NATIONAL INSTRUMENTS CORP
Form 10-Q
October 31, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: September 30, 2018 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
(address of principal executive offices)	(zip code)

Registrant's telephone number, including area code: (512) 683-0100
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 every Interactive Data File required to be submitted 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 such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
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 October 26, 2018
Common Stock - $0.01 par value	132,432,594

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 and per share data)

	September 30, 2018 (unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$311,381	$290,164
Short-term investments	171,028	121,888
Accounts receivable, net	239,468	248,825
Inventories, net	192,412	184,592
Prepaid expenses and other current assets	62,447	48,621
Total current assets	976,736	894,090
Property and equipment, net	245,898	249,715
Goodwill	263,119	266,783
Intangible assets, net	116,061	123,293
Other long-term assets	28,106	32,553
Total assets	$1,629,920	$1,566,434
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and accrued expenses	$51,321	$49,733
Accrued compensation	52,182	43,309
Deferred revenue - current	120,398	120,638
Other current liabilities	17,508	23,782
Other taxes payable	34,654	31,793
Total current liabilities	276,063	269,255
Deferred income taxes	36,638	33,609
Liability for uncertain tax positions	9,045	10,158
Income tax payable - long-term	74,015	81,515
Deferred revenue - long-term	31,762	33,742
Other long-term liabilities	5,488	10,134
Total liabilities	433,011	438,413
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; 360,000,000 shares authorized; 132,432,594 shares and 130,978,947 shares issued and outstanding, respectively	1,324	1,310
Additional paid-in capital	881,417	829,979
Retained earnings	329,342	313,241
Accumulated other comprehensive loss	(15,174)	(16,509)
Total stockholders’ equity	1,196,909	1,128,021
Total liabilities and stockholders’ equity	$1,629,920	$1,566,434

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

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NATIONAL INSTRUMENTS CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net sales:				
Product	$310,216	$291,891	$897,355	$853,219
Software maintenance	35,911	29,030	101,678	86,416
Total net sales	346,127	320,921	999,033	939,635
Cost of sales:				
Product	87,082	81,641	239,205	235,989
Software maintenance	1,933	2,110	6,493	6,744
Total cost of sales	89,015	83,751	245,698	242,733
Gross profit	257,112	237,170	753,335	696,902
Operating expenses:				
Sales and marketing	118,220	116,661	365,474	358,335
Research and development	66,170	56,526	194,921	171,701
General and administrative	26,712	26,468	81,882	78,400
Total operating expenses	211,102	199,655	642,277	608,436
Operating income	46,010	37,515	111,058	88,466
Other income:				
Interest income	1,539	657	3,845	1,509
Net foreign exchange (loss) gain	(956)	1,096	(2,082)	1,624
Other gain (loss), net	1,782	(1,153)	169	(957)
Income before income taxes	48,375	38,115	112,990	90,642
Provision for income taxes	5,181	4,726	14,474	13,949
Net income	$43,194	$33,389	$98,516	$76,693
Basic earnings per share	$0.33	$0.26	$0.75	$0.59
Weighted average shares outstanding - basic	132,357	130,660	131,792	130,103
Diluted earnings per share	$0.32	$0.25	$0.74	$0.59
Weighted average shares outstanding - diluted	133,197	131,617	133,067	131,050
Dividends declared per share	$0.23	$0.21	$0.69	$0.63

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

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NATIONAL INSTRUMENTS CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$43,194	$33,389	$98,516	$76,693
Other comprehensive income, before tax and net of reclassification adjustments:				
Foreign currency translation adjustment	(1,359)	6,226	(7,360)	21,890
Unrealized gain (loss) on securities available-for-sale	154	162	(404)	187
Unrealized gain (loss) on derivative instruments	3,316	(3,136)	11,578	(9,470)
Other comprehensive income, before tax	2,111	3,252	3,814	12,607
Tax expense (benefit) related to items of other comprehensive income	720	(1,186)	2,479	(3,333)
Other comprehensive income, net of tax	1,391	4,438	1,335	15,940
Comprehensive income	$44,585	$37,827	$99,851	$92,633

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

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NATIONAL INSTRUMENTS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30, 2018	2017
Cash flow from operating activities:		
Net income	$ 98,516	$ 76,693
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	53,735	54,794
Stock-based compensation	27,492	21,272
Deferred income taxes	732	(4,290)
Changes in operating assets and liabilities	6,862	(1,013)
Net cash provided by operating activities	187,337	147,456
Cash flow from investing activities:		
Capital expenditures	(27,373)	(24,084)
Capitalization of internally developed software	(13,152)	(34,406)
Additions to other intangibles	(5,165)	(1,379)
Purchases of short-term investments	(172,462)	(62,845)
Sales and maturities of short-term investments	122,726	45,582
Net cash used in investing activities	(95,426)	(77,132)
Cash flow from financing activities:		
Principal payments on revolving line of credit	—	(10,000)
	24,424	22,870

Proceeds from issuance of common stock		
Dividends paid	(91,034)	(82,051)
Net cash used in financing activities	(66,610)	(69,181)
Effect of exchange rate changes on cash	(4,084)	7,768
Net change in cash and cash equivalents	21,217	8,911
Cash and cash equivalents at beginning of period	290,164	285,283
Cash and cash equivalents at end of period	$ 311,381	$ 294,194

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, 2017, 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, 2018 and December 31, 2017, the results of our operations and comprehensive income for three and nine months ended September 30, 2018 and 2017, and the cash flows for the nine months ended September 30, 2018 and 2017. Our operating results for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

Out of Period Adjustments

During the three months ended September 30, 2018, we recorded a non-cash out of period adjustment of $2.3 million related to the deferral of gross profit associated with intercompany purchases from our equity-method investee that should have been recognized when realized, through transactions with third-parties, beginning in January 2011. This adjustment was recorded as an increase to "Other long-term assets" on our consolidated balance sheet and an increase to "Other gain (loss), net" on our consolidated statements of income. We evaluated the adjustment from a qualitative and quantitative perspective and concluded that the amount of income was not material to any individual prior quarter or year and that the cumulative out of period adjustment was not expected to be material to our full year 2018 results.

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 includes 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 and nine months ended September 30, 2018 and 2017, are as follows:

	Three Months Ended September 30, (In thousands) (Unaudited)		Nine Months Ended September 30, (In thousands) (Unaudited)	
	2018	2017	2018	2017
Weighted average shares outstanding-basic	132,357	130,660	131,792	130,103
Plus: Common share equivalents				
RSUs	840	957	1,275	947
Weighted average shares outstanding-diluted	133,197	131,617	133,067	131,050

Stock awards to acquire 36,600 shares and 40,700 shares for the three months ended September 30, 2018 and 2017, respectively, and 537,000 shares and 22,300 shares for the nine months ended September 30, 2018 and 2017, respectively, were excluded in the computations of diluted EPS because the effect of including the stock awards

would have been anti-dilutive.

Summary of Significant Accounting Policies

We adopted ASU 2014-09, Revenue from Contracts with Customers and all the related amendments ("new revenue standard") as of January 1, 2018. The impact of this new guidance on our accounting policies and operating results is described below. There were no other significant changes in our accounting policies during the nine months ended September 30, 2018 compared to the significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2017.

Accounts Receivable, net

Accounts receivable are recorded net of allowances for doubtful accounts. Our allowance for doubtful accounts is based on historical experience. We analyze historical bad debts, customer concentrations, customer creditworthiness and current economic trends when evaluating the adequacy of our allowance for doubtful accounts. Unbilled receivables represent amounts for which revenue has been recognized but which have not yet been invoiced to the customer. The current portion of unbilled receivables is included in "accounts receivable, net" on the consolidated balance sheet and is not material.

Sales Tax

Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected from our customers, are excluded from revenue.

Shipping and Handling Costs

Shipping and handling costs associated with outbound freight after control over a product has transferred to a customer are accounted for as a fulfillment cost and are in included in cost of sales.

Recently Adopted Accounting Pronouncements

Revenue from Contracts with Customers

On January 1, 2018, we adopted the new revenue standard using the modified retrospective transition method. Under this method, we evaluated all contracts that were in effect at the beginning of 2018 as if those contracts had been accounted for under the new revenue standard. We did not evaluate individual modifications for those periods prior to the adoption date, but the aggregate effect of all modifications as of the adoption date and such effects are provided below. Under the modified retrospective transition approach, periods prior to the adoption date were not adjusted and continue to be reported in accordance with historical GAAP. A cumulative catch-up adjustment was recorded to beginning retained earnings to reflect the impact of all existing arrangements under the new revenue standard.

We do not expect the impact of the adoption of the new revenue standard to be material to our annual net income on an ongoing basis. A majority of our sales revenue continues to be recognized when products are shipped from our manufacturing facilities. Historically, we have had to defer revenue for certain types of licenses arrangements and recognize revenue for such licenses ratably over the license term. Under the new revenue standard, we are no longer required to establish vendor-specific objective evidence ("VSOE") to recognize software license revenue separately from the other elements, and we are able to recognize all software license revenue once the customer obtains control of the license, which will generally occur at the start of each license term.

