

NATIONAL INSTRUMENTS CORP /DE/
Form 10-Q
November 06, 2012
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: September 30, 2012 or

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

For the transition period from _____ to _____

Commission file number: 0-25426

NATIONAL INSTRUMENTS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

74-1871327

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

11500 North MoPac Expressway

Austin, Texas

78759

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(address of principal executive offices)

(zip code)

Registrant's telephone number, including area code: (512) 338-9119

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at November 2, 2012
Common Stock - \$0.01 par value	122,815,363

NATIONAL INSTRUMENTS CORPORATION

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PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	September 30, 2012 (unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 311,536	\$ 142,608
Short-term investments	52,128	223,504
Accounts receivable, net	182,604	157,056
Inventories, net	155,273	131,995
Prepaid expenses and other current assets	49,668	38,082
Deferred income taxes, net	21,563	26,304
Total current assets	772,772	719,549
Property and equipment, net	223,144	190,148
Goodwill	129,092	130,747
Intangible assets, net	75,745	83,866
Other long-term assets	33,491	29,984
Total assets	\$ 1,234,244	\$ 1,154,294
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 52,211	\$ 41,111
Accrued compensation	34,850	29,616
Deferred revenue - current	87,803	80,059

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Accrued expenses and other liabilities	24,785	37,612
Other taxes payable	25,728	24,507
Total current liabilities	225,377	212,905
Deferred income taxes	42,030	43,186
Liability for uncertain tax positions	20,473	19,494
Deferred revenue - long-term	20,885	10,015
Other long-term liabilities	7,193	16,683
Total liabilities	315,958	302,283
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: par value \$0.01; 5,000,000 shares authorized; none issued and outstanding	-	-
Common stock: par value \$0.01; 180,000,000 shares authorized; 122,509,216 and 120,677,143 shares issued and outstanding, respectively	1,225	1,207
Additional paid-in capital	515,973	471,830
Retained earnings	400,694	382,474
Accumulated other comprehensive income (loss)	394	(3,500)
Total stockholders' equity	918,286	852,011
Total liabilities and stockholders' equity	\$ 1,234,244	\$ 1,154,294

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

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net sales:				
Product	\$ 267,894	\$ 247,256	\$ 776,208	\$ 699,007
Software maintenance	22,080	20,839	65,809	60,222
GSA accrual	-	(13,107)	1,349	(13,107)
Total net sales	289,974	254,988	843,366	746,122
Cost of sales:				
Product	71,796	63,579	201,374	169,340
Software maintenance	1,698	1,636	4,319	4,237
Total cost of sales	73,494	65,215	205,693	173,577
Gross profit	216,480	189,773	637,673	572,545
Operating expenses:				
Sales and marketing	109,213	103,195	320,021	286,547
Research and development	56,627	54,674	164,928	144,569
General and administrative	20,714	21,148	63,590	61,219
Total operating expenses	186,554	179,017	548,539	492,335
Operating income	29,926	10,756	89,134	80,210
Other income:				
Interest income	133	354	495	1,039
Net foreign exchange (loss)	(235)	(708)	(2,139)	(1,417)
Other income (expense), net	(899)	(95)	(644)	(220)
Income before income taxes	28,925	10,307	86,846	79,612
Provision for (benefit from) income taxes	4,585	(2,429)	17,423	9,867

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Net income	\$ 24,340	\$ 12,736	\$ 69,423	\$ 69,745
Basic earnings per share	\$ 0.20	\$ 0.11	\$ 0.57	\$ 0.58
Weighted average shares outstanding - basic	122,402	120,308	121,710	119,585
Diluted earnings per share	\$ 0.20	\$ 0.11	\$ 0.57	\$ 0.58
Weighted average shares outstanding - diluted	123,074	121,102	122,726	121,027
Dividends declared per share	\$ 0.14	\$ 0.10	\$ 0.42	\$ 0.30

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

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NATIONAL INSTRUMENTS CORPORATION

STATEMENT OF CONSOLIDATED COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	\$ 24,340	\$ 12,736	\$ 69,423	\$ 69,745
Other comprehensive income, before tax and net of reclassification adjustments:				
Foreign currency translation adjustment	2,278	(8,589)	1,324	(1,165)
Unrealized (loss) gain on securities available-for-sale, net	(609)	(281)	91	(1,285)
Unrealized (loss) gain on derivative instruments, net	(1,646)	(4,195)	2,986	(1,040)
Other comprehensive income (loss), before tax	23	(13,065)	4,401	(3,490)
Tax provision related to items of other comprehensive income	652	621	(507)	97
Other comprehensive income (loss), net of tax	675	(12,444)	3,894	(3,393)
Comprehensive income	\$ 25,015	\$ 292	\$ 73,317	\$ 66,352

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

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended		
	September 30,		
	2012		2011
Cash flow from operating activities:			
Net income	\$ 69,423	\$	69,745
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	41,029		35,745
Stock-based compensation	20,506		16,650
Tax expense (benefit) from deferred income taxes	3,626		(491)
Tax (benefit) from stock option plans	(2,353)		(5,047)
Changes in operating assets and liabilities:			
Accounts receivable	(25,549)		(23,509)
Inventories	(23,278)		(12,376)
Prepaid expenses and other assets	(10,296)		(9,000)
Accounts payable	11,100		4,112
Deferred revenue	(2,271)		10,215
Taxes, accrued expenses and other liabilities	8,325		30,456
Net cash provided by operating activities	90,262		116,500
Cash flow from investing activities:			
Capital expenditures	(52,483)		(40,329)
	(11,284)		(11,412)

Capitalization of internally developed software		
Additions to other intangibles	(1,426)	(3,226)
Acquisition, net of cash received	-	(73,558)
Purchases of short-term investments	(48,718)	(93,299)
Sales and maturities of short-term investments	220,094	86,086
Net cash provided/(used) by investing activities	106,183	(135,738)
Cash flow from financing activities:		
Proceeds from issuance of common stock	21,297	27,152
Dividends paid	(51,167)	(35,897)
Tax benefit from stock option plans	2,353	5,047
Net cash used by financing activities	(27,517)	(3,698)
Net change in cash and cash equivalents	168,928	(22,936)
Cash and cash equivalents at beginning of period	142,608	219,447
Cash and cash equivalents at end of period	\$ 311,536	\$ 196,511

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

NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of presentation

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2011, included in our annual report on Form 10-K, filed with the Securities and Exchange Commission. In our opinion, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring items) considered necessary to present fairly our financial position at September 30, 2012 and December 31, 2011, the results of our operations and comprehensive income for the three month and nine month periods ended September 30, 2012 and September 30, 2011, and our cash flows for the nine month periods ended September 30, 2012 and September 30, 2011. Operating results for the three month and nine month periods ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

Beginning in the three month period ended June 30, 2012, we have separately reported our current and long-term deferred revenue. The separation has no impact on total reported deferred revenue, total liabilities, or total stockholder's equity for any period on our Consolidated Balance Sheets. We assessed the materiality of this item on our previously reported periods and concluded the separation was not material. Certain prior year amounts have been reclassified to conform to the 2012 presentation as shown in the following table:

(In thousands)	December 31, 2011
Deferred revenue, as previously reported	\$ 90,074
Balances as reported in this Form 10-Q:	
Deferred revenue - current	80,059
Deferred revenue - long-term	10,015

Note 2 – Earnings per share

Basic earnings per share (“EPS”) is computed by dividing net income by the weighted average number of common shares outstanding during each period. Diluted EPS is computed by dividing net income by the weighted average number of common shares and common share equivalents outstanding (if dilutive) during each period. The number of common share equivalents, which include stock options and restricted stock units (“RSUs”), is computed using the treasury stock method.

The reconciliation of the denominators used to calculate basic EPS and diluted EPS for the three month and nine month periods ended September 30, 2012 and 2011, respectively, are as follows:

	Three months ended September 30, (In thousands) (Unaudited)		Nine months ended September 30, (In thousands) (Unaudited)	
	2012	2011	2012	2011
Weighted average shares outstanding-basic	122,402	120,308	121,710	119,585
Plus: Common share equivalents				
Stock options, restricted stock units	672	794	1,016	1,442
Weighted average shares outstanding-diluted	123,074	121,102	122,726	121,027

Stock awards to acquire 1,201,000 and 1,400,000 shares for the three month periods ended September 30, 2012 and 2011, respectively, and 5,030 and 640,000 shares for the nine month periods ended September 30, 2012 and 2011, respectively, were excluded in the computations of diluted EPS because the effect of including the stock awards would have been anti-dilutive.

