

ZEBRA TECHNOLOGIES CORP/DE

Form 10-Q

November 02, 2007

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

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**FORM 10-Q**

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x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended September 29, 2007

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: 000-19406

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**Zebra Technologies Corporation**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

333 Corporate Woods Parkway, Vernon Hills, IL 60061

36-2675536  
(I.R.S. Employer  
Identification No.)

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (847) 634-6700

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. Check one:

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act. Yes  No

As of October 29, 2007, there were the following shares outstanding:

Class A Common Stock, \$.01 par value 68,017,330

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**ZEBRA TECHNOLOGIES CORPORATION**

**QUARTER ENDED SEPTEMBER 29, 2007**

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**Table of Contents****PART I - FINANCIAL INFORMATION****Item 1. Consolidated Financial Statements****ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(Amounts in thousands)

	September 29, 2007 (Unaudited)	December 31, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 33,031	\$ 41,014
Investments and marketable securities	265,806	219,930
Accounts receivable, net	133,880	122,540
Inventories, net	84,512	81,190
Deferred income taxes	13,526	9,464
Prepaid expenses	5,975	5,552
<b>Total current assets</b>	<b>536,730</b>	<b>479,690</b>
Property and equipment at cost, less accumulated depreciation and amortization	62,616	57,431
Long-term deferred income taxes	31,903	11,917
Goodwill	161,877	70,714
Other intangibles, net	62,235	34,025
Long-term investments and marketable securities	170,523	298,245
Other assets	12,184	11,120
<b>Total assets</b>	<b>\$ 1,038,068</b>	<b>\$ 963,142</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 33,815	\$ 28,980
Accrued liabilities	58,932	43,191
Income taxes payable	510	2,683
<b>Total current liabilities</b>	<b>93,257</b>	<b>74,854</b>
Deferred rent	782	638
Other long-term liabilities	11,473	9,969
<b>Total liabilities</b>	<b>105,512</b>	<b>85,461</b>
Stockholders' equity:		
Preferred Stock		
Class A Common Stock	722	722
Additional paid-in capital	141,468	139,083
Treasury stock	(146,360)	(119,335)
Retained earnings	929,709	850,399
Accumulated other comprehensive income	7,017	6,812

<b>Total stockholders' equity</b>	932,556	877,681
<b>Total liabilities and stockholders' equity</b>	\$ 1,038,068	\$ 963,142

See accompanying notes to consolidated financial statements.

**Table of Contents****ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF EARNINGS**

(Amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Net sales	\$ 217,218	\$ 186,386	\$ 634,706	\$ 549,621
Cost of sales	112,590	98,600	330,886	289,611
Gross profit	104,628	87,786	303,820	260,010
Operating expenses:				
Selling and marketing	29,080	23,467	86,313	69,086
Research and development	13,904	11,774	41,958	36,191
General and administrative	21,694	14,642	59,502	44,372
Amortization of intangible assets	2,928	789	7,871	2,259
Litigation settlement		53,392		53,392
Acquired in-process research and development			1,853	
Total operating expenses	67,606	104,064	197,497	205,300
Operating income (loss)	37,022	(16,278)	106,323	54,710
Other income (expense):				
Investment income	4,393	6,008	15,421	16,202
Interest expense	(73)	(5)	(92)	(236)
Foreign exchange gains	(23)	457	(30)	187
Other, net	(157)	(287)	(438)	(912)
Total other income	4,140	6,173	14,861	15,241
Income (loss) before income taxes and cumulative effect of accounting change	41,162	(10,105)	121,184	69,951
Income tax (benefit)	14,201	(5,842)	41,874	21,770
Income (loss) before cumulative effect of accounting change	26,961	(4,263)	79,310	48,181
Cumulative effect of accounting change (net of tax effect of \$694)				1,319
Net income (loss)	\$ 26,961	\$ (4,263)	\$ 79,310	\$ 49,500
Basic earnings (loss) per share before cumulative effect of accounting change	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.68
Diluted earnings (loss) per share before cumulative effect of accounting change	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.68
Basic earnings (loss) per share	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.70
Diluted earnings (loss) per share	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.70
Basic weighted average shares outstanding	68,580	70,802	68,814	70,702
Diluted weighted average and equivalent shares outstanding	69,005	70,802	69,259	71,152

See accompanying notes to consolidated financial statements.



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**ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Amounts in thousands)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Net income (loss)	\$ 26,961	\$ (4,263)	\$ 79,310	\$ 49,500
Other comprehensive income (loss):				
Foreign currency translation adjustment	1,132	701	2,578	4,140
Changes in unrealized gains and (losses) on foreign currency hedging transactions, net of tax (benefit)	(3,217)	831	(3,102)	(559)
Changes in unrealized gains and (losses) on investments, net of tax (benefit)	1,144	1,990	729	(1,591)
Comprehensive income (loss)	\$ 26,020	\$ (741)	\$ 79,515	\$ 51,490

See accompanying notes to consolidated financial statements.



**Table of Contents****ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Amounts in thousands)

(Unaudited)

	Nine Months Ended	
	September 29, 2007	September 30, 2006
<b>Cash flows from operating activities:</b>		
Net income	\$ 79,310	\$ 49,500
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation and amortization	19,184	11,338
Stock-based compensation	11,333	5,272
Excess tax benefit from share-based compensation	(797)	(1,570)
Cumulative effect of accounting change (net of tax)		(1,319)
Acquired in-process research and development	1,853	
Deferred income taxes	(4,862)	(1,345)
<b>Changes in assets and liabilities, net of effects of acquisitions:</b>		
Accounts receivable, net	(1,050)	(1,146)
Inventories	257	(16,746)
Other assets	248	(1,157)
Accounts payable	(6,016)	(1,387)
Accrued liabilities	13,978	7,527
Income taxes payable	(1,614)	(6,149)
Other operating activities	(2,001)	(2,063)
<b>Net cash provided by operating activities</b>	<b>109,823</b>	<b>40,755</b>
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(15,702)	(14,640)
Acquisition of businesses acquired, net of cash acquired	(141,277)	
Acquisition of intangible assets	(2,800)	(18,091)
Purchases of investments and marketable securities	(645,843)	(860,250)
Maturities of investments and marketable securities	538,025	583,582
Sales of investments and marketable securities	190,393	275,601
<b>Net cash used in investing activities</b>	<b>(77,204)</b>	<b>(33,798)</b>
<b>Cash flows from financing activities:</b>		
Purchase of treasury stock	(48,913)	(4,069)
Proceeds from exercise of stock options and stock purchase plan purchases	7,593	9,050
Excess tax benefit from share-based compensation	797	1,570
<b>Net cash provided by (used in) financing activities</b>	<b>(40,523)</b>	<b>6,551</b>
Effect of exchange rate changes on cash	(79)	428
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(7,983)</b>	<b>13,936</b>
Cash and cash equivalents at beginning of period	41,014	25,621

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Cash and cash equivalents at end of period	\$ 33,031	\$ 39,557
Supplemental disclosures of cash flow information:		
Interest paid	\$ 92	\$ 236
Income taxes paid	45,063	29,402
See accompanying notes to consolidated financial statements.		

**Table of Contents****ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES**

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Note 1 Basis of Presentation**

Management prepared these unaudited interim consolidated financial statements for Zebra Technologies Corporation and subsidiaries (Zebra) according to the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial information. Accordingly, they do not include all of the information and footnotes required by United States generally accepted accounting principles (GAAP) for complete financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in Zebra's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

The consolidated balance sheet as of December 31, 2006, in this Form 10-Q is taken from the audited consolidated balance sheet in our Form 10-K. These interim financial statements include all adjustments (of a normal, recurring nature) necessary to present fairly Zebra's consolidated financial position as of September 29, 2007, the consolidated results of operations for the three and nine months ended September 29, 2007 and September 30, 2006, and cash flows for the nine months ended September 29, 2007 and September 30, 2006. These results, however, are not necessarily indicative of results for the full year.

