

COGNEX CORP  
Form 10-Q  
July 28, 2014

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 June 29, 2014 or
- Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-34218

COGNEX CORPORATION

(Exact name of registrant as specified in its charter)

Massachusetts

(State or other jurisdiction of  
incorporation or organization)

04-2713778

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

One Vision Drive

Natick, Massachusetts 01760-2059

(508) 650-3000

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

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

Yes  No

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

Yes  No

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

|                         |                                     |                           |
|-------------------------|-------------------------------------|---------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer         |
| Non-accelerated filer   |                                     | 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 June 29, 2014, there were 86,739,203 shares of Common Stock, \$.002 par value per share, of the registrant outstanding.

INDEX

PART I FINANCIAL INFORMATION

|                                  |  |           |
|----------------------------------|--|-----------|
| <u>Item 1.</u>                   | <u>Financial Statements (interim periods unaudited)</u>  | <u>3</u>  |
|                                  | <u>Consolidated Statements of Operations for the three-month and six-month periods ended June 29, 2014 and June 30, 2013</u>           | <u>3</u>  |
|                                  | <u>Consolidated Statements of Comprehensive Income for the three-month and six-month periods ended June 29, 2014 and June 30, 2013</u> | <u>4</u>  |
|                                  | <u>Consolidated Balance Sheets as of June 29, 2014 and December 31, 2013</u>   | <u>5</u>  |
|                                  | <u>Consolidated Condensed Statements of Cash Flows for the six-month periods ended June 29, 2014 and June 30, 2013</u>                 | <u>6</u>  |
|                                  | <u>Consolidated Statement of Shareholders' Equity for the six-month period ended June 29, 2014</u>                                     | <u>7</u>  |
|                                  | <u>Notes to Consolidated Financial Statements</u>  | <u>8</u>  |
| <u>Item 2.</u>                   | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>   | <u>22</u> |
| <u>Item 3.</u>                   | <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | <u>28</u> |
| <u>Item 4.</u>                   | <u>Controls and Procedures</u>   | <u>28</u> |
| <u>PART II OTHER INFORMATION</u> |  |           |
| <u>Item 1.</u>                   | <u>Legal Proceedings</u>   | <u>29</u> |
| <u>Item 1A.</u>                  | <u>Risk Factors</u>  | <u>29</u> |
| <u>Item 2.</u>                   | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | <u>30</u> |
| <u>Item 3.</u>                   | <u>Defaults Upon Senior Securities</u>   | <u>30</u> |
| <u>Item 4.</u>                   | <u>Mine Safety Disclosures</u>   | <u>30</u> |
| <u>Item 5.</u>                   | <u>Other Information</u>   | <u>30</u> |
| <u>Item 6.</u>                   | <u>Exhibits</u>  | <u>31</u> |
|                                  | <u>Signatures</u>  | <u>32</u> |

Table of Contents

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

|   | Three-months Ended           |               | Six-months Ended             |               |
|---|------------------------------|---------------|------------------------------|---------------|
|   | June 29, 2014<br>(unaudited) | June 30, 2013 | June 29, 2014<br>(unaudited) | June 30, 2013 |
| Revenue   |                              |               |                              |               |
| Product   | \$ 102,942                   | \$ 79,698     | \$ 186,511                   | \$ 154,370    |
| Service   | 5,860                        | 6,812         | 13,220                       | 13,032        |
|   | 108,802                      | 86,510        | 199,731                      | 167,402       |
| Cost of revenue   |                              |               |                              |               |
| Product   | 22,578                       | 17,910        | 39,864                       | 34,374        |
| Service   | 3,212                        | 3,240         | 7,010                        | 6,199         |
|   | 25,790                       | 21,150        | 46,874                       | 40,573        |
| Gross margin  |                              |               |                              |               |
| Product   | 80,364                       | 61,788        | 146,647                      | 119,996       |
| Service   | 2,648                        | 3,572         | 6,210                        | 6,833         |
|   | 83,012                       | 65,360        | 152,857                      | 126,829       |
| Research, development, and engineering expenses                       | 13,622                       | 11,887        | 26,124                       | 23,208        |
| Selling, general, and administrative expenses                         | 38,668                       | 33,300        | 73,568                       | 65,467        |
| Operating income  | 30,722                       | 20,173        | 53,165                       | 38,154        |
| Foreign currency gain (loss)  | (96                          | ) 76          | (206                         | ) 139         |
| Investment income   | 801                          | 774           | 1,588                        | 1,166         |
| Other expense   | (75                          | ) (257        | ) (348                       | ) (140        |
| Income before income tax expense                                      | 31,352                       | 20,766        | 54,199                       | 39,319        |
| Income tax expense  | 5,404                        | 3,946         | 9,745                        | 6,916         |
| Net income  | \$ 25,948                    | \$ 16,820     | \$ 44,454                    | \$ 32,403     |
| Earnings per weighted-average common and common-equivalent share (1): |                              |               |                              |               |
| Basic   | \$ 0.30                      | \$ 0.19       | \$ 0.51                      | \$ 0.37       |
| Diluted   | \$ 0.29                      | \$ 0.19       | \$ 0.50                      | \$ 0.37       |
| Weighted-average common and common-equivalent shares outstanding (1): |                              |               |                              |               |
| Basic   | 86,782                       | 87,044        | 86,830                       | 86,784        |
| Diluted   | 88,965                       | 88,714        | 89,112                       | 88,502        |

(1) Prior period results have been adjusted to reflect the two-for-one stock split effected in the form of a stock dividend which occurred in the third quarter of 2013.

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



Table of Contents

COGNEX CORPORATION  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (In thousands)

|  | Three-months Ended |               | Six-months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 29, 2014      | June 30, 2013 | June 29, 2014    | June 30, 2013 |
|  | (unaudited)        |               | (unaudited)      |               |
| Net income   | \$25,948           | \$16,820      | \$44,454         | \$32,403      |
| Other comprehensive income (loss), net of tax:   |                    |               |                  |               |
| Cash flow hedges:  |                    |               |                  |               |
| Change in net unrealized gain (loss), net of tax of \$10 and \$0 in the three-month periods and net of tax of (\$6) and \$0 in the six-month periods, respectively           | (36                | ) —           | (235             | ) —           |
| Reclassification adjustments for loss (gain) included in net income  | 24                 | —             | 57               | —             |
| Net change related to cash flow hedges   | (12                | ) —           | (178             | ) —           |
| Available-for-sale investments:  |                    |               |                  |               |
| Change in net unrealized gain (loss), net of tax of \$69 and (\$318) in the three-month periods and net of tax of \$182 and (\$276) in the six-month periods, respectively   | 542                | (1,279        | ) 1,561          | (1,106        |
| Reclassification adjustments for loss (gain) included in net income  | (105               | ) (52         | ) (606           | ) (83         |
| Net change related to available-for-sale investments   | 437                | (1,331        | ) 955            | (1,189        |
| Currency translation adjustments:  |                    |               |                  |               |
| Change in currency translation adjustments, net of tax of \$53 and \$46 in the three-month periods and net of tax of \$60 and (\$181) in the six-month periods, respectively | (544               | ) 687         | (99              | ) (1,807      |
| Net change related to currency translation adjustments   | (544               | ) 687         | (99              | ) (1,807      |
| Other comprehensive income (loss), net of tax  | (119               | ) (644        | ) 678            | (2,996        |
| Total comprehensive income   | \$25,829           | \$16,176      | \$45,132         | \$29,407      |