Note 3 – Cash, cash equivalents and short-term investments

The following tables summarize unrealized gains and losses related to our short-term investments designated as available-for-sale:

(In thousands)	As of September 30, 2012 (Unaudited)				
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Cumulative Translation Adjustment	Fair Value
Cash	\$ 128,384	\$ -	\$ -	\$ -	\$ 128,384
Money Market Accounts	131,753	-	-	-	131,753
Municipal bonds	1,463	3	-	-	1,466
Corporate bonds	5,100	7	-	-	5,107
U.S. treasuries and agencies	61,928	1	(1)	-	61,928
Foreign government bonds	36,616	98	-	(4,600)	32,114
Time deposits	2,912	-	-	-	2,912
Cash, cash equivalents, and short-term investments	\$ 368,156	\$ 109	\$ (1)	\$ (4,600)	\$ 363,664

(In thousands)	As of December 31, 2011				
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Cumulative Translation Adjustment	Fair Value
Cash	\$ 106,431	\$ -	\$ -	\$ -	\$ 106,431
Money Market Accounts	22,677	-	-	-	22,677
Municipal bonds	12,381	11	-	-	12,392
Corporate bonds	18,631	-	(67)	-	18,564
U.S. treasuries and agencies	170,926	2	(9)	-	170,919
Foreign government bonds	36,460	240	(1)	(4,482)	32,217
Time deposits	2,912	-	-	-	2,912
Cash, cash equivalents, and short-term investments	\$ 370,418	\$ 253	\$ (77)	\$ (4,482)	\$ 366,112

The following tables summarize the contractual maturities of our short-term investments designated as available-for-sale:

(in thousands)	As of September 30, 2012 (Unaudited)	
	Adjusted Cost	Fair Value
Due in less than 1 year	\$ 92,306	\$ 89,047
Due in 1 to 5 years	15,713	14,480
Total available-for-sale debt securities	\$ 108,019	\$ 103,527

(in thousands)	As of September 30, 2012 (Unaudited)	
	Adjusted Cost	Fair Value
Due in less than 1 year		
Corporate bonds	\$ 5,100	\$ 5,107
U.S. treasuries and agencies	57,519	57,520
Foreign government bonds	26,775	23,508
Time deposits	2,912	2,912
Total available-for-sale debt securities	\$ 92,306	\$ 89,047

(in thousands)	As of September 30, 2012 (Unaudited)	
	Adjusted Cost	Fair Value
Due in 1 to 5 years		
Municipal bonds	\$ 1,463	\$ 1,466
U.S. treasuries and agencies	4,409	4,408
Foreign government bonds	9,841	8,606
Total available-for-sale debt securities	\$ 15,713	\$ 14,480

Note 4 – Fair value measurements

We define fair value to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, we consider the principal or most advantageous market that market participants may use when pricing the asset or liability.

We follow a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Fair value measurement is determined based on the lowest level input that is significant to the fair value measurement. The three values of the fair value hierarchy are the following:

Level 1 – Quoted prices in active markets for identical assets or liabilities

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3 – Inputs that are not based on observable market data

Assets and liabilities measured at fair value on a recurring basis are summarized below:

(In thousands)	Fair Value Measurements at Reporting Date Using (Unaudited)			
	September 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents available for sale:				
Money Market Funds	\$ 131,753	\$ 131,753	\$ -	\$ -
U.S. treasuries and agencies	51,399	-	51,399	-
Short-term investments available for sale:				

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Municipal bonds	1,466	-	1,466	-
Corporate bonds	5,107	-	5,107	-
U.S. treasuries and agencies	10,529	-	10,529	-
Foreign government bonds	32,114	-	32,114	-
Time deposits	2,912	2,912	-	-
Derivatives	2,940	-	2,940	-
Total Assets	\$ 238,220	\$ 134,665	\$ 103,555	\$ -
Liabilities				
Derivatives	\$ (2,172)	\$ -	\$ (2,172)	\$ -
Total Liabilities	\$ (2,172)	\$ -	\$ (2,172)	\$ -

(In thousands)	Fair Value Measurements at Reporting Date Using				
		Quoted Prices in Active Markets for Identical Assets	Significant Inputs (Level 2)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Description	December 31, 2011	(Level 1)			
Assets					
Cash and cash equivalents available for sale:					
Money Market Funds	\$ 22,677	\$ 22,677	\$ -		\$ -
U.S. Treasuries and Agencies	13,500	-	13,500		-
Short-term investments available for sale:					
Municipal bonds	12,392	-	12,392		-
Corporate bonds	18,564	-	18,564		-
U.S. treasuries and agencies	157,419	-	157,419		-
Foreign government bonds	32,217	-	32,217		-
Time deposits	2,912	2,912	-		-
Derivatives	4,297	-	4,297		-
Total Assets	\$ 263,978	\$ 25,589	\$ 238,389		\$ -
Liabilities					
Derivatives	\$ (4,542)	\$ -	\$ (4,542)		\$ -
Total Liabilities	\$ (4,542)	\$ -	\$ (4,542)		\$ -

We value our available-for-sale short-term investments based on pricing from third party pricing vendors, who may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. We classify all of our fixed income available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of our financial instruments having Level 2 inputs were derived from non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques. We believe all of these sources reflect the credit risk associated with each of our available-for-sale short-term investments. Short-term investments available-for-sale consists of debt securities issued by states of the U.S. and political subdivisions of the U.S., corporate debt securities and debt securities issued by U.S. government corporations and agencies as well as debt securities issued by foreign governments. All short-term investments available-for-sale have contractual maturities of less than 24 months.

Derivatives include foreign currency forward and option contracts. Our foreign currency forward contracts are valued using an income approach (Level 2) based on the spot rate less the contract rate multiplied by the notional amount. Our foreign currency option contracts are valued using a market approach based on the quoted market prices which are derived from observable inputs including current and future spot rates, interest rate spreads as well as quoted market prices of similar instruments. We consider counterparty credit risk in the valuation of our derivatives. However, counterparty credit risk did not impact the valuation of our derivatives during the nine month period ended September 30, 2012. There were not any transfers in or out of Level 1 or Level 2 during the nine month period ended September 30, 2012.

Our foreign government bonds consist of German government sovereign debt denominated in Euro with maximum maturities of 24 months. Our short-term investments do not involve sovereign debt from any other country in Europe.

We did not have any items that were measured at fair value on a nonrecurring basis at September 30, 2012 and December 31, 2011.

The carrying value of net accounts receivable and accounts payable contained in the Consolidated Balance Sheets approximates fair value.

Note 5 – Derivative instruments and hedging activities

We recognize all of our derivative instruments as either assets or liabilities in our statement of financial position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on

whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, we designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

We have operations in over 40 countries. Sales outside of the Americas accounted for approximately 59% and 61% of our revenues during each of the three month periods ended September 30, 2012 and 2011, respectively, and 60% of our revenues during each of the nine month periods ended September 30, 2012 and 2011. Our activities expose us to a variety of market risks, including the effects of changes in foreign currency exchange rates. These financial risks are monitored and managed by us as an integral part of our overall risk management program.

We maintain a foreign currency risk management strategy that uses derivative instruments (foreign currency forward and purchased option contracts) to help protect our earnings and cash flows from fluctuations caused by the volatility in currency exchange rates. Movements in foreign currency exchange rates pose a risk to our operations and competitive position, since exchange rate changes may affect our profitability and cash flow, and the business or pricing strategies of our non-U.S. based competitors.

The vast majority of our foreign sales are denominated in the customers' local currency. We purchase foreign currency forward and option contracts as hedges of forecasted sales that are denominated in foreign currencies and as hedges of foreign currency denominated receivables. These contracts are entered into to help protect against the risk that the eventual dollar-net-cash inflows resulting from such sales or firm commitments will be adversely affected by changes in exchange rates. We also purchase foreign currency forward contracts as hedges of forecasted expenses that are denominated in foreign currencies. These contracts are entered into to help protect against the risk that the eventual dollar-net-cash outflows resulting from foreign currency operating and cost of revenue expenses will be adversely affected by changes in exchange rates.

We designate foreign currency forward and purchased option contracts as cash flow hedges of forecasted revenues or forecasted expenses. In addition, we hedge our foreign currency denominated balance sheet exposures using foreign currency forward contracts that are not designated as hedging instruments. None of our derivative instruments contain a credit-risk-related contingent feature.

Cash flow hedges

To help protect against the reduction in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales over the next one to two years, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue and forecasted expenses denominated in foreign currencies with forward and purchased option contracts. For forward contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the forward contracts designated as hedges. For option contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the option contracts net of the premium paid designated as hedges. Our foreign currency purchased option contracts are purchased “at-the-money” or “out-of-the-money”. We purchase foreign currency forward and option contracts for up to 100% of our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, Korean won and Hungarian forint) and limit the duration of these contracts to 40 months or less.

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (“OCI”) and reclassified into earnings in the same line item (net sales, operating expenses, or cost of sales) associated with the forecasted transaction and in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings or expenses during the current period and are classified as a component of “net foreign exchange gain (loss)”. Hedge effectiveness of foreign currency forwards and purchased option contracts designated as cash flow hedges are measured by comparing the hedging instrument’s cumulative change in fair value from inception to maturity to the forecasted transaction’s terminal value.

We held forward contracts with the following notional amounts:

(In thousands)	US Dollar Equivalent	
	As of September 30, 2012 (Unaudited)	As of December 31, 2011
Euro	\$ 58,443	\$ 60,992
Japanese yen	24,497	43,569
Korean won	-	3,309
Hungarian forint	21,229	28,189
Total forward contracts notional amount	\$ 104,169	\$ 136,059

The contracts in the foregoing table had contractual maturities of 24 months or less at September 30, 2012 and December 31, 2011, respectively.

