COGNEX CORP
Form 10-Q
November 01, 2011

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

(Mark One)

þ Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the quarterly period ended October 2, 2011 or

o Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the transition period from __________ to __________

Commission File Number 001-34218
COGNEX CORPORATION
(Exact name of registrant as specified in its charter)

Massachusetts	**04-2713778**
(State or other jurisdiction of incorporation or organization)	*(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 þ No o

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 þ No o

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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

Yes o No þ

As of October 2, 2011, there were 42,074,893 shares of Common Stock, $.002 par value, of the registrant outstanding.

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PART I: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

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

	Three-months Ended		Nine-months Ended	
	October 2, 2011	October 3, 2010	**October 2, 2011**	October 3, 2010
	(unaudited)		**(unaudited)**	
Revenue				
Product	**$ 74,165**	$ 69,288	**$ 220,608**	$ 190,968
Service	**5,920**	5,705	**17,264**	14,803
	80,085	74,993	**237,872**	205,771
Cost of revenue				
Product	**15,705**	15,537	**47,258**	44,362
Service	**3,248**	3,376	**9,457**	9,209
	18,953	18,913	**56,715**	53,571
Gross margin				
Product	**58,460**	53,751	**173,350**	146,606
Service	**2,672**	2,329	**7,807**	5,594
	61,132	56,080	**181,157**	152,200
Research, development, and engineering expenses	**10,608**	7,961	**30,596**	24,140
Selling, general, and administrative expenses	**28,135**	25,857	**86,762**	75,217
Restructuring charges		(13)		75
Operating income	**22,389**	22,275	**63,799**	52,768
Foreign currency gain (loss)	**(231)**	102	**(80)**	(71)
Investment income	**917**	384	**2,219**	949
Other expense	**(156)**	(129)	**(509)**	(531)
Income before income tax expense	**22,919**	22,632	**65,429**	53,115
Income tax expense	**4,882**	4,487	**14,659**	11,498
Net income	**$ 18,037**	$ 18,145	**$ 50,770**	$ 41,617

Earnings per weighted-average common and common-equivalent share:				
Basic	**$ 0.43**	$ 0.46	**$ 1.22**	$ 1.05
Diluted	**$ 0.42**	$ 0.45	**$ 1.19**	$ 1.05
Weighted-average common and common-equivalent shares outstanding:				
Basic	**42,128**	39,729	**41,765**	39,693
Diluted	**42,976**	39,917	**42,682**	39,792
Cash dividends per common share	**$ 0.09**	$ 0.06	**$ 0.26**	$ 0.17

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

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COGNEX CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands)

	October 2, 2011 (unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 30,175**	$ 33,203
Short-term investments	**142,409**	147,823
Accounts receivable, less reserves of $1,190 and $1,235 in 2011 and 2010, respectively	**45,827**	45,901
Inventories	**28,595**	22,717
Deferred income taxes	**6,498**	6,302
Prepaid expenses and other current assets	**20,835**	23,059
Total current assets	**274,339**	279,005
Long-term investments	**173,521**	102,055
Property, plant, and equipment, net	**30,869**	29,596
Deferred income taxes	**15,814**	15,555
Intangible assets, net	**19,969**	23,130
Goodwill	**82,277**	82,204
Other assets	**1,718**	1,559
	$ 598,507	$ 533,104
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	**$ 7,388**	$ 7,153
Accrued expenses	**30,296**	29,346
Accrued income taxes	**2,006**	7,771
Deferred revenue and customer deposits	**13,165**	10,162
Total current liabilities	**52,855**	54,432
Reserve for income taxes	**4,291**	5,361
Commitments and contingencies (Note 8)		
Shareholders equity:		

Common stock, $.002 par value Authorized: 140,000 shares, issued: 42,075 and 41,065 shares in 2011 and 2010, respectively		**84**		82
Additional paid-in capital		**129,845**		102,620
Retained earnings		**419,699**		379,826
Accumulated other comprehensive loss, net of tax		**(8,267)**		(9,217)
Total shareholders equity		**541,361**		473,311
	$	**598,507**	$	533,104

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

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COGNEX CORPORATION
CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME
(In thousands)

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive	Comprehensive	Total Shareholders
	Shares	Par Value	Capital	Earnings	Loss	Income	Equity
Balance as of December 31, 2010	41,065	$ 82	$ 102,620	$ 379,826	$ (9,217)		$ 473,311
Issuance of common stock under stock option plans	1,347	3	27,834				27,837
Stock-based compensation expense			5,829				5,829
Excess tax benefit from stock option exercises			3,624				3,624
Reduction of tax benefit for research and development credits as a result of stock option accounting			(63)				(63)
Repurchase of common stock	(337)	(1)	(9,999)				(10,000)
Payment of dividends				(10,897)			(10,897)
Comprehensive income:							
Net income				50,770		$ 50,770	50,770
Net unrealized gain on available-for-sale investments, net of tax of $62					48	48	48
Foreign currency translation adjustment, net of tax of $26					902	902	902
Comprehensive income						**$ 51,720**	
Balance as of October 2, 2011 (unaudited)	**42,075**	**$ 84**	**$ 129,845**	**$ 419,699**	**$ (8,267)**		**$ 541,361**

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

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COGNEX CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)