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

Table of Contents

COGNEX CORPORATION  
 CONSOLIDATED BALANCE SHEETS  
 (In thousands)

|   | June 29, 2014<br>(unaudited) | December 31,<br>2013 |
|---|------------------------------|----------------------|
| <b>ASSETS</b>   |                              |                      |
| Current assets:   |                              |                      |
| Cash and cash equivalents   | \$40,172                     | \$40,644             |
| Short-term investments  | 83,677                       | 184,822              |
| Accounts receivable, less reserves of \$1,214 and \$1,354 in 2014 and 2013, respectively                    | 69,780                       | 53,015               |
| Inventories   | 30,737                       | 25,694               |
| Deferred income taxes   | 7,829                        | 7,611                |
| Deferred costs  | 20,877                       | 4,688                |
| Prepaid expenses and other current assets   | 15,184                       | 15,577               |
| Total current assets  | 268,256                      | 332,051              |
| Long-term investments   | 343,725                      | 229,655              |
| Property, plant, and equipment, net   | 38,321                       | 37,136               |
| Deferred income taxes   | 13,535                       | 12,307               |
| Intangible assets, net  | 12,892                       | 14,723               |
| Goodwill  | 81,689                       | 81,689               |
| Other assets  | 2,038                        | 2,138                |
|   | <b>\$760,456</b>             | <b>\$709,699</b>     |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                              |                      |
| Current liabilities:  |                              |                      |
| Accounts payable  | \$15,329                     | \$9,487              |
| Accrued expenses  | 32,921                       | 34,331               |
| Accrued income taxes  | 569                          | 1,263                |
| Deferred revenue  | 25,327                       | 15,941               |
| Total current liabilities   | 74,146                       | 61,022               |
| Reserve for income taxes  | 3,803                        | 4,765                |
| Commitments and contingencies (Note 8)  |                              |                      |
| Shareholders' equity:   |                              |                      |
| Common stock, \$.002 par value –  |                              |                      |
| Authorized: 140,000 shares, issued and outstanding: 86,739 and 86,831 shares in 2014 and 2013, respectively | 174                          | 174                  |
| Additional paid-in capital  | 231,907                      | 211,440              |
| Retained earnings   | 479,581                      | 462,131              |
| Accumulated other comprehensive loss, net of tax  | (29,155                      | ) (29,833            |
| Total shareholders' equity  | 682,507                      | 643,912              |
|   | <b>\$760,456</b>             | <b>\$709,699</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)

|   | Six-months Ended |               |
|---|------------------|---------------|
|   | June 29, 2014    | June 30, 2013 |
|   | (unaudited)      |               |
| Cash flows from operating activities:   |                  |               |
| Net income  | \$44,454         | \$32,403      |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |               |
| Stock-based compensation expense  | 7,960            | 6,079         |
| Depreciation of property, plant, and equipment                                    | 4,051            | 3,596         |
| Amortization of intangible assets   | 1,830            | 1,921         |
| Amortization of discounts or premiums on investments                              | 1,284            | 1,443         |
| Realized gain on sale of investments  | (606)            | (83)          |
| Net unrealized loss on trading securities   | —                | 462           |
| Tax effect of stock option exercises  | (3,481)          | (2,773)       |
| Change in deferred income taxes   | (1,507)          | (1,748)       |
| Change in operating assets and liabilities:                                       |                  |               |
| Accounts receivable   | (16,952)         | (3,897)       |
| Inventories   | (5,150)          | (821)         |
| Deferred costs  | (16,189)         | (384)         |
| Deferred revenue  | 10,516           | (96)          |
| Other   | 5,498            | 2,873         |
| Net cash provided by operating activities   | 31,708           | 38,975        |
| Cash flows from investing activities:   |                  |               |
| Purchases of investments  | (189,746)        | (167,652)     |
| Maturities and sales of investments   | 177,280          | 129,329       |
| Purchases of property, plant, and equipment                                       | (5,341)          | (4,310)       |
| Net cash used in investing activities   | (17,807)         | (42,633)      |
| Cash flows from financing activities:   |                  |               |
| Issuance of common stock under stock option plans                                 | 9,026            | 16,242        |
| Repurchase of common stock  | (27,004)         | (11,891)      |
| Tax effect of stock option exercises  | 3,481            | 2,773         |
| Net cash provided by (used in) financing activities                               | (14,497)         | 7,124         |
| Effect of foreign exchange rate changes on cash and cash equivalents              | 124              | (752)         |
| Net change in cash and cash equivalents   | (472)            | 2,714         |
| Cash and cash equivalents at beginning of period                                  | 40,644           | 45,160        |
| Cash and cash equivalents at end of period  | \$40,172         | \$47,874      |

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



Table of Contents

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

|   | Common Stock |           | Additional | Retained  | Accumulated   | Total         |
|---|--------------|-----------|------------|-----------|---------------|---------------|
|   | Shares       | Par Value | Paid-in    | Earnings  | Other         | Shareholders' |
|   |              |           | Capital    |           | Comprehensive | Equity        |
|   |              |           |            |           | Loss          |               |
| Balance as of December 31, 2013   | 86,831       | \$174     | \$211,440  | \$462,131 | \$(29,833)    | ) \$643,912   |
| Issuance of common stock under stock plans  | 648          | —         | 9,026      | —         | —             | 9,026         |
| Repurchase of common stock  | (740)        | ) —       | —          | (27,004)  | ) —           | (27,004)      |
| Stock-based compensation expense  | —            | —         | 7,960      | —         | —             | 7,960         |
| Excess tax benefit from stock option exercises                                      | —            | —         | 3,481      | —         | —             | 3,481         |
| Net income  | —            | —         | —          | 44,454    | —             | 44,454        |
| Net unrealized loss on cash flow hedges, net of tax of \$6                          | —            | —         | —          | —         | (235)         | ) (235)       |
| Reclassification of net realized loss on cash flow hedges                           | —            | —         | —          | —         | 57            | 57            |
| Net unrealized gain on available-for-sale investments, net of tax of \$182          | —            | —         | —          | —         | 1,561         | 1,561         |
| Reclassification of net realized gain on the sale of available-for-sale investments | —            | —         | —          | —         | (606)         | ) (606)       |
| Foreign currency translation adjustment, net of tax of \$60                         | —            | —         | —          | —         | (99)          | ) (99)        |
| Balance as of June 29, 2014 (unaudited)   | 86,739       | \$174     | \$231,907  | \$479,581 | \$(29,155)    | ) \$682,507   |

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, 2013.

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 June 29, 2014, and the results of its operations for the three-month and six-month periods ended June 29, 2014 and June 30, 2013, 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 six-month periods ended June 29, 2014 are not necessarily indicative of the results to be expected for the full year.

## NOTE 2: New Pronouncements

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

The amendments in ASU 2014-09 will supersede and replace all currently existing U.S. GAAP, including industry-specific revenue recognition guidance, with a single, principle-based revenue recognition framework. The concept guiding this new model is that revenue recognition will depict transfer of control to the customer in an amount that reflects consideration to which an entity expects to be entitled. The core principles supporting this framework include 1) identifying the contract with a customer, 2) identifying separate performance obligations within the contract, 3) determining the transaction price, 4) allocating the transaction price to the performance obligations, and 5) recognizing revenue. This new framework will require entities to apply significantly more judgment. This increase in management judgment will require expanded disclosure on estimation methods, inputs, and assumptions for revenue recognition. The guidance in ASU 2014-09 is effective for public companies for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. Management is in the process of evaluating the impact of this update.

## NOTE 3: Fair Value Measurements

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

The following table summarizes the financial assets and liabilities required to be measured at fair value on a recurring basis as of June 29, 2014 (in thousands):

|                                   | Quoted Prices in<br>Active Markets<br>for Identical<br>Assets (Level 1) | Significant Other<br>Observable<br>Inputs (Level 2) |
|-----------------------------------|---|---|
| Assets:                           |   |   |
| Money market instruments          | \$1,358   | \$—   |
| Corporate bonds                   | —   | 235,780   |
| Treasury bills                    | —   | 87,967  |
| Asset-backed securities           | —   | 70,692  |
| Sovereign bonds                   | —   | 18,915  |
| Municipal bonds                   | —   | 10,592  |
| Agency bonds                      | —   | 1,500   |
| Cash flow hedge forward contracts | —   | 45  |
| Economic hedge forward contracts  | —   | 6   |
| Liabilities:                      |   |   |
| Cash flow hedge forward contracts | —   | 127   |
| Economic hedge forward contracts  | —   | 27  |

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.

8

---

Table of Contents

COGNEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

The Company did not record an other-than-temporary impairment of these financial assets or liabilities during the six-month period ended June 29, 2014.