At September 30, 2012, we expect to reclassify \$1.4 million of gains on derivative instruments from accumulated OCI to net sales during the next twelve months when the hedged international sales occur, \$98,000 of gains on derivative instruments from accumulated OCI to cost of sales when the cost of sales are incurred and \$85,000 of gains on derivative instruments from accumulated OCI to operating expenses during the next twelve months when the hedged operating expenses occur. Expected amounts are based on derivative valuations at September 30, 2012. Actual results may vary as a result of changes in the corresponding exchange rate subsequent to this date.

We did not record any ineffectiveness from our hedges during the three and nine month periods ended September 30, 2012 and 2011.

Other Derivatives

Other derivatives not designated as hedging instruments consist primarily of foreign currency forward contracts that we use to hedge our foreign denominated net receivable or net payable positions to protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically attempt to hedge up to 90% of our outstanding foreign denominated net receivables or net payables and typically limit the duration of these foreign currency forward contracts to approximately 120 days. The gain or loss on the derivatives as well as the offsetting gain or loss on the hedge item attributable to the hedged risk is recognized in current earnings under the line item "net foreign exchange gain (loss)". As of September 30, 2012 and December 31, 2011, we held foreign currency forward contracts with a notional amount of \$39.3 million and \$53.8 million, respectively.

The following tables present the fair value of derivative instruments on our Consolidated Balance Sheets and the effect of derivative instruments on our Consolidated Statements of Income.

Fair Values of Derivative Instruments:

(In thousands)	Asset Derivatives September 30, 2012 (Unaudited)		December 31, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Foreign exchange contracts - ST forwards	Prepaid expenses and other current assets	\$ 2,340	Prepaid expenses and other current assets	\$ 2,500
Foreign exchange contracts - LT forwards	Other long-term assets	461	Other long-term assets	190
Total derivatives designated as hedging instruments		\$ 2,801		\$ 2,690
Derivatives not designated as hedging instruments				

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Foreign exchange contracts - ST forwards	Prepaid expenses and other current assets	\$ 139	Prepaid expenses and other current assets	\$ 1,607
Total derivatives not designated as hedging instruments		\$ 139		\$ 1,607
Total derivatives		\$ 2,940		\$ 4,297

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(In thousands)	Liability Derivatives September 30, 2012 (Unaudited)		December 31, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Foreign exchange contracts - ST forwards	Accrued expenses and other liabilities	\$ (766)	Accrued expenses and other liabilities	\$ (2,007)
Foreign exchange contracts - LT forwards	Other long-term liabilities	(272)	Other long-term liabilities	(1,770)
Total derivatives designated as hedging instruments		\$ (1,038)		\$ (3,777)
Derivatives not designated as hedging instruments				
Foreign exchange contracts - ST forwards	Accrued expenses and other liabilities	\$ (1,134)		\$ (765)
Total derivatives not designated as hedging instruments		\$ (1,134)		\$ (765)
Total derivatives		\$ (2,172)		\$ (4,542)

The following tables present the effect of derivative instruments on our Consolidated Statements of Income for the three month periods ended September 30, 2012 and 2011, respectively:

September 30, 2012

(In thousands)

(Unaudited)

	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)
Derivatives in Cash Flow Hedging Relationship Foreign exchange contracts - forwards and	\$ (2,119)	Net sales	\$ 857	Net foreign exchange gain (loss)	\$ -

options

Foreign exchange contracts - forwards and options	309	Cost of sales	92	Net foreign exchange gain (loss)	-
Foreign exchange contracts - forwards and options	164	Operating expenses	62	Net foreign exchange gain (loss)	-
Total	\$ (1,646)		\$ 1,011		\$ -

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September 30, 2011

(In thousands)

(Unaudited)

	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)
Derivatives in Cash Flow Hedging Relationship Foreign exchange contracts - forwards and options	\$ 1,097	Net sales	\$ (1,124)	Net foreign exchange gain (loss)	\$ -
Foreign exchange contracts - forwards and options	(3,608)	Cost of sales	507	Net foreign exchange gain (loss)	-
Foreign exchange contracts - forwards and options	(1,684)	Operating expenses	190	Net foreign exchange gain (loss)	-
Total	\$ (4,195)		\$ (427)		\$ -

(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income September 30, 2012 (Unaudited)	Amount of Gain (Loss) Recognized in Income September 30, 2011 (Unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	\$ (1,164)	\$ 2,744
Total		\$ (1,164)	\$ 2,744

The following tables present the effect of derivative instruments on our Consolidated Statements of Income for the nine month periods ended September 30, 2012 and 2011, respectively:

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September 30, 2012

(In thousands)

(Unaudited)

	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)
Derivatives in Cash Flow Hedging Relationship Foreign exchange contracts - forwards and options	\$ (376)	Net sales	\$ 2,061	Net foreign exchange gain (loss)	\$ -
Foreign exchange contracts - forwards and options	2,180	Cost of sales	187	Net foreign exchange gain (loss)	-
Foreign exchange contracts - forwards and options	1,182	Operating expenses	125	Net foreign exchange gain (loss)	-
Total	\$ 2,986		\$ 2,373		\$ -

September 30, 2011

(In thousands)

(Unaudited)

	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)
Derivatives in Cash Flow Hedging Relationship Foreign exchange contracts - forwards and options	\$ 630	Net sales	\$ (2,864)	Net foreign exchange gain (loss)	\$ -
	(1,128)	Cost of sales	1,257		-

Foreign
exchange
contracts -
forwards and
options

Net foreign
exchange gain
(loss)

Foreign
exchange
contracts -
forwards and
options

Net foreign
exchange gain
(loss)

	(541)	Operating expenses	612		-
Total	\$ (1,039)		\$ (995)		\$ -

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(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income September 30, 2012 (Unaudited)	Amount of Gain (Loss) Recognized in Income September 30, 2011 (Unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	\$ (1,400)	\$ 641
Total		\$ (1,400)	\$ 641

Note 6 – Inventories

Inventories, net consist of the following:

(In thousands)	September 30, 2012 (Unaudited)	December 31, 2011
Raw materials	\$ 68,728	\$ 56,139
Work-in-process	6,898	5,708
Finished goods	79,647	70,148
	\$ 155,273	\$ 131,995

Note 7 – Intangibles

Intangibles at September 30, 2012 and December 31, 2011 are as follows:

(In thousands)	September 30, 2012 (Unaudited)			December 31, 2011		Net Carrying Amount
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	

Capitalized software development costs	\$ 64,858	\$ (40,208)	\$ 24,650	\$ 53,086	\$ (29,606)	\$ 23,480
Acquired technology	67,908	(39,363)	28,545	67,918	(32,210)	35,708
Patents	23,556	(9,043)	14,513	21,875	(7,992)	13,883
Other	24,098	(16,061)	8,037	24,614	(13,819)	10,795
	\$ 180,420	\$ (104,675)	\$ 75,745	\$ 167,493	\$ (83,627)	\$ 83,866

Software development costs capitalized for the three month periods ended September 30, 2012 and 2011 were \$1.7 million and \$2.1 million, respectively, and related amortization expense was \$3.5 million and \$3.3 million, respectively. For the nine month periods ended September 30, 2012 and 2011, capitalized software development costs were \$11.8 million and \$11.9 million, respectively, and related amortization expense was \$10.6 million and \$9.9 million, respectively. Capitalized software development costs for the three month periods ended September 30, 2012 and 2011 included costs related to stock based compensation of \$89,000 and \$96,000, respectively. For the nine month periods ended September 30, 2012 and 2011, capitalized software development costs included costs related to stock based compensation of \$489,000 and \$508,000, respectively.

Amortization of capitalized software development costs is computed on an individual product basis for those products available for market and is recognized based on the product's estimated economic life, generally three years. Acquired core technology and intangible assets are amortized over their useful lives, which range from three to eight years. Patents are amortized using the straight-line method over their estimated period of benefit, generally 10 to 17 years. Total intangible assets amortization expenses were \$7.3 million and \$6.8 million for the three months ended September 30, 2012 and 2011, respectively, and \$21.0 million and \$17.5 million for the nine month periods ended September 30, 2012 and 2011, respectively.

Note 8 – Goodwill

The carrying amount of goodwill as of September 30, 2012, was as follows:

	Amount (In thousands)
Balance as of December 31, 2011	\$ 130,747
Purchase price adjustments	(1,623)
Divestitures	-
Foreign currency translation impact	(32)
Balance as of September 30, 2012 (unaudited)	\$ 129,092

The excess purchase price over the fair value of assets acquired is recorded as goodwill. See Note 16 – Acquisitions, for discussion regarding the purchase price adjustment in the table above. As we have one operating segment, we allocate goodwill to one reporting unit for goodwill impairment testing. Goodwill is tested for impairment on an annual basis, and between annual tests if indicators of potential impairment exist, using a fair-value-based approach based on the market capitalization of the reporting unit. Our annual impairment test was performed as of February 29, 2012. No impairment of goodwill was identified during 2012 and 2011. Goodwill is deductible for tax purposes in certain jurisdictions.