	Nine-months Ended	
	October 2, 2011	October 3, 2010
	(unaudited)	
Cash flows from operating activities:		
Net income	**$ 50,770**	$ 41,617
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation expense	**5,829**	1,672
Depreciation of property, plant, and equipment	**4,082**	3,441
Amortization of intangible assets	**3,181**	3,788
Amortization of premiums/discounts on investments	**4,675**	1,972
Tax effect of stock option exercises	**(3,624)**	(81)
Change in deferred income taxes	**(359)**	(2,397)
Change in operating assets and liabilities	**(2,184)**	(3,264)
Net cash provided by operating activities	**62,370**	46,748
Cash flows from investing activities:		
Purchases of investments	**(288,045)**	(178,080)
Maturities and sale of investments	**217,495**	58,676
Purchases of property, plant, and equipment	**(5,545)**	(3,307)
Cash received related to disposition		315
Net cash used in investing activities	**(76,095)**	(122,396)
Cash flows from financing activities:		
Issuance of common stock under stock option plans	**27,837**	7,324
Stock option buyback		(83)
Repurchase of common stock	**(10,000)**	
Payment of dividends	**(10,897)**	(6,747)
Tax effect of stock option exercises	**3,624**	81
Net cash provided by financing activities	**10,564**	575
Effect of foreign exchange rate changes on cash	**133**	(6,545)
Net decrease in cash and cash equivalents	**(3,028)**	(81,618)
Cash and cash equivalents at beginning of period	**33,203**	119,831
Cash and cash equivalents at end of period	**$ 30,175**	$ 38,213

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

COGNEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1: Summary of Significant Accounting Policies

As permitted by the rules of the Securities and Exchange Commission applicable to Quarterly Reports on Form 10-Q, these notes are condensed and do not contain all disclosures required by generally accepted accounting principles (GAAP). Reference should be made to the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

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 necessary to present fairly the Company s financial position as of October 2, 2011, and the results of its operations for the three-month and nine-month periods ended October 2, 2011 and October 3, 2010, and changes in shareholders equity and cash flows for the periods presented.

The results disclosed in the Consolidated Statements of Operations for the three-month and nine-month periods ended October 2, 2011 are not necessarily indicative of the results to be expected for the full year.

NOTE 2: New Pronouncements

Accounting Standards Update (ASU) 2011-04, Fair Value Measurements: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs

The amendments in this ASU change certain aspects of the fair value measurement guidance in Accounting Standards Codification (ASC) 820, Fair Value Measurement in order to make U.S. GAAP and international standards more consistent. These changes include the application of the concepts of highest and best use and valuation premise, introduction of an option to measure groups of offsetting assets and liabilities on a net basis, incorporation of certain premiums and discounts in fair value measurements, and measurement of the fair value of certain instruments classified in shareholders equity. In addition, the amended guidance includes new fair value disclosure requirements, including, among other things, information about valuation techniques and unobservable inputs used in Level 3 fair value measurements and a narrative description of Level 3 measurements sensitivity to changes in unobservable inputs. ASU 2011-04 must be applied prospectively and is effective for the first quarter of 2012. Management is in the process of evaluating the impact of this ASU.

Accounting Standards Update (ASU) 2011-05, Comprehensive Income

The amendments in this ASU revise the manner in which companies present comprehensive income in their financial statements in order to make U.S. GAAP and international standards more consistent. This ASU requires companies to report the components of comprehensive income in either a continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement would present the components of net income, similar to the Company s current Consolidated Statements of Operations, while the second statement would include the components of other comprehensive income (OCI), as well as a cumulative total for comprehensive income. This ASU does not change the items that must be reported in OCI. ASU 2011-05 must be applied retrospectively. On October 21, 2011, the Financial Accounting Standards Board (FASB) proposed a deferral of the requirement to present reclassifications of OCI on the face of the income statement. Management is awaiting the FASB s final decision and will evaluate the impact of this ASU at that time.

Accounting Standards Update (ASU) 2011-08, Testing Goodwill For Impairment

In the third quarter of 2011, the Financial Accounting Standards Board (FASB) issued an ASU aimed at simplifying entities annual goodwill impairment test. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011; however, early adoption is allowed. Management has elected to adopt this standard early and will apply the provisions of this ASU to its 2011 annual analysis of goodwill.

COGNEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 3: Fair Value Measurements

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

The following table summarizes the financial assets and liabilities measured at fair value on a recurring basis as of October 2, 2011 (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets:		
Money market instruments	$ 2,137	$
Municipal bonds		120,209
Corporate bonds		125,329
Agency bonds		45,170
Sovereign bonds		12,971
Covered bonds		6,318
Currency forward contracts	13	
Liabilities:		
Currency forward contracts	370	

The majority of the Company s investments 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. These investments are priced daily by a large, third-party pricing service. The 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 current day s valuations. The Company s money market instruments are reported at fair value based upon the daily market price for identical assets in active markets, and are therefore classified as Level 1. The Company did not record an other-than-temporary impairment of investments in the nine-month period ended October 2, 2011. Further discussion of management s analysis related to an other-than-temporary impairment is included in Note 4.

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

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 measured at fair value on a non-recurring basis. The fair value of the Company s limited partnership interest is based upon 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 amount determined to be fair value also incorporates the General Partner s own judgment and close familiarity with the business activities of each portfolio company. Management monitors the carrying value of this investment compared to its fair value to determine if an other-than-temporary impairment has occurred. If a decline in fair value is considered to be other-than-temporary, an

impairment charge would be recorded to reduce the carrying value of the asset to its fair value. 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 in the nine-month period ended October 2, 2011 as there was no indication of impairment during this period.

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COGNEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 measured at fair value only when an impairment loss is recognized. The Company did not record an impairment charge related to these assets during the nine-month period ended October 2, 2011.

NOTE 4: Cash, Cash Equivalents, and Investments

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

	October 2, 2011	December 31, 2010
Cash	**$ 28,038**	$ 26,650
Money market instruments	**2,137**	6,553
Cash and cash equivalents	**30,175**	33,203
Treasury bills		2,494
Municipal bonds	**49,626**	75,457
Corporate bonds	**60,123**	34,543
Agency bonds	**31,276**	15,979
Sovereign bonds		19,350
Covered bonds	**1,384**	
Short-term investments	**142,409**	147,823
Municipal bonds	**70,583**	34,794
Corporate bonds	**65,206**	36,762
Agency bonds	**13,894**	21,025
Sovereign bonds	**12,971**	
Covered bonds	**4,934**	3,541
Limited partnership interest (accounted for using cost method)	**5,933**	5,933
Long-term investments	**173,521**	102,055
	$ 346,105	$ 283,081

The Company s portfolio consists of treasury bills, municipal bonds, corporate bonds, agency bonds, sovereign bonds, and covered bonds. Treasury bills consist of debt securities issued by the U.S. government; municipal bonds consist of debt securities issued by state and local government entities; corporate bonds consist of debt securities issued by both international and domestic companies; agency bonds consist of domestic or foreign obligations of government agencies and government sponsored enterprises that have government backing; sovereign bonds consist of direct debt issued by international governments (Germany as of October 2, 2011); and covered bonds consist of debt securities backed by governments, mortgages, or public sector loans.