**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 six-month period ended June 29, 2014.

**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 six-month period ended June 29, 2014.

Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

|                              | June 29, 2014 | December 31, 2013 |
|------------------------------|---------------|-------------------|
| Cash                         | \$38,814      | \$40,124          |
| Money market instruments     | 1,358         | 520               |
| Cash and cash equivalents    | 40,172        | 40,644            |
| Asset-backed securities      | 33,733        | 53,559            |
| Corporate bonds              | 28,013        | 109,040           |
| Treasury bills               | 12,996        | —                 |
| Municipal bonds              | 5,707         | 9,276             |
| Sovereign bonds              | 3,228         | 11,448            |
| Agency bonds                 | —             | 1,499             |
| Short-term investments       | 83,677        | 184,822           |
| Corporate bonds              | 207,767       | 109,909           |
| Treasury bills               | 74,971        | 73,666            |
| Asset-backed securities      | 36,959        | 21,820            |
| Sovereign bonds              | 15,687        | 16,385            |
| Municipal bonds              | 4,885         | 5,919             |
| Agency bonds                 | 1,500         | —                 |
| Limited partnership interest | 1,956         | 1,956             |
| Long-term investments        | 343,725       | 229,655           |
|                              | \$467,574     | \$455,121         |

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

The following table summarizes the Company's available-for-sale investments as of June 29, 2014 (in thousands):

|                         | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
|-------------------------|-------------------|------------------------------|-------------------------------|------------|
| Short-term:             |                   |                              |                               |            |
| Asset-backed securities | \$33,721          | \$32                         | \$(20)                        | \$33,733   |
| Corporate bonds         | 27,927            | 86                           | —                             | 28,013     |
| Treasury bills          | 12,995            | 1                            | —                             | 12,996     |
| Municipal bonds         | 5,699             | 8                            | —                             | 5,707      |
| Sovereign bonds         | 3,219             | 9                            | —                             | 3,228      |
| Long-term:              |                   |                              |                               |            |
| Corporate bonds         | 206,863           | 920                          | (16)                          | 207,767    |
| Treasury bills          | 74,953            | 20                           | (2)                           | 74,971     |
| Asset-backed securities | 36,930            | 36                           | (7)                           | 36,959     |
| Sovereign bonds         | 15,631            | 58                           | (2)                           | 15,687     |
| Municipal bonds         | 4,838             | 47                           | —                             | 4,885      |
| Agency bonds            | 1,500             | —                            | —                             | 1,500      |
|                         | \$424,276         | \$1,217                      | \$(47)                        | \$425,446  |



Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 June 29, 2014 (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 |
| Corporate bonds         | \$19,003                      | \$(15 )           | \$1,729              | \$(1 )            | \$20,732   | \$(16 )           |
| Treasury bills          | 19,147                        | (2 )              | —                    | —                 | 19,147     | (2 )              |
| Asset-backed securities | 8,050                         | (2 )              | 5,679                | (25 )             | 13,729     | (27 )             |
| Sovereign bonds         | 3,363                         | (2 )              | —                    | —                 | 3,363      | (2 )              |
|                         | \$49,563                      | \$(21 )           | \$7,408              | \$(26 )           | \$56,971   | \$(47 )           |

As of June 29, 2014, the Company did not recognize an other-than-temporary impairment of these investments. In its evaluation, management considered the type of security, the credit rating of the security, the length of time the security has been in a loss position, the size of the loss position, our intent and ability to hold the security to expected recovery of value, and other meaningful information. The Company does not intend to sell, and is unlikely to be required to sell, any of these available-for-sale investments before its effective maturity or market price recovery. The Company recorded gross realized gains and gross realized losses on the sale of investments totaling \$117,000 and \$12,000, respectively, during the three-month period ended June 29, 2014 and \$101,000 and \$49,000, respectively, during the three-month period ended June 30, 2013. The Company recorded gross realized gains and gross realized losses on the sale of investments totaling \$629,000 and \$23,000, respectively, during the six-month period ended June 29, 2014 and \$150,000 and \$67,000, respectively, during the six-month period ended June 30, 2013. These gains and losses are included in "Investment income" on the Consolidated Statements of Operations.

The following table presents the effective maturity dates of the Company's available-for-sale investments as of June 29, 2014 (in thousands):

|                         | 1<br>Year or Less | 1-2<br>Years | 2-3<br>Years | 3-4<br>Years | 4-5<br>Years | Total     |
|-------------------------|-------------------|--------------|--------------|--------------|--------------|-----------|
| Corporate bonds         | \$28,013          | \$70,775     | \$102,454    | \$12,061     | \$22,477     | \$235,780 |
| Treasury bills          | 12,996            | 66,770       | 8,201        | —            | —            | 87,967    |
| Asset-backed securities | 33,733            | 17,947       | 5,506        | 8,087        | 5,419        | 70,692    |
| Sovereign bonds         | 3,228             | 12,324       | 3,363        | —            | —            | 18,915    |
| Municipal bonds         | 5,707             | 1,848        | 2,533        | 504          | —            | 10,592    |
| Agency bonds            | —                 | —            | 1,500        | —            | —            | 1,500     |
|                         | \$83,677          | \$169,664    | \$123,557    | \$20,652     | \$27,896     | \$425,446 |

The Company is a Limited Partner in Venrock Associates III, L.P. (Venrock), a venture capital fund. The Company has committed to a total investment in the limited partnership of up to \$20,500,000, with an expiration date of December 31, 2015. As of June 29, 2014, the Company contributed \$19,886,000 to the partnership. The remaining commitment of \$614,000 can be called by Venrock at any time before December 31, 2015. Distributions and contributions are at the discretion of Venrock's management. No contributions were made and no distributions were received during the six-month period ended June 29, 2014.

## NOTE 5: Inventories

Inventories consisted of the following (in thousands):

|                 | June 29, 2014 | December 31, 2013 |
|-----------------|---------------|-------------------|
| Raw materials   | \$14,460      | \$13,101          |
| Work-in-process | 9,594         | 4,472             |
| Finished goods  | 6,683         | 8,121             |
|                 | \$30,737      | \$25,694          |





Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## NOTE 6: Intangible Assets and Goodwill

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 six-month period ended June 29, 2014 that would indicate a potential impairment of goodwill or other intangible assets.

## NOTE 7: Warranty Obligations

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

The changes in the warranty obligations were as follows (in thousands):

|  |         |   |
|--|---------|---|
| Balance as of December 31, 2013                    | \$3,016 |   |
| Provisions for warranties issued during the period | 1,416   |   |
| Fulfillment of warranty obligations                | (1,043  | ) |
| Foreign exchange rate changes                      | (28     | ) |
| Balance as of June 29, 2014                        | \$3,361 |   |

## 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 May 2014, the parties mutually agreed to dismiss this action with prejudice. This matter is now closed.

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 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. 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 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. In December 2013, the Federal Circuit affirmed the ITC's finding of non-infringement, and therefore did not also need to address the ITC's finding regarding validity. This matter is now closed.

In March 2013, the Company filed a lawsuit against Microscan Systems, Inc. ("Microscan") and Code Corporation in the United States District Court for the Southern District of New York alleging that Microscan's Mobile Hawk

handheld imager infringes U.S. Patent 7,874,487 owned by the Company (the “487 patent”). The lawsuit sought to prohibit Code Corporation from manufacturing the product, and Microscan from selling and distributing the product. The Company also sought monetary damages resulting from the alleged infringement. Late in the day on April 30, 2014, the jury found that Microscan willfully infringed the ‘487 patent and awarded Cognex \$2.6M in damages. Following the verdict, Microscan filed motions requesting judgment as a matter of law on the issues of infringement, invalidity and willfulness, as well as a motion to dismiss for lack of standing. The Company filed motions seeking treble damages (based on the finding of willfulness), attorneys’ fees as an exceptional case, and a permanent injunction against future infringement

Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

of the '487 patent and the import, manufacture and/or sale of Microscan's Mobile Hawk product within the U.S. Final briefs were filed on June 11, 2014. On June 29, 2014, the court issued an order denying all of Microscan's motions and the Company's motion for treble damages, while granting the Company's motion for permanent injunction (limited to enjoining future infringement of the '487 patent and the import, manufacture and/or sale of infringing versions Microscan's Mobile Hawk product within the U.S.) and the Company's motion for attorneys' fees, in part, pending a determination thereof following submission of supplemental briefs by both parties, which were due on July 25, 2014. The parties are currently awaiting a final judgment from the court.

The Company cannot predict the outcome of the above-referenced pending matter and an adverse resolution of this lawsuit 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: Guarantees

In the ordinary course of business, the Company enters into guarantee contracts with certain customers, generally in the Company's Surface Inspection Systems Division (SISD) business. These guarantees represent standby letters of credit (LOC) which can be grouped into three categories: (1) bank guarantees which may require the Company to return a customer's initial payment if the Company cannot deliver the order; (2) warranty bonds which may require the Company to resolve warranty issues within a specified time period; and (3) performance bonds which include a combination of the above two options. The type of LOC is generally determined based upon customer request and the guarantee amount represents the maximum potential amount of future payments. All of the Company's LOCs are with the same counterparty and they do not contain any recourse provisions or collateral obligations.

The following table details the letters of credit outstanding as of June 29, 2014:

| Type              | Guarantee<br>Amount<br>(in thousands) | Guarantee Due Date                      |
|-------------------|---------------------------------------|---|
| Warranty bonds    | \$1,036                               | Various from July 2014 to July 2016     |
| Bank guarantees   | 1,218                                 | Various from July 2014 to January 2016  |
| Performance bonds | 376                                   | Various from July 2014 to December 2017 |
|                   | \$2,630                               |   |

The Company evaluates losses for guarantees under accounting for contingencies. The Company considers such factors as the degree of probability that the Company would be required to satisfy the guarantee and the ability to make a reasonable estimate of the loss. To date, the Company has not incurred any losses as a result of these obligations, and therefore, has not recorded any liability related to such obligation in its financial statements. The fair value of the Company's outstanding guarantees is immaterial for all periods presented.