Note 9 – Income taxes

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Valuation allowances are established when necessary to reduce deferred tax assets to amounts which are more likely than not to be realized.

We account for uncertainty in income taxes recognized in our financial statements using prescribed recognition thresholds and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on our tax returns. We had \$20.5 million and \$19.5 million of unrecognized tax benefits at September 30, 2012 and December 31, 2011, respectively, all of which would affect our effective income tax rate if recognized. We recorded a gross increase in unrecognized tax benefits of \$1.2 million and \$2.9 million for the three and nine month periods ended September 30, 2012, respectively, as a result of tax positions taken during the period. We recorded a gross decrease in unrecognized tax benefits of \$2.2 million and \$2.5 million for the three and nine month periods ended September 30, 2012, respectively, as a result of settlements with taxing authorities and the closing of open years. As of September 30, 2012, it is deemed reasonable that we will recognize tax benefits in the amount of \$937,000 in the next twelve months due to the closing of open tax years. The nature of the uncertainty with regard to the amount of the benefit we may recognize is related to deductions taken on returns that have not been examined by the applicable tax authority. Our continuing policy is to recognize interest and penalties related to income tax matters in income tax expense. As of September 30, 2012, we have approximately \$1.0 million accrued for interest related to uncertain tax positions. The tax years 2005 through 2011 remain open to examination by the major taxing jurisdictions to which we are subject.

Our provision for income taxes reflected an effective tax rate of 16% and (24%) for the three month periods ended September 30, 2012 and 2011, respectively, and of 20% and 12% for the nine month periods ended September 30, 2012 and 2011, respectively. For the three and nine month periods ended September 30, 2012, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates, and a decrease in unrecognized tax benefits for uncertain tax positions. For the three and nine month periods ended September 30, 2011, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates, the U.S. federal research and development credit, a decrease in unrecognized tax benefits for uncertain tax provisions and the tax benefit from an accrual related to our terminated contract with the U.S. General Services Administration.

Our earnings in Hungary are subject to a statutory tax rate of 19%. The difference between this rate and the statutory U.S. rate of 35% resulted in income tax benefits of \$3.1 million and \$1.4 million for the three month periods ended September 30, 2012 and 2011, respectively, and \$8.3 million and \$8.8 million for the nine month periods ended September 30, 2012 and 2011, respectively. No countries other than Hungary had a significant impact on our effective tax rate. We have not entered into any advanced pricing or other agreements with the Internal Revenue Service with regard to any foreign jurisdictions.

The tax position of our Hungarian operation continues to benefit from assets created by the restructuring of our operations in Hungary. In addition, our research and development activities in Hungary continue to benefit from a tax law in Hungary that provides for an enhanced deduction for qualified research and development expenses. Partial release of the valuation allowance on assets from the restructuring and the enhanced tax deduction for research expenses resulted in income tax benefits of \$4.1 million and \$2.2 million for the three month periods ended September 30, 2012 and 2011, respectively, and \$11.8 million and \$12.2 million for the nine month periods ended September 30, 2012 and 2011, respectively.

Note 10 – Comprehensive income

Our comprehensive income is comprised of net income, foreign currency translation, unrealized gains and losses on forward and option contracts and securities classified as available-for-sale. The accumulated other comprehensive income/(loss), net of tax, as of September 30, 2012 and 2011, consisted of the following:

	September 30, 2012 (Unaudited)			
(In thousands)	Currency translation adjustment	Investments	Derivative instruments	Accumulated other comprehensive income
Balance as of December 31, 2011	\$ (1,543)	\$ (664)	\$ (1,293)	\$ (3,500)

Current-period other comprehensive income	1,324	91	2,479	3,894
Balance as of September 30, 2012	\$ (219)	\$ (573)	\$ 1,186	\$ 394

(In thousands)	September 30, 2011 (Unaudited) Currency translation adjustment	Investments	Derivative instruments	Accumulated other comprehensive income
Balance as of December 31, 2010	\$ (496)	\$ 196	\$ (410)	\$ (710)
Current-period other comprehensive (loss)	(1,165)	(1,285)	(943)	(3,393)
Balance as of September 30, 2011	\$ (1,661)	\$ (1,089)	\$ (1,353)	\$ (4,103)

Note 11 – Stock-based compensation plans

Stock option plans

Our stockholders approved the 1994 Incentive Stock Option Plan (the “1994 Plan”) in May 1994. At the time of approval, 13,668,750 shares of our common stock were reserved for issuance under this plan. In 1997, an additional 10,631,250 shares of our common stock were reserved for issuance under this plan, and an additional 1,125,000 shares were reserved for issuance under this plan in 2004. The 1994 Plan terminated in May 2005, except with respect to outstanding awards previously granted thereunder.

Awards under the plan were either incentive stock options within the meaning of Section 422 of the Internal Revenue Code or nonqualified options. The right to purchase shares under the options vests over a five to ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company's previous year's earnings and revenue growth but shares cannot accelerate to vest over a period of less than five years. Stock options must be exercised within ten years from date of grant. Stock options were issued with an exercise price which was equal to the market price of our common stock at the grant date. We estimate potential forfeitures of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods. During the nine month period ended September 30, 2012, we did not make any changes in accounting principles or methods of estimates.

Restricted stock plan

Our stockholders approved our 2005 Incentive Plan (the "2005 Plan") in May 2005. At the time of approval, 4,050,000 shares of our common stock were reserved for issuance under this plan, as well as the number of shares which had been reserved but not issued under the 1994 Plan (our incentive stock option plan which terminated in May 2005), and any shares that returned to the 1994 Plan as a result of termination of options or repurchase of shares issued under such plan. The 2005 Plan, administered by the Compensation Committee of the Board of Directors, provided for granting of incentive awards in the form of restricted stock and RSUs to directors, executive officers and employees of the Company and its subsidiaries. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company's previous year's earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. The 2005 Plan terminated on May 11, 2010, except with respect to outstanding awards previously granted thereunder. There were 3,362,304 shares of common stock that were reserved but not issued under the 1994 Plan and the 2005 Plan as of May 11, 2010.

Our stockholders approved our 2010 Incentive Plan (the "2010 Plan") on May 11, 2010. At the time of approval, 3,000,000 shares of our common stock were reserved for issuance under this plan, as well as the 3,362,304 shares of common stock that were reserved but not issued under the 1994 Plan and the 2005 Plan as of May 11, 2010, and any shares that are returned to the 1994 Plan and the 2005 Plan as a result of forfeiture or termination of options or RSUs or repurchase of shares issued under these plans. The 2010 Plan, administered by the Compensation Committee of the Board of Directors, provides for granting of incentive awards in the form of restricted stock and RSUs to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company's previous year's earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. There were 3,854,515 shares available for grant under the 2010 Plan at September 30, 2012.

We estimate potential forfeitures of RSUs and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods. During the nine month period ended September 30, 2012, we did not make any changes in accounting

principles or methods of estimates related to the 2010 Plan.

Employee stock purchase plan

Our employee stock purchase plan permits substantially all domestic employees and employees of designated subsidiaries to acquire our common stock at a purchase price of 85% of the lower of the market price at the beginning or the end of the purchase period. The plan has quarterly purchase periods generally beginning on February 1, May 1, August 1 and November 1 of each year. Employees may designate up to 15% of their compensation for the purchase of common stock under this plan. On May 10, 2011, our stockholders approved an additional 3,000,000 shares for issuance under our employee stock purchase plan, and at September 30, 2012, we had 2,859,480 shares of common stock reserved for future issuance under this plan. We issued 820,658 shares under this plan in the nine month period ended September 30, 2012. The weighted average fair value of the employees' purchase rights was \$22.50 per share and was estimated using the Black-Scholes model. During the nine months ended September 30, 2012, we did not make any changes in accounting principles or methods of estimates with respect to such plan.

Authorized Preferred Stock and Preferred Stock Purchase Rights Plan

We have 5,000,000 authorized shares of preferred stock. On January 21, 2004, our Board of Directors designated 750,000 of these shares as Series A Participating Preferred Stock in conjunction with its adoption of a Preferred Stock Rights Agreement (the "Rights Agreement") and declaration of a dividend of one preferred share purchase right (a "Right") for each share of common stock outstanding held as of May 10, 2004 or issued thereafter. Each Right will entitle its holder to purchase one one-thousandth of a share of National Instruments' Series A Participating Preferred Stock at an exercise price of \$200, subject to adjustment, under certain circumstances. The Rights Agreement was not adopted in response to any effort to acquire control of National Instruments.

The Rights only become exercisable in certain limited circumstances following the tenth day after a person or group announces acquisitions of or tender offers for 20% or more of our common stock. In addition, if an acquirer (subject to certain exclusions for certain current stockholders of National Instruments, an “Acquiring Person”) obtains 20% or more of our common stock, then each Right (other than the Rights owned by an Acquiring Person or its affiliates) will entitle the holder to purchase, for the exercise price, shares of our common stock having a value equal to two times the exercise price. Under certain circumstances, our Board of Directors may redeem the Rights, in whole, but not in part, at a purchase price of \$0.01 per Right. The Rights have no voting privileges and are attached to and automatically traded with our common stock until the occurrence of specified trigger events. The Rights will expire on the earlier of May 10, 2014 or the exchange or redemption of the Rights.

