

NATIONAL INSTRUMENTS CORP /DE/

Form 10-Q

November 03, 2010

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, 2010 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
(State or other jurisdiction of incorporation or organization)

74-1871327
(I.R.S. Employer Identification Number)

11500 North MoPac Expressway
Austin, Texas
(address of principal executive offices)

78759
(zip code)

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

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

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

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

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

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

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

| Class | Outstanding at November 2, 2010 |
|---------------------------------|---------------------------------|
| Common Stock - \$0.01 par value | 78,204,971 |

NATIONAL INSTRUMENTS CORPORATION

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PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

NATIONAL INSTRUMENTS CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

| | September 30, 2010 (unaudited) | December 31, 2009 |
|--|---|-------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$226,844 | \$201,465 |
| Short-term investments | 111,903 | 87,196 |
| Accounts receivable, net | 121,503 | 103,957 |
| Inventories, net | 101,532 | 86,515 |
| Prepaid expenses and other current assets | 42,132 | 36,523 |
| Deferred income taxes, net | 15,449 | 16,522 |
| Total current assets | 619,363 | 532,178 |
| P r o p e r t y a n d e q u i p m e n t , net | 151,667 | 153,265 |
| Goodwill, net | 69,383 | 64,779 |
| Intangible assets, net | 52,553 | 43,390 |
| Other long-term assets | 19,269 | 19,417 |
| Total assets | \$912,235 | \$813,029 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$33,005 | \$23,502 |
| Accrued compensation | 39,075 | 14,934 |
| Deferred revenue | 63,940 | 57,242 |
| A c c r u e d e x p e n s e s a n d o t h e r liabilities | 18,313 | 8,560 |
| Other taxes payable | 15,324 | 14,181 |
| Total current liabilities | 169,657 | 118,419 |
| Deferred income taxes | 24,725 | 25,012 |
| L i a b i l i t y f o r u n c e r t a i n t a x positions | 11,608 | 11,062 |
| Other long-term liabilities | 5,225 | 4,116 |
| Total liabilities | 211,215 | 158,609 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock: par value \$0.01; 5,000,000 shares authorized; none issued and outstanding | - | - |
| Common stock: par value \$0.01; 180,000,000 shares authorized; 78,042,121 and 77,367,874 shares issued and outstanding, respectively | 780 | 774 |
| Additional paid-in capital | 388,502 | 336,446 |

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| | | |
|---|-----------|-----------|
| Retained earnings | 308,535 | 303,655 |
| A c c u m u l a t e d o t h e r c o m p r e h e n s i v e income | 3,203 | 13,545 |
| Total stockholders' equity | 701,020 | 654,420 |
| Total liabilities and stockholders' equity | \$912,235 | \$813,029 |

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

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

| | Three Months Ended September 30, | | Nine months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2010 | 2009 | 2010 | 2009 |
| Net sales: | | | | |
| Product | \$ 203,188 | \$ 152,106 | \$ 573,413 | \$ 435,348 |
| S o f t w a r e | | | | |
| maintenance | 17,261 | 12,929 | 49,844 | 39,649 |
| Total net sales | 220,449 | 165,035 | 623,257 | 474,997 |
| Cost of sales: | | | | |
| Product | \$ 50,380 | \$ 40,476 | \$ 139,818 | \$ 119,234 |
| S o f t w a r e | | | | |
| maintenance | 1,523 | 1,423 | 3,966 | 4,034 |
| Total cost of sales | 51,903 | 41,899 | 143,784 | 123,268 |
| Gross profit | 168,546 | 123,136 | 479,473 | 351,729 |
| Operating expenses: | | | | |
| Sales and marketing | \$ 79,494 | \$ 65,126 | \$ 233,166 | \$ 199,089 |
| R e s e a r c h a n d | | | | |
| development | 39,971 | 35,016 | 114,912 | 99,252 |
| G e n e r a l a n d | | | | |
| administrative | 17,392 | 12,306 | 49,701 | 42,838 |
| T o t a l o p e r a t i n g | | | | |
| expenses | 136,857 | 112,448 | 397,779 | 341,179 |
| Operating income | 31,689 | 10,688 | 81,694 | 10,550 |
| Other income (expense): | | | | |
| Interest income | \$ 380 | \$ 339 | \$ 1,051 | \$ 1,335 |
| N e t f o r e i g n e x c h a n g e g a i n | | | | |
| (loss) | 426 | 940 | (2,475) | 1,301 |
| Other income, net | 160 | 482 | 970 | 979 |
| Income before income taxes | 32,655 | 12,449 | 81,240 | 14,165 |
| P r o v i s i o n f o r (b e n e f i t f r o m) i n c o m e | | | | |
| taxes | 4,522 | 2,518 | 10,152 | (554) |
| Net income | \$ 28,133 | \$ 9,931 | \$ 71,088 | \$ 14,719 |
| Basic earnings per share | \$ 0.36 | \$ 0.13 | \$ 0.91 | \$ 0.19 |
| Weighted average shares outstanding - basic | 78,176 | 77,653 | 77,832 | 77,497 |

| | | | | |
|--|---------|---------|---------|---------|
| Diluted earnings per share | \$ 0.36 | \$ 0.13 | \$ 0.90 | \$ 0.19 |
| Weighted average shares outstanding - diluted | 78,862 | 78,103 | 78,848 | 77,842 |
| D i v i d e n d s d e c l a r e d p e r share | \$ 0.13 | \$ 0.12 | \$ 0.39 | \$ 0.36 |

