the nine months ended September 30, 2012. The Company may repurchase shares under these programs in future periods depending upon a variety of factors, including, among other things, stock price, share availability, and cash reserve 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 September 30, 2012, the Company had approximately \$410,376,000 in cash, cash equivalents, or 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.

**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, 2011.

**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 September 30, 2012 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 May 2008, the Company filed a complaint against MvTec Software GmbH, MvTec LLC, and Fuji America Corporation in the United States District Court for the District of Massachusetts alleging infringement of certain patents owned by the Company. In April 2009 and again in June 2009, Defendant MvTec Software GmbH filed re-examination requests of the patents-at-issue with the United States Patent and Trademark Office. This matter is ongoing.

In May 2009, the Company pre-filed a complaint with the United States International Trade Commission (ITC) pursuant to Section 337 of the Tariff Act of 1930, as amended, 19 U.S.C. §1337, against MvTec Software GmbH, MvTec LLC, Fuji America, and several other respondents alleging unfair methods of competition and unfair acts in the unlawful importation into the United States, sale for importation, or sale within the United States after importation. By this filing, the Company requested the ITC to investigate the Company's contention that certain machine vision software, machine vision systems, and products containing the same infringe, and respondents directly infringe and/or actively induce and/or contribute to the infringement in the United States, of one or more of the Company's U.S. patents. In July 2009, the ITC issued an order that it would institute an investigation based upon the Company's assertions. In September 2009, the Company reached a settlement with two of the respondents, and in December 2009, the Company reached a settlement with five additional respondents. In March 2010, the Company reached a settlement with respondent Fuji Machine Manufacturing Co., Ltd. and its subsidiary Fuji America Corporation. These settlements did not have a material impact on the Company's financial results. An ITC hearing was held in May 2010. In July 2010, the Administrative Law Judge issued an initial determination finding two of the Company's patents invalid and that respondents did not infringe the patents-at-issue. In September 2010, the ITC issued a notice that it would review the initial determination of the Administrative Law Judge's determination, and terminate the investigation with a finding of no violation of Section 337 of the Tariff Act of 1930 (as amended 19 U.S.C. §1337). The Company has filed an appeal of the decision with the United States Court of Appeals for the Federal Circuit. An oral hearing before the United States Court of Appeals occurred in February 2012. This matter is ongoing.

The Company cannot predict the outcome of the above-referenced pending matters and an adverse resolution of these lawsuits could have a material adverse effect on the Company's financial position, liquidity, results of operations, and/or indemnification obligations. In addition, 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. While we cannot predict the outcome of these incidental 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, 2011.



**Table of Contents****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 of<br>Shares<br>Purchased | Average<br>Price Paid<br>per<br>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 of<br>Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|--------------------------------|---|---------------------------------------|--|---|
| July 2 - July 29, 2012         |   |                                       |  | \$ 100,000,631  |
| July 30 - August 26, 2012      |   |                                       |  | \$ 100,000,631  |
| August 27 - September 30, 2012 |   |                                       |  | \$ 100,000,631  |
| Total                          |   |                                       |  | \$ 100,000,631  |

- (1) In April 2008, the Company's Board of Directors authorized the repurchase of up to \$50,000,000 of the Company's common stock. In November 2011, the Company's Board of Directors authorized the repurchase of up to an additional \$80,000,000 of the Company's common stock to commence once the Company completes the \$50,000,000 program noted above.

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**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

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 September 30, 2012, formatted in xBRL: (i) Consolidated Statements of Operations for the three-month and nine-month periods ended September 30, 2012 and October 2, 2011; (ii) Consolidated Statements of Comprehensive Income for the three-month and nine-month periods ended September 30, 2012 and October 2, 2011; (iii) Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011; (iv) Consolidated Statement of Shareholders' Equity for the nine-month period ended September 30, 2012; (v) Consolidated Condensed Statements of Cash Flows for the nine-month periods ended September 30, 2012 and October 2, 2011; and (vi) Notes to Consolidated Financial Statements.

\* Filed herewith

\*\* Furnished herewith

\*\*\* Pursuant to Rule 406T of Regulation S-T, the xBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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**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: October 29, 2012

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)