**Note 2 Stock-Based Compensation**

As of September 29, 2007, Zebra had a stock option plan and a stock purchase plan available for future grants. Prior to January 1, 2006, we accounted for these plans using the intrinsic value method in accordance with the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, as permitted by SFAS No. 123, *Accounting for Stock Based Compensation*. Accordingly, we recognized no compensation cost, as all options granted under these plans had grant prices equal to the market value of the underlying common stock on the date of grant and the number of shares was fixed.

Effective January 1, 2006, Zebra adopted SFAS No. 123(R), *Share-Based Payments*, utilizing the modified retrospective approach, which requires the prior period financial statements to be restated to recognize compensation costs in the amounts previously reported in the pro forma footnote disclosures. Zebra recognizes compensation costs using the straight-line method over the vesting period of 4 to 5 years. Compensation costs were as follows:

	2007	2006
Three months ended September 29, 2007	\$ 4,776	
Three months ended September 30, 2006		\$ 1,787
Nine months ended September 29, 2007	11,333	
Nine months ended September 30, 2006		5,272

SFAS No. 123(R) requires the cash flows resulting from the tax benefits from tax deductions in excess of the compensation cost recognized (excess tax benefits) to be classified as financing cash flows in the statement of cash flows. As a result, \$797,000 of excess tax benefits for the nine months ended September 29, 2007, have been classified as financing cash flows. The excess tax benefits for the nine months ended September 30, 2006, was \$1,437,000.

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For purposes of calculating the compensation cost consistent with SFAS No. 123(R), the fair value is estimated on the date of grant using a binomial model. Volatility is based on an average of the implied volatility in the open market and the annualized volatility of Zebra's stock prices over our entire stock history. The following table shows the weighted-average assumptions used for stock option grants as well as the fair value of the options granted based on those assumptions:

	Nine months ended	
	September 29, 2007	September 30, 2006
Expected dividend yield	0%	0%
Forfeiture rate	7.69%	7.43%
Volatility	34.73%	38.30%
Risk free interest rate	4.55%	4.58%
- Range of interest rates	4.55% -5.03%	4.38% -4.73%
Expected weighted-average life	4.88 years	4.58 years
Fair value of options granted	\$8,859,000	\$5,802,000
Weighted-average grant date fair value of options granted	\$13.97	\$14.22

In accordance with the WhereNet acquisition agreement, we assumed the existing unvested WhereNet stock options and made them exercisable for Zebra common stock. These new options have vesting dates that ranged from February 6, 2007 through October 23, 2010. The following table shows the weighted-average assumptions used for these grants as well as the fair value of these grants based on those assumptions:

Expected dividend yield	0%
Forfeiture rate	0%
Volatility	35.23%
Risk free interest rate	4.85%
Expected weighted-average life	4.08 years
Fair value of options granted	\$4,345,000
Weighted-average grant date fair value of options granted	\$32.77

In conjunction with the WhereNet acquisition, on January 25, 2007, 41,924 shares of restricted stock were granted under the 2006 Zebra Technologies Corporation Incentive Compensation Plan (the 2006 Plan) to certain WhereNet executive officers. These restricted stock awards will vest over the next three years (one-third each year) after the grant date if the executive remains employed by Zebra throughout the specified time period. They will vest before the end of the specified time period in the event of death, disability, resignation for good reason, a change in control (as defined in the 2006 Plan), or termination by Zebra other than for Cause, as defined in the restricted stock agreement entered into by Zebra with each executive officer who was granted restricted stock (the Restricted Stock Agreement). The restricted stock is forfeited in certain situations specified in the Restricted Stock Agreement, including, if before the restricted stock vests, the executive's employment is terminated by Zebra for Cause (as defined in the Restricted Stock Agreement) or if the executive resigns for other than good reason.

On September 4, 2007, Edward Kaplan retired as Zebra's Chief Executive Officer (CEO) and Chairman of the Board. At that time, a modification was made to an option grant made to him on March 23, 2005, for 219,203 options. The option was modified so that the entire option became immediately exercisable, and the exercise period was extended until March 22, 2015, its original exercise period, irrespective of his retirement as an officer and the time period for which he remains a director. This modification resulted in an additional stock-based compensation expense for the third quarter of 2007 of \$1,702,000.

Also on September 4, 2007, Anders Gustafsson became Zebra's new CEO and was granted an initial non-qualified stock option (the Initial Option) under the 2006 Zebra Technologies Corporation Incentive Compensation Plan (the Plan) to purchase 75,000 shares of the Zebra Class A Common Stock. The Initial Option's exercise price per share is equal to \$36.80, the price of a share of Class A Common Stock as of September 4, 2007. In addition, on or after January 1, 2008, Mr. Gustafsson will be eligible to receive an annual equity award of non-qualified stock options (Annual Options) under the Plan. The amount of the Annual Options will be approved by the Compensation Committee. The Initial Option and the Annual Options will vest in four substantially equal annual installments on the each of the first four anniversaries of the option's respective grant dates, subject to Mr. Gustafsson's continued employment with Zebra on the respective anniversary dates.

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On September 4, 2007, Mr. Gustafsson also received a restricted stock grant for 56,250 shares of Zebra Class A Common Stock (the Restricted Shares), and an additional option to purchase 168,750 shares of Zebra Class A Common Stock (the Additional Option), each of which will vest only upon the attainment of specified average total stockholder return targets. The Additional Option's exercise price per share is also equal to \$36.80.

If Mr. Gustafsson terminates his employment with good reason or Zebra terminates his employment without cause, any portion of his Initial Option and any Annual Options which are unvested at the time of such termination will immediately vest. In addition, if Mr. Gustafsson terminates his employment with good reason or Zebra terminates his employment without cause, and such termination of employment occurs within 120 days immediately preceding or one year immediately following a change in control under the Plan, then a percentage of the unvested Restricted Shares will vest and the Additional Option will vest with respect to a percentage of the otherwise unexercisable portion of the Additional Option, with the applicable percentage in each case determined based upon when the change in control occurs relative to the Start Date. Upon such a termination, Mr. Gustafsson will also become fully vested in his Initial Option and any Annual Options which are unvested at such time.

The fair value of the purchase rights of all Zebra employees issued under the Stock Purchase Plan is estimated using the following weighted-average assumptions for purchase rights granted. Expected lives of three months to one year have been used along with these assumptions.

	Nine months ended	
	September 29, 2007	September 30, 2006
Fair market value	\$ 36.49	\$ 34.16
Option price	\$ 31.02	\$ 29.04
Expected dividend yield	0%	0%
Expected volatility	25%	28%
Risk free interest rate	4.83%	4.49%

Stock option activity for the period ended September 29, 2007, was as follows:

Fixed Options	Shares	2007
		Weighted-Average Exercise Price
Outstanding at beginning of year	2,460,367	\$ 34.08
Granted	766,555	33.99
Exercised	(312,080)	19.28
Forfeited	(92,789)	40.24
Expired	(16,699)	48.75
Outstanding at end of period	2,805,354	\$ 35.41
Options exercisable at end of period	1,254,277	\$ 28.93

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The following table summarizes information about fixed stock options outstanding at September 29, 2007:

Range of Exercise Prices	Number of Shares	Options Outstanding		Options Exercisable	
		Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
\$ 1.29-\$21.31	268,108	4.26 years	\$ 10.61	209,046	\$ 12.81
\$ 21.31-\$26.94	729,226	4.30 years	24.02	625,037	23.83
\$ 26.94-\$41.25	626,616	8.66 years	38.82	89,548	34.23
\$ 41.25-\$46.18	708,063	8.31 years	44.13	130,226	44.90
\$ 46.18-\$53.92	473,341	6.86 years	49.42	200,420	48.92
	2,805,354			1,254,277	

	Options Outstanding	Options Exercisable
Aggregate intrinsic value	\$ 16,544,000	\$ 13,101,000
Weighted-average remaining contractual term	6.7 years	4.9 years

As of September 29, 2007, there was \$17,005,000 of unearned compensation cost related to stock options granted under the plans. That cost is expected to be recognized over a weighted-average period of 2.9 years.