The following table summarizes the Company s available-for-sale investments as of October 2, 2011 (in thousands):

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COGNEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term:				
Municipal bonds	$ 49,575	$ 57	$ (6)	$ 49,626
Corporate bonds	60,879	9	(765)	60,123
Agency bonds	31,289	15	(28)	31,276
Covered bonds	1,384			1,384
Long-term:				
Municipal bonds	70,413	227	(57)	70,583
Corporate bonds	65,143	162	(99)	65,206
Agency bonds	13,878	27	(11)	13,894
Sovereign bonds	12,768	203		12,971
Covered bonds	4,919	15		4,934
	$ 310,248	**$ 715**	**$ (966)**	**$ 309,997**

The following tables summarize the Company s gross unrealized losses and fair value for available-for-sale investments in an unrealized loss position as of October 2, 2011, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position (in thousands):

	Unrealized Loss Position For:					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Municipal bonds	$ 31,230	$ (62)	$ 704	$ (1)	$ 31,934	$ (63)
Corporate bonds	56,169	(839)	18,630	(25)	74,799	(864)
Agency bonds	19,663	(30)	8,608	(9)	28,271	(39)
	$ 107,062	**$ (931)**	**$ 27,942**	**$ (35)**	**$ 135,004**	**$ (966)**

As of October 2, 2011, the Company did not identify an other-than-temporary impairment on these investments. In its evaluation, management considered the types of securities, the credit rating of the securities, the length of time the securities have been in a loss position, the size of the loss position, our intent and ability to hold the securities 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 securities before its effective maturity or market price recovery. The Company recorded gross realized gains and gross realized losses on the sale of debt securities totaling $47,000 and $28,000, respectively, in the three-month period ended October 2, 2011, and $78,000 and $45,000, respectively, in the nine-month period ending October 2, 2011.
The following table presents the effective maturity dates of the Company s available-for-sale investments as of October 2, 2011 (in thousands):

	<1 Year	1-2 Years	2-3 Years	3-4 Years	4-5 Years	Total

Municipal bonds	$ 49,626	$ 27,175	$ 19,999	$ 14,585	$ 8,824	$ 120,209
Corporate bonds	60,123	36,032	24,312	1,221	3,641	125,329
Agency bonds	31,276	11,499	2,395			45,170
Sovereign bonds		4,220	6,986		1,765	12,971
Covered bonds	1,384	4,934				6,318
	$ 142,409	**$ 83,860**	**$ 53,692**	**$ 15,806**	**$ 14,230**	**$ 309,997**

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 October 2, 2011, 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 are received and contributions are requested at the discretion of Venrock s management. No contributions were made and no distributions were received during the nine-month period in 2011.

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COGNEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 5: Inventories

Inventories consisted of the following (in thousands):

	October 2, 2011	December 31, 2010
Raw materials	**$ 18,902**	$ 14,791
Work-in-process	**3,212**	2,051
Finished goods	**6,481**	5,875
	$ 28,595	$ 22,717

NOTE 6: Intangible Assets and Goodwill

The change in the carrying value of goodwill during the nine-month period ended October 2, 2011 ($73,000) is wholly attributable to fluctuations in foreign currency exchange rates, as a portion of this asset is recorded on the books of the Company s Irish subsidiary.

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 October 2, 2011 that would indicate a potential impairment of goodwill or other intangible assets. However, the Company continues to monitor market conditions, and changes in market conditions could result in an impairment of goodwill or other intangible assets in a future period.

NOTE 7: Warranty Obligations

The Company warrants its hardware products to be free from defects in material and workmanship for periods primarily ranging from six months to two years from the time of sale based upon the product being purchased and the terms of the customer arrangement. Warranty obligations are evaluated and recorded at the time of sale since it is probable that customers will make claims under warranties related to products that have been sold and the amount of these claims can be reasonably estimated 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. 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, 2010	$ 1,985
Provisions for warranties issued during the period	1,342
Fulfillment of warranty obligations	(1,236)
Foreign exchange rate changes	19
Balance as of October 2, 2011	**$ 2,110**

NOTE 8: 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.

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COGNEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 Commission 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. 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 9: 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

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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 10: 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 does not currently manage its interest rate risk with derivative instruments; however, foreign currency exchange rate risk is currently mitigated with derivative instruments. The Company 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.

These forward contracts do not qualify for hedge accounting. Both the underlying exposure and the forward contracts are recorded at fair value on the Consolidated Balance Sheets and changes in fair value are reported as Foreign currency gain (loss) on the Consolidated Statements of Operations. The Company recorded a net foreign currency loss of $231,000 in the three-month period ended October 2, 2011 and a net foreign currency gain of $102,000 in the three-month period ended October 3, 2010. The Company recorded net foreign currency losses of $80,000 and $71,000 in the nine-month periods ended October 2, 2011 and October 3, 2010, respectively.