The cumulative effects of the changes made to our consolidated January 1, 2018 balance sheet for the adoption of ASU 2014-09, Revenue - Revenue from Contracts with Customers were as follows (in thousands):

(in thousands)	Balance at December 31, 2017	Adjustments Due to ASU 2014-09	Balance at January 1, 2018
Balance Sheet			
Assets			
Accounts receivable, net	$ 248,825	2,399	$ 251,224

Other long-term assets	32,553	(106)	32,447
Liabilities and Stockholders' Equity			
Deferred revenue - current	120,638	(9,067)	111,571
Deferred revenue - long-term	33,742	(997)	32,745
Other current liabilities	23,782	2,100	25,882
Deferred income taxes	33,609	1,638	35,247
Retained earnings	$ 313,241	8,619	$ 321,860

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The following tables present the amounts by which financial statement line items were affected in the current period due to the adoption of ASU 2014-09. Our historical net cash flows are not impacted by this accounting change.

(In thousands, except per share data)	For the three month period ended September 30, 2018 Increase / (Decrease)	For the nine month period ended September 30, 2018 Increase / (Decrease)
Consolidated Statements of Income*		
Net Sales		
Products	$ (626)	$ 6,828
Software Maintenance	—	—
Total net sales	(626)	6,828
Operating Expenses	8	(198)
Operating Income	(634)	7,026
Provision for income taxes	(109)	1,173
Net income	$ (525)	$ 5,853
Basic earnings per share	—	0.04
Diluted earnings per share	—	0.04

* Excludes line items that were not materially affected by our adoption of ASU 2014-09.

(in thousands)	September 30, 2018 Increase / (Decrease)
Consolidated Balance Sheet*	
Assets	
Accounts receivable, net	$ 2,093
Other long-term assets	92
Liabilities and Stockholder's Equity	
Deferred revenue - current	(14,521)
Deferred revenue - long-term	(2,620)
Other current liabilities	3,273
Deferred income taxes	1,638
Retained earnings	$ 14,415

* Excludes line items that were not materially affected by our adoption of ASU 2014-09. Balance sheet line item amounts include the cumulative-effect adjustment recorded on January 1, 2018.

Recently Issued Accounting Pronouncements

In August 2018, the SEC issued Release No. 33-10532 that amends and clarifies certain financial reporting requirements. The principal change to our financial reporting will be the inclusion of the annual disclosure requirement of changes in stockholders’ equity in Rule 3-04 of Regulation S-X to interim periods. We will adopt this new rule beginning with our financial reporting for the quarter ended March 31, 2019. Upon adoption, we will include our Consolidated Statements of Stockholders' Equity with each quarterly filing on Form 10-Q.

In January 2018, the FASB issued ASU 2018-02, Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which gives entities the option to reclassify to retained earnings tax effects resulting from the Tax Cuts and Jobs Act (the "Act") related to items that the FASB refers to as having been stranded in accumulated other comprehensive income ("OCI"). The new guidance may be applied retrospectively to each period in which the effect of the Act is recognized or in the period of adoption. We must adopt this guidance for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted for periods for which financial statements have not yet been issued or made available for issuance, including the period the Act was enacted. The guidance, when adopted, will require new disclosures regarding a company’s accounting policy for releasing the tax effects in accumulated OCI and permit the company the option to reclassify to retained earnings the tax effects resulting from the Act that are stranded in accumulated OCI. The adoption of ASU 2018-02 is not expected to have a material effect on our consolidated financial statements. We do not plan to adopt the new standard prior to the required effective date and we do not plan to elect the option to reclassify to retained earnings the tax effects resulting from the Act that are stranded in accumulated OCI.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The ASU simplifies certain aspects of hedge accounting and improves disclosures of hedging arrangements through the elimination of the requirement to separately measure and report hedge ineffectiveness. The ASU generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item in order to align financial reporting of hedge relationships with the associated economic results. Entities must apply the amendments to cash flow and net investment hedge relationships that exist on the date of adoption using a modified retrospective approach. The presentation and disclosure requirements must be applied prospectively. Our effective date for adoption of this guidance is our fiscal year beginning January 1, 2019. We are currently evaluating the effect that this guidance will have on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes ASC 840, Leases. The guidance requires lessees to recognize most lease liabilities on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. The update states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The update is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted.We do not expect to adopt the new standard prior to the required effective date. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures. Based on our initial assessment, we expect that the adoption of this standard will have a material impact on our balance sheet but that it will not have a material impact on our consolidated statements of income, comprehensive income, or cash flows. We have completed a qualitative and quantitative assessment of our lease portfolio and are in the process of testing our new real estate lease accounting system, collecting data for leases entered into during 2018 and implementing new processes and controls to account for our leases in accordance with the new standard. As permitted by ASU 2018-11, Leases (Topic 842): Targeted Improvements, we do not expect to adjust comparative-period financial statements.

Note 2 - Revenue

Revenue Recognition

Revenue is recognized upon transfer of control of the promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of our products or services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Nature of Goods and Services

We derive revenues from two primary sources: products and software maintenance.

Product revenues are primarily generated from the sale of off-the-shelf modular test and measurement hardware components and related drivers, and application software licenses. Sales of most hardware components may also include optional extended hardware warranties, which typically provide additional service-type coverage for three years from the purchase date. Our software licenses typically provide for a perpetual right to use our software. We also offer some term-based software licenses that expire, which are referred to as subscription arrangements. We do not customize software for customers and installation services are not required. The software is delivered before related services are provided and is functional without professional services, updates and technical support. We sell our customer support contracts as a percentage of net software purchases the support is related. Revenues from offerings related to our hardware and software products such as extended hardware warranties, training, consulting and installation services are not significant and presented within product revenues, as further discussed below.

Software maintenance revenues consists of post contract customer support that provides the customer with unspecified upgrades and technical support. For these contracts, we account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices of software licenses are estimated based on our established pricing practices and maximize the use of observable inputs. Standalone selling prices of hardware products are typically estimated based on observable transactions when these services are sold on a standalone basis. Our typical performance obligations include the following:

Performance Obligation	When performance obligation is typically satisfied	When payment is typically due	How standalone selling price is typically estimated
Product revenue			
Modular hardware	When customer obtains control of the product (point in time)	Within 30-90 days of shipment	Observable in transactions without multiple performance obligations
Software licenses	When software media is delivered to customer or made available for download electronically, and the applicable license period has begun (point-in-time)	Within 30-90 days of the beginning of license period	Established pricing practices for software licenses bundled with maintenance, which are separately observable in renewal transactions
Extended hardware warranty	Ratably over the course of the support contract (over time)	At the beginning of the contract period	Observable in renewal transactions
Other related support offerings	As work is performed (over time) or course is delivered (point in time)	Within 30-90 days of delivery	Observable in transactions without multiple performance obligations

Software maintenance revenue

Software maintenance	Ratably over the course of the support contract (over time)	At the beginning of the contract period	Observable in renewal transactions

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Significant Judgments

Judgment is required to determine the standalone selling price ("SSP") for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including perpetual and term licenses sold with software maintenance. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount that needs to be allocated based on the relative SSP of the various products and services.

Due to the various benefits from and the nature of our enterprise agreement program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers. Additionally, whether a renewal option represents a distinct performance obligation could significantly impact the timing of revenue recognized.

Our products are generally sold with a right of return which is accounted for as variable consideration when estimating the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period as additional information becomes available and only to the extent that it is probable that a significant reversal of any incremental revenue will not occur. During the first quarter of 2018, we began to reclassify our allowance for sales returns to
"other current liabilities" from "accounts receivable, net" due to the adoption of the new revenue standard.

Disaggregation of Revenues

We disaggregate revenue from contracts with customers based on the timing of transfer of goods or services to customers (point-in-time or over time) and geographic region based on the billing location of the customer. The geographic regions that are tracked are the Americas (United States, Canada and Latin America), EMEIA (Europe, Middle East, India and Africa) and APAC (Australia, New Zealand, Southeast Asia and China). Total net sales based on the disaggregation criteria described above are as follows:

(In thousands)	Three Months Ended September 30, (Unaudited)					
	2018			2017 (1)		
Net sales:	Point-in-Time	Over Time	Total	Point-in-Time	Over Time	Total
Americas	$115,214	27,702	$142,916	$108,988	24,203	$133,191
EMEIA	79,952	19,461	99,413	73,459	19,818	93,277
APAC	95,837	7,961	103,798	84,678	9,775	94,453
Total net sales (2)	$291,003	55,124	$346,127	$267,125	53,796	$320,921

(1) As discussed in "Note 1 - Basis of presentation", prior periods have not been adjusted for adoption of ASU 2014-09

(2) Net sales contains hedging gains and losses, which do not represent revenues recognized from customers. See "Note 5 - Derivative instruments and hedging activities" for more information on the impact of our hedging activities on our results of operations

(In thousands)	Nine Months Ended September 30, (Unaudited)	
	2018	2017 (1)

Net sales:	Point-in-Time	Over Time	Total	Point-in-Time	Over Time	Total
Americas	$317,426	75,003	$392,429	$300,043	73,234	$373,277
EMEIA	257,346	57,520	314,866	232,270	56,295	288,565
APAC	267,773	23,965	291,738	251,626	26,167	277,793
Total net sales (2)	$842,545	156,488	$999,033	$783,939	155,696	$939,635

(1) As discussed in "Note 1 - Basis of presentation", prior periods have not been adjusted for adoption of ASU 2014-09

(2) Net sales contains hedging gains and losses, which do not represent revenues recognized from customers. See "Note 5 - Derivative instruments and hedging activities" for more information on the impact of our hedging activities on our results of operations

Information about Contract Balances

Amounts collected in advance of services being provided are accounted for as deferred revenue. Nearly all of our deferred revenue balance is related to extended hardware and software maintenance contracts. Payment terms and conditions vary by contract type, although payment is typically due within 30 to 90 days of contract inception. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers, such as invoicing at the beginning of a subscription term with a portion of the revenue recognized ratably over the contract period, or to provide customers with financing, such as multi-year on-premises licenses that are invoiced annually with revenue recognized upfront.