## NOTE 10: 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.

Table of Contents

COGNEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 11: 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. 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. These transaction gains and losses are reported in "Foreign currency gain (loss)" on the Consolidated Statements of Operations.

Functional currency/reporting currency exchange rate exposures from the revaluation of the assets and liabilities of our foreign subsidiaries, whose functional currency is generally their local currency, to the Company's reporting currency, which is the U.S. Dollar. These translation gains and losses are reported in "Accumulated other comprehensive loss" on the Consolidated Balance Sheets and also on the Consolidated Statements of Comprehensive Income.

The Company's foreign currency risk management strategy is principally designed to mitigate the potential financial impact of changes in the value of transactions and balances denominated in foreign currencies resulting from changes in foreign currency exchange rates. Currently, the Company enters into two types of hedges to manage this risk. The first are economic hedges which utilize foreign currency forward contracts with maturities of up to 45 days to manage the exposure to fluctuations in foreign currency exchange rates arising primarily from foreign-denominated receivables and payables. The gains and losses on these derivatives are largely offset by changes in the fair value of the assets and liabilities being hedged. The second are cash flow hedges which utilize foreign currency forward contracts with maturities of up to 18 months to hedge specific forecasted transactions of the Company's foreign subsidiaries with the goal of protecting our budgeted revenues and expenses against foreign currency exchange rate changes compared to our budgeted rates.

Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Company had the following outstanding forward contracts that were entered into to mitigate foreign currency exchange rate risk (in thousands):

| Currency  | As of June 29, 2014 |                | As of December 31, 2013 |                |
|---|---------------------|----------------|-------------------------|----------------|
|   | Notional Value      | USD Equivalent | Notional Value          | USD Equivalent |
| <b>Derivatives Designated as Hedging Instruments:</b>     |                     |                |                         |                |
| Japanese Yen  | 696,500             | \$6,765        | 625,000                 | \$6,122        |
| Hungarian Forint  | 641,750             | 2,830          | 570,175                 | 2,603          |
| Singapore Dollar  | 2,955               | 2,361          | 2,867                   | 2,346          |
| British Pound   | 744                 | 1,230          | 613                     | 1,010          |
| Canadian Dollar   | 1,202               | 1,106          | 985                     | 932            |
| <b>Derivatives Not Designated as Hedging Instruments:</b> |                     |                |                         |                |
| Japanese Yen  | 1,000,000           | \$9,850        | 294,500                 | \$2,797        |
| British Pound   | 1,500               | 1,881          | 1,100                   | 1,820          |
| Taiwanese Dollar  | 32,500              | 1,090          | 27,000                  | 908            |
| Korean Won  | 900,000             | 886            | 650,000                 | 620            |
| Singapore Dollar  | 1,000               | 800            | —                       | —              |
| Hungarian Forint  | 99,000              | 436            | 123,000                 | 568            |
| Euro  | —                   | —              | 2,828                   | 3,887          |
| Chinese Renminbi  | —                   | —              | 9,000                   | 1,467          |
| Brazilian Real  | —                   | —              | 250                     | 106            |

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

|   | Asset Derivatives                         |                          |                              | Liability Derivatives  |                          |                              |
|---|---|--------------------------|------------------------------|------------------------|--------------------------|------------------------------|
|   | Balance Sheet Location                    | Fair Value June 29, 2014 | Fair Value December 31, 2013 | Balance Sheet Location | Fair Value June 29, 2014 | Fair Value December 31, 2013 |
| <b>Derivatives Designated as Hedging Instruments:</b>     |   |                          |                              |                        |                          |                              |
| Cash flow hedge forward contracts                         | Prepaid expenses and other current assets | \$45                     | \$204                        | Accrued expenses       | \$127                    | \$98                         |
| <b>Derivatives Not Designated as Hedging Instruments:</b> |   |                          |                              |                        |                          |                              |
| Economic hedge forward contracts                          | Prepaid expenses and other current assets | \$6                      | \$6                          | Accrued expenses       | \$27                     | \$24                         |

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

| Asset Derivatives                  | June 29, 2014 |   | December 31, 2013 |  | Liability Derivatives                   | June 29, 2014 |   | December 31, 2013 |  |
|------------------------------------|---------------|---|-------------------|--|---|---------------|---|-------------------|--|
|                                    |               |   |                   |  |   |               |   |                   |  |
| Gross amounts of recognized assets | \$57          |   | \$210             |  | Gross amounts of recognized liabilities | \$179         |   | \$122             |  |
| Gross amounts offset               | (6            | ) | —                 |  | Gross amounts offset                    | (25           | ) | —                 |  |
| Net amount of assets presented     | \$51          |   | \$210             |  | Net amount of liabilities presented     | \$154         |   | \$122             |  |



Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

|  | Location in Financial Statements   | Three-months Ended |               | Six-months Ended |               |
|--|--|--------------------|---------------|------------------|---------------|
|  |  | June 29, 2014      | June 30, 2013 | June 29, 2014    | June 30, 2013 |
| <b>Derivatives Designated as Hedging Instruments:</b>  |  |                    |               |                  |               |
| Gains (losses) in Shareholders' equity on derivatives (effective portion)  | Accumulated other comprehensive income (loss), net of tax  | \$ (74 )           | \$ —          | \$ (74 )         | \$ —          |
| Gains (losses) reclassified from accumulated other comprehensive income (loss) into net income (effective portion) | Product revenue  | \$ 4               | \$ —          | \$ 17            | \$ —          |
|  | Research, development, and engineering expenses  | (9 )               | —             | (25 )            | —             |
|  | Selling, general, and administrative expenses  | (19 )              | —             | (49 )            | —             |
|  | Total gains (losses) reclassified from accumulated other comprehensive income (loss) into net income | \$ (24 )           | \$ —          | \$ (57 )         | \$ —          |
| Gains (losses) recognized in net income on derivatives (ineffective portion and discontinued derivatives)          | Foreign currency gain (loss)   | \$ —               | \$ —          | \$ —             | \$ —          |
| <b>Derivatives Not Designated as Hedging Instruments:</b>  |  |                    |               |                  |               |
| Gains (losses) recognized in net income  | Foreign currency gain (loss)   | \$ (21 )           | \$ 64         | \$ (173 )        | \$ 197        |

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

|  |          |
|--|----------|
| Beginning balance as of December 31, 2013      | \$ 104   |
| Amount of loss reclassified to net income      | 57       |
| Change in fair value of derivative instruments | (235 )   |
| Ending balance as of June 29, 2014             | \$ (74 ) |

Net losses expected to be reclassified from accumulated other comprehensive income (loss), net of tax, into net income within the next twelve months are \$70,000.

**NOTE 12: Stock-Based Compensation Expense**

The Company's share-based payments that result in compensation expense consist of stock option and restricted stock award grants. As of June 29, 2014, the Company had 9,957,589 shares available for grant. Generally, stock options are granted with an exercise price equal to the market value of the Company's common stock at the grant date, vest over four years based upon continuous service, and expire ten years from the grant date. Restricted stock awards are granted with an exercise price equal to the market value of the Company's common stock at the time of grant. Conditions of the award may be based on continuing employment and or achievement of pre-established performance goals and objectives. Vesting for performance-based restricted stock awards and time-based restricted stock awards must be greater than one year and three years, respectively.



Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table summarizes the Company's stock option activity for the six-month period ended June 29, 2014:

|  | Shares<br>(in thousands) | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic<br>Value<br>(in thousands) |
|--|--------------------------|---|---|---|
| Outstanding as of December 31, 2013                        | 6,138                    | \$ 15.65                                  |   |   |
| Granted  | 1,311                    | 38.89                                     |   |   |
| Exercised  | (635                     | ) 14.20                                   |   |   |
| Forfeited or expired                                       | (138                     | ) 19.55                                   |   |   |
| Outstanding as of June 29, 2014                            | 6,676                    | \$ 20.27                                  | 7.3   | \$ 118,374  |
| Exercisable as of June 29, 2014                            | 2,744                    | \$ 13.13                                  | 5.7   | \$ 67,421   |
| Options vested or expected to vest at<br>June 29, 2014 (1) | 6,026                    | \$ 19.44                                  | 7.1   | \$ 111,631  |

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

|                          | Three-months Ended |               | Six-months Ended |               |
|--------------------------|--------------------|---------------|------------------|---------------|
|                          | June 29, 2014      | June 30, 2013 | June 29, 2014    | June 30, 2013 |
| Risk-free rate           | 2.7                | % 2.0         | % 2.7            | % 2.0         |
| Expected dividend yield  | —                  | % —           | % —              | % —           |
| Expected volatility      | 41                 | % 42          | % 41             | % 42          |
| Expected term (in years) | 5.4                | 5.9           | 5.4              | 5.9           |

**Risk-free rate**

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

**Expected dividend yield**

Generally, the current dividend yield is calculated by annualizing the cash dividend declared by the Company's Board of Directors and dividing that result by the closing stock price on the grant date. However, in the fourth quarter of 2012, the Company paid the full annual dividends for 2013 and 2014 in advance, and therefore, the dividend yield for those years has been adjusted to zero. At the time of the 2014 valuation, a dividend yield of 0.56% was estimated for future periods from 2015 through the expected life of the option.