**Note 3 Inventories**

The components of inventories are as follows (in thousands):

	September 29, 2007	December 31, 2006
Raw materials	\$ 47,202	\$ 49,172
Work in process	3,563	1,014
Finished goods	33,747	31,004
Total inventories	\$ 84,512	\$ 81,190

**Note 4 Business Combinations**

*proveo AG*. On July 2, 2007, Zebra acquired all of the outstanding stock of *proveo AG* for \$13,851,000 ( 10,182,000), which is net of cash acquired and transaction costs. Headquartered in Crailsheim, Germany, *proveo AG* provides integrated hardware and software systems that locate and track airport ground support equipment. The consolidated statements of earnings reflect the results of operations of *proveo AG* since the effective date of the purchase. The pro forma impact of this acquisition was not significant.

The following table (in thousands) summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition.

	At July 2, 2007
Current assets	\$ 2,062
Property and equipment	113
Intangible assets	4,176
Goodwill	9,959

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Total assets acquired	\$	16,310
Deferred tax liability		(1,572)
Current liabilities		(887)
Net assets acquired	\$	13,851

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On a preliminary basis, the purchase price was allocated to identifiable tangible and intangible assets acquired and liabilities assumed based on their estimated fair values resulting in goodwill of \$9,959,000. The intangible assets of \$4,176,000 consist mainly of the following (in thousands):

	Amount	Useful life
Trade names	\$ 130	1.5 years
Customer relationships	1,523	8 years
Developed technology hardware	1,504	8 year
Developed technology software	1,019	5 years

The transaction calls for payments in addition to the original payment. These payments are contingent upon revenue related to specific products for the first eighteen months after the acquisition.

The goodwill is not deductible for tax purposes.

*WhereNet Corp.* On January 25, 2007, Zebra acquired all of the outstanding stock of WhereNet Corp., for \$127,426,000, which is net of cash acquired and transaction costs. Headquartered in Santa Clara, CA, WhereNet provides integrated wireless real time locating systems (RTLs) to companies primarily in the industrial manufacturing, transportation and logistics, and aerospace and defense sectors. The consolidated statements of earnings reflect the results of operations of WhereNet since the effective date of the purchase. The pro forma impact of this acquisition was not significant.

The following table (in thousands) summarizes the adjusted fair values of the assets acquired and the liabilities assumed at the date of acquisition.

	At January 25, 2007
Current assets	\$ 9,254
Deferred tax assets	20,686
Property and equipment	360
Intangible assets	30,616
Goodwill	80,756
Total assets acquired	\$ 141,672
Current liabilities	(14,246)
Net assets acquired	\$ 127,426

The purchase price was allocated to identifiable tangible and intangible assets acquired and liabilities assumed based on their estimated fair values resulting in goodwill of \$80,756,000. The future benefit of the acquired net operating loss of \$30,513,000 is included in the deferred tax assets. The intangible assets of \$30,616,000 consist mainly of the following (in thousands):

	Amount	Useful life
Developed technology	\$ 14,978	6 years
Customer relationships	12,324	10 years
Backlog	1,461	1 year
Acquired in-process research and development	1,853	N/A

The acquired in-process research and development of \$1,853,000 was written-off at the date of the acquisition in accordance with FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*. Acquired in-process technology is stated separately in the operating expense section of the consolidated statements of earnings.



The goodwill is not deductible for tax purposes.

**Note 5 Investments and Marketable Securities**

We classify the majority of our investments in marketable debt securities as available-for-sale in accordance with the classifications defined in SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. As of September 29, 2007, all of our investments in marketable debt securities with maturities greater than one year are classified as long-term in the balance sheet due to our ability and intent to hold them until maturity.

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SFAS No. 115 requires that changes in the market value of available-for-sale securities are reflected in the accumulated other comprehensive income caption of stockholders' equity in the balance sheet, until we dispose of the securities. Once these securities are disposed of, either by sale or maturity, the accumulated changes in market value are transferred to investment income. On the cash flow statements, changes in the balances of *available-for-sale* securities are shown as purchases, sales and maturities of investments and marketable securities under investing activities.

Changes in market value of *trading* securities would be recorded in investment income as they occur, and the related cash flow statement would include changes in the balances of trading securities as operating cash flows.

Our investments include marketable debt securities, marketable equity securities and partnership interests. We account for marketable debt securities as available-for-sale securities. We account for the marketable equity securities as trading securities. We account for the partnership interests using the cost method until our ownership percentage reaches 5% of the total partnership portfolio value, because at that point we begin using the equity method to account for them. We recorded a loss of \$42,000 on trading securities in investment income during the nine months ended September 29, 2007.

During 2006, we reached the 5% threshold on one of our partnership interests. For the nine months ended September 29, 2007, we recorded \$763,000 in equity in earnings related to this partnership interest, which is included in investment income. During the third quarter of 2007, we liquidated 90% of this partnership interest, with the balance to be liquidated during 2008. Within the next year we intend to liquidate all of our partnership interests.

Change in unrealized gains and losses on available-for-sale securities are included in these financial statements as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Changes in unrealized gains and (losses) on available-for-sale securities, net of tax, recorded in accumulated other comprehensive income	\$ 1,144	\$ 1,990	\$ 729	\$ (1,591)

**Note 6 Stockholders' Equity**

Share count and par value data related to stockholders' equity are as follows:

	September 29, 2007	December 31, 2006
<b>Preferred Stock</b>		
Par value per share	\$ 0.01	\$ 0.01
Shares authorized	10,000,000	10,000,000
Shares outstanding		
<b>Common Stock - Class A</b>		
Par value per share	\$ 0.01	\$ 0.01
Shares authorized	150,000,000	150,000,000
Shares issued	72,151,857	72,151,857
Shares outstanding	68,018,814	68,830,029
Treasury stock		
Shares held	4,133,043	3,321,828

During the nine months ended September 29, 2007, we purchased 1,270,030 shares of Zebra Class A Common Stock for \$44,209,000. Cash payments for treasury share purchases during the year were \$48,913,000. This amount included a payment for \$4,704,000 in January for shares that were purchased prior to December 31, 2006. Treasury shares are being reissued for exercise of stock options and purchases under stock purchase plan.

**Table of Contents****Note 7 Other Comprehensive Income (Loss)**

Stockholders' equity includes certain items classified as other comprehensive income, including:

**Foreign currency translation adjustment** relates to our non-U.S. subsidiary companies that have designated a functional currency other than the U.S. dollar. We are required to translate the subsidiary functional currency financial statements to dollars using a combination of historical, month-end, and average foreign exchange rates. This combination of rates creates the foreign currency translation adjustment component of other comprehensive income.

**Unrealized gains (losses) on foreign currency hedging transactions** relate to derivative instruments used to hedge the currency exchange rates for forecasted euro sales. These hedges are designated as cash flow hedges, and we have deferred income statement recognition of gains and losses until the hedged transaction occurs. See Note 10 for more details.

**Unrealized gains (losses) on investments classified as available-for-sale** are deferred from income statement recognition until the gains or losses are realized. See Note 5 above for more details.