As of October 2, 2011, the Company had the following outstanding forward contracts that were entered into to mitigate foreign currency exchange rate risk:

Currency	**Amount**
Japanese Yen/Euro	350,000,000 Japanese Yen
U.S. Dollar/Euro	11,310,000 U.S. Dollars

Information regarding the fair value of the forward contracts outstanding as of October 2, 2011 and December 31, 2010 was as follows (in thousands):

	Asset Derivatives			**Liability Derivatives**		
	Balance Sheet Location	**Fair Value**		**Balance Sheet Location**	**Fair Value**	
		October 2, 2011	December 31, 2010		**October 2, 2011**	December 31, 2010
Currency forward contracts	Prepaid expenses and other current assets	**$13**	$ 83	Accrued expenses	**$370**	$ 125

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 October 2, 2011 and October 3, 2010 were as follows (in thousands):

Location of Loss Recognized in Income on Derivatives	**Amount of Loss Recognized in Income on Derivatives Three-months ended**		**Location of Gain (Loss) Recognized in Income on Derivatives**	**Amount of Gain (Loss) Recognized in Income on Derivatives Nine-months ended**	
	October 2, 2011	October 3, 2010		**October 2, 2011**	October 3, 2010

Currency forward contracts	Foreign currency loss	**$ (171)**	$ (88)	Foreign currency loss	**$ (43)**	$ 185

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NOTE 11: Stock-Based Compensation Expense

The Company s share-based payments that result in compensation expense consist solely of stock option grants. As of October 2, 2011, the Company had 7,013,112 shares available for grant under two stock option plans: the 2001 General Stock Option Plan (5,519,627) and the 2007 Stock Option and Incentive Plan (1,493,485). Each of these plans expires ten years from the date the plan was approved. The 2001 General Stock Option Plan will expire in December of 2011, unless the Company s shareholders approve an amendment and restatement of the plan which would extend the plan until September of 2021. Generally, stock options are granted with an exercise price equal to the market value of the Company s common stock at the grant date, vest over four years based upon continuous service, and expire ten years from the grant date.

The following table summarizes the Company s stock option activity for the nine-month period ended October 2, 2011:

	Shares (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2010	4,318	$ 20.05		
Granted	986	30.43		
Exercised	(1,351)	20.70		
Forfeited or expired	(67)	21.96		
Outstanding as of October 2, 2011	**3,886**	**$ 22.46**	**7.2**	**$ 21,850**
Exercisable as of October 2, 2011	**1,305**	**$ 20.39**	**4.9**	**$ 8,989**

The fair values of stock options granted in each period presented were estimated using the following weighted-average assumptions:

	Three-months Ended		**Nine-months Ended**	
	October 2, 2011	October 3, 2010	**October 2, 2011**	October 3, 2010
Risk-free rate	**3.6%**	3.2%	**3.6%**	3.4%
Expected dividend yield	**1.0%**	1.4%	**1.0%**	1.3%
Expected volatility	**42%**	44%	**42%**	44%
Expected term (in years)	**5.2**	5.3	**5.4**	5.3

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.

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 October 2, 2011 and October 3, 2010 were $11.89 and $6.89, respectively. The weighted-average grant-

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date fair values of stock options granted during the nine-month periods ended October 2, 2011 and October 3, 2010 were $11.78 and $7.10, 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 66% of its stock options granted to senior management and 68% of its options granted to all other employees will actually vest. Therefore, the Company currently applies an estimated forfeiture rate of 13% to all unvested options for senior management and a rate of 14% for all other employees. The Company revised its estimated forfeiture rates in the first quarter of 2011, and the cumulative effect of this change resulted in a reduction in compensation expense of approximately $80,000.

The total stock-based compensation expense and the related income tax benefit recognized for the three-month period ended October 2, 2011 were $1,520,000 and $502,000, respectively, and for the three-month period ended October 3, 2010 were $1,278,000 and $421,000, respectively. The total stock-based compensation expense and the related income tax benefit recognized for the nine-month period ended October 2, 2011 were $5,829,000 and $1,947,000, respectively, and for the nine-month period ended October 3, 2010 were $1,672,000 and $552,000, respectively. No compensation expense was capitalized as of October 2, 2011 or December 31, 2010.

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

	Three-months Ended		**Nine-months Ended**	
	October 2, 2011	October 3, 2010	**October 2, 2011**	October 3, 2010
Product cost of revenue	**$ 80**	$ 63	**$ 350**	$ 135
Service cost of revenue	**27**	32	**136**	44
Research, development, and engineering	**394**	346	**1,732**	680
Selling, general, and administrative	**1,019**	837	**3,611**	813
	$ 1,520	$ 1,278	**$ 5,829**	$ 1,672

The total intrinsic values of stock options exercised for the three-month periods ended October 2, 2011 and October 3, 2010 were $5,254,000 and $2,004,000, respectively. The total intrinsic values of stock options exercised for the nine-month periods ended October 2, 2011 and October 3, 2010 were $17,808,000 and $2,055,000, respectively.

The total fair values of stock options vested for the three-month periods ended October 2, 2011 and October 3, 2010 were $469,000 and $557,000, respectively. The total fair values of stock options vested for the nine-month periods ended October 2, 2011 and October 3, 2010 were $9,846,000 and $12,790,000, respectively. As of October 2, 2011, total unrecognized compensation expense related to non-vested stock options was $8,789,000, which is expected to be recognized over a weighted-average period of 1.6 years.

NOTE 12: Stock Repurchase Program

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 October 2, 2011, the Company had repurchased a total of 1,375,875 shares at a cost of $30,000,000 under this program, including 337,078 shares at a cost of $10,000,000 during the third quarter of 2011. The Company may repurchase shares under this program in future periods depending upon a variety of factors, including, among other things, stock price levels, share availability, and cash reserve requirements.

NOTE 13: Taxes

A reconciliation of the United States federal statutory corporate tax rate to the Company s effective tax rate was as follows:

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	Three-months Ended		Nine-months Ended	
	October 2, 2011	October 3, 2010	**October 2, 2011**	October 3, 2010
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	**(13)**	(13)	**(13)**	(13)
Discrete tax events	**(2)**	(3)	**(1)**	(1)
Other				
Income tax provision	**21%**	20%	**22%**	22%

The Company s effective tax rates were provisions of 21% and 22% for the three-month and nine-month periods ended in 2011, respectively, compared to provisions of 20% and 22% for the same periods in 2010.

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 the 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 credits may be utilized in a future period and would be reversed if appropriate at that time. 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.