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

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

| | Nine months Ended September 30, | |
|--|------------------------------------|-----------|
| | 2010 | 2009 |
| Cash flow from operating activities: | | |
| Net income | \$ 71,088 | \$ 14,719 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| D e p r e c i a t i o n a n d amortization | 28,220 | 28,536 |
| S t o c k - b a s e d compensation | 14,194 | 15,238 |
| T a x e x p e n s e (b e n e f i t) f r o m d e f e r r e d i n c o m e taxes | 1,174 | (6,802) |
| T a x e x p e n s e f r o m s t o c k o p t i o n plans | 599 | 1,445 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (17,298) | 30,758 |
| Inventories | (14,712) | 18,632 |
| P r e p a i d e x p e n s e s a n d o t h e r assets | (15,328) | 3,920 |
| Accounts payable | 9,171 | (5,444) |
| Deferred revenue | 6,698 | 3,588 |
| Taxes and other liabilities | 33,938 | (14,245) |
| N e t c a s h p r o v i d e d b y o p e r a t i n g activities | 117,744 | 90,345 |
| Cash flow from investing activities: | | |
| Capital expenditures | (14,404) | (12,331) |
| C a p i t a l i z a t i o n o f i n t e r n a l l y d e v e l o p e d software | (14,300) | (10,611) |
| A d d i t i o n s t o o t h e r intangibles | (2,253) | (4,009) |
| A c q u i s i t i o n , n e t o f c a s h received | (2,191) | — |
| P u r c h a s e s o f s h o r t - t e r m a n d l o n g - t e r m investments | (88,226) | (38,876) |
| S a l e s a n d m a t u r i t i e s o f s h o r t - t e r m a n d l o n g - t e r m investments | 63,519 | 10,034 |
| N e t c a s h (u s e d b y) i n v e s t i n g activities | (57,855) | (55,793) |
| Cash flow from financing activities: | | |
| P r o c e e d s f r o m i s s u a n c e o f c o m m o n stock | 38,368 | 16,351 |

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| | | |
|---|------------|------------|
| R e p u r c h a s e o f c o m m o n stock | (41,862) | (18,200) |
| Dividends paid | (30,417) | (27,958) |
| T a x (b e n e f i t) f r o m s t o c k o p t i o n plans | (599) | (1,445) |
| N e t c a s h (u s e d b y) f i n a n c i n g activities | (34,510) | (31,252) |
| N e t c h a n g e i n c a s h a n d c a s h equivalents | 25,379 | 3,300 |
| C a s h a n d c a s h e q u i v a l e n t s a t b e g i n n i n g o f period | 201,465 | 229,400 |
| C a s h a n d c a s h e q u i v a l e n t s a t e n d o f period | \$ 226,844 | \$ 232,700 |

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, 2009, 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, 2010 and December 31, 2009, and the results of our operations for the three month and nine month periods ended September 30, 2010 and September 30, 2009 and the cash flows for the nine month periods ended September 30, 2010 and September 30, 2009. Operating results for the three month and nine month periods ended September 30, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

Note 2 – Earnings per share

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

The reconciliation of the denominators used to calculate basic EPS and diluted EPS for the three month and nine month periods ended September 30, 2010 and 2009, respectively, are as follows (in thousands):

| | Three Months Ended | | Nine months Ended | |
|---|------------------------------|--------|------------------------------|--------|
| | September 30, (unaudited) | | September 30, (unaudited) | |
| | 2010 | 2009 | 2010 | 2009 |
| Weighted average shares outstanding-basic | 78,176 | 77,653 | 77,832 | 77,497 |
| Plus: Common share equivalents | | | | |
| Stock options, restricted stock units | 686 | 450 | 1,016 | 345 |
| Weighted average shares outstanding-diluted | 78,862 | 78,103 | 78,848 | 77,842 |

Stock options to acquire 478,000 shares and 3,509,000 shares for the three month periods ended September 30, 2010 and 2009, respectively, and 568,000 and 3,619,000 shares for the nine month periods ended September 30, 2010 and 2009, respectively, were excluded in the computations of diluted EPS because the effect of including the stock options would have been anti-dilutive.

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

Cash, cash equivalents and short-term investments consist of the following (in thousands):

| As of September 30, 2010 | As of December 31, 2009 |
|--------------------------------|-------------------------------|
|--------------------------------|-------------------------------|

(unaudited)

| | | |
|--|-----------|-----------|
| Cash and cash equivalents: | | |
| Cash | \$81,264 | \$85,612 |
| Cash equivalents: | | |
| Money market accounts | 145,580 | 115,853 |
| Total cash and cash equivalents | 226,844 | 201,465 |
| Short-term investments: | | |
| Municipal bonds | 19,952 | 12,549 |
| Corporate bonds | 42,040 | 7,587 |
| U.S. treasuries and agencies | 14,235 | 21,033 |
| Foreign government bonds | 33,224 | 34,674 |
| Time deposits | 2,452 | 2,753 |
| Auction rate securities | - | 8,177 |
| Auction rate securities put option | - | 423 |
| Total short-term investments | 111,903 | 87,196 |
| Total cash, cash equivalents and investments | \$338,747 | \$288,661 |

The following table summarizes unrealized gains and losses related to our investments designated as available-for-sale (in thousands):

| | As of September 30, 2010 (unaudited) | | | | |
|------------------------------|---|-----------------------------|-----------------------------|---|------------|
| | Adjusted Cost | Gross Unrealized Gain | Gross Unrealized Loss | Cumulative Translation Adjustment | Fair Value |
| Municipal bonds | \$19,923 | \$33 | \$(4) | \$- | \$19,952 |
| Corporate bonds | 41,988 | 58 | (6) | - | 42,040 |
| U.S. treasuries and agencies | 14,217 | 18 | - | - | 14,235 |
| Foreign government bonds | 36,065 | 16 | (134) | (2,723) | 33,224 |
| Time deposits | 2,452 | - | - | - | 2,452 |
| Total investments | \$114,645 | \$125 | \$(144) | \$(2,723) | \$111,903 |

| | As of December 31, 2009 | | | | |
|------------------------------------|-------------------------|-----------------------------|-----------------------------|---|------------|
| | Adjusted Cost | Gross Unrealized Gain | Gross Unrealized Loss | Cumulative Translation Adjustment | Fair Value |
| Municipal bonds | \$12,491 | \$58 | \$- | \$- | \$12,549 |
| Corporate bonds | 7,478 | 110 | (1) | - | 7,587 |
| U.S. treasuries and agencies | 21,080 | - | (47) | - | 21,033 |
| Foreign government bonds | 36,105 | 76 | - | (1,507) | 34,674 |
| Time deposits | 2,753 | - | - | - | 2,753 |
| Auction rate securities | 8,600 | - | (423) | - | 8,177 |
| Auction rate securities put option | - | 423 | - | - | 423 |
| Total investments | \$88,507 | \$667 | \$(471) | \$(1,507) | \$87,196 |