The components of other comprehensive income included in the Consolidated Statements of Comprehensive Income are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Foreign currency translation adjustments	\$ 1,132	\$ 701	\$ 2,578	\$ 4,140
Changes in unrealized gains and (losses) on foreign currency hedging transactions:				
Gross	\$ (5,159)	\$ 1,333	\$ (4,974)	\$ (897)
Income tax (benefit)	(1,942)	502	(1,872)	(338)
Net	\$ (3,217)	\$ 831	\$ (3,102)	\$ (559)
Changes in unrealized gains and (losses) on investments classified as available-for-sale:				
Gross	\$ 1,835	\$ 3,191	\$ 1,169	\$ (2,552)
Income tax (benefit)	691	1,201	440	(961)
Net	\$ 1,144	\$ 1,990	\$ 729	\$ (1,591)

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The components of accumulated other comprehensive income (loss) included in the Consolidated Balance Sheets are as follows (in thousands):

	September 29, 2007	As of December 31, 2006
Foreign currency translation adjustments	\$ 10,978	\$ 8,400
Changes in unrealized losses on foreign currency hedging transactions:		
Gross	\$ (5,880)	\$ (906)
Income tax benefit	(2,213)	(341)
Net	\$ (3,667)	\$ (565)
Changes in unrealized losses on investments classified as available-for-sale:		
Gross	\$ (472)	\$ (1,641)
Income tax benefit	(178)	(618)
Net	\$ (294)	\$ (1,023)

**Note 8 Earnings Per Share**

Earnings (loss) per share before cumulative effect of accounting change were computed as follows (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
<b>Basic earnings (loss) per share:</b>				
Income (loss) before cumulative effect of accounting change	\$ 26,961	\$ (4,263)	\$ 79,310	\$ 48,181
Weighted average common shares outstanding	68,580	70,802	68,814	70,702
Per share amount	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.68
<b>Diluted earnings (loss) per share:</b>				
Income (loss) before cumulative effect of accounting change	\$ 26,961	\$ (4,263)	\$ 79,310	\$ 48,181
Weighted average common shares outstanding	68,580	70,802	68,814	70,702
Add: Effect of dilutive securities stock options	425		445	450
Diluted weighted average and equivalent shares outstanding	69,005	70,802	69,259	71,152
Per share amount	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.68

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Earnings (loss) per share after the cumulative effect of the accounting change were computed as follows (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
<b>Basic earnings (loss) per share:</b>				
Net income (loss)	\$ 26,961	\$ (4,263)	\$ 79,310	\$ 49,500
Weighted average common shares outstanding	68,580	70,802	68,814	70,702
Per share amount	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.70
<b>Diluted earnings (loss) per share:</b>				
Net income (loss)	\$ 26,961	\$ (4,263)	\$ 79,310	\$ 49,500
Weighted average common shares outstanding	68,580	70,802	68,814	70,702
Add: Effect of dilutive securities stock options	425		445	450
Diluted weighted average and equivalent shares outstanding	69,005	70,802	69,259	71,152
Per share amount	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.70

The calculation of loss per share for the three months ended September 30, 2006, did not include the effect of dilutive securities (stock options) because to do so would have been anti-dilutive.

Potentially dilutive securities that were excluded from the earnings per share calculation consist of stock options with an exercise price greater than the average market price of the Class A common stock. These options were as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Potentially dilutive shares	1,614,000	1,233,000	1,608,000	1,151,000

**Table of Contents****Note 9 Goodwill and Other Intangible Asset Data**

Intangible asset data are as follows (in thousands):

	September 29, 2007		December 31, 2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<b>Amortized intangible assets</b>				
Current technology	\$ 34,497	\$ (12,293)	\$ 15,481	\$ (9,566)
Patent and patent rights	29,797	(5,496)	28,247	(2,645)
Customer relationships	19,337	(3,607)	3,798	(1,290)
<b>Total</b>	<b>\$ 83,631</b>	<b>\$ (21,396)</b>	<b>\$ 47,526</b>	<b>\$ (13,501)</b>
<b>Unamortized intangible assets</b>				
Goodwill	\$ 161,877		\$ 70,714	
<b>Aggregate amortization expense</b>				
For the year ended December 31, 2006			\$ 3,653	
For the three months ended September 30, 2006			789	
For the nine months ended September 30, 2006			2,259	
For the three months ended September 29, 2007	\$ 2,928			
For the nine months ended September 29, 2007	7,871			
<b>Estimated amortization expense</b>				
For the year ended December 31, 2007	\$ 10,839			
For the year ended December 31, 2008	10,441			
For the year ended December 31, 2009	10,114			
For the year ended December 31, 2010	9,347			
For the year ended December 31, 2011	8,999			
Thereafter	20,366			

During 2007, in addition to the intangible assets we acquired in conjunction with our acquisitions of WhereNet and proveo AG, we acquired intangible assets in the amount of \$2,800,000 for software licenses and patents with estimated useful lives of 7 to 9 years.

We test the impairment of goodwill each year or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We completed our last assessment during June 2007. At that time, no adjustment to goodwill was necessary due to impairment.

We evaluate the impairment of identifiable intangibles and other long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Factors considered that may trigger an impairment review consist of:

Significant underperformance relative to expected historical or projected future operating results,

Significant changes in the manner of use of the acquired assets or the strategy for the overall business,

Significant negative industry or economic trends,

Significant decline in Zebra's stock price for a sustained period, and

Significant decline in market capitalization relative to net book value.

If we believe that one or more of the above indicators of impairment have occurred and the undiscounted cash flow test is failed, we measure impairment based on a projected discounted cash flow methodology using a discount rate that incorporates the risk inherent in the cash flows.

**Note 10 Derivative Instruments**

In the normal course of business, portions of Zebra's operations are subject to fluctuations in currency values. We manage these risks using derivative financial instruments.

**Table of Contents***Hedging of Net Assets*

We use forward contracts and options to manage exposure related to our pound- and euro-denominated net assets. We record gains and losses on these contracts and options in income each quarter along with the transaction gains and losses related to our net euro asset position, which would ordinarily offset each other. Summary financial information related to these activities follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Change in gains and (losses) from foreign exchange derivatives	\$ (1,770)	\$ 1,190	\$ (1,877)	\$ 11
Gain (loss) on net foreign currency assets	1,747	(733)	1,847	176
Net foreign exchange gain and (losses)	\$ (23)	\$ 457	\$ (30)	\$ 187

	As of	
	September 29, 2007	December 31, 2006
Notional balance of outstanding contracts:		
Pound/US dollar	£ 3,000	£ 2,660
Euro/US dollar	15,000	17,000
Euro/Pound	19,500	22,000
Net fair value of outstanding contracts	\$ 109	\$ (172)

*Hedging of Anticipated Sales*

We manage the exchange rate risk of anticipated euro denominated sales using forward contracts and option collars. We designate these contracts as cash flow hedges. Gains and losses on these contracts are deferred in other comprehensive income until the contracts are settled and the hedged sales are realized, at which time the deferred gains or losses will be reported as an increase or decrease to sales. Summary financial information related to the cash flow hedges of future revenues follows (in thousands, except percentages):

	As of	
	September 29, 2007	December 31, 2006
Net unrealized losses deferred in other comprehensive income:		
Gross	\$ (5,880)	\$ (906)
Income tax benefit	(2,213)	(341)
Net	\$ (3,667)	\$ (565)
Notional balance of outstanding contracts	109,200	44,075
Hedge effectiveness	100%	100%
	<b>2007</b>	<b>2006</b>
Net losses included in revenue for the:		
Three months ended September 29, 2007	\$ (705)	
Three months ended September 30, 2006		\$ (721)
Nine months ended September 29, 2007	(1,795)	
Nine months ended September 30, 2006		(553)

The duration of our forecasted sales hedge contracts ranges from nine to twelve months.



**Note 11 Contingencies**

On January 31, 2003, a Writ of Summons was filed in the Nantes Commercial Court, Nantes, France, by Printherm, a French corporation, and several of its shareholders (collectively, Printherm ), against Zebra Technologies France ( ZTF ), a French corporation and wholly-owned subsidiary of Zebra. Printherm seeks damages in the amount of 15,304,000 and additional unspecified damages in connection with ZTF s termination of negotiations in December

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2000 respecting the proposed acquisition by Zebra of the capital stock of Printherm. The negotiation was terminated based on unsatisfactory results of the ongoing due diligence. We believe that Printherm's claims are without merit and that a loss is not likely to occur. We will vigorously defend the action.

Printherm filed bankruptcy proceedings on August 30, 2004, and the Commercial Court ordered its liquidation on November 30, 2004. The case was put on hold until the Court appointed liquidator filed a submission in August 2005, which started the proceedings again. ZTF filed its answer on November 19, 2005, in anticipation of a Court-ordered December 19, 2005, hearing date. In response to a request by Printherm's liquidator, the Court postponed the hearing date so as to provide time for Printherm to respond to ZTF's answer. The hearing has not been scheduled and we are unsure when it will be scheduled.