The Company s effective tax rate for the third quarter of 2010 included a decrease in tax expense of $462,000 due to the settlement of the Competent Authority tax case with Japan, a decrease in tax expense of $151,000 for the final true-up of the prior year s tax accrual upon filing the actual tax returns, and a decrease in tax expense of $105,000 upon the expiration of statutes of limitations for certain reserves for income tax uncertainties. These discrete tax events decreased the effective tax rate from a provision of 23% to a provision of 20% for the three-month period in 2010 and decreased the effective tax rate from a provision of 23% to a provision of 22% for the nine-month period in 2010. Excluding these discrete tax events, the Company s effective tax rate remained a provision of 23% of the Company s pretax income for both 2011 and 2010.

During the nine-month period ended October 2, 2011, excluding the impact of discrete events, the Company recorded a $478,000 increase in liabilities, net of deferred tax benefit, for uncertain tax positions that were recorded as income tax expense, of which $179,000 was recorded in the three-month period ended October 2, 2011. Estimated interest and penalties included in these amounts totaled $61,000 for the nine-month period ended October 2, 2011, of which $20,000 was recorded in the three-month period ended October 2, 2011.

The Company s reserve for income taxes, including gross interest and penalties of $1,158,000, was $4,849,000 as of October 2, 2011, of which $558,000 are classified as current and $4,291,000 are classified as non-current. 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 $147,000 that would be recorded through 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 $250,000 to $500,000 over the next twelve months.

The Company has defined its major tax jurisdictions as the United States, Ireland, and Japan, and within the United States, Massachusetts and California. The tax years 2007 through 2010 remain open to examination by various taxing

authorities in the jurisdictions in which the Company operates.

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NOTE 14: Weighted-Average Shares

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

	Three-months Ended		Nine-months Ended	
	October 2, 2011	October 3, 2010	**October 2, 2011**	October 3, 2010
Basic weighted-average common shares outstanding	**42,128**	39,729	**41,765**	39,693
Effect of dilutive stock options	**848**	188	**917**	99
Weighted-average common and common-equivalent shares outstanding	**42,976**	39,917	**42,682**	39,792

Stock options to purchase 1,007,991 and 821,035 shares of common stock, on a weighted-average basis, were outstanding during the three-month and nine-month periods ended October 2, 2011, respectively, and 3,665,742 and 3,441,414 for the same periods in 2010, but were not included in the calculation of dilutive net income per share because they were anti-dilutive.

NOTE 15: 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, papers, non-wovens, plastics, and glass, to ensure there are no flaws or defects on the surfaces. Segments are determined based upon the way that senior 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 Company s segments (in thousands):

Three-months Ended October 2, 2011	**MVSD**	**SISD**	**Reconciling Items**	**Consolidated**
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 October 2, 2011	**MVSD**	**SISD**	**Reconciling Items**	**Consolidated**
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

Three-months Ended October 3, 2010	**MVSD**	**SISD**	**Reconciling Items**	**Consolidated**
Product revenue	$61,454	$7,834	$	$69,288
Service revenue	1,618	4,087		5,705
Operating income	24,651	2,290	(4,666)	22,275

Nine-months Ended October 3, 2010	**MVSD**	**SISD**	**Reconciling Items**	**Consolidated**
Product revenue	$170,459	$20,509	$	$190,968
Service revenue	4,768	10,035		14,803
Operating income	63,035	3,292	(13,559)	52,768

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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 divisions share assets and resources in a number of locations around the world.

NOTE 16: Subsequent Events

On November 1, 2011, the Company s Board of Directors declared a cash dividend of $0.10 per share. The dividend is payable on December 16, 2011 to all shareholders of record at the close of business on December 2, 2011.

In addition, on November 1, 2011, the Company s Board of Directors authorized the repurchase of up to $80,000,000 of Cognex common stock in open market transactions to help reduce share dilution associated with equity incentive plans. This new authorization will commence once the Company completes the existing $50,000,000 repurchase program, of which approximately $20,000,000 remains available.

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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, could, should, and similar words and other statements of a similar sense. These statements are based upon our current estimates and expectations as to prospective events and circumstances, which may or may not be in our control and as to which there can be no firm assurances given. These forward-looking statements, which include statements regarding business and market trends, future financial performance, customer order rates, and growth 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 cyclicality 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; and (18) exposure to additional tax liabilities. 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, 2010, as well as Part II- Item 1A of this report. 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 manufacturing 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 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 segment includes a broad base of customers across a variety of industries, including automotive, consumer electronics, food and beverage, health and beauty, medical devices, packaging, pharmaceutical, 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 approximately 74% of total revenue in the third quarter of 2011.

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Semiconductor and electronics capital equipment manufacturers 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 approximately 11% of total revenue in the third quarter of 2011.

Surface inspection customers are manufacturers of materials processed in a continuous fashion, such as metals, paper, non-wovens, plastics, and glass. These customers need sophisticated machine vision to detect and classify defects on the surfaces of those materials as they are being processed at high speeds. Surface inspection sales represented approximately 15% of total revenue in the third quarter of 2011.

Revenue for the third quarter of 2011 totaled $80,085,000, representing a 7% increase from the third quarter of 2010. Gross margin was 76% of revenue in the third quarter of 2011, compared to 75% of revenue in the same period of 2010. Operating expenses increased by $4,938,000 over the prior year s third quarter due primarily to expenses associated with increased headcount in strategic areas and the unfavorable impact of changes in foreign currency exchange rates. The Company generated an operating profit of $22,389,000, or 28% of revenue, in the third quarter of 2011, compared to an operating profit of $22,275,000, or 30% of revenue, in the third quarter of 2010.

Results of Operations

Revenue

Revenue increased by $5,092,000, or 7%, over the equivalent three-month period in 2010 and increased by $32,101,000, or 16%, over the equivalent nine-month period in 2010. Increases in both periods were primarily due to higher sales to customers in the factory automation market.