The following table summarizes the contractual maturities of our investments designated as available-for-sale (in thousands):

| | As of September 30, 2010 | | As of December 31, 2009 | |
|-------------------------|--------------------------|------------|-------------------------|------------|
| | Adjusted Cost | Fair Value | Adjusted Cost | Fair Value |
| Due in less than 1 year | \$81,762 | \$80,460 | \$44,029 | \$43,267 |
| Due in 1 to 5 years | 32,883 | 31,443 | 44,478 | 43,929 |
| Total investments | \$114,645 | \$111,903 | \$88,507 | \$87,196 |

| | Adjusted | | Adjusted | |
|------------------------------------|----------|------------|----------|------------|
| | Cost | Fair Value | Cost | Fair Value |
| Due in less than 1 year | | | | |
| Municipal bonds | \$16,910 | \$16,940 | \$4,103 | \$4,110 |
| Corporate bonds | 36,604 | 36,640 | 5,384 | 5,473 |
| U.S. treasuries and agencies | 8,199 | 8,205 | 5,065 | 5,057 |
| Foreign government bonds | 17,597 | 16,223 | 18,124 | 17,274 |
| Time deposits | 2,452 | 2,452 | 2,753 | 2,753 |
| Auction rate securities | - | - | 8,600 | 8,177 |
| Auction rate securities put option | - | - | - | 423 |
| Total investments | \$81,762 | \$80,460 | \$44,029 | \$43,267 |

| | Adjusted | | Adjusted | |
|------------------------------|----------|------------|----------|------------|
| | Cost | Fair Value | Cost | Fair Value |
| Due in 1 to 5 years | | | | |
| Municipal bonds | \$3,013 | \$3,012 | \$8,388 | \$8,439 |
| Corporate bonds | 5,384 | 5,400 | 2,094 | 2,114 |
| U.S. treasuries and agencies | 6,018 | 6,030 | 16,015 | 15,976 |
| Foreign government bonds | 18,468 | 17,001 | 17,981 | 17,400 |
| Total investments | \$32,883 | \$31,443 | \$44,478 | \$43,929 |

Note 4 – Fair value measurements

FASB ASC 820, Fair Value Measurements and Disclosures (FASB ASC 820) clarifies the definition of fair value, prescribes methods for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and expands disclosures about the use of fair value measurements. Effective January 1, 2010, we adopted the update to FASB ASC 820 that required additional disclosures and clarified existing disclosures regarding fair value measurements. The additional disclosures include transfers in and out of Level 1 and 2 as well as activity within Level 3 fair value measurements. The update also provides amendments that clarify existing disclosures on level of disaggregation and disclosures about inputs and valuation techniques. The adoption of the update to FASB ASC 820 did not have a material impact on our consolidated financial position or results of operations.

The following tables present our assets and liabilities that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value (in thousands). We did not have any items that were measured at fair value on a nonrecurring basis at September 30, 2010 and December 31, 2009.

| Description | Fair Value Measurements at Reporting Date Using (unaudited) | | | |
|-------------|--|--|---|---|
| | September 30, 2010 | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | | | | |

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(Level 1)

| Assets | | | | |
|--|-------------------|-------------------|------------------|-------------|
| Money Market Funds | \$ 145,580 | \$ 145,580 | \$ - | \$ - |
| Short-term investments available for sale: | | | | |
| Municipal bonds | 19,952 | 19,952 | - | - |
| Corporate bonds | 42,040 | 42,040 | - | - |
| U.S. treasuries and agencies | 14,235 | 14,235 | - | - |
| Foreign government bonds | 33,224 | 33,224 | - | - |
| Time deposits | 2,452 | 2,452 | - | - |
| Derivatives | 5,569 | - | 5,569 | - |
| Total Assets | \$ 263,052 | \$ 257,483 | \$ 5,569 | \$ - |
| Liabilities | | | | |
| Derivatives | \$(5,456) | \$ - | \$(5,456) | \$ - |
| Total Liabilities | \$(5,456) | \$ - | \$(5,456) | \$ - |

Fair Value Measurements at Reporting Date Using Quoted Prices in

| Description | December 31, 2009 | Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|-------------------|---|---|---|
| | | | | |
| Money Market Funds | \$ 115,853 | \$ 115,853 | \$ - | \$ - |
| Short-term investments available for sale: | | | | |
| Municipal bonds | 12,549 | 12,549 | - | - |
| Corporate bonds | 7,587 | 7,587 | - | - |
| U.S. treasuries and agencies | 21,033 | 21,033 | - | - |
| Foreign government bonds | 34,674 | 34,674 | - | - |
| Time deposits | 2,753 | 2,753 | - | - |
| Auction rate securities | 8,177 | - | - | 8,177 |
| Auction rate securities put option | 423 | - | - | 423 |
| Derivatives | 11,016 | - | 11,016 | - |
| Total Assets | \$ 214,065 | \$ 194,449 | \$ 11,016 | \$ 8,600 |
| Liabilities | | | | |
| Derivatives | \$(318) | \$ - | \$(318) | \$ - |
| Total Liabilities | \$(318) | \$ - | \$(318) | \$ - |

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

| | Short-term investments available for sale (unaudited) |
|---|---|
| Beginning Balance at December 31, 2009 | \$ 8,600 |
| Total gains or (losses) (realized/unrealized) | |
| Included in earnings | - |
| Included in other comprehensive income | - |
| Total losses (realized/unrealized) | |
| Included in earnings | - |
| Included in other comprehensive income | - |
| Purchases, issuances and settlements | (8,600) |
| Transfer in and/or out of Level 3 | - |
| Ending Balance at September 30, 2010 | \$ - |
| The amount of total gains or (losses) for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date | - |
| | \$ - |

Short-term investments available-for-sale are valued using a market approach (Level 1) based on the quoted market prices of identical instruments when available or other observable inputs such as trading prices of identical instruments in active markets. Short-term investments available-for-sale consists of debt securities issued by states of the U.S. and political subdivisions of the U.S., corporate debt securities and debt securities issued by U.S. government corporations and agencies as well as debt securities issued by foreign governments. All short-term investments available-for-sale have contractual maturities of less than 24 months. There were not any transfers in or out of Level 1 during the nine months ended September 30, 2010.