**Note 12 Warranty.** In general, Zebra provides warranty coverage of one year on printers against defects in material and workmanship. Printheads are warranted for nine months and batteries are warranted for three months. A provision for warranty expense is recorded at the time of shipment and adjusted quarterly based on historical warranty experience. The following is a summary of Zebra's accrued warranty obligation.

	Nine Months Ended September 29, 2007	Nine Months Ended September 30, 2006
Balance at the beginning of the year	\$ 2,250	\$ 1,922
Warranty expense year-to-date	4,863	3,876
Warranty payments made year-to-date	(4,025)	(3,773)
Balance at the end of the period	\$ 3,088	\$ 2,025

During 2005, Zebra began providing for environmental recycling reserves similar to warranty reserves. In the European Union, we have an obligation in the future to recycle printers. This reserve is based on all new printers sold after August 13, 2005, and printers sold prior to that date that are returned to us upon our sale of a new printer to a customer. The following is a summary of Zebra's accrued recycling obligation.

	Nine Months Ended September 29, 2007	Nine Months Ended September 30, 2006
Balance at the beginning of the year	\$ 2,115	\$ 632
Recycling expense year-to-date	1,357	1,005
Recycling payments made year-to-date		
Exchange rate impact	94	23
Balance at the end of the period	\$ 3,566	\$ 1,660

**Note 13 Income Taxes**

On January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. According to FIN No. 48, we identified, evaluated, and measured the amount of income tax benefits to be recognized for all of our income tax positions. The net income tax assets recognized under FIN No. 48 did not differ from the net assets recognized before adoption, and, therefore, we did not record an adjustment related to the adoption of FIN No. 48. Zebra did not have any unrecognized tax benefits as of September 29, 2007 or December 31, 2006.

Zebra has concluded all U.S. federal income tax audits for years through 2003. The tax years 2002 through 2006 remain open to examination by multiple state taxing jurisdictions.

Zebra's continuing practice is to recognize interest and/or penalties related to income tax matters as part of income tax expense. For the quarter ended September 29, 2007, we did not accrue any interest or penalties into income tax expense.

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The effective income tax rate for the third quarter of 2007 was 34.5%, compared with an income tax benefit of 57.8% for the third quarter of 2006. The change in the effective tax rate is a result of the impact of permanent tax differences, including tax-exempt interest income, on the effective income tax rate due to the loss before income taxes incurred in the third quarter of 2006. In addition, we reduced tax reserves last year in the amount of \$1,189,000 related to the completion of various state tax audits and 2005 state income tax returns. The resulting year-to-date effective income tax rate for 2007 was 34.6%, compared with 31.2% for the same period in 2006.

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### **Note 14 New Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement will be effective for Zebra beginning in fiscal 2008, and we are in the process of determining any potential impact to the financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which allows entities to voluntarily choose, at specified election dates, to measure many financial assets and financial liabilities (as well as certain non-financial instruments) at fair value (the "fair value option"). The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, the Statement specifies that all subsequent changes in fair value for that instrument shall be reported in earnings. This Statement is effective for Zebra for the fiscal year ending December 31, 2008. We have not yet determined the effect this Statement will have on our operations or financial position.

### **Note 15 Related Party Transactions**

As previously reported, Zebra leased a facility from Unique Building Corporation, an entity controlled by certain officers and stockholders of Zebra. On August 1, 2007, this facility was sold to an unrelated third party with the existing lease with Zebra continuing according to its terms.

### **Note 16 Subsequent Events**

On October 15, 2007, Zebra signed a definitive agreement to purchase all of the outstanding stock of Navis Holdings LLC (Navis) for \$145,000,000 in cash. Navis is based in Oakland, CA, and is a supply chain logistics systems provider whose products help to optimize the flow of goods through cargo ports and other distribution centers. Navis was the first company to provide automated container terminal operating systems, which improve velocity and visibility of cargo movement through port and intermodal facilities. The Navis suite of products helps companies enhance productivity, efficiency and profitability by automating and integrating data input functions for real-time analysis and planning. These products unite various functions to streamline workflow and reduce overhead, administration and maintenance costs. This transaction, which is subject to an antitrust waiting period and other customary closing conditions, is expected to close in the fourth quarter of 2007.

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

Net sales for the third quarter of 2007, compared with the third quarter of 2006, increased 16.5% principally on the strength of sales in international sales regions. Continued robust sales growth of our established printer and service lines were supplemented by sales from recent acquisitions. Gross margin expanded due to improved manufacturing variances, a favorable product mix, and favorable exchange rate movements. Higher operating expenses resulted from increases in payroll costs, information system costs, professional service fees, and recent acquisitions. In addition, operating expenses include \$3,979,000 in one-time charges related to the retirement of former CEO Ed Kaplan and Board of Director project activity related to the search and hiring of a new chief executive officer.

**Results of Operations: Third Quarter of 2007 versus Third Quarter of 2006***Sales*

Sales by product category, percent change, and percent of total sales for the three and nine months ended September 29, 2007, and September 30, 2006, were (in thousands, except percentages):

Product Category	Three Months Ended		Percent Change	Percent of Total Sales - 2007	Percent of Total Sales - 2006
	September 29, 2007	September 30, 2006			
Hardware	\$ 164,756	\$ 140,892	16.9	75.8	75.6
Supplies	41,731	38,408	8.7	19.2	20.6
Service and software	9,728	6,280	54.9	4.5	3.4
Shipping and handling	1,708	1,527	11.9	0.8	0.8
Cash flow hedging activities	(705)	(721)	NM	(0.3)	(0.4)
Total sales	\$ 217,218	\$ 186,386	16.5	100.0	100.0

Product Category	Nine Months Ended		Percent Change	Percent of Total Sales - 2007	Percent of Total Sales - 2006
	September 29, 2007	September 30, 2006			
Hardware	\$ 482,640	\$ 414,921	16.3	76.1	75.5
Supplies	120,098	112,130	7.1	18.9	20.4
Service and software	28,681	18,710	53.3	4.5	3.4
Shipping and handling	5,082	4,413	15.2	0.8	0.8
Cash flow hedging activities	(1,795)	(553)	NM	(0.3)	(0.1)
Total sales	\$ 634,706	\$ 549,621	15.5	100.0	100.0

Sales to customers by geographic region, percent changes and percent of total sales for the three and nine months ended September 29, 2007, and September 30, 2006, were (in thousands, except percentages):

Geographic Region	Three Months Ended		Percent Change	Percent of Total Sales - 2007	Percent of Total Sales - 2006
	September 29, 2007	September 30, 2006			
Europe, Middle East and Africa	\$ 74,200	\$ 59,250	25.2	34.2	31.8
Latin America	16,703	13,589	22.9	7.7	7.3
Asia-Pacific	21,221	16,776	26.5	9.8	9.0
Total International	112,124	89,615	25.1	51.7	48.1

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North America	105,094	96,771	8.6	48.3	51.9
Total sales	\$ 217,218	\$ 186,386	16.5	100.0	100.0

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Geographic Region	Nine Months Ended			Percent Change	Percent of Total Sales - 2007	Percent of Total Sales - 2006
	September 29, 2007	September 30, 2006				
Europe, Middle East and Africa	\$ 226,330	\$ 190,272	19.0	35.7	34.6	
Latin America	44,638	39,765	12.3	7.0	7.2	
Asia-Pacific	55,771	44,651	24.9	8.8	8.1	
Total International	326,739	274,688	18.9	51.5	49.9	
North America	307,967	274,933	12.0	48.5	50.1	
Total sales	\$ 634,706	\$ 549,621	15.5	100.0	100.0	

Our North America, Latin America, and Asia-Pacific regions achieved record quarterly sales. Overall, sales growth for Zebra was affected by the success of programs to accelerate sales growth in the international territories, and by the impact of the WhereNet acquisition on North American sales.

Our international sales are denominated in multiple currencies, primarily the U.S. dollar, British pound and euro. This directly causes our reported sales to be subject to fluctuations based on changes in currency rates. We estimate that favorable foreign exchange movements of the euro and the pound versus the dollar had a positive impact of \$4,850,000 on sales for the third quarter of 2007 and \$15,134,000 for the year to-date.