Factory Automation

Sales to manufacturing customers in the factory automation area, which are included in the Company s MVSD segment, represented 74% and 73% of total revenue for the three-month and nine-month periods in 2011, respectively, compared to 65% and 68% for the same periods in 2010. Sales to these customers increased by $10,858,000, or 22%, for the three-month period and increased by $33,244,000, or 24%, for the nine-month period. A weaker U.S. Dollar in 2011 compared to the prior year contributed to the higher revenue, as sales denominated in foreign currencies were translated to U.S. Dollars. Excluding the impact of foreign exchange rate changes on revenue, sales to factory automation customers increased by $7,704,000, or 16%, for the three-month period and increased by $27,369,000, or 20%, for the nine-month period. The largest dollar increases were experienced in the Americas and Europe, where the Company has a broad base of factory automation customers, and the largest percentage increase was experienced in Asia, where the Company has expanded its sales and support infrastructure, particularly in China, in order to access more of the machine vision market in this high-potential growth region. Revenue in Japan was lower for both the three-month and nine-month periods as business levels in 2011 have been negatively impacted by the earthquake that hit this region earlier in the year, as well as lower demand from electronics customers.

On a sequential basis, sales to factory automation customers decreased by $2,237,000, or 4%, from the second quarter of 2011. The Company typically experiences a sequential revenue decline in the third quarter due to lower demand during the summer months, particularly in Europe. However, this third quarter, sales to factory automation customers in Europe and the Americas were relatively flat from the second quarter. The sequential decrease came from a decline in factory automation revenue in Asia and Japan, primarily from customers that serve the electronics industry. We expect revenue for the factory automation market to increase for the fourth quarter compared to the third quarter of 2011.

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Semiconductor and Electronics Capital Equipment

Sales to customers who make automation equipment for the semiconductor and electronics industries, which are included in the Company s MVSD segment, represented 11% and 14% of total revenue for the three-month and nine-month periods in 2011, respectively, compared to 19% and 17% for the same periods in 2010. Sales to these customers decreased by $5,755,000, or 39%, for the three-month period and decreased by $2,734,000, or 8%, for the nine-month period. Revenue for this market has declined sequentially in each quarter of 2011. 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

Sales to surface inspection customers, which comprise the Company s SISD segment, represented 15% and 13% of total revenue for the three-month and nine-month periods in 2011, respectively, compared to 16% and 15% for the same periods in 2010. Revenue from these customers was relatively flat for the three-month period and increased by $1,591,000, or 5%, for the nine-month period due to higher service revenue from customer installations, training, and support. The revenue reported each quarter can vary depending upon the timing of customer orders, system deliveries, and installations, as well as the impact of revenue deferrals.

Product Revenue

Product revenue increased by $4,877,000, or 7%, for the three-month period and increased by $29,640,000, or 16%, for the nine-month period due primarily to a higher volume of vision systems sold to customers in the factory automation market. The impact of the higher volume was partially offset by lower MVSD average selling prices, as the Company introduced new products at lower price points.

Service Revenue

Service revenue, which is derived from the sale of maintenance and support, training, consulting, and installation services, increased by $215,000, or 4%, for the three-month period and $2,461,000, or 17%, for the nine-month period due to higher revenue from MVSD consulting services. In the nine-month period, this increase was also attributed to higher revenue from SISD installation, training, and support services. Service revenue was relatively consistent as a percentage of total revenue at 7% for both the three-month and nine-month periods in 2011, as compared to 8% and 7% for the same periods in 2010.

Gross Margin

Gross margin as a percentage of revenue was 76% for both the three-month and nine-month periods in 2011, respectively, compared to 75% and 74% for the same periods in 2010. This increase was primarily due to higher SISD margins, as well as a greater percentage of total revenue from the sale of modular vision systems, which have higher margins than the sale of surface inspection systems. In the nine-month period, this increase was also attributed to higher MVSD margins.

MVSD Margin

MVSD gross margin as a percentage of revenue was 80% for both the three-month and nine-month periods in 2011, respectively, compared to 80% and 79% for the same periods in 2010. The increase in MVSD margin for the nine-month period was primarily due to certain manufacturing efficiencies achieved from higher revenue levels, as fixed manufacturing costs were spread over a higher revenue base.

SISD Margin

SISD gross margin as a percentage of revenue was 53% and 51% for the three-month and nine-month periods in 2011, respectively, compared to 46% and 44% for the same periods in 2010. The increase in SISD margin was due to improved product margins resulting from low-cost sourcing initiatives and higher average selling prices, as well as improved installation service margins.

Product Margin

Product gross margin as a percentage of revenue was 79% for both the three-month and nine-month periods in 2011, respectively, compared to 78% and 77% for the same periods in 2010. This increase was primarily due to higher SISD product margins as described above, as well as a higher percentage of total revenue from the sale of modular vision systems, which have higher margins than the sale of surface inspection systems. In the nine-month period, this increase was also attributed to higher MVSD product margins as described above.

Service Margin

Service gross margin as a percentage of revenue was 45% for both the three-month and nine-month periods in 2011, respectively, compared to 41% and 38% for the same periods in 2010. This increase was primarily due to improved margins from SISD installation services.

Operating Expenses

Research, Development, and Engineering Expenses

Research, development, and engineering (RD&E) expenses increased by $2,647,000, or 33%, over the equivalent three-month period in 2010 and increased by $6,456,000, or 27%, over the equivalent nine-month period in 2010. MVSD RD&E expenses increased by $2,531,000, or 35%, for the three-month period and increased by $6,563,000, or 30%, for the nine-month period, while SISD RD&E expenses increased by $116,000, or 16%, for the three-month period and decreased by $107,000, or 4%, for the nine-month period.

The table below details the $2,531,000 and $6,563,000 net increase in MVSD RD&E for the three-month and nine-month periods, respectively:

	Three-Month Period	Nine-Month Period
MVSD RD&E expenses in 2010	$ 7,216	$ 21,610
Personnel-related costs	1,104	3,258
Stock-based compensation expense	52	1,052
Outsourced engineering services	352	601
Foreign currency exchange rate changes	339	488
Patent-related costs	124	367
Company bonus accruals	241	319
Other	319	478
MVSD RD&E expenses in 2011	**$ 9,747**	**$ 28,173**

Over the past year, the Company has increased RD&E headcount in strategic areas, resulting in higher personnel-related costs. The Company also recorded increased stock-based compensation expense due to a higher valuation of stock options granted in the first quarter of 2011, higher costs from outsourced engineering services, higher costs to patent new technology, and increased company bonus accruals. In addition, a weaker U.S. Dollar in 2011 compared to the prior year resulted in higher RD&E costs when expenses of the Company s foreign operations were translated to U.S. Dollars.