**Expected volatility**

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

**Expected term**

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

The Company stratifies its employee population into two groups: one consisting of senior management and another consisting of all other employees. The Company currently expects that approximately 72% of its stock options granted to senior management and 70% of its options granted to all other employees will actually vest. Therefore, the Company currently applies an estimated annual forfeiture rate of 11% to all unvested options for senior management and a rate of 12% for all other employees. The Company revised its estimated forfeiture rates in the first quarters of 2014 and 2013, resulting in an increase to compensation expense of \$288,000 and \$300,000, respectively.

The weighted-average grant-date fair values of stock options granted during the three-month periods ended June 29, 2014 and June 30, 2013 were \$15.28 and \$8.07, respectively. The weighted-average grant-date fair values of stock



Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

options granted during the six-month periods ended June 29, 2014 and June 30, 2013 were \$15.34 and \$8.07, respectively.

The total intrinsic values of stock options exercised for the three-month periods ended June 29, 2014 and June 30, 2013 were \$5,710,000 and \$6,759,000, respectively. The total intrinsic values of stock options exercised for the six-month periods ended June 29, 2014 and June 30, 2013 were \$14,643,000 and \$13,952,000, respectively. The total fair values of stock options vested for the three-month periods ended June 29, 2014 and June 30, 2013 were \$2,621,000 and \$2,298,000, respectively. The total fair values of stock options vested for the six-month periods ended June 29, 2014 and June 30, 2013 were \$10,982,000 and \$9,230,000, respectively.

As of June 29, 2014, total unrecognized compensation expense related to non-vested stock options was \$17,817,000, which is expected to be recognized over a weighted-average period of 1.56 years.

The following table summarizes the Company's restricted stock award activity for the six-month period ended June 29, 2014:

|                                   | Shares (in thousands) | Weighted-Average Exercise Price | Aggregate Intrinsic Value (in thousands) |
|-----------------------------------|-----------------------|---------------------------------|--|
| Nonvested as of December 31, 2013 | —                     | \$—                             |  |
| Granted                           | 20                    | 34.05                           |  |
| Vested                            | —                     | —                               |  |
| Forfeited or expired              | —                     | —                               |  |
| Nonvested as of June 29, 2014     | 20                    | \$34.05                         | \$73                                     |

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

The total stock-based compensation expense and the related income tax benefit recognized for the three-month period ended June 29, 2014 were \$3,956,000 and \$1,266,000, respectively, and for the three-month period ended June 30, 2013 were \$2,781,000 and \$911,000, respectively. The total stock-based compensation expense and the related income tax benefit recognized for the six-month period ended June 29, 2014 were \$7,960,000 and \$2,572,000, respectively, and for the six-month period ended June 30, 2013 were \$6,079,000, and \$2,004,000, respectively. No compensation expense was capitalized as of June 29, 2014 or December 31, 2013.

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 |               | Six-months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 29, 2014      | June 30, 2013 | June 29, 2014    | June 30, 2013 |
| Product cost of revenue                | \$268              | \$177         | \$553            | \$404         |
| Service cost of revenue                | 44                 | 47            | 107              | 110           |
| Research, development, and engineering | 988                | 650           | 2,044            | 1,463         |
| Selling, general, and administrative   | 2,656              | 1,907         | 5,256            | 4,102         |
|  | \$3,956            | \$2,781       | \$7,960          | \$6,079       |

Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## NOTE 13: 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, primarily as a means to reduce the dilutive effect of employee stock options. Stock repurchases under this program were completed in 2013. 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 the dilutive effect of employee stock options. Purchases under this 2011 program began in 2013 upon completion of the 2008 program. As of June 29, 2014, the Company repurchased a total of 1,632,000 shares at a cost of \$54,912,000 under the 2011 program, including 380,000 shares at a cost of \$14,287,000 in the first quarter of 2014 and 360,000 shares at a cost of \$12,717,000 in the second quarter of 2014. On April 29, 2014, the Company's Board of Directors authorized the repurchase of an additional \$50,000,000 of the Company's stock. This new authorization will commence once the Company completes the November 2011 program. The Company may repurchase shares under this program in future periods depending upon a variety of factors, including, among other things, the impact of dilution from employee stock options, stock price, share availability, and cash requirements.

## NOTE 14: 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 |               | Six-months Ended |               |    |
|--|--------------------|---------------|------------------|---------------|----|
|  | June 29, 2014      | June 30, 2013 | June 29, 2014    | June 30, 2013 |    |
| Income tax provision at federal statutory rate | 35                 | % 35          | % 35             | % 35          | %  |
| State income taxes, net of federal benefit     | 1                  | % 2           | % 1              | % 2           | %  |
| Foreign tax rate differential                  | (17)               | )% (17        | )% (17           | )% (17        | )% |
| Tax credit                                     | —                  | % (1          | )% —             | % (1          | )% |
| Discrete tax events                            | (2                 | )% —          | % (1             | )% (1         | )% |
| Income tax provision                           | 17                 | % 19          | % 18             | % 18          | %  |

The effective tax rate for the six-month period ended June 29, 2014 included a discrete event recorded in the second quarter related to the closing of the Internal Revenue Service (IRS) audit of the Company for tax years 2010 and 2011. This adjustment resulted in a decrease to tax expense of \$553,000, which includes \$296,000 for the release of certain tax reserves related to the audit period and a change in risk assessment based on the audit results. This discrete event decreased the effective tax rate from a provision of 19% to a provision of 17% and 18% for the three-month and six-month periods ended June 29, 2014, respectively.

The effective tax rate for the six-month period ended June 30, 2013 included a discrete event recorded in the first quarter of 2013 that decreased tax expense by \$555,000, net of related reserves for income taxes, from the retroactive application of the 2012 research and development credit. The American Taxpayer Relief Act of 2012 was passed by Congress and signed into law on January 1, 2013. The provisions under this law were applied retroactively to January 1, 2012. As a result of the law being signed on January 1, 2013, the financial impact of the retroactive provision was recorded as a discrete event in the first quarter of 2013. This discrete tax event decreased the effective tax rate from a provision of 19% to a provision of 18% for the six-month period ended June 30, 2013.

During the six-month period ended June 29, 2014, the Company recorded a \$39,000 increase in reserves for income taxes, net of deferred tax benefit, for uncertain tax positions that were recorded as income tax expense, of which \$136,000 was recorded as a reduction to income tax expense in the three-month period ended June 29, 2014. The reduction in expense in the three-month period ended June 29, 2014 includes the \$296,000 decrease in tax expense for the recent conclusion of the IRS examination. Estimated interest and penalties included in these amounts totaled \$60,000 for the six-month period ended June 29, 2014, of which \$20,000 related to the three-month period ended June 29, 2014.

In the first quarter of 2014, management adopted Accounting Standards Update (ASU) 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." This ASU requires companies to present an unrecognized tax benefit, or a portion thereof, as a

reduction to a deferred tax asset for a net operating loss (NOL) carryforward or a similar tax loss or tax credit carryforward. In the first quarter of 2014, the Company reclassified a reserve for income taxes of \$1,028,000 as a reduction to noncurrent deferred tax assets in compliance with this new guidance. Retroactive application was not required under this ASU, and therefore, prior periods were not restated.

Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Company's reserve for income taxes, including gross interest and penalties, was \$4,831,000 as of June 29, 2014, which included \$3,803,000 classified as a noncurrent liability and \$1,028,000 recorded as a reduction to noncurrent deferred tax assets. The amount of gross interest and penalties included in these balances was \$441,000. 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 \$451,000 that would be recorded through additional paid-in capital. As a result of the expiration of certain statutes of limitations and the conclusion of the IRS examination, there is a potential that a portion of these reserves could be released, which would decrease income tax expense by approximately \$500,000 to \$600,000 over the next twelve months.