Changes in deferred revenue, current and long-term, during the nine months ended September 30, 2018 were as follows:

	Amount (In thousands)
Deferred Revenue at December 31, 2017	$ 154,380
Impact of adopting new revenue standard	(10,064)
Deferred Revenue at January 1, 2018	$ 144,316
Deferral of revenue billed in current period, net of recognition	116,507
Recognition of revenue deferred in prior periods	(105,291)
Foreign currency translation impact	(3,372)
Balance as of September 30, 2018 (unaudited)	$ 152,160

For the nine months ended September 30, 2018, revenue recognized from performance obligations related to prior periods (for example, due to changes in transaction price) was not material. Amounts recognized as revenue in excess of amounts billed are recorded as unbilled receivables. Unbilled receivables which are anticipated to be invoiced in the next twelve months are included in "accounts receivable, net" on the consolidated balance sheet. Based on the nature of our contracts with customers, we do not typically recognize unbilled receivables related to revenues recognized in excess of amounts billed. For the nine months ended September 30, 2018, amounts recognized related to unbilled receivables were not material.

Unsatisfied Performance Obligations

Revenue expected to be recognized in any future period related to remaining performance obligations, excluding revenue pertaining to contracts that have an original expected duration of one year or less, and excluding contracts where revenue is recognized as invoiced, was approximately $54.9 million as of September 30, 2018. Since we typically invoice customers at contract inception, this amount is included in our current and non-current deferred revenue balances. As of September 30, 2018, we expect to recognize approximately 12% of the revenue related to these unsatisfied performance obligations during the remainder of 2018, 44% during 2019, and 44% thereafter.

Assets Recognized from the Costs to Obtain a Contract with a Customer

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized. Capitalized incremental costs related to initial contracts and renewals are amortized

over the same period because the commissions paid on both the initial contract and renewals are commensurate with one another. Total capitalized costs to obtain a contract were immaterial during the periods presented and are included in other long-term assets on our consolidated balance sheets.

Practical Expedients

As discussed in "Note 1 - Basis of presentation" and elsewhere in "Note 2 - Revenue," we have elected the following practical expedients in accordance with the new revenue standard:

- We generally expense sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within sales and marketing expenses.
- We do not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.
- We do not consider the time value of money for contracts with original durations of one year or less.

Note 3 – 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, 2018 (Unaudited)			
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Corporate bonds	$147,158	$ 211	$ (823)	$146,546
U.S. treasuries and agencies	24,468	—	(5)	24,463
Time deposits	19	—	—	19
Total Short-term investments	$171,645	$ 211	$ (828)	$171,028

(In thousands)	As of December 31, 2017			
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Corporate bonds	$120,341	$ 182	$ (395)	$120,128
Time deposits	1,760	—	—	1,760
Total Short-term investments	$122,101	$ 182	$ (395)	$121,888

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

(In thousands)	As of September 30, 2018 (Unaudited)	
	Adjusted Cost	Fair Value
Due in less than 1 year	$67,609	$67,511
Due in 1 to 5 years	104,036	103,517
Total available-for-sale debt securities	$171,645	$171,028

Due in less than 1 year

	Adjusted Cost	Fair Value
Corporate bonds	$43,122	$43,029
U.S. treasuries and agencies	24,468	24,463
Time deposits	19	19
Total available-for-sale debt securities	$67,609	$67,511

Due in 1 to 5 years	Adjusted Cost	Fair Value
Corporate bonds	$104,036	$103,517
Total available-for-sale debt securities	$104,036	$103,517

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)			
Description	September 30, 2018	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	$120,395	$120,395	$—	$ —
Short-term investments available for sale:				
Corporate bonds	146,546	—	146,546	—
U.S. treasuries and agencies	24,463	—	24,463	—
Time deposits	19	19	—	—
Derivatives	9,296	—	9,296	—
Total Assets	$300,719	$120,414	$180,305	$ —
Liabilities				
Derivatives	$(1,724)	$—	$(1,724)	$ —
Total Liabilities	$(1,724)	$—	$(1,724)	$ —

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(In thousands)	Fair Value Measurements at Reporting Date Using			
Description	December 31, 2017	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	$61,423	$61,423	$—	$ —
U.S. treasuries and agencies	39,461	—	39,461	—
Short-term investments available for sale:				
Corporate bonds	120,128	—	120,128	—
Time deposits	1,760	1,760	—	—
Derivatives	7,232	—	7,232	—
Total Assets	$230,004	$63,183	$166,821	$ —
Liabilities				
Derivatives	$(12,743)	$—	$(12,743)	$ —
Total Liabilities	$(12,743)	$—	$(12,743)	$ —

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 organizations and agencies. All of our short-term investments available-for-sale have contractual maturities of less than 60 months.

Derivatives include foreign currency forward 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. 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 months ended September 30, 2018. There were no transfers in or out of Level 1 or Level 2 during the nine months ended September 30, 2018.

As of September 30, 2018, our short-term investments did not include sovereign debt from any country other than the United States.

We did not have any items that were measured at fair value on a nonrecurring basis at September 30, 2018 and December 31, 2017. The carrying value of net accounts receivable, accounts payable, and long-term debt 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 approximately 50 countries. Sales outside of the Americas accounted for approximately 59% and 58% of our net sales during the three months ended September 30, 2018 and 2017, and approximately 61% and 60% of our net sales during the nine months ended September 30, 2018 and 2017, respectively. 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 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, in that 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 contracts as hedges of forecasted sales that are denominated in foreign currencies and as hedges of foreign currency denominated financial assets or liabilities. 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 sales expenses will be adversely affected by changes in exchange rates.

We designate foreign currency forward contracts as cash flow hedges of forecasted net sales 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 three years, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted net sales and forecasted expenses denominated in foreign currencies with forward 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. We purchase foreign currency forward contracts for up to 100% of our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, Hungarian forint, British pound, Malaysian ringgit, Korean won and Chinese yuan) and limit the duration of these contracts to 36 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 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 designated as cash flow hedges with the following notional amounts:

(In thousands)	US Dollar Equivalent	
	As of September 30, 2018 (Unaudited)	As of December 31, 2017
Chinese yuan	$64,020	$39,197
Euro	164,488	177,406
Japanese yen	10,754	22,857
Hungarian forint	28,284	41,296
British pound	16,197	9,931
Malaysian ringgit	26,325	28,287
Korean won	10,984	—
Total forward contracts notional amount	$321,052	$318,974

The contracts in the foregoing table had contractual maturities of 27 months or less and 24 months or less at September 30, 2018 and December 31, 2017, respectively.

At September 30, 2018, we expect to reclassify $5.1 million of gains on derivative instruments from accumulated OCI to net sales during the next twelve months when the hedged international sales occur, $0.2 million of gains on derivative instruments from accumulated OCI to cost of sales during the next twelve months when the cost of sales are incurred and $0.3 million 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, 2018. Actual results may vary materially as a result of changes in the corresponding exchange rates subsequent to this date.

The gains and losses recognized in earnings due to hedge ineffectiveness were not material for each of the nine months ended September 30, 2018 and 2017 and are included as a component of net income under the line item “net foreign exchange gain (loss).”

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 help 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 90 days or less. 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, 2018 and December 31, 2017, we held foreign currency forward contracts that were not designated as hedging instruments with a notional amount of $52 million and $63 million, respectively.
The following tables present the fair value of derivative instruments on our Consolidated Balance Sheets at September 30, 2018 and December 31, 2017, respectively.