The increase in SISD RD&E expenses for the three-month period was due to both increased company bonus accruals ($64,000) and higher costs from outsourced engineering services ($57,000). The decrease in SISD RD&E expenses for the nine-month period was primarily due to a change in personnel mix, resulting in lower personnel-related costs ($144,000).

RD&E expenses as a percentage of revenue were 13% for both the three-month and nine-month periods in 2011 compared to 11% and 12% for the same periods in 2010. 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, and therefore, we expect to continue to make RD&E investments in the future in strategic areas, such as the ID products business. In addition, we consider our ability to accelerate time to market for new products to be critical to our revenue growth. Although we target our RD&E spending to be between 10% and 15% of

revenue, this percentage is impacted by revenue levels.

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Selling, General, and Administrative Expenses

Selling, general, and administrative (SG&A) expenses increased by $2,278,000, or 9%, over the equivalent three-month period in 2010 and increased by $11,545,000, or 15%, over the equivalent nine-month period in 2010. MVSD SG&A expenses increased by $3,126,000, or 16%, for the three-month period and increased by $13,759,000, or 25%, for the nine-month period, while SISD SG&A expenses increased by $108,000, or 4%, for the three-month period and increased by $474,000, or 6%, for the nine-month period. Corporate expenses that are not allocated to either division decreased by $956,000, or 25%, for the three-month period and decreased by $2,688,000, or 21%, for the nine-month period.

The table below details the $3,126,000 and $13,759,000 net increase in MVSD SG&A for the three-month and nine-month periods, respectively:

	Three-Month Period	Nine-Month Period
MVSD SG&A expenses in 2010	$ 19,496	$ 54,697
Personnel-related costs	2,842	7,912
Foreign currency exchange rate changes	1,555	3,371
Stock-based compensation expense	197	1,803
Marketing and promotional expenses	358	1,741
Sales commissions	(1,783)	(2,615)
Other	(43)	1,547
MVSD SG&A expenses in 2011	**$ 22,622**	**$ 68,456**

Over the past year, the Company has increased SG&A headcount in strategic areas, resulting in higher personnel-related costs, such as salaries, fringe benefits, commissions, and travel expenses. The Company also recorded increased stock-based compensation expense due to a higher valuation of stock options granted in the first quarter of 2011, higher spending on marketing and promotional activities intended to grow factory automation revenue, and the unfavorable impact of changes in foreign currency exchange rates. Offsetting these increases was lower sales commissions, as fewer sales employees are exceeding their bookings quotas compared to the prior year.

The increase in SISD SG&A expense was primarily due to the unfavorable impact of changes in foreign currency exchange rates ($143,000 for the three-month period and $318,000 for the nine-month period).

The decrease in corporate expenses was due to lower legal fees primarily related to patent infringement actions ($861,000 for the three-month period and $3,568,000 for the nine-month period). In the nine-month period, these savings were partially offset by increased stock-based compensation expense due to a higher valuation of stock options ($876,000).

Nonoperating Income (Expense)

The Company recorded foreign currency losses of $231,000 and $80,000 for the three-month and nine-month periods in 2011, respectively, compared to a gain of $102,000 and a loss of $71,000 for the same periods in 2010. The foreign currency gains and losses in each period resulted primarily from the revaluation and settlement of accounts receivable and intercompany balances that are reported in one currency and collected in another. Although the foreign currency exposure of accounts receivable is largely 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 increased by $533,000, or 139%, and $1,270,000, or 134%, for the three-month and nine-month periods, respectively. For the three-month period, the increase was primarily due to improving yields on the Company s portfolio of debt securities. For the nine-month period, the increase was due to improving yields, as well as an increase in funds available for investment.

The Company recorded other expense of $156,000 and $509,000 for the three-month and nine-month periods in 2011, respectively, compared to expense of $129,000 and $531,000 for the same periods in 2010. Other income

(expense) 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 21% and 22% for the three-month and nine-month periods in 2011, respectively, compared to provisions of 20% and 22% for the same periods in 2010.

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 credits may be utilized in a future period and would be reversed if appropriate at that time. 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.

The Company s effective tax rate for the third quarter of 2010 included a decrease in tax expense of $462,000 due to the settlement of the Competent Authority tax case with Japan, a decrease in tax expense of $151,000 for the final true-up of the prior year s tax accrual upon filing the actual tax returns, and a decrease in tax expense of $105,000 upon the expiration of statutes of limitations for certain reserves for income tax uncertainties. These discrete tax events decreased the effective tax rate from a provision of 23% to a provision of 20% for the three-month period in 2010 and decreased the effective tax rate from a provision of 23% to a provision of 22% for the nine-month period in 2010. Excluding these discrete tax events, the Company s effective tax rate remained a provision of 23% of the Company s pretax income for both 2011 and 2010.

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 $346,105,000 as of October 2, 2011. 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-month period in 2011 were met with its existing cash balances, cash from investment maturities, positive cash flows from operations, and proceeds from stock option exercises. Cash requirements primarily consisted of operating activities, purchases of investments, the payment of dividends, the repurchase of common stock, and capital expenditures. Capital expenditures for the nine-month period in 2011 totaled $5,545,000 and consisted primarily of expenditures for computer hardware, computer software, and manufacturing test equipment for new product introductions.

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 October 2, 2011, the Company had contributed $19,886,000 to the partnership. No contributions were made and no distributions were received during the nine-month period in 2011. The remaining commitment of $614,000 can be called by Venrock in any period through December 31, 2013.