Derivatives include foreign currency forward and option contracts. Our foreign currency forward contracts are valued using an income approach (Level 2) based on the spot rate less the contract rate multiplied by the notional amount. Our foreign currency option contracts are valued using a market approach based on the quoted market prices which are derived from observable inputs including current and future spot rates, interest rate spreads as well as quoted market prices of identical instruments. There were not any transfers in or out of Level 2 during the nine months ended September 30, 2010.

The short-term investments available-for-sale included in Level 3 at December 31, 2009, were reported at their fair market value and consisted of auction rate securities backed by education loan revenue bonds. Auction rate securities are variable rate debt instruments whose interest rates are typically reset approximately every 7 to 35 days.

In November 2008, we accepted the UBS Auction Rate Securities Rights (the "Rights") agreement offered by UBS as a liquidity alternative to the failed auction process for our auction rate securities. The Rights agreement included a nontransferable right to sell our auction rate securities, at par value, back to UBS at any time during the period June 30, 2010, through July 2, 2012. Under the terms of this Rights agreement, UBS purchased back from us our auction rate securities on June 14, 2010, and July 1, 2010. We received the full par value of \$8.6 million from UBS in accordance with the terms of our Rights agreement.

The estimated fair market value of the auction rate securities and the Rights agreement was determined using significant unobservable inputs (Level 3). We considered many factors in determining the fair market value of our auction rate securities as well as our corresponding Rights agreement at December 31, 2009, including the fact that the debt instruments underlying the auction rate securities have redemption features which call for redemption at 100% of

par value, current credit curves for like securities and discount factors to account for the illiquidity of the market for these securities.

Note 5 – Derivative instruments and hedging activities

FASB ASC 815, Derivatives and Hedging, (FASB ASC 815) requires companies to recognize all of their derivative instruments as either assets or liabilities in the 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, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

We have operations in over 40 countries. Sales outside of the Americas as a percentage of consolidated sales were 56% and 54% in each of the three month periods ended September 30, 2010 and 2009, respectively, and 57% and 55% in each of the nine month periods ended September 30, 2010 and 2009, 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 and purchased option contracts) to help protect our earnings and cash flows from fluctuations caused by the volatility in currency exchange rates. Movements in foreign currency exchange rates pose a risk to our operations and competitive position, since exchange rate changes may affect our profitability and cash flow, and the business or pricing strategies of our non-U.S. based competitors.

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

We designate foreign currency forward and purchased option contracts as cash flow hedges of forecasted revenues or forecasted expenses. In addition, we hedge our foreign currency denominated balance sheet exposures using foreign currency forward contracts. These derivatives are not designated as hedging instruments under FASB ASC 815. 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 or expenses over the next one to two years, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue and forecasted expenses denominated in foreign currencies with forward and purchased option contracts. For forward contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the forward contracts designated as hedges. For option contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the option contracts net of the premium paid designated as hedges. Our foreign currency purchased option contracts are purchased "at-the-money" or "out-of-the-money". From time to time, we purchase foreign currency forward and option contracts for up to 100% of

our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, British pound sterling, South Korean won and Hungarian forint) and limit the duration of these contracts to 40 months or less.

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

We held forward contracts with a notional amount of \$31.2 million dollar equivalent of Euro, \$7.1 million dollar equivalent of British pound sterling, \$22.2 million dollar equivalent of Japanese yen, and \$32.8 million dollar equivalent of Hungarian forint at September 30, 2010. These contracts are for terms of up to 24 months. At December 31, 2009, we held forward contracts with a notional amount of \$28.6 million dollar equivalent of Euro, \$4.0 million dollar equivalent of British pound sterling, \$24.4 million dollar equivalent of Japanese yen, and \$17.8 million dollar equivalent of Hungarian forint.

We held purchased option contracts with a notional amount of \$8.7 million dollar equivalent of Euro at September 30, 2010. These contracts are for terms of up to 12 months. At December 31, 2009, we held purchased option contracts with a notional amount of \$28.4 million dollar equivalent of Euro.

At September 30, 2010, we expect to reclassify \$580,000 of losses on derivative instruments from accumulated other comprehensive income to net sales during the next twelve months when the hedged international sales occur, \$1.1 million of gains on derivative instruments from accumulated OCI to cost of sales when the cost of sales are incurred and \$584,000 of gains on derivative instruments from accumulated OCI to operating expenses during the next twelve months when the hedged operating expenses occur. Expected amounts are based on derivative valuations at September 30, 2010. Actual results may vary as a result of changes in the corresponding exchange rate subsequent to this date.

We did not record any gains or losses due to the ineffectiveness of our hedges during the nine months ended September 30, 2010. During the nine months ended September 30, 2009, hedges with a notional amount of \$18.9 million were determined to be ineffective. As a result, we recorded a net gain of \$1.2 million related to these hedges as a component of “net foreign exchange gain (loss)” during the nine months ended September 30, 2009.

Other Derivatives

Other derivatives not designated as hedging instruments under FASB ASC 815 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 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. 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, 2010 and December 31, 2009, we held foreign currency forward contracts with a notional amount of \$29.9 million and \$45.2 million, respectively.