There were not any shares of preferred stock issued and outstanding at September 30, 2012.

Note 12 – Segment information

We determine operating segments using the management approach. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of our operating segments. It also requires disclosures about products and services, geographic areas and major customers.

We have defined our operating segment based on geographic regions. We sell our products in three geographic regions. Our sales to these regions share similar economic characteristics, similar product mix, similar customers, and similar distribution methods. Accordingly, we have elected to aggregate these three geographic regions into a single operating segment. Revenue from the sale of our products which are similar in nature and software maintenance are reflected as total net sales in our Consolidated Statements of Income.

Total net sales, operating income, interest income and long-lived assets, classified by the major geographic areas in which we operate, are as follows:

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30, (Unaudited)		September 30, (Unaudited)	
	2012	2011	2012	2011
Net sales:				

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Americas:	\$ 117,542	\$ 98,537	\$ 337,601	\$ 299,614
Europe:	69,820	75,127	218,491	222,566
Asia Pacific:	102,612	81,324	287,274	223,942
	\$ 289,974	\$ 254,988	\$ 843,366	\$ 746,122

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30, (Unaudited)		September 30, (Unaudited)	
	2012	2011	2012	2011
Operating income:				
Americas	\$ 11,503	\$ 1,401	\$ 33,721	\$ 40,186
Europe	32,066	31,867	99,850	100,562
Asia Pacific	42,984	32,162	120,491	84,031
Unallocated:				
Research and development expenses	(56,627)	(54,674)	(164,928)	(144,569)
	\$ 29,926	\$ 10,756	\$ 89,134	\$ 80,210

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30, (Unaudited)		September 30, (Unaudited)	
	2012	2011	2012	2011
Interest income:				
Americas	\$ 28	\$ 82	\$ 135	\$ 352
Europe	98	238	282	591
Asia Pacific	7	34	78	96
	\$ 133	\$ 354	\$ 495	\$ 1,039

(In thousands)	September 30, 2012 (Unaudited)		December 31, 2011	
Long-lived assets:				
Americas			\$ 113,126	\$ 110,153
Europe			48,873	47,000
Asia Pacific			61,145	32,995
			\$ 223,144	\$ 190,148

Total sales outside the U.S. for the three month periods ended September 30, 2012 and 2011 were \$178.9 million and \$163.7 million, respectively, and \$528.9 million and \$470.2 million for the nine month periods ended September 30, 2012 and 2011, respectively.

Note 13 – Commitments and Contingencies

We offer a one-year limited warranty on most hardware products, with a two or three-year warranty on a subset of our hardware products, which is included in the sales price of many of our products. Provision is made for estimated future warranty costs at the time of the sale for the estimated costs that may be incurred under the basic limited warranty. Our estimate is based on historical experience and product sales during the period.

The warranty reserve for the nine month periods ended September 30, 2012 and 2011, respectively, was as follows:

(In thousands)	Nine months ended September 30, (Unaudited)	
	2012	2011
Balance at the beginning of the period	\$ 1,271	\$ 921
Accruals for warranties issued during the period	1,634	2,175
Settlements made (in cash or in kind) during the period	(1,652)	(2,175)
Balance at the end of the period	\$ 1,253	\$ 921

As of September 30, 2012, we had non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately \$7.2 million over the next twelve months.

As of September 30, 2012, we had outstanding guarantees for payment of customs and foreign grants totaling approximately \$5.0 million, which are generally payable over the next twelve months.

From November 1999 to May 2011, we sold products to the U.S. government under a contract with the General Services Administration ("GSA"). Our previous contract with GSA contained a price reduction or "most favored customer" pricing provision. During 2011 and 2012, we had been in discussions with GSA regarding our compliance with this pricing provision and provided GSA with information regarding our pricing practices. In 2011, GSA conducted an on-site review of our GSA pricing practices and orally informed us that GSA did not agree with our

previous determination of the potential non-compliance amount. GSA subsequently requested that we conduct a further analysis of the non-compliance amount based upon a methodology that GSA proposed. This analysis resulted in calculated overpayments (including added interest) by GSA to us of approximately \$13.1 million. During the quarter ended September 30, 2011, we established an accrual for \$13.1 million which represented the amount of the loss contingency that was reasonably estimable at that time. On June 6, 2012, we entered into a Settlement Agreement with GSA and paid approximately \$11.8 million in settlement of the foregoing matters. Due to the complexities of conducting business with GSA, the relatively small amount of revenue we realized from our previous GSA contract, and our belief that we can continue to sell our products to U.S. government agencies through other contracting methods, we cancelled our contract with GSA in April 2011, effective May 2011. To date, we have not experienced any material adverse impact on our results of operations as a result of the cancellation of our previous GSA contract.

Note 14 – Recently issued accounting pronouncements

In January 2010, the FASB updated FASB ASC 820, Fair Value Measurements and Disclosures (FASB ASC 820) that requires additional disclosures and clarifies existing disclosures regarding fair value measurements. The additional disclosures include (i) transfers in and out of Levels 1 and 2 and (ii) activity in Level 3 fair value measurements. The update provides amendments that clarify existing disclosures on level of disaggregation and disclosures about inputs and valuation techniques. This update is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements which were effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We adopted the update on January 1, 2010 as required and subsequently adopted on January 1, 2011, the update surrounding disclosures on Level 3 fair value measurements and concluded it did not have a material impact on our consolidated financial position or results of operations. In May 2011, the FASB updated FASB ASC 820 that resulted in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRSs). Some of the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments are to be applied prospectively and are effective during interim and annual periods beginning after December 15, 2011. We adopted the update as required in the first quarter of 2012 and concluded it did not have a material impact on our consolidated financial position or results of operations.

In June 2011, the FASB updated FASB ASC 220, Comprehensive Income (FASB ASC 220) that gives an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The update does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The update does not change the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, with one amount shown for the aggregate income tax expense or benefit related to the total of other comprehensive income items. The update does not affect how earnings per share is calculated or presented. The update should be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We adopted the update as required in the first quarter of 2012, and concluded that the adoption did not have a material impact on our financial position or results of operations; however, the adoption resulted in an additional statement of other comprehensive income. In December 2011, the FASB deferred the effective date for the amendment issued in June 2011 regarding the presentation of reclassifications of items out of accumulated other comprehensive income. This update deferred the implementation requirement to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. The amended guidance specifies that entities should continue to report reclassifications out of accumulated other comprehensive income consistent with presentation requirements in effect before the update in June 2011.

In September 2011, the FASB updated FASB ASC 350, Goodwill and Other (FASB ASC 350) that gives an entity the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a

determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. We adopted the update as required in the first quarter of 2012 and concluded it did not have a material impact on our consolidated financial position or results of operations.

Note 15 – Litigation

We are not currently a party to any material litigation. However, in the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. No assurances can be given with respect to the extent or outcome of any future litigation or dispute.

Note 16 – Acquisitions

AWR Corporation

On June 30, 2011, we acquired all of the outstanding shares of AWR Corporation (AWR), a privately held company that is a leading supplier of electronic design automation software for designing radio frequency and high-frequency components and systems for the semiconductor, aerospace and defense, communications and test equipment industries. The acquisition is expected to improve customer productivity through increased interoperability between upfront design and validation and production test functions. The purchase price of the acquisition was \$66 million consisting of \$54 million in cash and a three-year earn-out arrangement. We funded the purchase price from existing cash balances. The range of potential undiscounted payments that we could be required to make under the earn-out arrangement is between \$0 and \$29 million and are payable if AWR achieves certain revenue and operating income targets. The fair value of the earn-out arrangement was estimated at \$12 million using the income approach, the key assumptions of which included probability-weighted revenue and operating expense growth projections. In July 2012, the Company paid the amount due to the former AWR shareholders based on the first earn-out year performance of AWR. The amount paid was \$3.3 million, and it is being recorded as a reduction of the earn-out liability. We re-measure the fair value of the earn-out liability each quarter and no other adjustments have been recorded to date.

The allocation of the purchase price was determined using the fair value of assets and liabilities acquired as of June 30, 2011. The finalization of our purchase price allocation during the three months ended June 30, 2012 resulted in an increase in acquired deferred tax assets and a decrease in goodwill of approximately \$1.6 million. Our consolidated financial statements include the operating results from the date of acquisition. Pro-forma results of operations have not been presented because the effects of those operations were not material. The following table summarizes the allocation of the purchase price of AWR:

	Amount (in thousands)
Net tangible assets acquired	\$ 10,718
Amortizable intangible assets	31,685
Deferred tax liability	(8,387)
Goodwill	32,379
Total	\$ 66,395

Goodwill is not deductible for tax purposes. Amortizable intangible assets have useful lives of 5 years from the date of acquisition.

Phase Matrix Inc.