The Company has defined its major tax jurisdictions as the United States, Ireland, China, and Japan, and within the United States, Massachusetts and California. Within the United States, the tax years 2012 through 2013 remain open to examination by various taxing authorities, while the tax years 2009 through 2013 remain open to examination by various taxing authorities in other jurisdictions in which the Company operates.

## NOTE 15: Weighted-Average Shares

In July 2013, the Company's Board of Directors declared a two-for-one stock split of the Company's common stock, which was effected through a stock dividend distributed on September 16, 2013. All references made to share or per share amounts in the accompanying consolidated financial statements and applicable disclosures reflect this two-for-one stock split.

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

|  | Three-months Ended |               | Six-months Ended |               |
|--|--------------------|---------------|------------------|---------------|
|  | June 29, 2014      | June 30, 2013 | June 29, 2014    | June 30, 2013 |
| Basic weighted-average common shares outstanding                 | 86,782             | 87,044        | 86,830           | 86,784        |
| Effect of dilutive stock options                                 | 2,183              | 1,670         | 2,282            | 1,718         |
| Weighted-average common and common-equivalent shares outstanding | 88,965             | 88,714        | 89,112           | 88,502        |

Stock options to purchase 1,301,306 and 947,235 shares of common stock, on a weighted-average basis, were outstanding during the three-month and six-month periods ended June 29, 2014, respectively, and 1,632,214 and 1,264,311 for the same periods in 2013, but were not included in the calculation of dilutive net income per share because they were anti-dilutive.

## NOTE 16: 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 | June 29, 2014 | MVSD      | SISD     | Reconciling Items | Consolidated |
|--------------------|---------------|-----------|----------|-------------------|--------------|
| Product revenue    |               | \$90,069  | \$12,873 | \$—               | \$102,942    |
| Service revenue    |               | 2,207     | 3,653    | —                 | 5,860        |
| Operating income   |               | 34,184    | 4,571    | (8,033)           | 30,722       |
| Six-months Ended   | June 29, 2014 | MVSD      | SISD     | Reconciling Items | Consolidated |
| Product revenue    |               | \$167,687 | \$18,824 | \$—               | \$186,511    |
| Service revenue    |               | 5,905     | 7,315    | —                 | 13,220       |
| Operating income   |               | 62,476    | 5,584    | (14,895)          | 53,165       |



Table of Contents

## COGNEX CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

|                    |               |           |          |                   |              |
|--------------------|---------------|-----------|----------|-------------------|--------------|
| Three-months Ended | June 30, 2013 | MVSD      | SISD     | Reconciling Items | Consolidated |
| Product revenue    |               | \$72,012  | \$7,686  | \$—               | \$79,698     |
| Service revenue    |               | 2,301     | 4,511    | —                 | 6,812        |
| Operating income   |               | 23,527    | 2,227    | (5,581            | ) 20,173     |
| Six-months Ended   | June 30, 2013 | MVSD      | SISD     | Reconciling Items | Consolidated |
| Product revenue    |               | \$140,331 | \$14,039 | \$—               | \$154,370    |
| Service revenue    |               | 4,393     | 8,639    | —                 | 13,032       |
| Operating income   |               | 45,603    | 3,959    | (11,408           | ) 38,154     |

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.



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,” “could,” “should,” and similar words and other statements of a similar sense. These statements are based upon our current estimates and expectations as to prospective events and circumstances, which may or may not be in our control and as to which there can be no firm assurances given. These forward-looking statements, which include statements regarding business and market trends, future financial performance, customer order rates, expected areas of growth, emerging markets, future product mix, research and development activities, investments, and strategic plans, involve known and unknown risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include: (1) current and future conditions in the global economy; (2) the cyclical nature of the semiconductor and electronics industries; (3) the reliance on revenue from the automotive or consumer electronics industries; (4) the inability to penetrate new markets; (5) the inability to achieve significant international revenue; (6) fluctuations in foreign currency exchange rates and the use of derivative instruments; (7) the loss of a large customer; (8) the inability to attract and retain skilled employees; (9) the reliance upon key suppliers to manufacture and deliver critical components for our products; (10) the failure to effectively manage product transitions or accurately forecast customer demand; (11) the inability to design and manufacture high-quality products; (12) the technological obsolescence of current products and the inability to develop new products; (13) the failure to properly manage the distribution of products and services; (14) the inability to protect our proprietary technology and intellectual property; (15) our involvement in time-consuming and costly litigation; (16) the impact of competitive pressures; (17) the challenges in integrating and achieving expected results from acquired businesses; (18) potential impairment charges with respect to our investments or for acquired intangible assets or goodwill; (19) exposure to additional tax liabilities; and (20) information security breaches or business system disruptions. The foregoing list should not be construed as exhaustive and we encourage readers to refer to the detailed discussion of risk factors included in Part I—Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013. 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 and ID Products, 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 vision.

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, pharmaceutical, and medical devices. 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 second quarter of 2014.

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 second quarter of 2014.

Table of Contents

Surface vision 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 second quarter of 2014.

Revenue for the second quarter of 2014 totaled \$108,802,000, representing an increase of \$22,292,000, or 26%, from the same period in the prior year driven primarily by higher sales to customers in the factory automation market.

Gross margin was 76% of revenue in the second quarters of both 2014 and 2013. Operating expenses increased by \$7,103,000, or 16%, from the second quarter of 2013 due primarily to expenses associated with increased headcount and higher stock-based compensation expense. Operating income was \$30,722,000, or 28% of revenue, in the second quarter of 2014 compared to \$20,173,000, or 23% of revenue, in the second quarter of 2013; net income was \$25,948,000, or 24% of revenue, in the second quarter of 2014 compared to \$16,820,000, or 19% of revenue, in the second quarter of 2013; and net income per diluted share was \$0.29 in the second quarter of 2014 compared to \$0.19 in the second quarter of 2013.

**Results of Operations**

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

**Revenue**

Revenue increased by \$22,292,000, or 26%, for the three-month period in 2014 compared to the same period in 2013, and increased by \$32,329,000, or 19%, for the six-month period in 2014 compared to the same period in 2013. The increase in revenue for both periods was due to higher sales in all three markets served by the Company; however, the majority of the increase was attributable to higher sales in the factory automation market.

**Factory Automation Market**

Sales to customers in the factory automation market represented 77% and 80% of total revenue in the three-month and six-month periods in 2014, respectively, compared to 78% for the same periods in 2013. Sales to these customers increased by \$16,567,000, or 25%, for the three-month period and increased by \$28,299,000, or 22%, for the six-month period. Foreign currency exchange rate changes had a positive impact on total factory automation revenue as a stronger Euro in 2014 compared to the prior year was partially offset by the negative impact of a weaker Japanese Yen in 2014 compared to the prior year. Excluding the impact of foreign currency exchange rate changes on revenue, sales to factory automation customers increased by \$15,027,000, or 22%, for the three-month period and increased by \$26,700,000, or 20%, for the six-month period.

Geographically, increases were noted across all major regions in the three-month period and across all major regions except for Japan in the six-month period. However, excluding the impact of foreign currency exchange rate changes, the Japanese market increased in the six-month period as well. In both the three-month and six-month periods, the largest increases were noted in the Americas and Europe regions.

Sales to factory automation customers increased by \$8,622,000, or 12%, from the first quarter of 2014 driven by increases in Asia, where the first quarter is seasonally low, as well as positive momentum in Europe. In the third quarter of 2014, the Company expects to record a significant amount of factory automation revenue from a single customer.

**Semiconductor and Electronics Capital Equipment Market**

Sales to customers who make automation equipment for the semiconductor and electronics industries represented 8% and 7% of total revenue in the three-month and six-month periods in 2014, respectively, compared to 8% for the same periods in 2013. Sales to these customers increased by \$1,396,000, or 20%, for the three-month period and increased

by \$569,000, or 4%, for the six-month period. Excluding the impact of foreign currency exchange rate changes, sales to semiconductor and electronics capital equipment customers increased \$918,000, or 7%, for the six-month period. The impact of foreign currency exchange rate changes on revenue was not significant to the three-month period.

Table of Contents

Although sales to these customers increased by \$2,338,000, or 38%, from the first quarter of 2014, representing the second sequential quarter of sales growth, 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% and 13% of total revenue in the three-month and six-month periods in 2014, respectively, compared to 14% for the same periods in 2013. Revenue from these customers increased by \$4,329,000, or 36%, for the three-month period and increased by \$3,461,000, or 15%, for the six-month period. Excluding the impact of foreign currency exchange rate changes on revenue, sales to surface inspection customers increased by \$3,679,000, or 16%, for the six-month period. The impact of foreign currency exchange rate changes on revenue was not significant to the three-month period. The increases noted in both periods of 2014 were primarily due to the recognition of revenue in the second quarter of 2014 that had been deferred in the fourth quarter of 2013 and the first quarter of 2014 related to a new software release.