(In thousands)	Asset Derivatives September 30, 2018 (Unaudited)		December 31, 2017	
	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	$6,717	Prepaid expenses and other current assets	$4,707
Foreign exchange contracts - LT forwards	Other long-term assets	2,016	Other long-term assets	2,339
Total derivatives designated as hedging instruments		$8,733		$7,046
Derivatives not designated as hedging instruments				
Foreign exchange contracts - ST forwards	Prepaid expenses and other current assets	$563	Prepaid expenses and other current assets	$187
		$563		$187

Total derivatives not designated as hedging instruments		
Total derivatives	$9,296	$7,233

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(In thousands)	Liability Derivatives September 30, 2018 (Unaudited)		December 31, 2017	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Foreign exchange contracts - ST forwards	Other current liabilities	$(1,078)	Other current liabilities	$(7,487)
Foreign exchange contracts - LT forwards	Other long-term liabilities	(493)	Other long-term liabilities	(3,959)
Total derivatives designated as hedging instruments		$(1,571)		$(11,446)
Derivatives not designated as hedging instruments				
Foreign exchange contracts - ST forwards	Other current liabilities	$(153)	Other current liabilities	$(1,297)
Total derivatives not designated as hedging instruments		$(153)		$(1,297)
Total derivatives		$(1,724)		$(12,743)

The following tables present the effect of derivative instruments on our Consolidated Statements of Income for three months ended September 30, 2018 and 2017, respectively:

September 30, 2018
(In thousands)
(Unaudited)

Derivatives in Cash Flow Hedging Relationship	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)
Foreign exchange contracts - forwards	$ 3,569	Net sales	$ 1,424	Net foreign exchange gain/(loss)	$ —
Foreign exchange contracts - forwards	(96)	Cost of sales	74	Net foreign exchange gain/(loss)	—
Foreign exchange contracts - forwards	(157)	Operating expenses	111	Net foreign exchange gain/(loss)	—
Total	$ 3,316		$ 1,609		$ —

September 30, 2017
(In thousands)
(Unaudited)

Derivatives in Cash Flow Hedging Relationship	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)
Foreign exchange contracts - forwards	$ (5,804)	Net sales	$ (1,401)	Net foreign exchange gain/(loss)	$ —
Foreign exchange contracts - forwards	1,421	Cost of sales	(105)	Net foreign exchange gain/(loss)	—
Foreign exchange contracts - forwards	1,247	Operating expenses	(148)	Net foreign exchange gain/(loss)	—
Total	$ (3,136)		$ (1,654)		$ —

(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income

		September 30, 2018 (Unaudited)	September 30, 2017 (Unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	$ 865	(887)
Total		$ 865	$ (887)

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The following tables present the effect of derivative instruments on our Consolidated Statements of Income for the nine months ended September 30, 2018 and 2017, respectively:

September 30, 2018
(In thousands)
(Unaudited)

Derivatives in Cash Flow Hedging Relationship	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)
Foreign exchange contracts - forwards	$ 16,128	Net sales	$ (2,491)	Net foreign exchange gain/(loss)	$ —
Foreign exchange contracts - forwards	(2,422)	Cost of sales	717	Net foreign exchange gain/(loss)	—
Foreign exchange contracts - forwards	(2,128)	Operating expenses	888	Net foreign exchange gain/(loss)	—
Total	11,578		$ (886)		$ —

September 30, 2017
(In thousands)
(Unaudited)

Derivatives in Cash Flow Hedging Relationship	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)
Foreign exchange contracts - forwards	$ (20,601)	Net sales	$ 1,348	Net foreign exchange gain/(loss)	$ —
Foreign exchange contracts - forwards	5,901	Cost of sales	(1,083)	Net foreign exchange gain/(loss)	—
Foreign exchange contracts - forwards	5,230	Operating expenses	(1,127)	Net foreign exchange gain/(loss)	—
Total	$ (9,470)		$ (862)		$ —

(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income

		September 30, 2018 (Unaudited)	September 30, 2017 (Unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	$ 678	(4,065)
Total		$ 678	$ (4,065)

Note 6 – Inventories, net

Inventories, net consist of the following:

(In thousands)	September 30, 2018 (Unaudited)	December 31, 2017
Raw materials	$ 100,603	$ 91,513
Work-in-process	10,291	8,938
Finished goods	81,518	84,141
Total	$ 192,412	$ 184,592

Note 7 – Intangible assets, net

Intangible assets at September 30, 2018 and December 31, 2017 are as follows:

(In thousands)	September 30, 2018 (Unaudited)			December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Capitalized software development costs	$118,424	$ (38,154)	$80,270	$116,691	$ (30,345)	$86,346
Acquired technology	95,691	(89,507)	6,184	96,198	(87,341)	8,857
Patents	34,248	(21,264)	12,984	33,163	(19,931)	13,232
Other	51,049	(34,426)	16,623	45,565	(30,707)	14,858
Total	$299,412	$ (183,351)	$116,061	$291,617	$ (168,324)	$123,293

Software development costs capitalized for the three months ended September 30, 2018 and 2017 were $1.9 million and $10.1 million, respectively, and related amortization expense was $6.9 million and $5.7 million, respectively. For the nine months ended September 30, 2018 and 2017, capitalized software development costs were $13.8 million and $35.8 million, respectively, and related amortization expense was $19.9 million and $16.5 million, respectively. Capitalized software development costs for the three months ended September 30, 2018 and 2017 included costs related to stock based compensation of $0.1 million and $0.5 million, respectively. For the nine months ended September 30, 2018 and 2017, capitalized software development costs included costs related to stock based compensation of $0.6 million and $1.4 million, respectively. The related amounts in the table above are net of fully amortized assets.

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 to six years. Acquired technology and other 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 $9.0 million and $8.7 million for the three months ended September 30, 2018 and 2017, respectively, and $26.4 million and $25.7 million for the nine months ended September 30, 2018 and 2017, respectively.

Note 8 – Goodwill

The carrying amount of goodwill as of September 30, 2018, was as follows:

	Amount (In thousands)
Balance as of December 31, 2017	$ 266,783
Foreign currency translation impact	(3,664)
Balance as of September 30, 2018 (unaudited)	$ 263,119

The excess purchase price over the fair value of assets acquired is recorded as goodwill. As we have one operating segment comprised of components with similar economic characteristics, 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. Effective for the annual goodwill impairment test for 2018 and for future testing, we will perform the required annual testing as of November 30 of each year rather than on February 28. In anticipation of this change, we reperformed our annual goodwill impairment test as of November 30, 2017 and determined that it was more likely than not that the estimated fair value for the reporting unit exceeded the carrying amount and that no impairment existed as of the assessment date. We do not believe that the change in the date of the annual goodwill impairment test is a material change in the method of applying an accounting principle nor do we expect that it will result in any delay, acceleration or impact to the results of the impairment testing. We believe this date is preferable because it aligns with the timing of our annual planning process which largely occurs during the fourth quarter. Retrospective application to prior periods is impracticable as we are unable to objectively determine, without the use of hindsight, the assumptions that would be used in those earlier periods.

No impairment of goodwill was identified during the nine months ended September 30, 2018 or the twelve months ended December 31, 2017.

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 had a valuation allowance of $78 million at September 30, 2018 and December 31, 2017. A majority of the valuation allowance is related to the deferred tax assets of National Instruments Hungary Kft. (“NI Hungary”).

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 $9.0 million and $10.2 million of unrecognized tax benefits at September 30, 2018 and December 31, 2017, respectively, all of which would affect our effective income tax rate if recognized. We recorded a gross increase in unrecognized tax benefits of $1 million and $1.6 million for the three and nine months ended September 30, 2018, respectively, as a result of the tax positions taken during these and prior periods. We recorded a gross decrease in unrecognized tax benefits of $3.1 million for each of the three-and nine-month periods ended September 30, 2018 as a result of closing open tax years and the enactment-date effects of the Tax Cuts and Jobs Act. As of September 30, 2018, it is reasonably possible that we will recognize tax benefits in the amount of $3.4 million in the next twelve months due to the closing of open tax years. The nature of the uncertainty 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, 2018, we had

approximately $1.2 million accrued for interest related to uncertain tax positions. The tax years 2009 through 2018 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 11% and 12% for the three months ended September 30, 2018 and 2017, respectively, and 13% and 15% for the nine months ended September 30, 2018 and 2017, respectively. For the three and nine months ended September 30, 2018, our effective tax rate was lower than the U.S. federal statutory rate of 21% as a result of an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates, the research and development tax credit, a tax benefit from disqualifying dispositions of equity awards that do not ordinarily result in a tax benefit, excess tax benefits from share-based compensation, and the deduction for foreign-derived deduction eligible income, offset by the U.S. tax on global intangible low-taxed income. For the three and nine months ended September 30, 2017, 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 research and development tax credit, a tax benefit from disqualifying dispositions of equity awards that do not ordinarily result in a tax benefit, and excess tax benefits from share-based compensation.

Our earnings in Hungary are subject to a statutory tax rate of 9%. In addition, our research and development activities in Hungary benefit from a tax law in Hungary that provides for an enhanced deduction for qualified research and development expenses. The tax position of our Hungarian operations resulted in income tax benefits of $2.6 million and $4.3 million for the three months ended September 30, 2018 and 2017, respectively, and $7.1 million and $11.6 million for the nine months ended September 30, 2018 and 2017, respectively.