On May 20, 2011, we acquired all of the outstanding shares of Phase Matrix, Inc. (PMI), a privately held company that designs and manufactures radio frequency and microwave test and measurement instruments, subsystems and components. The acquisition is expected to speed our deployment of high-performance RF and wireless technologies to our production test and R&D customers. The purchase price of the acquisition was \$40.7 million consisting of \$38.9 million in cash and \$1.8 million in shares of our common stock. We funded the cash portion of the purchase price from existing cash balances.

The allocation of the purchase price was determined using the fair value of assets and liabilities acquired as of May 20, 2011. Our consolidated financial statements include the operating results from the date of acquisition. Pro-forma results of operations have not been presented because the effects of those operations were not material. The following table summarizes the allocation of the purchase price of Phase Matrix, Inc.:

	Amount (in thousands)
Net tangible assets acquired	\$ 5,624
Amortizable intangible assets	8,331
Goodwill	26,725
Total	\$ 40,680

Goodwill is deductible for tax purposes. Amortizable intangible assets have useful lives which range from 9 months to 8 years from the date of acquisition. These assets are also deductible for tax purposes.

Note 17 – Subsequent events

We have evaluated subsequent events through the date the financial statements were issued.

On October 25, 2012, our Board of Directors declared a quarterly cash dividend of \$0.14 per common share, payable December 3, 2012, to shareholders of record on November 12, 2012.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Any statements contained herein regarding our future financial performance or operations (including, without limitation, statements to the effect that we "believe," "expect," "plan," "may," "will," "project," "continue," or "estimate" or other variations thereof or comparable terminology or the negative thereof) should be considered forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of important factors, including those set forth under the heading "Risk Factors" beginning on page 33, and the discussion below. Readers are also encouraged to refer to the documents regularly filed by us with the Securities and Exchange Commission, including our Annual Report on Form 10-K for further discussion of our business and the risks attendant thereto.

Overview

National Instruments Corporation ("we", "us" or "our") designs, manufactures and sells tools to engineers and scientists that accelerate productivity, innovation and discovery. Our graphical system design approach to engineering provides an integrated software and hardware platform that speeds the development of systems needing measurement and control. We believe our long-term vision and focus on technology supports the success of our customers, employees, suppliers and stockholders. We sell to a large number of customers in a wide variety of industries. We have been profitable in every year since 1990.

The key strategies that we focus on in running our business are the following:

Expanding our broad customer base

We strive to increase our already broad customer base by serving a large market on many computer platforms, through a global marketing and distribution network. We also seek to acquire new technologies and expertise from time to time to open new opportunities for our existing product portfolio.

Maintaining a high level of customer satisfaction

To maintain a high level of customer satisfaction we strive to offer innovative, modular and integrated products through a global sales and support network. We strive to maintain a high degree of backwards compatibility across different platforms to preserve the customer's investment in our products. In this time of intense global competition, we believe it is crucial that we continue to offer products with quality and reliability, and that our products provide cost-effective solutions for our customers.

Leveraging external and internal technology

Our product strategy is to provide superior products by leveraging generally available technology, supporting open architectures on multiple platforms and by leveraging our core technologies such as custom application specific integrated circuits ("ASICs") across multiple products.

We sell into test and measurement ("T&M") and industrial/embedded applications in a broad range of industries and as such are subject to the economic and industry forces which drive those markets. It has been our experience that the performance of these industries and our performance is impacted by general trends in industrial production for the global economy and by the specific performance of certain vertical markets that are intensive consumers of measurement technologies. Examples of these markets are semiconductor capital equipment, telecom and mobile devices, consumer electronics, defense, aerospace and automotive.

In assessing our business, we consider the trends in the Global Purchasing Managers Index ("PMI") published by JP Morgan, global industrial production as well as industry reports on the specific vertical industries that we target. A PMI reading above 50 is indicative of expansion in the global industrial economy. Our business is sensitive to fluctuations in general economic conditions, both in the U.S. and globally. Historically, our business cycles have generally followed the expansion and contraction cycles in the global industrial economy as measured by the PMI. The most recent reading for September 2012, showed the PMI had decreased to 48.5 down from a reading of 48.9 for June 2012. This marks the fourth consecutive month where the PMI reading has been below 50. Of ongoing concern is the new order element of the PMI which was 48.1 in September of 2012 and also represents the fourth consecutive month of readings below 50 for this component of the PMI. We are unable to predict whether the industrial economy, as measured by the PMI, will strengthen or continue to contract during the remainder of 2012 and in 2013. If the industrial economy, as measured by the PMI, continues to contract or remains at or near a neutral reading of around 50, indicating general weakness, it could have an adverse effect on the spending patterns of businesses, including our current and potential customers, which could adversely affect our revenues and result of operations.

We distribute our software and hardware products primarily through a direct sales organization. We also use independent distributors, OEMs, VARs, system integrators and consultants to market our products. We have sales offices in the U.S. and sales offices and distributors in key international markets. Sales outside of the Americas accounted for approximately 59% and 61% of our revenues during the three month periods ended September 30, 2012 and 2011, respectively, and 60% of our revenues for each of the nine month periods ended September 30, 2012 and 2011. The vast majority of our foreign sales are denominated in the customers' local currency, which exposes us to the effects of changes in foreign currency exchange rates. We expect that a significant portion of our total revenues will continue to be derived from international sales. (See Note 12 - Segment information of Notes to Consolidated Financial Statements for details concerning the geographic breakdown of our net sales, operating income, interest income and long-lived assets).

We manufacture a substantial majority of our products at our facility in Debrecen, Hungary. Additional production primarily of low volume or newly introduced products is done in Austin, Texas. Our product manufacturing operations can be divided into four areas: electronic circuit card and module assembly; chassis and cable assembly; technical manuals and product support documentation; and software duplication. We manufacture most of the electronic circuit card assemblies, modules and chassis in-house, although subcontractors are used from time to time. We manufacture some of our electronic cable assemblies in-house, but many assemblies are produced by subcontractors. We primarily subcontract our software duplication, our technical manuals and product support documentation.

We believe that our long-term growth and success depend on delivering high quality software and hardware products on a timely basis. Accordingly, we focus significant efforts on research and development. We focus our research and development efforts on enhancing existing products and developing new products that incorporate appropriate features and functionality to be competitive with respect to technology, price and performance. Our success also is dependent on our ability to obtain and maintain patents and other proprietary rights related to technologies used in our products. We have engaged in litigation and, where necessary, will likely engage in future litigation to protect our intellectual property rights. In monitoring and policing our intellectual property rights, we have been and may be required to spend significant resources.

Our operating results fluctuate from period to period due to changes in global economic conditions and a number of other factors. As a result, we believe our historical results of operations should not be relied upon as indications of future performance. There can be no assurance that our net sales will grow or that we will remain profitable in future periods.

Current business outlook

Many of the industries we serve have historically been cyclical and have experienced periodic downturns. In assessing our business, we consider the trends in the PMI, global industrial production as well as industry reports on the specific vertical industries that we target. We remain very concerned by the continued weakness of the Global PMI in the three month period ended September 30, 2012. with the average for the quarter of 48.5, the lowest average since the second quarter of 2009. Of ongoing concern is the level of the new order element of the index at 48.1 in September. This

suggests that the overall index may remain well below 50 in the fourth quarter of 2012 and into 2013. We believe this trend will restrain growth in the test and measurement industry in the near term. In the past, we have seen this sort of deterioration in the industrial economy have a negative impact on larger orders at year end. This may also have a negative impact on our normal seasonal surge in orders toward the end of the quarter. These trends could have an adverse effect on the spending patterns of businesses, including our current and potential customers, which could adversely affect our revenues and result of operations. Our key strategies are to maintain a stable gross margin and to optimize our operating cost structure while maintaining strong employee productivity.

Results of Operations

The following table sets forth, for the periods indicated, the percentage of net sales represented by certain items reflected in our Consolidated Statements of Income:

	Three Months Ended September 30, (Unaudited) 2012		2011		Nine Months Ended September 30, (Unaudited) 2012		2011	
Net sales:								
Americas	40.5	%	38.6	%	40.0	%	40.2	%
Europe	24.1		29.5		25.9		29.8	
Asia Pacific	35.4		31.9		34.1		30.0	
Consolidated net sales	100.0		100.0		100.0		100.0	
Cost of sales	25.3		25.6		24.4		23.3	
Gross profit	74.7		74.4		75.6		76.7	
Operating expenses:								
Sales and marketing	37.8		40.5		37.9		38.4	
Research and development	19.5		21.4		19.6		19.4	
General and administrative	7.1		8.3		7.5		8.2	
Total operating expenses	64.4		70.2		65.0		66.0	
Operating income	10.3		4.2		10.6		10.7	
Other income (expense):								
Interest income	0.0		0.1		0.1		0.2	
Net foreign exchange gain (loss)	(0.1)		(0.3)		(0.3)		(0.2)	
Other income, net	(0.2)		-		(0.1)		-	
Income before income taxes	10.0		4.0		10.3		10.7	
Provision for (benefit from) income taxes	1.6		(1.0)		2.1		1.4	
Net income	8.4	%	5.0	%	8.2	%	9.3	%

Results of Operations for the Three and Nine Month Periods ended September 30, 2012 and 2011

Despite difficult economic conditions, we were pleased with our disciplined execution which allowed us to deliver record revenue for a third quarter. While we remain cautious in the short-term due to uncertain economic conditions, we are optimistic about our long-term position in the industry from the sustained differentiation we deliver to customers through graphical system design. We believe this approach to measurement and control systems provide higher performance, better integration and lower cost, while enabling unique testing approaches not possible with traditional equipment.