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

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Fair Values of Derivative Instruments (in thousands):

| | Asset Derivatives | | | |
|---|---|------------|---|------------|
| | September 30, 2010 (unaudited) | | December 31, 2009 | |
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Derivatives designated as hedging instruments | | | | |
| Foreign exchange contracts - ST forwards | Prepaid expenses and other current assets | \$2,849 | Prepaid expenses and other current assets | \$7,947 |
| Foreign exchange contracts - LT forwards | Other long-term assets | 871 | Other long-term assets | 274 |
| Foreign exchange contracts - ST options | Prepaid expenses and other current assets | 877 | Prepaid expenses and other current assets | 1,821 |
| Total derivatives designated as hedging instruments | | \$4,597 | | \$10,042 |
| Derivatives not designated as hedging instruments | | | | |
| Foreign exchange contracts - ST forwards | Prepaid expenses and other current assets | \$972 | Prepaid expenses and other current assets | \$974 |
| Total derivatives not designated as hedging instruments | | \$972 | | \$974 |
| Total derivatives | | \$5,569 | | \$11,016 |

| | Liability Derivatives | | | |
|---|--|------------|--|------------|
| | September 30, 2010 (unaudited) | | December 31, 2009 | |
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Derivatives designated as hedging instruments | | | | |
| Foreign exchange contracts - ST forwards | Accrued expenses and other liabilities | \$(2,156) | Accrued expenses and other liabilities | \$- |
| Foreign exchange contracts - LT forwards | Other long-term liabilities | (850) | Other long-term liabilities | - |
| Total derivatives designated as hedging instruments | | \$(3,006) | | \$- |
| Derivatives not designated as hedging instruments | | | | |
| Foreign exchange contracts - ST forwards | Accrued expenses and other liabilities | \$(2,450) | Accrued expenses and other liabilities | \$(318) |

| | | |
|---|------------|----------|
| Total derivatives not designated as hedging instruments | \$(2,450) | \$(318) |
| Total derivatives | \$(5,456) | \$(318) |

The following unaudited table shows the effect of derivative instruments on the Consolidated Statements of Income for the three month periods ended September 30, 2010 and 2009, respectively (in thousands):

| Derivatives in Cash Flow Hedging Relationship | September 30, 2010 (unaudited) | | | | |
|---|---|--|---|---|--|
| | Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2010 | Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2010 | Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) | Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) 2010 |
| Foreign exchange contracts - forwards and options | \$(6,201) | Net sales | \$ 1,358 | Net foreign exchange gain (loss) | \$ - |
| Foreign exchange contracts - forwards and options | 2,558 | Cost of sales | 374 | Net foreign exchange gain (loss) | - |
| Foreign exchange contracts - forwards and options | 1,299 | Operating expenses | 266 | Net foreign exchange gain (loss) | - |
| Total | \$(2,344) | | \$ 1,998 | | \$ - |

| Derivatives in Cash Flow Hedging Relationship | September 30, 2009 (unaudited) | | | | |
|---|---|--|---|---|--|
| | Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2009 | Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2009 | Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) | Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) 2009 |
| Foreign exchange contracts - forwards and options | \$(5,037) | Net sales | \$ (401) | Net foreign exchange gain (loss) | \$ 181 |

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| | | | | | |
|---|-------------|--------------------|----------|----------------------------------|--------|
| Foreign exchange contracts - forwards and options | 1,465 | Cost of sales | (72) | Net foreign exchange gain (loss) | 395 |
| Foreign exchange contracts - forwards and options | 82 | Operating expenses | 380 | Net foreign exchange gain (loss) | 81 |
| Total | \$ (3,490) | | \$ (93) | | \$ 657 |

| Derivatives not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income September 30, 2010 (unaudited) | Amount of Gain (Loss) Recognized in Income September 30, 2009 (unaudited) |
|---|--|---|---|
| Foreign exchange contracts - forwards | Net foreign exchange gain/(loss) | \$ (2,233) | \$ (1,607) |
| Total | | \$ (2,233) | \$ (1,607) |

The following unaudited table shows the effect of derivative instruments on the Consolidated Statements of Income for the nine month periods ended September 30, 2010 and 2009, respectively (in thousands):

| Derivatives in Cash Flow Hedging Relationship | September 30, 2010 (unaudited) | | | | Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) 2010 |
|---|---|--|---|---|--|
| | Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2010 | Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2010 | Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) | |
| Foreign exchange contracts - forwards and options | \$ (4,457) | Net sales | \$ 4,407 | Net foreign exchange gain (loss) | \$ - |
| Foreign exchange contracts - forwards and options | (2,152) | Cost of sales | 1,785 | Net foreign exchange gain (loss) | - |
| Foreign exchange contracts - forwards and options | (1,095) | Operating expenses | 853 | Net foreign exchange gain (loss) | - |
| Total | \$ (7,704) | | \$ 7,045 | | \$ - |

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September 30, 2009
(unaudited)

| Derivatives in Cash Flow Hedging Relationship | Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2009 | Location of Gain or (Loss) Reclassified into Income (Effective Portion) | Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2009 | Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) | Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) 2009 |
|---|---|---|---|---|--|
| Foreign exchange contracts - forwards and options | \$ (8,822) | Net sales | \$ 2,578 | Net foreign exchange gain (loss) | \$ 1,132 |
| Foreign exchange contracts - forwards and options | 2,776 | Cost of sales | (740) | Net foreign exchange gain (loss) | (44) |
| Foreign exchange contracts - forwards and options | 1,747 | Operating expenses | 184 | Net foreign exchange gain (loss) | 81 |
| Total | \$ (4,299) | | \$ 2,022 | | \$ 1,169 |

| Derivatives not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income September 30, 2010 (unaudited) | Amount of Gain (Loss) Recognized in Income September 30, 2009 (unaudited) |
|---|--|---|---|
| Foreign exchange contracts - forwards | Net foreign exchange gain/(loss) | \$ (857) | \$ (1,791) |
| Total | | \$ (857) | \$ (1,791) |