Earnings from our operations in Malaysia are free of tax under a tax holiday effective January 1, 2013. This tax holiday expires in 2027. If we fail to satisfy the conditions of the tax holiday, this tax benefit may be terminated early. The income tax benefits of the tax holiday for the three and nine months ended September 30, 2018 were approximately $0.8 million and $1.9 million, respectively. The impact of the tax holiday on a per share basis for each of the three and nine months ended September 30, 2018 was a benefit of $0.01 per share. The income tax benefits of the tax holiday for the three and nine months ended September 30, 2017 were approximately $0.8 million and $1.9 million, respectively. The impact of the tax holiday on a per share basis for each of the three and nine months ended September 30, 2017 was a benefit of $0.01 per share.

No other taxing jurisdictions had a significant impact on our effective tax rate. We have not entered into any advanced pricing or other agreements with the IRS with regard to any foreign jurisdictions.

The Tax Cuts and Jobs Act was enacted on December 22, 2017. The Act reduced the federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and creates new taxes on certain foreign earnings.

We are applying the guidance in SAB 118 when accounting for the enactment-date effects of the Act. As of September 30, 2018, we had not completed our accounting for the tax effects of enactment of the Act. However, we have made a reasonable estimate of the effects on our existing deferred tax balances and the one-time transition tax. At December 31, 2017, we recognized a provisional amount of $69.9 million, which is included as a component of income tax expense from continuing operations. During the three month period ended September 30, 2018, we recognized a $(1.8) million adjustment to the provisional amounts recorded at December 31, 2017, primarily related to foreign withholding and distribution taxes. We expect to finalize our calculation during the fourth quarter of 2018.

The Act subjects a U.S. shareholder to tax on global intangible low-taxed income ("GILTI") earned by certain foreign subsidiaries. The FASB staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the years the tax is incurred as a period expense only. Given the complexity of the GILTI provisions, we are still evaluating the effects of the GILTI provisions and have not yet determined our accounting policy. At September 30, 2018, because we are still evaluating the GILTI provisions and our analysis of future taxable income that is subject to GILTI, we

have included GILTI related to current-year operations only in our estimated annual effective tax rate and have not provided additional GILTI on deferred items.

Note 10 – Comprehensive income

Our comprehensive income is comprised of net income, foreign currency translation, unrealized gains and losses on forward contracts and securities classified as available-for-sale. The accumulated OCI, net of tax, for the nine months ended September 30, 2018 and 2017, consisted of the following:

	September 30, 2018 (Unaudited)			
(In thousands)	Currency translation adjustment	Investments	Derivative instruments	Accumulated other comprehensive income/(loss)
Balance as of December 31, 2017	$(12,717)	$ (782)	(3,010)	$ (16,509)
Current-period other comprehensive (loss) income	(7,360)	(404)	10,692	2,928
Reclassified from accumulated OCI into income	—	—	886	886
Income tax expense	—	30	2,449	2,479
Balance as of September 30, 2018	$(20,077)	$ (1,216)	$ 6,119	$ (15,174)

	September 30, 2017 (Unaudited)			
(In thousands)	Currency translation adjustment	Investments	Derivative instruments	Accumulated other comprehensive income/(loss)
Balance as of December 31, 2016	$(37,174)	$ (669)	3,222	$ (34,621)
Current-period other comprehensive income (loss)	21,890	187	(10,332)	11,745
Reclassified from accumulated OCI into income	—	—	862	862
Income tax expense (benefit)	13	14	(3,360)	(3,333)
Balance as of September 30, 2017	$(15,297)	$ (496)	$ (2,888)	$ (18,681)

Note 11 – Authorized shares of common and preferred stock and stock-based compensation plans

Authorized shares of common and preferred stock

Following approval by the Company's Board of Directors and stockholders, on May 14, 2013, the Company's certificate of incorporation was amended to increase the authorized shares of common stock by 180,000,000 shares to a total of 360,000,000 shares. As a result of this amendment, the total number of shares which the Company is authorized to issue is 365,000,000 shares, consisting of (i) 5,000,000 shares of preferred stock, par value $0.01 per share, and (ii) 360,000,000 shares of common stock, par value $0.01 per share.

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 our 1994 Incentive Plan which terminated in May 2005 (the "1994 Plan"), 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 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 the 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. The 2010 Plan terminated on May 12, 2015, except with respect to the outstanding awards previously granted thereunder. There were 2,518,416 shares of common stock that were reserved but not issued under the 2010 Plan as of May 12, 2015.

Our stockholders approved our 2015 Equity Incentive Plan (the "2015 Plan") on May 12, 2015. At the time of approval, 3,000,000 shares of our common stock were reserved for issuance under this plan, as well as the 2,518,416 shares of common stock that were reserved but not issued under the 2010 Plan as of May 12, 2015, and any shares that were returned to the 1994, 2005, and the 2010 Plans as a result of the forfeiture or termination of options or RSUs or repurchase of shares issued under these plans. The 2015 Plan, administered by the Compensation Committee of the Board of Directors, provides for the 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, four, 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 3,026,600 shares available for grant under the 2015 Plan at September 30, 2018.

During the three months ended September 30, 2018, we did not make any changes in accounting principles or methods of estimates related to the 2005, 2010 and 2015 Plans.

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 9, 2017, our stockholders approved an additional 3,000,000 shares for issuance under our employee stock purchase plan. At September 30, 2018, we had 2,187,766 shares of common stock reserved for future issuance under this plan. We issued 680,131 shares under this plan in the nine months ended September 30, 2018 and the weighted average purchase price of the employees' purchase rights was $35.91 per share. During the nine months ended September 30, 2018, 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 the adoption of a Preferred Stock Rights Agreement which expired on May 10, 2014. There were no shares of preferred stock issued and outstanding at September 30, 2018.

Stock repurchases and retirements

From time to time, our Board of Directors has authorized various programs for our repurchase of shares of our common stock depending on market conditions and other factors. Under the current program, we did not make any share repurchases during the nine months ended September 30, 2018 or the nine months ended September 30, 2017. At September 30, 2018, there were 1,134,247 shares remaining available for repurchase under this program. This repurchase program does not have an expiration date.

Note 12 – Segment and geographic information

We operate as one operating segment. Operating segments are defined as components of an enterprise for which separate financial information is evaluated regularly by the chief operating decision maker, who is our chief executive officer, in deciding how to allocate resources and in assessing performance. Our chief operating decision maker evaluates our financial information and resources and assesses the performance of these resources on a consolidated basis. Since we operate in one operating segment, all required financial segment information can be found in the condensed consolidated financial statements and the notes thereto.

We sell our products in three geographic regions which consist of Americas; Europe, Middle East, India, and Africa (EMEIA); and Asia-Pacific (APAC). Our sales to these regions share similar economic characteristics, similar product mix, similar customers, and similar distribution methods. Revenue from the sale of our products, which are similar in nature, and software maintenance is reflected as total net sales in our Consolidated Statements of Income. (See "Note 2 -Revenue" of Notes to consolidated financial statements for total net sales by the major geographic areas in which we operate).

Based on the billing location of the customer, total sales outside the U.S. for the three months ended September 30, 2018 and 2017 were $213 million and $195 million, respectively, and $635 million and $588 million for the nine months ended September 30, 2018 and 2017, respectively. Total property and equipment, net, outside the U.S. was $132 million as of September 30, 2018 and $132 million at December 31, 2017.

Note 13 - Debt

On May 9, 2013, we entered into a Loan Agreement (the “Loan Agreement”) with Wells Fargo Bank (the “Lender”). The Loan Agreement provided for a $50 million unsecured revolving line of credit with a scheduled maturity date of May 9, 2018 (the “Maturity Date”). On October 29, 2015, we entered into a First Amendment to Loan Agreement (the “Amendment”) with the Lender, which amended our Loan Agreement to among other things, (i) increase the unsecured revolving line of credit from $50 million to $125 million, (ii) extend the Maturity Date of the line of credit from May 9, 2018 to October 29, 2020, and (iii) provide us with an option to request increases to the line of credit of up to an additional $25 million in the aggregate, subject to consent of the Lender and terms and conditions to be mutually agreed between us and the Lender. On April 27, 2018, we entered into a Second Amendment to Loan Agreement (the "Second Amendment") which amended the Loan Agreement, as amended by the Amendment to, among other things, (i) reduce the revolving line of credit from $125.0 million to $5.0 million, (ii) reduce the letter of credit sublimit under the line of credit from $10.0 million to $5.0 million and (iii) require us and our subsidiaries to comply with certain of the affirmative and negative covenants under the Loan Agreement only if loans are outstanding under the Loan Agreement or if we have not reimbursed any drawing under a letter of credit issued under the Loan Agreement within five business days following the request of the Lender.