Net Sales. Our consolidated net sales were \$290 million and \$255 million for the three month periods ended September 30, 2012 and 2011, respectively, an increase of 14%. For the same periods, product sales were \$268 million and \$247 million, an increase of 8%, and software maintenance sales were \$22 million and \$21 million, an increase of 6%. For the three month period ended September 30, 2011 our consolidated net sales were negatively impacted by the \$13 million accrual related to our GSA contract. There was no impact from our GSA contract in the three month period ended September 30, 2012 as our Settlement Agreement with GSA was executed in the second quarter of 2012. See Note 13 – Commitments and Contingencies in the Notes to our Consolidated Financial Statements for further discussion of our GSA Settlement Agreement. Products in the areas of virtual instrumentation and graphical system design, which comprised approximately 95% of our revenue in the three months ended September 30, 2012, saw a year-over-year revenue increase of 8%. Instrument control products, which comprised approximately 5% of our revenue in the three months ended September 30, 2012, saw a year-over-year revenue decrease of 8%. Products in the areas of virtual instrumentation and graphical system design comprised approximately 94% of our revenue in the three months ended September 30, 2011 and instrument control products comprised approximately 6% of our revenues in the three months ended September 30, 2011.

For the nine month periods ended September 30, 2012 and 2011, our consolidated net sales were \$843 million and \$746 million, respectively, an increase of 13%. For the same periods, product sales were \$776 million and \$699 million, respectively, an increase of 11%, and software maintenance sales were \$66 million and \$60 million, respectively, an increase of 9%. For the nine month period ended September 30, 2012, our consolidated net sales were positively impacted by our Settlement Agreement with GSA which was \$1.3 million less than the amount previously accrued, and for the nine month period ended September 30, 2011 our consolidated net sales were negatively impacted by the \$13 million accrual related to our GSA contract. Products in the areas of virtual instrumentation and graphical system design, which comprised approximately 95% of our revenue in the nine month period ended September 30, 2012, saw a year-over-year revenue increase of 12%. Instrument control products, which comprised approximately 5% of our revenues in the nine month period ended September 30, 2012, saw a year-over-year revenue decrease of 12%. In the nine month period ended September 30, 2011, products in the areas of virtual instrumentation and graphical system design comprised approximately 94% of our revenue while instrument control products comprised approximately 6% of our revenues.

We did not take any significant action with regard to pricing during the three and nine month periods ended September 30, 2012 and 2011.

Large orders, defined as orders with a value greater than \$20,000, grew by 11%, year over year, during the three month period ended September 30, 2012 and grew by 25%, year over year, during the nine month period ended September 30, 2012. During the three and nine month periods ended September 30, 2012, these large orders were 51% of our total sales for each of the periods. During the three and nine month periods ended September 30, 2011, these large orders were 48% and 45%, respectively, of our total sales. During the nine month period ended September 30, 2012, we received a \$53 million order for a large graphical system design application from one customer of which \$41 million was recognized in revenue during the nine month period ended September 30, 2012. Including this order, we received a total of \$17 million and \$67 million in orders from this customer in the three and nine month periods ended

September 30, 2012, respectively, of which \$29 million or 10% of total net sales and \$56 million or 7% of total net sales was recognized as revenue in the three and nine month periods ended September 30, 2012, respectively. Larger orders may be more sensitive to changes in the global industrial economy, may be subject to greater discount variability, may contract at a faster pace during an economic downturn, may expose us to greater business and legal risks and may impose product acceptance clauses that could impact the timing of when the associated revenue can be recognized.

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For the three month periods ended September 30, 2012 and 2011, net sales in the Americas were \$117 million and \$98 million, respectively, an increase of 19%. Sales in the Americas, as a percentage of consolidated sales were 41% and 39% in the three month periods ended September 30, 2012 and 2011, respectively. In Europe, net sales were \$70 million and \$75 million in the three month periods ended September 30, 2012 and 2011, respectively, a decrease of 7%. Sales in Europe, as a percentage of consolidated sales were 24% and 30% in the three month periods ended September 30, 2012 and 2011, respectively. In Asia, net sales were \$103 million and \$81 million in the three month periods ended September 30, 2012 and 2011 periods, respectively, an increase of 26%. Sales in Asia, as a percentage of consolidated sales were 35% and 32% in the three month periods ended September 30, 2012 and 2011, respectively.

For the nine month periods ended September 30, 2012 and 2011, net sales in the Americas were \$338 million and \$300 million, respectively, an increase of 13%. For these same periods, sales in the Americas, as a percentage of consolidated sales were 40% and 40%, respectively. In Europe, net sales were \$218 million and \$223 million in the nine month periods ended September 30, 2012 and 2011, respectively, a decrease of 2%. For these same periods, sales in Europe, as a percentage of consolidated sales were 26% and 30%, respectively. In Asia, net sales were \$287 million and \$224 million, in the nine month periods ended September 30, 2012 and 2011 respectively, an increase of 28%. For these same periods, sales in Asia, as a percentage of consolidated sales were 34% and 30%, respectively.

We expect sales outside of the Americas to continue to represent a significant portion of our revenue. We intend to continue to expand our international operations by increasing our presence in existing markets, adding a presence in some new geographical markets and continuing the use of distributors to sell our products in some countries. We anticipate that sales growth in Asia will continue to outpace growth in the Americas and Europe and continue to grow as a percent of our total net sales.

Almost all of the sales made by our direct sales offices in the Americas, outside of the U.S., in Europe and in Asia are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in foreign currency exchange rates. For the three month period ended September 30, 2012, in local currency terms, our consolidated net sales increased by \$30 million or 11%, Americas sales increased by \$3.6 million or 3%, European sales increased by \$3.1 million or 4%, and sales in Asia increased by \$23 million or 29%, compared to the three month period ended September 30, 2011. During this same period, the change in exchange rates had the effect of decreasing our consolidated sales by \$12 million or 4%, decreasing Americas sales by \$440,000 or 0.4%, decreasing European sales by \$9 million or 12%, and decreasing sales in Asia by \$2.1 million or 3%.

For the three month period ended September 30, 2011, in local currency terms, our consolidated sales increased by \$18 million or 9%, Americas sales increased by \$626,000 or 1%, European sales increased by \$5 million or 14%, and sales in Asia Pacific increased by \$12 million or 19%. During this same period, the change in exchange rates had the effect of increasing our consolidated sales by \$18 million or 9%, increasing Americas sales by \$879,000 or 1%, increasing European sales by \$11 million or 30%, and increasing sales in Asia Pacific by \$6 million or 10%.

For the nine month period ended September 30, 2012, in local currency terms, our consolidated net sales increased by \$96 million or 12%, Americas sales increased by \$25 million or 8%, European sales increased by \$6 million or 2%, and sales in Asia Pacific increased by \$65 million or 29%, compared to the nine month period ended September 30, 2011. During this same period, the change in exchange rates had the effect of decreasing our consolidated sales by \$16 million or 2%, decreasing Americas sales by \$2.0 million or 0.6%, decreasing European sales by \$12 million or 5%, and decreasing sales in Asia Pacific by \$2.6 million or 1%.

For the nine month period ended September 30, 2011, in local currency terms, our consolidated net sales increased by \$99 million or 17%, Americas sales increased by \$32 million or 12%, European sales increased by \$33 million or 23%, and sales in Asia Pacific increased by \$35 million or 20%, compared to the nine month period ended September 30, 2010. During this same period, the change in exchange rates had the effect of increasing our consolidated sales by \$26 million or 4%, increasing Americas sales by \$1.7 million or 1%, increasing European sales by \$14 million or 9%,

and increasing sales in Asia Pacific by \$11 million or 6%.

To help protect against a reduction in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue denominated in foreign currencies with forward and purchased option contracts. During the three month periods ended September 30, 2012 and 2011, these hedges had the effect of increasing our consolidated sales by \$857,000 and decreasing our consolidated sales by \$1.1 million, respectively. During the nine month periods ended September 30, 2012 and 2011, these hedges had the effect of increasing our consolidated sales by \$2.1 million and decreasing our consolidated sales by \$2.9 million, respectively. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impacted on our consolidated sales for 2012 and 2011).

Gross Profit. For the three month periods ended September 30, 2012 and 2011, gross profit was \$216 million and \$190 million, respectively, an increase of 14%. As a percentage of sales, gross profit was 75% and 74% for the three month periods ended September 30, 2012 and 2011, respectively. For the nine month periods ended September 30, 2012 and 2011, gross profit was \$638 million and \$573 million, respectively, an increase of 11%. For these same periods, as a percentage of sales, gross profit was 76% and 77%, respectively. During the three and nine month periods ended September 30, 2012, gross margin was negatively impacted by the decline in our European business as a result of the weakness of the European industrial economy and the weaker Euro as well as the lower than average gross margin on our largest order. We continued to focus on cost control and cost reduction measures throughout our manufacturing cycle. These cost control and cost reduction measures along with sales growth have allowed us to maintain stability in our gross margin percentage.