Revenue from the surface inspection market increased by \$6,913,000, or 72%, from the first quarter of 2014 due principally to the recognition of previously deferred revenue noted above. 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 increased by \$23,244,000, or 29%, for the three-month period and increased by \$32,141,000, or 21%, for the six-month period. These increases were driven by a higher volume of MVSD products sold than in the same periods in 2013, as well as the recognition in the second quarter of 2014 of SISD product revenue that was deferred in prior quarters.

Service Revenue

Service revenue, which is derived from the sale of maintenance and support, training, consulting, and installation services, decreased by \$952,000, or 14%, for the three-month period and was relatively flat for the six-month period. The decrease noted in the three-month period was primarily due to lower revenue from SISD installation services. Service revenue as a percentage of total revenue was 5% and 7% in the three-month and six-month periods in 2014, respectively, compared to 8% for the same periods in 2013.

Gross Margin

Gross margin as a percentage of revenue was 76% and 77% in the three-month and six-month periods in 2014, respectively, compared to 76% for the same periods in 2013. The increase noted in the six-month period was due to higher product margins at MVSD resulting from manufacturing efficiencies achieved from higher revenue levels, as fixed manufacturing costs were spread over a higher revenue base and favorable purchase price variances were achieved from higher purchasing volumes.

MVSD Margin

MVSD gross margin as a percentage of revenue was 80% for both the three-month and six-month periods in 2014, compared to 80% and 79% for the three-month and six-month periods in 2013, respectively. The increase noted in the six-month period was due to the impact of higher product margins noted above.

SISD Margin

SISD gross margin as a percentage of revenue was 54% and 53% for the three-month and six-month periods in 2014, respectively, compared to 52% and 53% for the same periods in 2013. The increase noted in the three-month period was due to a higher percentage of total revenue from the sale of products, which have higher margins than the sale of services.

Product Margin

Product gross margin as a percentage of revenue was 78% and 79% in the three-month and six-month periods in 2014, respectively, compared to 78% for the same periods in 2013. The increase noted in the six-month period was due to higher MVSD product margins as described above.



Table of Contents

## Service Margin

Service gross margin as a percentage of revenue was 45% and 47% in the three-month and six-month periods in 2014, respectively, compared to 52% for the same periods in 2013. These decreases were primarily due to lower SISD installation margins.

## Research, Development, and Engineering Expenses

Research, development, and engineering (RD&E) expenses increased by \$1,735,000, or 15%, for the three-month period in 2014 compared to the same period in 2013, and increased by \$2,916,000, or 13%, for the six-month period in 2014 compared to the same period in 2013. MVSD RD&E expenses increased by \$1,577,000, or 15%, for the three-month period and increased by \$2,693,000, or 13%, for the six-month period, while SISD RD&E expenses increased by \$158,000, or 15%, for the three-month period and increased by \$223,000, or 11%, for the six-month period.

The table below details the \$1,577,000 and the \$2,693,000 net increases in MVSD RD&E for the three-month and six-month periods, respectively (in thousands):

|  | Three-month<br>Period | Six-month<br>Period |
|--|-----------------------|---------------------|
| MVSD RD&E expenses in 2013             | \$10,845              | \$21,208            |
| Personnel costs                        | 306                   | 853                 |
| Engineering prototypes                 | 388                   | 679                 |
| Stock-based compensation expense       | 304                   | 521                 |
| Foreign currency exchange rate changes | 169                   | 131                 |
| Other                                  | 410                   | 509                 |
| MVSD RD&E expenses in 2014             | \$12,422              | \$23,901            |

The increase in MVSD RD&E expenses was primarily due to headcount additions, resulting in higher personnel costs, such as salaries and fringe benefits, as well as higher spending on materials for engineering prototypes and increased stock-based compensation expense due to a higher valuation of stock options granted in the first quarter of 2014. In addition, the Company recorded higher expense due to the unfavorable impact of a stronger Euro, as expenses denominated in Euro were translated to U.S. Dollars at a higher rate.

The increase in SISD RD&E expenses was primarily due to higher spending on outsourced engineering services (\$119,000 in the three-month period and \$177,000 in the six-month period).

RD&E expenses as a percentage of revenue were 13% for both the three-month and six-month periods in 2014, compared to 14% for the same periods in 2013. We believe that a continued commitment to RD&E activities is essential in order to maintain or achieve product leadership with our existing products and to provide innovative new product offerings. In addition, we consider our ability to accelerate time to market for new products to be critical to our revenue growth. Therefore, we expect to continue to make significant RD&E investments in the future, and we target our RD&E spending to be between 10% and 15% of revenue.

## Selling, General, and Administrative Expenses

Selling, general, and administrative (SG&A) expenses increased by \$5,368,000, or 16%, for the three-month period in 2014 compared to the same period in 2013, and increased by \$8,101,000, or 12%, for the six-month period in 2014 compared to the same period in 2013. MVSD SG&A expenses increased by \$3,647,000, or 14%, for the three-month period and increased by \$5,728,000, or 11%, for the six-month period, while SISD SG&A expenses increased by \$151,000, or 5%, for the three-month period and increased by \$303,000, or 5%, for the six-month period. Corporate expenses that are not allocated to either division increased by \$1,570,000, or 43%, for the three-month period and increased by \$2,070,000, or 29%, for the six-month period.

Table of Contents

The table below details the \$3,647,000 and the \$5,728,000 net increases in MVSD SG&A for the three-month and six-month periods, respectively (in thousands):

|  | Three-month<br>Period | Six-month<br>Period |
|--|-----------------------|---------------------|
| MVSD SG&A expenses in 2013             | \$26,448              | \$51,938            |
| Personnel costs                        | 2,472                 | 4,569               |
| Sales commissions                      | 219                   | 820                 |
| Stock-based compensation expense       | 375                   | 532                 |
| Foreign currency exchange rate changes | 406                   | 161                 |
| Other                                  | 175                   | (354)               |
| MVSD SG&A expenses in 2014             | \$30,095              | \$57,666            |

The increase in MVSD SG&A expenses was primarily due to headcount additions principally in Sales, resulting in higher personnel costs, such as salaries, fringe benefits, commissions, and travel expenses. The Company also recorded higher expenses related to sales commissions resulting from higher business levels and stock-based compensation expense due to a higher stock price valuation for options granted in the first quarter of 2014. In addition, the Company recorded higher expense due to the unfavorable impact of a stronger Euro, as expenses denominated in Euro were translated to U.S. Dollars at a higher rate.

The increase in SISD SG&A expenses was primarily due to higher sales commissions (\$34,000 for the three-month period and \$155,000 for the six-month period) and higher stock-based compensation expense (\$49,000 for the three-month period and \$121,000 for the six-month period).

The increase in corporate expenses was principally due to higher legal fees related to patent-infringement actions (\$1,060,000 for the three-month period and \$1,408,000 for the six-month period) and increased stock-based compensation expense (\$293,000 in the three-month period and \$464,000 in the six-month period).

#### Nonoperating Income (Expense)

The Company recorded foreign currency losses of \$96,000 and \$206,000 for the three-month and six-month periods in 2014, respectively, compared to foreign currency gains of \$76,000 and \$139,000 for the three-month and six-month periods of 2013, respectively. The foreign currency gains and losses in each period resulted primarily from the revaluation and settlement of accounts receivable, accounts payable, and intercompany balances that are reported in one currency and collected in another. Although a portion of the Company's foreign currency exposure 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 balance may not perfectly offset losses or gains on the contracts.

Investment income increased by \$27,000, or 3%, and \$422,000, or 36%, for the three-month and six-month periods in 2014 compared to the same periods in 2013, respectively. The six-month period in 2013 included a \$462,000 unrealized loss related to a corporate stock holding designated as a trading security, which was liquidated in late 2013. The majority of this loss was recorded in the first quarter of 2013.

The Company recorded other expense, net of other income, of \$75,000 and \$348,000 for the three-month and six-month periods in 2014, respectively, compared to other expense of \$257,000 and \$140,000 for the same periods in 2013. Other income (expense) includes rental income, net of associated expenses, from leasing buildings adjacent to the Company's corporate headquarters. In the first quarter of 2013, the Company recorded \$354,000 of other income due to the expiration of the statutes of limitations relating to tax holidays, during which time the Company collected value-added taxes from customers that were not required to be remitted to the government authority.