The loans bear interest, at our option, at a base rate determined in accordance with the Loan Agreement, plus a spread of 0.0% to 0.50%, or a LIBOR rate plus a spread of 1.13% to 2.00%, in each case with such spread determined based on a ratio of consolidated indebtedness to EBITDA, determined in accordance with the Loan Agreement. Principal, together with all accrued and unpaid interest, is due and payable on the Maturity Date. We are also obligated to pay a quarterly commitment fee, payable in arrears, based on the available commitments at a rate of 0.18% to 0.30%, with such rate determined based on the ratio described above. The Loan Agreement contains customary affirmative and negative covenants. The affirmative covenants include, among other things, delivery of financial statements, compliance certificates and notices; payment of taxes and other obligations; maintenance of existence; maintenance of properties and insurance; and compliance with applicable laws and regulations. The negative covenants include, among other things, limitations on indebtedness, liens, mergers, consolidations, acquisitions and sales of assets, investments, changes in the nature of the business, affiliate transactions and certain restricted payments. The Loan Agreement also requires us to maintain a ratio of consolidated indebtedness to EBITDA equal to or less than 3.25 to 1.00, and a ratio of consolidated EBITDA to interest expense greater than or equal to 3.00 to 1.00, in each case determined in accordance with the Loan Agreement. As of September 30, 2018, we were in compliance with all applicable covenants in the Loan Agreement.

The Loan Agreement contains customary events of default including, among other things, payment defaults, breaches of covenants or representations and warranties, cross-defaults with certain other indebtedness, bankruptcy and insolvency events, judgment defaults and change in control events, subject to grace periods in certain instances. Upon an event of default, the lender may declare all or a portion of the outstanding obligations payable by us to be

immediately due and payable and exercise other rights and remedies provided for under the Loan Agreement. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default under the Loan Agreement at a per annum rate of interest equal to 2.00% above the otherwise applicable interest rate. Proceeds of loans made under the Loan Agreement may be used for working capital and other general corporate purposes. We may prepay the loans under the Loan Agreement in whole or in part at any time without premium or penalty. Certain of our existing and future material domestic subsidiaries are required to guaranty our obligations under the Loan Agreement.

As of September 30, 2018, we had no outstanding borrowings under this line of credit. During the three months ended September 30, 2018 and September 30, 2017, we incurred interest expense related to our outstanding borrowings of $0 and $176,000, respectively. During the nine months ended September 30, 2018 and September 30, 2017, we incurred interest expense related to our outstanding borrowings of $0 and $519,000, respectively. As of September 30, 2018 and September 30, 2017, the weighted-average interest rate on the revolving line of credit was 3.4% and 2.4%, respectively. These charges are included in “Other income (loss), net” in our Consolidated Statements of Income.

Note 14 – Commitments and contingencies

We offer a one-year limited warranty on most hardware products which is included in the terms of sale of such products. We also offer optional extended warranties on our hardware products for which the related revenue is recognized ratably over the warranty period. Provision is made for estimated future warranty costs at the time of the sale for the estimated costs that may be incurred under the standard warranty. Our estimate is based on historical experience and product sales during the period. The warranty reserve for the nine months ended September 30, 2018 and 2017 was as follows:

(In thousands)	Nine Months Ended September 30, (Unaudited)	
	2018	2017
Balance at the beginning of the period	$2,846	$2,686
Accruals for warranties issued during the period	2,224	1,929
Accruals related to pre-existing warranties	335	193
Settlements made (in cash or in kind) during the period	(2,235)	(1,983)
Balance at the end of the period	$3,170	$2,825

As of September 30, 2018, we had non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately $7.3 million over the next twelve months.

As of September 30, 2018, we had outstanding guarantees for payment of customs and foreign grants totaling less than $0.1 million, which are generally payable over the next twelve months.

Note 15 – Restructuring

Since the first quarter of 2017, we have been taking steps to optimize our processes, reduce job duplication, evaluate where we should shift and centralize activities, improve efficiencies, and rebalance our resources on higher return activities. This has led to headcount reductions. The timing and scope of our headcount reductions will vary.

A summary of the charges in our consolidated statement of operations resulting from our restructuring activities is shown below:

(In thousands)	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2018	2017	2018	2017
Cost of sales	$(179)	79	$(150)	986
Research and development	631	86	1,607	1,382
Sales and marketing	3,676	1,618	8,354	7,997
General and Administration	373	207	1,538	801
Total restructuring and other related costs	$4,501	1,990	$11,349	11,166

A summary of balances and activity related to our restructuring activity is shown below:

	Restructuring Liability (in thousands)
Balance as of December 31, 2017	$ 5,408
Income statement expense	11,349
Cash payments	(12,923)
Balance as of September 30, 2018	$ 3,834

The restructuring liability of $3.8 million at September 30, 2018 relating to our restructuring activity is recorded in the “accrued compensation” line item of our consolidated balance sheet.

Note 16 – Litigation

We are not currently a party to any material litigation. However, in the ordinary course of our business, we have in the past, are currently and will likely become involved in various legal proceedings, claims, and regulatory, tax or government inquiries and investigations, and could incur uninsured liability in any one or more of them. We also periodically receive notifications from various third parties related to alleged infringement of patents or intellectual property rights, commercial disputes or other matters. No assurances can be given with respect to the extent or outcome of any investigation, litigation or dispute.

Note 17 – Subsequent events

On October 24, 2018, our Board of Directors declared a quarterly cash dividend of $0.23 per common share, payable on December 3, 2018, to stockholders of record on November 12, 2018.

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, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Any statements contained herein regarding our future financial performance, operations or other matters (including, without limitation, statements to the effect that we “believe,” "expect," "plan," "may," "will," “intend to,” "project," “anticipate,” "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 44, and in 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 the year ended December 31, 2017, for further discussion of our business and the risks attendant thereto.

Overview

National Instruments Corporation (the “Company”, “we”, “us” or “our”) designs, manufactures and sells systems to engineers and scientists that accelerate productivity, innovation and discovery. Our software defined platform provides integrated software and modular hardware that speeds the development of automated test and automated measurement systems. 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 and to grow our large order business by serving a large market on many computer platforms, through a global marketing and distribution network. We also seek new opportunities for our existing product portfolio through acquisitions of new technologies and expertise aligned with our strategic initiatives.

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 that it is crucial that we continue to offer products with high 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 leveraging our core technologies across multiple products.

We sell automated test and automated measurement systems in a broad range of industries and are subject to the economic and industry forces that drive those markets. It has been our experience that the performance of these industries and our performance are 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 advanced research, automotive, automated test equipment, consumer electronics,

commercial aerospace, computers and electronics, continuous process manufacturing, education, government/defense, medical research/pharmaceutical, power/energy, semiconductors, and telecommunications.

Leveraging a worldwide sales, distribution and manufacturing network

We distribute and sell our software and hardware products primarily through a direct sales organization. We also use independent distributors, OEMs, VARs, system integrators, and consultants to market and sell 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 58% of our net sales during the three months ended September 30, 2018 and 2017, respectively, and approximately 61% and 60% of our net sales during the nine months ended September 30, 2018 and 2017, respectively. 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 net sales will continue to be derived from international sales. (See "Note 2 - Revenue" of Notes to consolidated financial statements for details concerning the geographic breakdown of our net sales).

We manufacture substantially all of our product volume at our facilities in Debrecen, Hungary and Penang, Malaysia. 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. Most of our electronic circuit card assemblies, modules and chassis are manufactured in house, although contractors are used from time to time. The majority of our electronic cable assemblies are produced by contractors; however, we do manufacture some on an exception basis. Our software duplication, technical manuals and product support documentation are primarily produced by contractors.

Delivering high quality, reliable products

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 depends 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 Global Purchasing Managers' Index ("PMI"), global industrial production as well as industry reports on the specific vertical industries that we target. Historically, our business cycles have generally followed the expansion and contraction cycles in the global industrial economy as measured by the Global PMI. For the three months ended September 30, 2018, the average of the Global PMI was 52.5 and the average of the new order element of the Global PMI was 52.4. Although these readings are indicative of expansion in the industrial sector we are unable to predict whether the industrial economy, as measured by the PMI, will remain above the neutral reading of 50, strengthen or contract during the remainder of 2018.

We are optimistic about our long-term position in the industry through the sustained differentiation we deliver to our customers through our platform-based approach. We continue to see growth in our orders above $20,000 which we believe reflects our focus on developing highly differentiated products, particularly for complex test and measurement systems. In the third quarter of 2018, we saw a 5% year over year increase from orders under $20,000 and a 21% year over year increase from orders over $20,000.

Since the first quarter of 2017, we have been taking steps to reduce our overall employee headcount in an effort to reduce job duplication, shift and centralize activities, improve efficiencies, and rebalance our resources on higher return activities. In connection with these activities, we expect to incur an additional $1 million to $2 million in severance and other restructuring-related charges, net of tax, by the end of 2018.

During the third quarter of 2018, we saw continued volatility in the exchange rates between the U.S. dollar and many of the currency markets where we have exposure. During the third quarter of 2018, the year over year impact from exchange rates was not significant to our results of operations. As of the date of this filing, the U.S. dollar index, as

tracked by the St. Louis Federal Reserve, remains near its ten year high. Despite the relative strength of the U.S dollar, we continue to see strength in the overall industrial economy, as measured by the PMI. See "Results of Operations" below for additional discussion on the impact of foreign exchange rates on our business for the three and nine months ended September 30, 2018. See "Our Revenues are Subject to Seasonal Variations" under "Risk Factors" for additional discussion of potential fluctuations in our net sales.