We currently hedge a portion of anticipated euro-denominated sales to partially protect Zebra against exchange rate movements. This program resulted in a loss of \$705,000 for the third quarter of 2007 and a loss of \$1,795,000 for the year to-date. See Note 10 to the Consolidated Financial Statements included in this Form 10-Q for a more detailed discussion of this hedging program.

New printer products (defined as printers released within 18 months prior to the end of the applicable fiscal period) accounted for 5.1% of printer sales in the third quarter of 2007, compared with 12.1% of printer sales in the third quarter of 2006 and 8.9% for the second quarter of 2007. Year to-date, new printer products accounted for 8.7% in 2007, compared with 13.1% for the corresponding period in 2006. Zebra released four new printer products in the third quarter, and we expect sales for these printers to increase the new product percentage starting in the fourth quarter of 2007.

Printer unit volumes and average selling price information is summarized below:

	Three Months Ended			Nine Months Ended		
	September 29, 2007	September 30, 2006	Percent Change	September 29, 2007	September 30, 2006	Percent Change
Total printers shipped	228,313	192,710	18.5	684,642	591,788	15.7
Average selling price of printers shipped	\$ 585	\$ 621	(5.8)	\$ 575	\$ 599	(4.0)

For the third quarter of 2007, unit volumes increased significantly in our desktop and mobile product lines. The decrease in average selling price is primarily related to higher sales growth of these printer lines, compared with the product mix for the third quarter of 2006. Year to-date, unit volumes of mid range printers increased, which contributed to a lower average selling price from the prior year.

*Gross Profit*

Gross profit information is summarized below (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	September 29, 2007	September 30, 2006	Percent Change	September 29, 2007	September 30, 2006	Percent Change
Gross Profit	\$ 104,628	\$ 87,786	19.2	\$ 303,820	\$ 260,010	16.8
Gross Profit Margin (%)	48.2	47.1		47.9	47.3	





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Gross profit margin was affected by favorable foreign currency movements, which resulted in increased gross profit by \$4,026,000 for the third quarter, and \$12,417,000 for the year to-date. Gross margin also improved due to reductions in manufacturing variances and a favorable product mix.

*Selling and Marketing Expenses*

Selling and marketing expenses are summarized below (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	September 29, 2007	September 30, 2006	Percent Change	September 29, 2007	September 30, 2006	Percent Change
Selling and marketing expenses	\$ 29,080	\$ 23,467	23.9	\$ 86,313	\$ 69,086	24.9
Percent of sales	13.4	12.6		13.6	12.6	

During the third quarter of 2007, selling and marketing expenses increased due to higher payroll costs of \$4,106,000 over the third quarter of 2006, which was, in part, related to our recent acquisitions. Year to-date, advertising and market development costs, outside commissions, and travel and entertainment costs also increased.

*Research and Development Costs*

The development of new products and enhancements to existing products are important to Zebra's business and growth prospects. To maintain and build our product pipeline, we made investments in research and development, summarized below (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	September 29, 2007	September 30, 2006	Percent Change	September 29, 2007	September 30, 2006	Percent Change
Research and development costs	\$ 13,904	\$ 11,774	18.1	\$ 41,958	\$ 36,191	15.9
Percent of sales	6.4	6.3		6.6	6.6	

Quarterly product development expenses fluctuate widely depending on the status of on-going projects. We are committed to a long-term strategy of significant investment in product development. For the third quarter of 2007, payroll costs increased \$1,647,000 in relation to the third quarter of 2006. Year-to-date, research and development costs were also affected by increased payroll costs.

*General and Administrative Expenses*

General and administrative expenses are summarized in the table below (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	September 29, 2007	September 30, 2006	Percent Change	September 29, 2007	September 30, 2006	Percent Change
General and administrative expenses	\$ 21,694	\$ 14,642	48.2	\$ 59,502	\$ 44,372	34.1
Percent of sales	10.0	7.9		9.4	8.1	

For the third quarter of 2007, the increase in general and administrative expenses compared with the third quarter of 2006 is related to \$2,368,000 of increased payroll costs and \$3,979,000 in one-time charges related to the retirement of former CEO Ed Kaplan and Board of Director project activity related to the search and hiring of a new chief executive officer. Year-to-date, the general and administrative expense change was also a result of increased information systems costs offset by a decrease in legal expenses.

*Settlement and Licensing Agreement with Paxar Americas, Inc.*

During the third quarter of 2006, Zebra paid \$63,750,000 to settle all issues surrounding the litigation with Paxar Americas, Inc. Of this amount, \$53,392,000 was included as operating expense.



**Table of Contents***Operating Income (Loss)*

Operating income (loss) is summarized in the following table (in thousands, except percentages):

	Three Months Ended			Nine Months Ended		
	September 29, 2007	September 30, 2006	Percent Change	September 29, 2007	September 30, 2006	Percent Change
Operating income (loss)	\$ 37,022	\$ (16,278)	NM	\$ 106,323	\$ 54,710	94.3
Percent of sales	17.0	(8.7)		16.8	10.0	

*Non-operating Income and Expenses*

Zebra's non-operating income and expense items are summarized in the following table (in thousands):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Investment income	\$ 4,393	\$ 6,008	\$ 15,421	\$ 16,202
Interest expense	(73)	(5)	(92)	(236)
Foreign exchange gain (loss)	(23)	457	(30)	187
Other, net	(157)	(287)	(438)	(912)
Total other income	\$ 4,140	\$ 6,173	\$ 14,861	\$ 15,241

**Rate of Return Analysis:**

Average cash and marketable securities balances	\$ 480,509	\$ 566,235	\$ 514,275	\$ 545,931
Annualized rate of return	3.7%	4.2%	4.0%	4.0%

*Income Tax (Benefit)*

The effective income tax rate for the third quarter of 2007 was 34.5%, compared with an income tax benefit of 57.8% for the same period last year. The change in the effective tax rate is a result of the impact of permanent tax differences, including tax-exempt interest income, on the effective income tax rate due to the loss before income taxes incurred in the third quarter of 2006. In addition, we reduced tax reserves last year in the amount of \$1,189,000 related to the completion of various state tax audits and 2005 state income tax returns. The resulting year-to-date effective income tax rate for 2007 was 34.6% compared to 31.2% for the same period in 2005.

*Income (Loss) before Cumulative Effect of Accounting Change*

Zebra's income (loss) before cumulative effect of accounting change is summarized below (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Income (loss) before cumulative effect of accounting change	\$ 26,961	\$ (4,263)	\$ 79,310	\$ 48,181
Diluted earnings (loss) per share	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.68

*Cumulative Effect of Accounting Change*

During the first quarter of 2006, Zebra adopted SFAS No. 123(R), *Share-Based Payments*, utilizing the modified retrospective approach. SFAS No. 123(R) requires entities to estimate the number of forfeitures of unvested options expected to occur and record expense based upon the number of awards expected to vest. Prior to the adoption of SFAS No. 123(R), we accounted for forfeitures as they occurred as permitted under previous accounting standards. The requirement to estimate forfeitures is classified as an accounting change under APB Opinion No. 20, *Accounting Changes*, which requires a one-time adjustment in the period of adoption. The one-time adjustment (cumulative effect of accounting

change) related to the change in estimating forfeitures increased 2006 income by \$1,319,000, net of applicable taxes.

**Table of Contents***Net Income (Loss)*

Zebra's net income (loss) is summarized below (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Net income (loss)	\$ 26,961	\$ (4,263)	\$ 79,310	\$ 49,500
Diluted earnings (loss) per share	\$ 0.39	\$ (0.06)	\$ 1.15	\$ 0.70

**Liquidity and Capital Resources**

During the first nine months of 2007, Zebra purchased WhereNet Corp. for \$127,426,000, and proveo AG for \$13,851,000. As a result, Zebra's cash and investment balances decreased to \$469,360,000 at September 29, 2007, compared with \$559,189,000 at December 31, 2006. Factors affecting cash and investment balances during the first nine months of 2007 include (note that changes discussed below include the impact of foreign currency):

Operations provided cash in the amount of \$109,823,000, primarily from net income.