Note 6 – Inventories

Inventories, net at September 30, 2010 and December 31, 2009, consist of the following (in thousands):

| | September 30, 2010 (unaudited) | December 31, 2009 |
|-----------------|--------------------------------|-------------------|
| Raw materials | \$48,054 | \$42,121 |
| Work-in-process | 4,351 | 2,042 |
| Finished goods | 49,127 | 42,352 |
| | \$101,532 | \$86,515 |

Note 7 – Intangibles

Intangibles at September 30, 2010 and December 31, 2009, are as follows:

| | September 30, 2010 (unaudited) | | | December 31, 2009 | | |
|--|-----------------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Capitalized software development costs | \$53,883 | \$ (28,321) | \$25,562 | \$38,928 | \$ (20,455) | \$18,473 |
| Acquired technology | 32,853 | (23,995) | 8,858 | 28,022 | (20,967) | 7,055 |
| Patents | 20,464 | (6,078) | 14,386 | 19,033 | (5,377) | 13,656 |
| Leasehold equipment and other | 13,936 | (10,189) | 3,747 | 12,577 | (8,371) | 4,206 |
| | \$121,136 | \$ (68,583) | \$52,553 | \$98,560 | \$ (55,170) | \$43,390 |

Software development costs capitalized during the three month periods ended September 30, 2010 and 2009, were \$3.4 million and \$1.3 million, respectively, and related amortization expense was \$2.8 million and \$2.5 million, respectively. Capitalized software development costs for the three month periods ended September 30, 2010 and 2009, included costs related to stock based compensation of \$144,000 and \$71,000, respectively. During the nine month periods ended September 30, 2010 and 2009, we capitalized software development costs of \$15.0 million and \$11.2 million, respectively, and related amortization expense was \$7.9 million and \$6.6 million, respectively. Capitalized software development costs for the nine month periods ended September 30, 2010 and 2009, included costs related to stock based compensation of \$655,000 and \$617,000, respectively. Amortization of capitalized software development costs is computed on an individual product basis for those products available for market and is recognized based on the product's estimated economic life, generally three years. Patents are amortized using the straight-line method over their estimated period of benefit, generally ten to seventeen years.

Total intangible assets amortization expenses were \$5.2 million and \$4.7 million during the three month periods ended September 30, 2010 and 2009, respectively, and \$13.4 million and \$12.2 million during the nine month periods ended September 30, 2010 and 2009, respectively.

Acquired core technology and intangible assets are amortized over their useful lives, which range from three to eight years. Amortization expense for intangible assets acquired was approximately \$1.0 million and \$1.0 million for the three month periods ended September 30, 2010 and 2009, respectively, of which approximately \$921,000 and \$853,000 was recorded in cost of sales, respectively, and approximately \$89,000 and \$125,000 was recorded in operating expenses, respectively. For the nine month periods ended September 30, 2010 and 2009, amortization expense for intangible assets acquired was approximately \$2.9 million and \$3.0 million, respectively, of which approximately \$2.6 million and \$2.6 million was recorded in cost of sales, respectively, and approximately \$311,000 and \$377,000 was recorded in operating expenses, respectively.

Note 8 – Goodwill

The carrying amount of goodwill as of September 30, 2010, is as follows (in thousands):

| | Amount |
|-------------------------------------|----------|
| Balance as of December 31, 2009 | \$64,779 |
| Acquisitions | 5,013 |
| Divestitures | - |
| Foreign currency translation impact | (409) |
| Balance as of September 30, 2010 | \$69,383 |

The excess purchase price over the fair value of assets acquired is recorded as goodwill. As we have one operating segment, we allocate goodwill to one reporting unit for goodwill impairment testing. Goodwill is tested for impairment on an annual basis, and between annual tests if indicators of potential impairment exist, using a fair-value-based approach based on the market capitalization of the reporting unit. Our annual impairment test was performed as of February 28, 2010. No impairment of goodwill has been identified during the period presented. Goodwill is deductible for tax purposes in certain jurisdictions.

On February 1, 2010, we acquired all of the outstanding shares of a privately-held company for \$2.2 million in net cash, \$3.0 million in shares of our common stock with the remainder to be paid in cash over the next four years. The purchase price allocation for this acquisition included net working capital of \$1.1 million, amortizable intangible assets of \$5.0 million, and goodwill of \$5.0 million. Our consolidated financial statements include the operating results of the acquired company from the date of acquisition.

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.

FASB ASC 740, Income Taxes (FASB ASC 740) addresses the accounting for uncertainty in income taxes recognized in an entity's financial statements and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. We had \$11.6 million and \$11.1 million of unrecognized tax benefits at September 30, 2010 and December 31, 2009, respectively, all of which would affect our effective income tax rate if recognized. We recorded a gross decrease in unrecognized tax benefits of \$2.4 million and \$3.5 million for the three and nine month periods ended September 30, 2010, as a result of the closing of open tax years and a settlement with a taxing authority. As of September 30, 2010, it is deemed reasonable that we will recognize tax benefits in the amount of \$3.5 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, 2010, we have approximately \$652,000 accrued for interest related to uncertain tax positions. The tax years 2003 through 2009 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 14% and 20% for the three month periods ended September 30, 2010 and 2009, respectively, and 12% and (4)% for the nine month periods ended September 30, 2010 and 2009, respectively. For the three months ended September 30, 2010, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of the partial release of a deferred tax asset valuation allowance, an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates and a decrease in unrecognized tax benefits for uncertain tax positions. For the nine months ended September 30, 2010, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of the partial release of a deferred tax asset valuation allowance, an enhanced deduction for certain research and development expenses and profits in foreign jurisdictions with reduced income tax rates. For the three and nine month periods ended September 30, 2009, our effective tax rate was lower than the U.S. federal statutory rate of 35% due to a partial release of a deferred tax asset valuation allowance, the research credit and a decrease in unrecognized tax benefits for uncertain tax positions. These benefits were partially offset by non-deductible stock-based compensation expenses, losses in foreign jurisdictions with reduced income tax rates and a valuation allowance related to a deferred tax asset for which a tax benefit was previously recognized.