We have hedging programs in place to help mitigate the risks associated with foreign currency risks. However, there can be no assurance the hedges will offset more than a portion of the financial impact resulting from movements in the foreign currency markets in which we do business. (See "Note 5 – Derivative instruments and hedging activities" of Notes to consolidated financial statements for additional details concerning our hedging programs.)

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)		Nine Months Ended September 30, (Unaudited)	
	2018	2017	2018	2017
Net sales:				
Americas	41.3 %	41.5 %	39.3 %	39.7 %
EMEIA	28.7	29.1	31.5	30.7
APAC	30.0	29.4	29.2	29.6
Total net sales	100.0	100.0	100.0	100.0
Cost of sales	25.7	26.1	24.6	25.8
Gross profit	74.3	73.9	75.4	74.2
Operating expenses:				
Sales and marketing	34.2	36.4	36.6	38.1
Research and development	19.1	17.6	19.5	18.3
General and administrative	7.7	8.2	8.2	8.3
Total operating expenses	61.0	62.2	64.3	64.7
Operating income	13.3	11.7	11.1	9.4
Other income (expense):				
Interest income	0.4	0.2	0.4	0.2
Net foreign exchange loss	(0.3)	0.3	(0.2)	0.2
Other gain (loss), net	0.5	(0.4)	—	(0.1)
Income before income taxes	14.0	11.8	11.3	9.7
Provision for income taxes	1.5	1.5	1.4	1.5
Net income	12.5 %	10.4 %	9.9 %	8.2 %

Figures may not sum due to rounding.

Results of Operations for the three and nine months ended September 30, 2018 and 2017

Net Sales. The following table sets forth our net sales for the three and nine months ended September 30, 2018 and 2017 along with the changes between the corresponding periods.

	Three Months Ended September 30, (Unaudited)				Nine Months Ended September 30, (Unaudited)			
			Change				Change	
(In millions)	2018	2017	Dollars	Percentage	2018	2017	Dollars	Percentage
Product sales	$310.2	$291.9	18.3	6%	$897.4	$853.2	44.2	5%
Software maintenance sales	35.9	29.0	6.9	24%	101.7	86.4	15.3	18%
Total net sales	$346.1	$320.9	25.2	8%	$999.0	$939.6	59.4	6%

Figures may not sum due to rounding.

Orders with a value greater than $20,000 increased by 21% year over year during the three months ended September 30, 2018, compared to the year over year increase of 7% in the three months ended September 30, 2017. During the nine months ended September 30, 2018, orders with a value greater than $20,000 increased by 16% year over year compared to the year over year increase of 10% in the nine months ended September 30, 2017. A significant factor in the continued expansion of these orders in the three and nine months ended September 30, 2018, compared to the comparable periods in 2017 was strong demand for our data acquisition and control hardware, and software licenses including enterprise-wide licensing agreements, indicating broader adoption of our platform. The year over year increase in software maintenance for each of the three and nine months ended September 30, 2018 was driven by increased adoption of our software platform and an increase in billings for annual software maintenance renewals for many of our products.

During the three months ended September 30, 2018 and 2017, orders over $20,000 were 56% and 52% of our total orders, respectively, and for the nine months ended September 30, 2018 and 2017, these orders were 55% and 52% of our total orders, respectively. Orders with a value greater than $20,000, particularly those orders with a value greater than $100,000, are more volatile, are subject to greater discount variability, and may contract at a faster pace during an economic downturn compared to our other orders.

The following table sets forth our net sales by geographic region for the three and nine months ended September 30, 2018 and 2017 along with the changes between the corresponding periods and the region's percentage of total net sales.

	Three Months Ended September 30, (Unaudited)				Nine Months Ended September 30, (Unaudited)			
			Change				Change	
(In millions)	2018	2017	Dollars	Percentage	2018	2017	Dollars	Percentage
Americas	$142.9	$133.2	9.7	7%	$392.4	$373.3	19.1	5%
Percentage of total net sales	41.3 %	41.5 %			39.3 %	39.7 %		
EMEIA	99.4	$93.3	6.1	7%	314.9	288.6	26.3	9%
Percentage of total net sales	28.7 %	29.1 %			31.5 %	30.7 %		
APAC	$103.8	$94.5	9.3	10%	291.7	277.8	13.9	5%
Percentage of total net sales	30.0 %	29.4 %			29.2 %	29.6 %		

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We expect sales outside of the Americas to continue to represent a significant portion of our net sales. 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. Almost all of the sales made by our direct sales offices in the Americas (excluding the U.S.), EMEIA, and APAC are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in foreign currency exchange rates. In order to provide a framework for assessing how our underlying business performed excluding the effects of foreign currency fluctuations between periods, we compare the percentage change in our results from period to period using constant currency disclosure. To calculate the change in constant currency, current and comparative prior period results for entities reporting in currencies other than U.S. Dollars are converted into U.S. Dollars at constant exchange rates (i.e., the average rates in effect during the three and nine months ended September 30, 2017). The following tables present this information, along with the impact of changes in foreign currency exchange rates on sales denominated in local currencies, for the three and nine months ended September 30, 2018.

	Three Months Ended September 30, 2017	Change in Constant Dollars		Impact of changes in foreign currency exchange rates on net sales		Three Months Ended September 30, 2018
(In millions)	GAAP Net Sales	Dollars	Percentage	Dollars	Percentage	GAAP Net Sales
Americas	$ 133.2	9.7	7.3%	—	—%	$ 142.9
EMEIA	$ 93.3	5.2	5.6%	0.9	1.0%	$ 99.4
APAC	$ 94.5	8.3	8.7%	1.1	1.2%	$ 103.8
Total net sales	$ 320.9	23.2	7.2%	2.0	0.6%	$ 346.1

	Nine Months Ended September 30, 2017	Change in Constant Dollars		Impact of changes in foreign currency exchange rates on net sales		Nine Months Ended September 30, 2018
(In millions)	GAAP Net Sales	Dollars	Percentage	Dollars	Percentage	GAAP Net Sales
Americas	$ 373.3	18.2	4.9%	0.9	—%	$ 392.4
EMEIA	$ 288.6	10.9	3.8%	15.4	5.3%	$ 314.9
APAC	$ 277.8	5.4	1.9%	8.6	3.1%	$ 291.7
Total net sales	$ 939.6	34.5	3.7%	24.9	2.7%	$ 999.0

Figures may not sum due to rounding.

To help protect against changes in U.S. dollar equivalent value caused by fluctuations in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales, we maintain a foreign currency cash flow hedging program. We hedge portions of our forecasted net sales denominated in foreign currencies with average rate forward contracts. During the three months ended September 30, 2018 and 2017, these hedges had the effect of increasing our net sales by $1.4 million and decreasing our net sales by $(1.4) million, respectively. During the nine months ended September 30, 2018 and 2017, these hedges had the effect of decreasing our net sales by $(2.5) million and increasing our net sales by $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 impact on our net sales for 2018 and 2017).

Gross Profit. Our gross profit as a percentage of sales is impacted by many factors including changes in the amount of revenues from our large customers and changes in the foreign currency exchange markets. We continue to focus on cost control and cost reduction measures throughout our manufacturing cycle. The following table sets forth our gross profit and gross profit as a percentage of net sales for the three and nine months ended September 30, 2018 and 2017 along with the percentage changes in gross profit for the corresponding periods.

	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
(In millions)	2018	2017	2018	2017
Gross Profit	$257.1	$237.2	$753.3	$696.9
% change compared with prior period	8.4%		8.1%	
Gross Profit as a percentage of net sales	74.3%	73.9%	75.4%	74.2%

The increases in our gross profit and gross profit as a percentage of net sales for the three and nine months ended September 30, 2018, compared to the same periods in 2017 are primarily attributable to the favorable changes in our sales mix, primarily related to strong growth in our software business. The increase in net sales attributable to software maintenance was driven by increased adoption of our software platform and a year over year increase in billings for annual software maintenance renewals for many of our products. For the three months ended September 30, 2018 and 2017, the change in exchange rates had the effect of increasing our cost of sales by $0.02 million and increasing our cost of sales by $0.1 million, respectively. For the nine months ended September 30, 2018 and 2017, the change in exchange rates had the effect of increasing our cost of sales by $4.0 million and decreasing our cost of sales by $1.4 million, 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 average rate forward contracts. During the three months ended September 30, 2018 and 2017, these hedges had the effect of decreasing our cost of sales by $0.1 million and increasing our cost of sales by $0.1 million, respectively. During the nine months ended September 30, 2018 and 2017, these hedges had the effect of decreasing our cost of sales by $0.7 million and increasing our cost of sales by $1.1 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 impact on our cost of sales for 2018 and 2017).

We do not typically maintain a large amount of order backlog as orders typically translate to sales quickly. As such, any weakness in orders typically has a pronounced impact on our net sales in the short term.