The accounts receivable included \$8,114,000 of acquired accounts receivable resulting in a decrease in the overall cash flow amount of \$1,050,000. Days sales outstanding increased to 56 days for the third quarter of 2007 compared with 53 days at the end of 2006.

Accounts payable increased by \$6,016,000, due to the timing of vendor payments.

Accrued liabilities increased by \$13,978,000 for payroll, unearned revenue, warranty, and hedge contract valuations.

Purchases of property and equipment totaled \$15,702,000.

Purchase of acquired businesses totaled \$141,277,000.

Net sales of investments totaled \$82,575,000.

Cash payments for treasury shares totaled \$48,913,000. Zebra made open market repurchases of our shares under authorizations of the Board of Directors dated October 4, 2005 and July 30, 2007.

Stock option exercises and purchases under the stock purchase plan contributed \$7,593,000.

Management believes that existing capital resources and funds generated from operations are sufficient to finance anticipated capital requirements. It is our intention to actively pursue opportunities to acquire other businesses.

**Critical Accounting Policies and Estimates**

## Edgar Filing: ZEBRA TECHNOLOGIES CORP/DE - Form 10-Q

Management prepared the consolidated financial statements of Zebra Technologies Corporation under accounting principles generally accepted in the United States of America. These principles require the use of estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions we used are reasonable, based upon the information available.

Our estimates and assumptions affect the reported amounts in our financial statements. The following accounting policies comprise those that we believe are the most critical in understanding and evaluating Zebra's reported financial results.

### *Revenue Recognition*

Product revenue is recognized once four criteria are met: (1) we have persuasive evidence that an arrangement exists; (2) delivery has occurred and title has passed to the customer, which happens at the point of shipment provided that no significant obligations remain; (3) the price is fixed and determinable; and (4) collectibility is reasonably assured. Other items that affect our revenue recognition include:

### Customer Returns

Customers have the right to return products that do not function properly within a limited time after delivery. We monitor and track product returns and record a provision for the estimated future returns based on historical experience and any notification received of pending returns. Returns have historically been within expectations and the provisions established, but Zebra cannot guarantee that it will continue to experience return rates consistent with historical patterns. Historically, our product returns have not been significant. If a significant issue should arise, however, it could have a material impact on our financial statements.

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### Growth Rebates

Some of our channel program partners are offered incentive rebates based on the attainment of specific growth targets related to products they purchase from us over a quarter or year. These rebates are recorded as a reduction to revenue. Each quarter, we estimate the amount of outstanding growth rebates and establish a reserve for them based on shipment history. Historically, actual growth rebates have been in line with our estimates.

### Price Protection

We offer some of our customers price protection as an incentive to carry inventories of our product. These price protection plans provide that if we lower prices, we will credit them for the price decrease on the inventories they hold. We estimate future payments under price protection programs quarterly and establish a reserve, which is charged against revenue. Our customers typically carry limited amounts of inventory, and Zebra infrequently lowers prices on current products. As a result, the amounts paid under these plans have been minimal.

### Software Revenue

We sell three types of software and record revenue as follows:

Our printers contain *embedded firmware*, which is part of the hardware purchase. We consider the sale of this firmware to be incidental to the sale of the printer and do not attribute any revenue to it.

We sell a limited amount of *prepackaged*, or *off-the-shelf*, software for the creation of bar code labels using our printers. There is no customization required to use this software, and we have no post-shipment obligations on the software. Revenue is recognized at the time this prepackaged software is shipped.

We sometimes provide *custom software* as part of a printer installation project. We bill custom software development services separate from the related hardware. Revenue related to custom software is recognized once the custom software development services have been completed and accepted by the customer.

### Shipping and Handling

We charge our customers for shipping and handling services based upon our internal price list for these items. The amounts billed to customers are recorded as revenue when the product ships. Any costs incurred related to these services are included in cost of sales.

From time to time, Zebra will enter into sales transactions that include more than one product type. This bundle of products might include printers, current or future supplies, and services. When this type of transaction occurs, we allocate the purchase price to each product type based on the fair value of the individual products. The revenue for each individual product is then recognized when the recognition criteria for that product is fully met.

### *Investments and Marketable Securities*

Investments and marketable securities at September 29, 2007, consisted of the following:

U.S. government securities	8.1%
State and municipal bonds	83.9%
Corporate bonds	0.4%
Equity securities	0.8%
Partnership interests	6.8%

## Edgar Filing: ZEBRA TECHNOLOGIES CORP/DE - Form 10-Q

We classify our debt and marketable equity securities in one of three categories: trading, available-for-sale or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity securities are those debt securities that Zebra has the ability and intent to hold until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale, except for partnership interests described below.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at amortized cost, adjusted for the amortization or accretion of discounts or premiums. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of stockholders



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equity until realized. As of September 29, 2007, Zebra's investments in marketable debt securities are classified as available-for-sale. In addition, all of our investments in marketable debt securities with maturities greater than one year are classified as long-term investments on the balance sheet because of our ability and intent to hold them until maturity. Our investment in marketable equity securities is classified as trading.

We account for the partnership interests using the cost method until our ownership percentage in a partnership reaches 5% of the total partnership portfolio value. At that time, we begin using the equity method to account for that particular partnership. During 2006, we reached the 5% threshold on one of our partnership interests. During the third quarter of 2007, we liquidated 90% of this partnership interest, with the balance to be liquidated in 2008. Within the next year we intend to liquidate all of our partnership interests.

### *Accounts Receivable*

We have standardized credit granting and review policies and procedures for all customer accounts, including:

Credit reviews of all new customer accounts,

Ongoing credit evaluations of current customers,

Credit limits and payment terms based on available credit information,

Adjustments to credit limits based upon payment history and the customer's current credit worthiness, and

An active collection effort by regional credit functions, reporting directly to the corporate financial officers.

We reserve for estimated credit losses based upon historical experience and specific customer collection issues. Over the last three years, accounts receivable reserves varied from 0.6% to 3.3% of total accounts receivable. Accounts receivable reserves as of September 29, 2007, were \$4,324,000, or 3.1% of the balance due. We feel this reserve level is appropriate considering the quality of the portfolio as of September 29, 2007. While credit losses have historically been within expectations and the provisions established, we cannot guarantee that our credit loss experience will continue to be consistent with historical experience.

### *Inventories*

We value our inventories at the lower of the actual cost to purchase or manufacture using the first-in, first-out (FIFO) method, or the current estimated market value. We review inventory quantities on hand and record a provision for excess and obsolete inventory based on forecasts of product demand and production requirements for the subsequent twelve months.

Over the past three years, our reserves for excess and obsolete inventories have ranged from 10.0% to 12.8% of gross inventory. As of September 29, 2007, reserves for excess and obsolete inventories were \$10,886,000, or 11.2% of gross inventory. We believe this reserve level is appropriate considering the quantities and quality of the inventories as of September 29, 2007.

### *Valuation of Long-Lived and Intangible Assets and Goodwill.*

We test the impairment of goodwill each year or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We completed our last assessment during June 2007. At that time, no adjustment to goodwill was necessary due to impairment.

We evaluate the impairment of identifiable intangibles and other long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Factors considered that may trigger an impairment review consist of:

Significant underperformance relative to expected historical or projected future operating results,

Significant changes in the manner of use of the acquired assets or the strategy for the overall business,

Significant negative industry or economic trends,

Significant decline in Zebra's stock price for a sustained period, and

Significant decline in market capitalization relative to net book value.

If we believe that one or more of the above indicators of impairment have occurred and the undiscounted cash flow test is failed in the case of amortizable assets, we measure impairment based on projected discounted cash flows using a discount rate that incorporates the risk inherent in the cash flows. Net intangible assets, long-lived assets and goodwill amounted to \$286,728,000 as of September 29, 2007.

**Table of Contents***Income Taxes*

On January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. According to FIN No. 48, we identified, evaluated, and measured the amount of income tax benefits to be recognized for all of our income tax positions. The net income tax assets recognized under FIN No. 48 did not differ from the net assets recognized before adoption, and, therefore, we did not record an adjustment related to the adoption of FIN No. 48. Zebra did not have any unrecognized tax benefits as of September 29, 2007.