The tax position of our Hungarian operation continues to benefit from assets created by the restructuring of our operations in Hungary. In addition, effective January 1, 2010, a new tax law in Hungary provides for an enhanced deduction for the qualified research and development expenses of NI Hungary Software and Hardware Manufacturing Kft. (“NI Hungary”). Partial release of the valuation allowance on assets from the restructuring and the enhanced tax deduction for research expenses resulted in income tax benefits of \$4.5 million and \$1.7 million for the three month periods ended September 30, 2010 and 2009, respectively and \$12.3 million and \$5.9 million for the nine month periods ended September 30, 2010 and 2009, respectively.

Note 10 – Comprehensive income

Our comprehensive income is comprised of net income, foreign currency translation, unrealized gains and losses on forward and option contracts and unrealized gains and losses on our investments designated as available for sale. Comprehensive income for the three and nine month periods ended September 30, 2010 and September 30, 2009, was as follows (in thousands):

| | Three Months Ended September 30, (unaudited) | | Nine months Ended September 30, (unaudited) | |
|---|--|----------|---|----------|
| | 2010 | 2009 | 2010 | 2009 |
| Comprehensive income: | | | | |
| Net income | \$28,133 | \$9,931 | \$71,088 | \$14,719 |
| Foreign currency translation gains (losses), net of taxes | 8,792 | 2,413 | (2,577) | 2,908 |
| Unrealized gains (losses) on derivative instruments, net of taxes | (908) | (1,987) | (8,000) | (1,838) |
| Unrealized gains (losses) on investments designated as available for sale, net of taxes | (536) | 241 | 235 | 115 |
| Total comprehensive income | \$35,481 | \$10,598 | \$60,746 | \$15,904 |

Note 11 – Stock-based compensation plans

Stock option plans

Our stockholders approved the 1994 Incentive Stock Option Plan (the “1994 Plan”) on May 9, 1994. At the time of approval, 9,112,500 shares of our common stock were reserved for issuance under this plan. In 1997, an additional 7,087,500 shares of our common stock were reserved for issuance under this plan, and an additional 750,000 shares were reserved for issuance under this plan in 2004. The 1994 Plan terminated in May 2005, except with respect to outstanding awards previously granted thereunder.

Awards under the plan were either incentive stock options within the meaning of Section 422 of the Internal Revenue Code or nonqualified options. The right to purchase shares vests over a five to ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and revenue growth but shares cannot accelerate to vest over a period of less than five years. Stock options must be exercised within ten years from date of grant. Stock options were issued with an exercise price which was equal to the market price of our common stock at the grant date. We estimate potential forfeitures of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods. During the nine months ended September 30, 2010, we did not make any changes in accounting principles or methods of estimates.

Restricted stock plans

Our stockholders approved our 2005 Incentive Plan (the “2005 Plan”) on May 10, 2005. At the time of approval, 2,700,000 shares of our common stock were reserved for issuance under this plan, as well as the number of shares which had been reserved but not issued under the 1994 Plan (our incentive stock option plan which terminated in May 2005), and any shares that returned to the 1994 Plan as a result of termination of options or repurchase of shares issued under such plan. The 2005 Plan, administered by the Compensation Committee of the Board of Directors, provided for granting of incentive awards in the form of restricted stock and restricted stock units (“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 2,241,536 share of common stock that were reserved but not issued under the 1994 Plan and the 2005 Plan as of May 11, 2010.

Our stockholders approved our 2010 Incentive Plan (the “2010 Plan”) on May 11, 2010. At the time of approval, 2,000,000 shares of our common stock were reserved for issuance under this plan, as well as the 2,241,536 share of common stock that were reserved but not issued under the 1994 Plan and the 2005 Plan as of May 11, 2010, and any shares that are returned to the 1994 Plan and the 2005 Plan as a result of forfeiture or termination of options or RSUs or repurchase of shares issued under these plans. The 2010 Plan, administered by the Compensation Committee of the Board of Directors, provides for granting of incentive awards in the form of restricted stock and RSUs to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. There were 4,188,716 shares available for grant under the 2010 Plan at September 30, 2010.

We estimate potential forfeitures of RSUs and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods. During the nine months ended September 30, 2010, we did not make any changes in accounting principles or methods of estimates related to the 2010 Plan.

Employee stock purchase plan

Our employee stock purchase plan permits substantially all domestic employees and employees of designated subsidiaries to acquire our common stock at a purchase price of 85% of the lower of the market price at the beginning or the end of the purchase period. The plan has quarterly purchase periods 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. We had 1,237,994 shares of common stock reserved for future employee purchases under this plan at September 30, 2010. We issued 517,077 shares under this plan in the nine months ended September 30, 2010. The weighted average fair value of the employees’ purchase rights was \$24.84 per share and was estimated using the Black-Scholes model. During the nine months ended September 30, 2010, we did not make any changes in accounting principles or methods of estimates related to the employee stock purchase plan.

For the three and nine month periods ended September 30, 2010 and September 30, 2009, stock-based compensation recorded as a component of cost of sales, sales and marketing, research and development, and general and administrative was as follows (in thousands):

| Three Months Ended September 30, | Nine months Ended September 30, |
|-------------------------------------|------------------------------------|
|-------------------------------------|------------------------------------|

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| | (unaudited) | | (unaudited) | |
|----------------------------|-------------|---------|-------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| Stock-based compensation | | | | |
| Cost of sales | \$332 | \$335 | \$1,014 | \$975 |
| Sales and marketing | 1,960 | 2,210 | 6,060 | 6,626 |
| Research and development | 1,771 | 1,929 | 5,129 | 5,349 |
| General and administrative | 672 | 728 | 1,991 | 2,288 |
| Provision for income taxes | (1,295) | (409) | (4,422) | (5,288) |
| Total | \$3,440 | \$4,793 | \$9,772 | \$9,950 |