For three month periods ended September 30, 2012 and 2011, the change in exchange rates had the effect of decreasing our cost of sales by \$779,000 or (1)% and increasing our cost of sales by \$1.9 million or 4%, respectively. For the nine month periods ended September 30, 2012 and 2011, the change in exchange rates had the effect of decreasing our cost of sales by \$1.4 million or (1)% and increasing our cost of sales by \$4.5 million or 3%, respectively. To help protect against changes in our cost of sales caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows, we have a foreign currency cash flow hedging program. We hedge portions of our forecasted costs of sales denominated in foreign currencies with forward contracts. During the three month periods ended September 30, 2012 and 2011, these hedges had the effect of decreasing our cost of sales by \$92,000 and \$507,000, respectively. During the nine month periods ended September 30, 2012 and 2011, these hedges had the effect of decreasing our cost of sales by \$187,000 and \$1.3 million, respectively. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impacted on our consolidated sales for 2012 and 2011).

Operating Expenses. For the three month periods ended September 30, 2012 and 2011, operating expenses were \$187 million and \$179 million, respectively, an increase of 4%. This increase in our operating expenses was due to higher personnel related expenses of \$6 million which included commissions, variable compensation and benefits. The increase in personnel expenses is related to a net increase in our overall headcount of 523 employees. The majority of these personnel additions occurred during the second and third quarter of 2011 resulting in a more significant impact on our September 30, 2012 year over year comparison. In addition, this increase is attributed to higher expenses for building and equipment of \$2.0 million, higher expenses related to marketing and outside services of \$2.1 million, and higher travel related expenses of \$1.9 million. Over the same period, the net impact of changes in foreign currency exchange rates decreased our operating expense by \$6.8 million.

For the nine month periods ended September 30, 2012 and 2011, operating expenses were \$549 million and \$492 million respectively, an increase of 11%. This increase in our operating expenses was due to higher personnel related expenses of \$41 million which included commissions, variable compensation and benefits, higher expenses related to marketing and outside services of \$8 million, higher expenses for building and equipment of \$8 million, and higher travel related expenses of \$5.5 million. Over the same period, the net impact of changes in foreign currency exchange rates decreased our operating expense by \$11 million. The increase in personnel expenses is related to a net increase in our average headcount of 523 employees.

As a percentage of net sales, operating expenses in the three month periods ended September 30, 2012 and 2011 were 64% and 70%, respectively. The year over year decrease in our operating expenses as a percent of sales is attributed to the fact that our net sales grew by 14% while operating expenses only increased by 4% based on the factors above. For the nine month periods ended September 30, 2012 and 2011, operating expenses as a percentage of net sales were 65% and 66%, respectively. This year over year increase in our operating expenses as a percentage of net sales is attributed to the fact that we grew our overall operating expenses by 11% while our net sales grew by 13%.

We believe that our long-term growth and success depends on developing high quality software and hardware products on a timely basis. To that end, we have made investments in research and development and our field sales force a priority. For the three month periods ended September 30, 2012 and 2011, our research and development expenses were \$57 million and \$55 million, respectively. For the nine month periods ended September 30, 2012 and 2011, our research and development expenses were \$165 million and \$145 million, respectively. From a regional perspective, the increase in research and development in the nine month period ended September 30, 2012, had a larger impact on the operating income of the Americas as the Americas absorbed \$18 million of the overall \$20 million increase. The overall increase in research and development expense was due to an increase in our research and development headcount to 1,942 at September 30, 2012 from 1,873 at September 30, 2011. This increase in headcount is consistent with our stated plan to make investment in research and development a priority in order to support our long-term growth.

Operating Income. For the three month periods ended September 30, 2012 and 2011, operating income was \$30 million and \$11 million, respectively, an increase of 178%. As a percent of net sales, operating income was 10% and 4%, respectively in these same periods. For the three month period ended September 30, 2011, our operating income was negatively impacted by the \$13 million accrual related to our GSA contract. There was no impact from our GSA contract in the three month period ended September 30, 2012, as our Settlement Agreement with GSA was executed in the second quarter of 2012. For the nine month periods ended September 30, 2012 and 2011, operating income was \$89 million and \$80 million, respectively, an increase of 11%. As a percentage of net sales, operating income was 11% for each of the nine month periods ended September 30, 2012 and 2011.

Interest Income. For the three month periods ended September 30, 2012 and 2011, interest income was \$133,000 and \$354,000, respectively. For the nine month periods ended September 30, 2012 and 2011, interest income was \$495,000 and \$1.0 million, respectively. We continue to see low yields for high quality investment alternatives that comply with our corporate investment policy. We do not expect yields in these types of investments to increase during the remainder of 2012.

Net Foreign Exchange (Loss). For the three month periods ended September 30, 2012 and 2011, net foreign exchange (loss) was \$(235,000) and \$(708,000), respectively. During the nine month periods ended September 30, 2012 and 2011, net foreign exchange (loss) was \$(2.1) million and \$(1.4) million, respectively. These results are attributable to movements in the foreign currency exchange rates between the U.S. dollar and foreign currencies in subsidiaries for which our functional currency is not the U.S. dollar. During the three and nine month periods ended September 30, 2012, there was mixed volatility in the exchange rates between the U.S. dollar and most of the major currencies in the markets in which we do business. We cannot predict the direction or degree of future volatility in these exchange rates. In the past, we have noted that significant volatility in foreign currency exchange rates in the markets in which we do business has had a significant impact on the revaluation of our foreign currency denominated firm commitments, on our ability to forecast our U.S. dollar equivalent revenues and expenses and on the effectiveness of our hedging programs. In the past, these dynamics have also adversely affected our revenue growth in international markets and may pose similar challenges in the future. We recognize the local currency as the functional currency in virtually all of our international subsidiaries.

We utilize foreign currency forward contracts to hedge our foreign denominated net foreign currency balance sheet positions to help protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically hedge up to 90% of our outstanding foreign denominated net receivable or payable positions and typically limit the duration of these foreign currency forward contracts to approximately 90 days. The gain or loss on these derivatives as well as the offsetting gain or loss on the hedged item attributable to the hedged risk is recognized in current earnings under the line item "Net foreign exchange gain (loss)". Our hedging strategy decreased our foreign exchange gains by \$1.2 million in the three month period ended September 30, 2012 and reduced our foreign exchange losses by \$2.7 million in the three month period ended September 30, 2011. Our hedging strategy increased our foreign exchange losses by \$1.4 million in the nine month period ended September 30, 2012 and reduced our foreign exchange losses by \$641,000 in nine month period ended September 30, 2011.

Provision for Income Taxes. For the three month periods ended September 30, 2012 and 2011, our provision for income taxes reflected an effective tax rate of 16% and (24)%, respectively. For the nine month periods ended September 30, 2012 and 2011, our provision for income taxes reflected an effective tax rate of 20% and 12%, respectively. The factors that caused our effective tax rate to change year-over-year are detailed in the table below:

	Three Months Ended September 30, 2012 (Unaudited)	Nine Months Ended September 30, 2012	
Effective tax rate at September 30, 2011	(24)	% 12	%
Change in unrecognized tax benefits for uncertain tax positions	7	1	
Change in percentage of profits in foreign jurisdictions with reduced income tax rates	(2)	(1)	

Decrease in the partial release of a deferred tax asset valuation allowance	2	2	
Change in tax benefit from equity awards	(2)	0	
Change in research and development tax credit	0	1	
GSA accrual	33	3	
Other	2	2	
Effective tax rate at September 30, 2012	16	% 20	%

(See Note 9 – Income taxes of Notes to Consolidated Financial Statements for further discussion regarding changes in our effective tax rate and a reconciliation of income taxes at the U.S. federal statutory income tax rate of 35% to our effective tax rate).

Other operational metrics

We believe that the following additional unaudited operational metrics assist investors in assessing our operational performance relative to our peers and to our historical results.

Acquisition related deferred revenue excluded from revenue and GSA accrual adjustment. For the three and nine month periods ended September 30, 2012 and 2011, our excluded acquisition related deferred revenue was as follows:

(In thousands)	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2012	2011	2012	2011
Revenue				
Acquisition related deferred revenue	\$ -	\$ 2,818	\$ 2,156	\$ 2,818
GSA accrual	-	13,107	(1,349)	13,107
Provision for income taxes	-	(5,573)	(282)	(5,573)
Total	\$ -	\$ 10,352	\$ 525	\$ 10,352

Charges related to stock-based compensation, amortization of acquired intangibles and acquisition related transaction costs. For the three and nine month periods ended September 30, 2012 and 2011, the gross charges related to stock-based compensation as a component of cost of sales, sales and marketing, research and development, and general and administrative expenses and the total charges were as follows:

	Three Months Ended September 30, (Unaudited) 2012	Nine Months Ended September 30, (Unaudited) 2011
(In thousands)		