Operating Expenses. The following table sets forth our operating expenses for the three and nine months ended September 30, 2018 and 2017 along with the percentage changes between the corresponding periods and the line item as a percentage of total net sales.

	Three Months Ended September 30, (Unaudited)			Nine Months Ended September 30, (Unaudited)		
(In thousands)	2018	2017	Change	2018	2017	Change
Sales and marketing	$118,220	$116,661	1%	$365,474	$358,335	2%
Percentage of total net sales	34%	36%		37%	38%	
Research and development	$66,170	$56,526	17%	$194,921	$171,701	14%
Percentage of total net sales	19%	18%		20%	18%	

General and Administrative	$26,712	$26,468	1%	$81,882	$78,400	4%
Percentage of total net sales	8%	8%		8%	8%	
Total operating expenses	$211,102	$199,655	6%	$642,277	$608,436	6%
Percentage of total net sales	61%	62%		64%	65%	

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During the three months ended September 30, 2018, operating expenses were up 6% year over year, which was primarily the result of a $9.6 million increase in research and development expenses mostly related to a decrease in software development costs eligible for capitalization, in addition to a $1.9 million increase in equity compensation costs and a $2.8 million increase in severance and other costs related to our ongoing restructuring initiative. In the three months ended September 30, 2018, we capitalized $1.9 million of software development costs compared to $10.1 million in the three months ended September 30, 2017. In the second quarter of 2018, we began moving toward more frequent releases for many of our software products. Specifically, for many of our software development projects we started applying agile development methodologies which are characterized by a more dynamic development process with more frequent and iterative revisions to a product release's features and functions as the software is being developed. Due to the shorter development cycle and focus on rapid production associated with agile development, we expect that for a significant majority of our software development projects the costs incurred subsequent to the achievement of technological feasibility will be immaterial in future periods and we expect to record significantly less capitalized software development costs than under our historical software development approaches. Consequently, a larger portion of our software development expenditures will be recognized as operating expenses in the future. We also expect amortization of previously capitalized software development costs to steadily decline as previously capitalized software development costs become fully amortized over the next four years.

During the nine months ended September 30, 2018, the year over year increase in operating expenses was primarily the result of a $23 million increase in research and development expenses primarily related to a decrease in software development costs eligible for capitalization and an $11 million increase due to the year over year change in exchange rates. Additionally, a decrease in outside services and travel-related expenses of $2.8 million compared to the nine months ended September 30, 2017 was mostly offset by increases in equity compensation costs due to higher grant-date share prices. The decrease in cash expenses related to travel and outside services is consistent with our continued focus on disciplined expense management and cost optimization.

We believe that our long-term growth and success depends on developing high quality software and hardware products on a timely basis. We are focused on leveraging recent investments in research and development and in our field sales force and taking actions to help ensure that those resources are concentrated in areas and on initiatives that will contribute to future growth in our business.

Operating Income. For the three months ended September 30, 2018 and 2017, operating income was $46 million and $38 million, respectively, an increase of 23%. As a percentage of net sales, operating income was 13.3% and 11.7% for the three months ended September 30, 2018 and 2017, respectively. For the nine months ended September 30, 2018 and 2017, operating income was $111 million and $88 million, respectively, an increase of 26%. As a percentage of net sales, operating income was 11.1% and 9.4% for the nine months ended September 30, 2018 and 2017, respectively. The increases in operating income in absolute dollars for the three months ended September 30, 2018, compared to the three months ended September 30, 2017, and for the nine months ended September 30, 2018, compared to the nine months ended September 30, 2017, are attributable to the factors discussed in Net Sales, Gross Profit and Operating Expenses above.

Interest Income. For the three months ended September 30, 2018 and 2017, interest income was $1.5 million and $0.7 million, respectively. For the nine months ended September 30, 2018 and 2017, interest income was $3.8 million and $1.5 million, respectively. We continue to see improving yields for high quality investment alternatives that comply with our corporate investment policy. We expect yields in these types of investments to increase moderately during the remainder of 2018.

Net Foreign Exchange Gain/(Loss). For the three months ended September 30, 2018 and 2017, net foreign exchange gain/(loss) was $(1.0) million and $1.1 million, respectively. During the nine months ended September 30, 2018 and 2017, net foreign exchange gain/(loss) was $(2.1) million and $1.6 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 third quarter of 2018, we saw continued volatility in the exchange rates between the U.S. dollar and many of the currency markets where we have exposure. During the third quarter of 2018, the year over year impact from exchange rates was not significant to our results of operations. As of the date of this filing, the U.S. dollar index, as tracked by the St. Louis Federal Reserve, remains near its ten year high. In the past, we have noted that significant volatility in the foreign currency exchange 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 net sales and expenses and on the effectiveness of our hedging programs. We cannot predict to what degree foreign currency markets will fluctuate in the future. In the past, these dynamics have also adversely affected our net sales 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 loss by $0.9 million and decreased our foreign exchange gain by $0.9 million in the three months ended September 30, 2018 and September 30, 2017, respectively. Our hedging strategy decreased our foreign exchange loss by $0.7 million and decreased our foreign exchange gain by $4.1 million in the nine months ended September 30, 2018 and 2017, respectively. (See "Note 5 - Derivative instruments and hedging activities" of Notes to Consolidated Financial Statements for a further description of our derivative instruments and hedging activities).

Provision for Income Taxes. For the three months ended September 30, 2018 and 2017, our provision for income taxes reflected an effective tax rate of 11% and 12%, respectively. For the nine months ended September 30, 2018 and 2017, our provision for income taxes reflected an effective tax rate of 13% and 15%, 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, 2018 (Unaudited)		Nine Months Ended September 30, 2018 (Unaudited)	
Effective tax rate at September 30, 2017	12	%	15	%
Change in federal statutory rate	(14	)%	(14	)%
Change in profit in foreign jurisdictions with reduced tax rates	8	%	9	%
Change in U.S. tax on global intangible low-taxed income	2	%	2	%
Change in deduction for foreign-derived deduction eligible income	(1	)%	(1	)%
Change in unrecognized tax benefits	7	%	3	%
Change in foreign tax on undistributed earnings	(4	)%	(2	)%
Other	1	%	1	%
Effective tax rate at September 30, 2018	11	%	13	%

The Tax Cuts and Jobs Act was enacted on December 22, 2017. The Act reduced the US federal corporate tax rate from 35% to 21%, required companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and created new taxes on certain foreign sourced earnings. As of September 30, 2018, we had not completed our accounting for the tax effects of enactment of the Act. However, we have made a reasonable estimate of the effects on our existing deferred tax balances and the one-time transition tax. We recognized a provisional amount of $69.9 million, which was included as a component of income tax expense from continuing operations during the twelve months ended December 31, 2017. During the three-month period ended September 30, 2018, we recognized a $(1.8) million adjustment to the provisional amounts recorded at December 31, 2017, primarily related to foreign withholding and distribution taxes. We expect to finalize our calculation during the fourth quarter of 2018. For additional discussion about our income taxes including the effect of the Tax Cuts and Jobs Act, see "Note 9 - Income taxes" of Notes to Consolidated Financial Statements.

Other operational metrics

We believe that the following additional unaudited operational metrics assist investors in assessing our operational performance relative to others in our industry and to our historical results. The following tables provide details with respect to the amount of GAAP charges related to stock-based compensation, amortization of acquisition related intangibles, acquisition related transaction costs, restructuring charges, capitalization and amortization of internally developed software costs, and other items that were recorded in the line items indicated below (in thousands).

	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2018	2017	2018	2017
Stock-based compensation				
Cost of sales	$844	$689	$2,415	$1,914
Sales and marketing	3,452	3,014	10,408	8,523
Research and development	3,318	2,328	9,091	6,552
General and administrative	1,942	1,514	5,578	4,358
Provision for income taxes	(1,455)	(2,369)	(6,115)	(7,388)
Total	$8,101	$5,176	$21,377	$13,959

	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2018	2017	2018	2017
Amortization of acquired intangibles				
Cost of sales	$701	$1,502	$2,448	$4,648
Sales and marketing	510	515	1,580	1,479
Research and development	28	283	84	813
Provision for income taxes	(149)	(546)	(518)	(1,656)
Total	$1,090	$1,754	$3,594	$5,284

	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2018	2017	2018	2017
Acquisition transaction costs, restructuring charges, and other				
Cost of sales	$1,784	$79	$1,813	$988
Sales and marketing	3,676	1,618	8,354	8,018
Research and development	692	235	1,794	1,816
General and administrative	373	207	1,538	803
Other (income) loss, net	—	—	709	—
Provision for income taxes	(1,800)	(720)	(3,983)	(3,655)
Total	$4,725	$1,419	$10,225	$7,970

	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2018	2017	2018	2017
Capitalization and amortization of internally developed software costs				

Cost of sales	$6,412	$5,332	$18,736	$15,521
Research and development	(1,808)	(9,590)	(13,152)	(34,406)
Provision for income taxes				