Zebra has concluded all U.S. federal income tax audits for years through 2003. The tax years 2002 through 2006 remain open to examination by multiple state taxing jurisdictions.

Zebra's continuing practice is to recognize interest and penalties related to income tax matters as part of income tax expense. For the quarter ended September 29, 2007, we did not accrue any interest or penalties into income tax expense.

*Contingencies*

We record estimated liabilities related to contingencies based on our estimates of the probable outcomes. Quarterly, we assess the potential liability related to pending litigation, tax audits and other contingencies and confirm or revise estimates and reserves as appropriate.

For a discussion of the Printherm litigation matters, see Note 11 to the Consolidated Financial Statements included in this Form 10-Q.

*Stock-based Compensation*

As of September 29, 2007, we had two stock-based compensation plans available for future grants. As of January 1, 2006, Zebra adopted SFAS No. 123(R), *Share-Based Payments*, utilizing the modified retrospective approach, which requires the prior period financial statements to be restated to recognize compensation costs in the amounts previously reported in the pro forma footnote disclosures. See Note 2 to the Consolidated Financial Statements included in this Form 10-Q for further information on the adoption and impact of SFAS No. 123(R).

**Significant Customer**

ScanSource, Inc. is our most significant customer. Our net sales to ScanSource, Inc., an international distributor of products related to automatic identification, telephony and security, as a percentage of total net sales, were as follows:

	September 29, 2007	September 30, 2006
For the three months ended	15.2%	17.0%
For the nine months ended	16.3%	17.0%

No other customer accounted for 10% or more of total net sales during these time periods.

**Expectations**

As stated on our quarterly conference call on October 22, 2007, we estimate net sales, gross profit margins, operating expenses, and earnings for the fourth quarter of 2007 as follows (in thousands, except per share amounts and percentages):

	<b>Fourth Quarter 2007</b>
Net sales	\$215,000 to \$227,000
Gross profit margins	48.0% to 49.0%
Operating expenses	\$68,000 to \$69,000
Diluted earnings per share	\$0.38 to \$0.45

The effective tax rate is expected to be 34.5% of income before income taxes for the fourth quarter of 2007.



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### **Safe Harbor**

Forward-looking statements contained in this filing are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995 and are highly dependent upon a variety of important factors which could cause actual results to differ materially from those reflected in such forward looking statements. These factors include:

Market acceptance of Zebra's printer and software products and competitors' product offerings and the potential effects of technological changes,

The effect of market conditions in North America and other geographic regions,

Our ability to control manufacturing and operating costs,

Success of integrating acquisitions,

Interest rate and financial market conditions because of our large investment portfolio,

Foreign exchange rates due to the large percentage of our international sales,

The outcome of litigation in which Zebra is involved, particularly litigation or claims related to infringement of third-party intellectual property rights, and

Regulations in the European Union that restrict the use of certain hazardous substances in electrical and electronic equipment.

When used in this document and documents referenced, the words anticipate, believe, estimate, will and expect and similar expressions as they relate to Zebra or its management are intended to identify such forward-looking statements. We encourage readers of this report to review Item 1A, Risk Factors in Part I of our Annual Report on Form 10-K for the year ended December 31, 2006 and Part II of this Form 10-Q, for a further discussion of issues that could affect Zebra's future results. Zebra undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason after the date of this report.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There were no material changes in Zebra's market risk during the quarter ended September 29, 2007. For additional information on market risk, refer to the "Quantitative and Qualitative Disclosures About Market Risk" section of our Form 10-K for the year ended December 31, 2006. See Note 5 to the Consolidated Financial Statements included in this Form 10-Q for further discussion of investments and marketable securities.

In the normal course of business, portions of Zebra's operations are subject to fluctuations in currency values. We manage these risks using derivative financial instruments.

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### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this Form 10-Q. The controls evaluation was conducted under the supervision of our Disclosure Committee, and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based on that evaluation, our Chief Executive Office and Chief Financial Officer, have concluded that our disclosure controls and procedures were effective to provide reasonable assurance that (i) the information required to be disclosed by us in this report on Form 10-Q was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

#### **Changes in Internal Control over Financial Reporting**

There were no changes in our internal controls over financial reporting during the quarter ended September 29, 2007, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting. As permitted by the rules and regulations of the SEC, we excluded Wherenet and proveo AG from our assessment of our internal control over financial reporting for the quarter ended September 29, 2007. We also expect to exclude WhereNet and proveo AG from our annual assessment for the year ended December 31, 2007. We are in the process of integrating the internal control procedures of these two companies into our internal control structure.

#### **Inherent Limitations on the Effectiveness of Controls**

Our management, including our Chief Executive Office and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Zebra have been detected.

These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

**Table of Contents****PART II - OTHER INFORMATION****Item 1. Legal Proceedings**

See Note 11 to the Consolidated Financial Statements included in this Form 10-Q.

**Item 1A. Risk Factors**

In addition to the other information included in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006, and the factors identified under Safe Harbor at the end of Item 2 of Part I of this Quarterly Report on Form 10-Q, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing Zebra. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and/or operating results.

In addition, the following updates the Risk Factors in our Form 10-K and should be read in conjunction with those Risk Factors:

*Larger orders may take longer to close and may not be completely fulfilled during a particular quarter.*

Zebra has been pursuing larger customer orders which typically involve a longer sales cycle. Such orders are more difficult to forecast, and whether a larger order is received by Zebra in a particular quarter or deferred to a later quarter could have a material effect on the financial results of Zebra from quarter to quarter.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****Treasury Shares**

During the third quarter of 2007, Zebra purchased 1,231,641 shares of Zebra's Class A common stock as follows:

**ISSUER PURCHASES OF EQUITY SECURITIES**

<b>Period</b>	<b>Total number of shares purchased</b>	<b>Average price paid per share</b>	<b>Total number of shares purchased as part of publicly announced program</b>	<b>Maximum number of shares that may yet be purchased under the program</b>
July 2007 (July 1 - July 28)				3,380,700
August 2007 (July 29 - August 25)	1,231,641	\$ 34.80	1,231,641	2,149,059
September 2007 (August 26 - September 29)				2,149,059
<b>Total</b>	<b>1,231,641</b>	<b>\$ 34.80</b>	<b>1,231,641</b>	<b>2,149,059</b>

1. On October 4, 2005, Zebra announced that the Board authorized the purchase of up to 2,500,000 shares of Zebra common stock. The purchase price is at management's discretion, and there is no expiration on the authorization. On August 1, 2007, Zebra announced that the Board authorized the purchase of an additional 3,000,000 shares under the same terms.



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**Item 6. Exhibits and Reports on Form 8-K**

- 3(ii) Amended and Restated By-laws of the Company.
  - 10.1 Letter agreement by and between Edward L. Kaplan and the Company dated August 31, 2007.(1)
  - 10.2 Employment Agreement by and between Anders Gustafsson and the Company dated August 23, 2007.(1)
  - 10.3 Non-Qualified Stock Option Agreement by and between Anders Gustafsson and the Company dated September 4, 2007.(1)
  - 10.4 LTI Restricted Stock Agreement by and between Anders Gustafsson and the Company dated September 4, 2007.(1)
  - 10.5 LTI Non-Qualified Stock Option Agreement by and between Anders Gustafsson and the Company dated September 4, 2007.(1)
  - 31.1 Rule 13a-14(a)/15d-14(a) Certification
  - 31.2 Rule 13a-14(a)/15d-14(a) Certification
  - 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
  - 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- (1) Previously filed with the Securities and Exchange Commission as an Exhibit to the Company's Current Report on Form 8-K filed on September 4, 2007, and incorporated herein by reference.

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**SIGNATURES**

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

**ZEBRA TECHNOLOGIES CORPORATION**

Date: November 1, 2007

By: /s/ Anders Gustafsson  
Anders Gustafsson  
Chief Executive Officer

Date: November 1, 2007

By: /s/ Charles R. Whitchurch  
Charles R. Whitchurch  
Chief Financial Officer

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