Beginning in the third quarter of 2003, the Company s Board of Directors has declared and paid a cash dividend in each quarter, including dividends of $0.08 per share in the first quarter of 2011 and $0.09 per share in both the second and third quarters of 2011 that amounted to $10,897,000 for the nine-month period in 2011. On November 1, 2011, the Company s Board of Directors declared a cash dividend of $0.10 per share payable in the fourth quarter of 2011. 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.

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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, primarily as a means to reduce the dilutive effect of employee stock options. As of October 2, 2011, the Company had repurchased 1,375,875 shares at a cost of $30,000,000 under this program. The Company purchased 337,078 shares at a cost of $10,000,000 during the third quarter of 2011. The Company did not purchase any shares under this program during the first half of 2011. The Company may repurchase shares under this program in future periods depending upon a variety of factors, including, among other things, stock price levels, share availability, and cash reserve requirements.

The Company believes that its existing cash, cash equivalents, and investments balances, together with cash flow from operations, will be sufficient to meet its operating, investing, and financing activities for the next twelve months. As of October 2, 2011, the Company had approximately $340,172,000 in either cash or investments that could be converted into cash. In addition, Cognex has no long-term debt and does not anticipate needing debt financing in the near future. We believe that our strong cash position has put us in a relatively good position with respect to our longer-term liquidity needs.

New Pronouncements

Accounting Standards Update (ASU) 2011-04, Fair Value Measurements: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs

The amendments in this ASU change certain aspects of the fair value measurement guidance in Accounting Standards Codification (ASC) 820, Fair Value Measurement in order to make U.S. GAAP and international standards more consistent. These changes include the application of the concepts of highest and best use and valuation premise, introduction of an option to measure groups of offsetting assets and liabilities on a net basis, incorporation of certain premiums and discounts in fair value measurements, and measurement of the fair value of certain instruments classified in shareholders equity. In addition, the amended guidance includes new fair value disclosure requirements, including, among other things, information about valuation techniques and unobservable inputs used in Level 3 fair value measurements and a narrative description of Level 3 measurements sensitivity to changes in unobservable inputs. ASU 2011-04 must be applied prospectively and is effective for the first quarter of 2012. Management is in the process of evaluating the impact of this ASU.

Accounting Standards Update (ASU) 2011-05, Comprehensive Income

The amendments in this ASU revise the manner in which companies present comprehensive income in their financial statements in order to make U.S. GAAP and international standards more consistent. This ASU requires companies to report the components of comprehensive income in either a continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement would present the components of net income, similar to the Company s current Consolidated Statements of Operations, while the second statement would include the components of other comprehensive income (OCI), as well as a cumulative total for comprehensive income. This ASU does not change the items that must be reported in OCI. ASU 2011-05 must be applied retrospectively. On October 21, 2011, the Financial Accounting Standards Board (FASB) proposed a deferral of the requirement to present reclassifications of OCI on the face of the income statement. Management is awaiting the FASB s final decision and will evaluate the impact of this ASU at that time.

Accounting Standards Update (ASU) 2011-08, Testing Goodwill For Impairment

In the third quarter of 2011, the Financial Accounting Standards Board (FASB) issued an ASU aimed at simplifying entities annual goodwill impairment test. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The revised standard is effective for annual and interim goodwill impairment tests performed in 2012; however, early adoption is allowed. Management has elected to adopt this standard early and will apply the provisions of this ASU to its 2011 annual analysis of goodwill.

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, 2010.

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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 three-month period ended October 2, 2011 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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 Commission 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. 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, 2010. The language below has been added to an existing risk factor previously included on Form 10-K to address the current risks associated with international sales.

Economic, political, and other risks associated with international sales and operations could adversely affect our business and operating results.

On March 11, 2011, a large earthquake hit the northeast region of Japan. While the majority of our customers located in Japan are outside of the affected areas, certain customers requested that orders totaling approximately $800,000, originally scheduled for March shipment, be pushed to April. The remaining orders that were on the backlog at the time of

the earthquake, and any new orders, were fulfilled from our Cork, Ireland distribution center. Our Koriyama, Japan distribution center suspended shipments for approximately five weeks, but began shipping product again in April. Cognex does not manufacture in Japan.

Our key suppliers located in Japan are up and running, subject to power outages. Cognex has a policy of maintaining strategic inventory reserves of critical components. We have taken action to secure additional supply of Japanese-manufactured critical parts, such as imagers. For this reason, we do not expect significant supply disruption as a result of the earthquake. There is uncertainty, however, regarding how demand from our customers will be impacted going forward, as the aftermath of this disaster continues to unfold through layers of the supply chain. A decrease in demand for our products and services, or the postponement or cancellation of orders from our customers, could negatively impact our business and operating results.

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 Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 4- July 31, 2011				$ 30,000,000
August 1- August 28, 2011	161,390	$ 29.96	161,390	$ 25,165,335
August 29 - October 2, 2011	175,688	$ 29.40	175,688	$ 20,000,631
Total	337,078	$ 29.66	337,078	$ 20,000,631

(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.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. REMOVED AND RESERVED

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**

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101 xBRL (Extensible Business Reporting Language)

The following materials from Cognex Corporation s Quarterly Report on Form 10-Q for the period ended October 2, 2011, formatted in xBRL: (i) Consolidated Statements of Operations for the three-month and nine-month periods ended October 2, 2011 and October 3, 2010; (ii) Consolidated Balance Sheets as of October 2, 2011 and December 31, 2010; (iii) Consolidated Statement of Shareholders Equity and Comprehensive Income for the nine-month period ended October 2, 2011; (iv) Consolidated Condensed Statements of Cash Flows for the nine-month periods ended October 2, 2011 and October 3, 2010; and (v) 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: November 1, 2011 COGNEX CORPORATION

By: /s/ Robert J. Willett

Robert J. Willett
President and Chief Executive Officer
(duly authorized officer, principal executive officer)

By: /s/ Richard A. Morin

Richard A. Morin
Executive Vice President of Finance and Chief Financial Officer
(duly authorized officer, principal financial and accounting officer)