Table of Contents

## Income Tax Expense

The Company's effective tax rate was 17% and 18% for the three-month and six-month periods in 2014, respectively, compared to 19% and 18% for the three-month and six-month periods in 2013, respectively. The effective tax rate for the six-month period in 2014 was impacted by a discrete event recorded in the second quarter of 2014 related to the closing of the Internal Revenue Service audit of the Company for tax years 2010 and 2011, which reduced tax expense by \$553,000, including \$296,000 for the release of certain tax reserves related to the audit period and a change in risk assessment based on the audit results. The effective tax rate for the six-month period in 2013 was impacted by a discrete event recorded in the first quarter of 2013 related to the retroactive application of the 2012 research and development credit passed by Congress under the American Taxpayer Relief Act of 2012, which reduced tax expense by \$555,000. Although the provisions under this law were made retroactive to January 1, 2012, the law was signed on January 1, 2013, and therefore, the financial impact of any retroactive provision was recorded as a discrete event in the first quarter of 2013. Excluding the impact of these discrete events, the Company's effective tax rate was 19% in all periods presented.

## 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 \$467,574,000 as of June 29, 2014. 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 six months ended June 29, 2014 were met with its existing cash balances, cash from investment maturities, positive cash flows from operations, and the proceeds from stock option exercises. Cash requirements primarily consisted of operating activities, purchases of investments, the Company's stock repurchase program, and capital expenditures. In the first half of 2014, operating activities included significant cash outlays for inventories related to a revenue arrangement with a single customer. Although a significant amount of this inventory shipped and a portion of the fee was billed in the second quarter of 2014, the criteria for revenue recognition were not met as of June 29, 2014. Therefore, these costs are currently shown on the Consolidated Balance Sheets in "Deferred costs." The arrangement fee is expected to be collected during the second half of 2014. Capital expenditures for the six months ended June 29, 2014 totaled \$5,341,000 and consisted primarily of expenditures for building improvements at the Company's headquarters and adjacent buildings in Natick, Massachusetts, as well as computer hardware.

The Company is a Limited Partner in Venrock Associates III, L.P. (Venrock), a venture capital fund. The Company has committed to a total investment in the limited partnership of up to \$20,500,000, with the commitment period expiring on December 31, 2015. The Company does not have the right to withdraw from the partnership prior to this date. As of June 29, 2014, the Company had contributed \$19,886,000 to the partnership. The remaining commitment of \$614,000 can be called by Venrock in any period through December 31, 2015. Distributions and contributions are at the discretion of Venrock's management. No contributions were made and no distributions were received during the six months ended June 29, 2014.

In December 2012, the Company declared and paid a \$0.055 dividend that would typically have been declared in the first quarter of 2013 in conjunction with the 2012 earnings release. A special dividend of \$0.50 was also declared and paid in the fourth quarter of 2012 to replace expected quarterly dividend declarations for the next eight quarters, beginning in 2013. The additional \$0.055 dividend and the \$0.50 dividend were accelerated due to the anticipated increase in the federal tax on dividends paid after December 31, 2012. Due to these accelerated payments, no cash dividends were declared or paid during the six months ended June 29, 2014. 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 November 2011, the Company's Board of Directors authorized the repurchase of up to \$80,000,000 of the Company's common stock as a means to reduce the dilutive effect of employee stock options. Purchases under this 2011 program began in 2013. In 2014, the Company repurchased a total of 740,000 shares at a cost of \$27,004,000, including 360,000 shares at a cost of \$12,717,000 in the second quarter of 2014. On April 29, 2014, the Company's Board of Directors authorized the repurchase of an additional \$50,000,000 of the Company's stock. This new

authorization will commence once the Company completes the November 2011 program. The Company may repurchase shares under this program in future periods depending upon a variety of factors, including, among other things, the impact of dilution from employee stock options, stock price, share availability, and cash requirements. The Company believes that its existing cash, cash equivalent, and investment balances, together with cash flow from operations, will be sufficient to meet its operating, investing, and financing activities for the next twelve months. As of June 29, 2014, the Company had approximately \$465,618,000 in cash, cash equivalents, and debt securities that

Table of Contents

could be converted into cash. In addition, the Company has no debt and does not anticipate needing debt financing in the near future. We believe that our strong cash position has put us in a relatively good position with respect to our longer-term liquidity needs.

New Pronouncements

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

The amendments in ASU 2014-09 will supersede and replace all currently existing U.S. GAAP, including industry-specific revenue recognition guidance, with a single, principle-based revenue recognition framework. The concept guiding this new model is that revenue recognition will depict transfer of control to the customer in an amount that reflects consideration to which an entity expects to be entitled. The core principles supporting this framework include 1) identifying the contract with a customer, 2) identifying separate performance obligations within the contract, 3) determining the transaction price, 4) allocating the transaction price to the performance obligations, and 5) recognizing revenue. This new framework will require entities to apply significantly more judgment. This increase in management judgment will require expanded disclosure on estimation methods, inputs, and assumptions for revenue recognition. The guidance in ASU 2014-09 is effective for public companies for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. Management is in the process of evaluating the impact of this update.

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, 2013.

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 June 29, 2014 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

Table of Contents

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 May 2014, the parties mutually agreed to dismiss this action with prejudice. This matter is now closed.

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 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. 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. In December 2013, the Federal Circuit affirmed the ITC's finding of non-infringement, and therefore did not also need to address the ITC's finding regarding validity. This matter is now closed.

In March 2013, the Company filed a lawsuit against Microscan Systems, Inc. ("Microscan") and Code Corporation in the United States District Court for the Southern District of New York alleging that Microscan's Mobile Hawk handheld imager infringes U.S. Patent 7,874,487 owned by the Company (the "'487 patent"). The lawsuit sought to prohibit Code Corporation from manufacturing the product, and Microscan from selling and distributing the product. The Company also sought monetary damages resulting from the alleged infringement. Late in the day on April 30, 2014, the jury found that Microscan willfully infringed the '487 patent and awarded Cognex \$2.6M in damages. Following the verdict, Microscan filed motions requesting judgment as a matter of law on the issues of infringement, invalidity and willfulness, as well as a motion to dismiss for lack of standing. The Company filed motions seeking treble damages (based on the finding of willfulness), attorneys' fees as an exceptional case, and a permanent injunction against future infringement of the '487 patent and the import, manufacture and/or sale of Microscan's Mobile Hawk product within the U.S. Final briefs were filed on June 11, 2014. On June 29, 2014, the court issued an order denying all of Microscan's motions and the Company's motion for treble damages, while granting the Company's motion for permanent injunction (limited to enjoining future infringement of the '487 patent and the import, manufacture and/or sale of infringing versions Microscan's Mobile Hawk product within the U.S.) and the Company's motion for attorneys' fees, in part, pending a determination thereof following submission of supplemental briefs by both parties, which were due on July 25, 2014. The parties are currently awaiting a final judgment from the court.

The Company cannot predict the outcome of the above-referenced pending matter and an adverse resolution of this lawsuit 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, 2013.

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<br>of Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total Number of<br>Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans or<br>Programs (1) | Approximate<br>Dollar Value<br>of Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|-------------------------|---|------------------------------------|--|---|
| March 31—April 27, 2014 | —   | —                                  | —  | \$37,805,000  |
| April 28 —May 25, 2014  | 168,000                                   | 34.05                              | 168,000  | \$82,084,000  |
| May 26—June 29, 2014    | 192,000                                   | 36.44                              | 192,000  | \$75,088,000  |
| Total                   | 360,000                                   | 35.33                              | 360,000  | \$75,088,000  |

(1) In November 2011, the Company's Board of Directors authorized the repurchase of up to \$80,000,000 of the Company's common stock. On April 29, 2014, the Company's Board of Directors authorized the repurchase of an additional \$50,000,000 of the Company's stock to commence once the Company completes the \$80,000,000 program noted above.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

Exhibit Number

|      |   |
|------|---|
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934*  |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934*  |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**   |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**   |
| 101  | xBRL (Extensible Business Reporting Language)<br>The following materials from Cognex Corporation's Quarterly Report on Form 10-Q for the period ended June 29, 2014, formatted in xBRL: (i) Consolidated Statements of Operations for the three-month and six-month periods ended June 29, 2014 and June 30, 2013; (ii) Consolidated Statements of Comprehensive Income for the three-month and six-month periods ended June 29, 2014 and June 30, 2013; (iii) Consolidated Balance Sheets as of June 29, 2014 and December 31, 2013; (iv) Consolidated Condensed Statements of Cash Flows for the six-month periods ended June 29, 2014 and June 30, 2013; (v) Consolidated Statement of Shareholders' Equity for the six-month period ended June 29, 2014; and (vi) Notes to Consolidated Financial Statements. |
| *    | Filed herewith  |
| **   | Furnished herewith  |

Table of Contents

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: July 28, 2014

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)