Authorized Preferred Stock and Preferred Stock Purchase Rights Plan

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

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

Note 12 – Segment information

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

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

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

| Three Months Ended | | Nine Months Ended | |
|--------------------|------|-------------------|------|
| September 30, | | September 30, | |
| (unaudited) | | (unaudited) | |
| 2010 | 2009 | 2010 | 2009 |

Net sales:

Americas:

| | | | | |
|-----------------------------|----------|----------|-----------|-----------|
| Unaffiliated customer sales | \$97,031 | \$75,459 | \$266,300 | \$211,991 |
|-----------------------------|----------|----------|-----------|-----------|

Europe:

| | | | | |
|-----------------------------|--------|--------|---------|---------|
| Unaffiliated customer sales | 59,882 | 46,683 | 177,681 | 143,026 |
|-----------------------------|--------|--------|---------|---------|

Asia Pacific:

| | | | | |
|-----------------------------|--------|--------|---------|---------|
| Unaffiliated customer sales | 63,536 | 42,893 | 179,276 | 119,980 |
|-----------------------------|--------|--------|---------|---------|

| | | | | |
|--|-----------|-----------|-----------|-----------|
| | \$220,449 | \$165,035 | \$623,257 | \$474,997 |
|--|-----------|-----------|-----------|-----------|

| | Three Months Ended September 30, (unaudited) | | Nine Months Ended September 30, (unaudited) | |
|--|--|------|---|------|
| | 2010 | 2009 | 2010 | 2009 |

Operating income:

| | | | | |
|----------|----------|----------|----------|----------|
| Americas | \$21,395 | \$15,058 | \$52,689 | \$28,658 |
|----------|----------|----------|----------|----------|

| | | | | |
|--------|--------|--------|--------|--------|
| Europe | 31,347 | 20,087 | 87,409 | 52,562 |
|--------|--------|--------|--------|--------|

| | | | | |
|--------------|--------|--------|--------|--------|
| Asia Pacific | 18,918 | 10,559 | 56,508 | 28,582 |
|--------------|--------|--------|--------|--------|

Unallocated:

| | | | | |
|-----------------------------------|-----------|-----------|------------|-----------|
| Research and development expenses | (39,971) | (35,016) | (114,912) | (99,252) |
|-----------------------------------|-----------|-----------|------------|-----------|

| | | | | |
|--|----------|----------|----------|----------|
| | \$31,689 | \$10,688 | \$81,694 | \$10,550 |
|--|----------|----------|----------|----------|

| | Three Months Ended September 30, (unaudited) | | Nine Months Ended September 30, (unaudited) | |
|--|--|------|---|------|
| | 2010 | 2009 | 2010 | 2009 |

Interest income:

| | | | | |
|----------|-------|-------|-------|-------|
| Americas | \$177 | \$165 | \$433 | \$685 |
|----------|-------|-------|-------|-------|

| | | | | |
|--------|-----|-----|-----|-----|
| Europe | 182 | 145 | 546 | 581 |
|--------|-----|-----|-----|-----|

| | | | | |
|--------------|----|----|----|----|
| Asia Pacific | 21 | 29 | 72 | 69 |
|--------------|----|----|----|----|

| | | | | |
|--|-------|-------|---------|---------|
| | \$380 | \$339 | \$1,051 | \$1,335 |
|--|-------|-------|---------|---------|

| | September 30, 2010 | December 31, 2009 |
|--|--------------------------|-------------------------|
|--|--------------------------|-------------------------|

(unaudited)

Long-lived assets:

| | | |
|----------|-----------|-----------|
| Americas | \$100,245 | \$100,489 |
|----------|-----------|-----------|

| | | |
|--------|--------|--------|
| Europe | 34,773 | 36,555 |
|--------|--------|--------|

| | | |
|--------------|--------|--------|
| Asia Pacific | 16,649 | 16,221 |
|--------------|--------|--------|

| | | |
|--|-----------|-----------|
| | \$151,667 | \$153,265 |
|--|-----------|-----------|

Total sales outside the United States for the three month periods ended September 30, 2010 and 2009, were \$131.3 million and \$95.4 million, respectively. Total sales outside the United States for the nine month periods ended September 30, 2010 and 2009, were \$378.9 million and \$282.5 million, respectively.

Note 13 – Commitments and contingencies

We offer a one-year limited warranty on most hardware products, with a two or three-year warranty on a subset of our hardware products, which is included in the sales price of many of our products. Provision is made for estimated

future warranty costs at the time of the sale, for the estimated costs that may be incurred under the basic limited warranty. Our estimate is based on historical experience and product sales during this period.

The warranty reserve for the nine month periods ended September 30, 2010 and 2009, was as follows (in thousands):.

| | Nine Months Ended September 30, (unaudited) | |
|---|---|----------|
| | 2010 | 2009 |
| Balance at the beginning of the period | \$921 | \$952 |
| Accruals for warranties issued during the period | 1,485 | 1,518 |
| Settlements made(in cash or in kind) during the period | (1,483) | (1,551) |
| Balance at the end of the period | \$923 | \$919 |

As of September 30, 2010, we have outstanding guarantees for payment of foreign operating leases, customs and foreign grants totaling approximately \$2.0 million.

As of September 30, 2010, we have non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately \$8.9 million over the next twelve months.

Note 14 – Recently issued accounting pronouncements

In October 2009, the FASB updated FASB ASC 605, Revenue Recognition (FASB ASC 605) that amended the criteria for separating consideration in multiple-deliverable arrangements. The amendments establish a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. The amendments will change the application of the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. The relative selling price method allocates any discount in the arrangement proportionally to each deliverable on the basis of each deliverable's selling price. This update will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. We are currently evaluating the requirements of this update and have not yet determined the impact on our consolidated financial statements.

In October 2009, the FASB updated FASB ASC 985, Software (FASB ASC 985) that changes the accounting model for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality are no longer within the scope of the software revenue guidance in Subtopic 985-605. In addition, the amendments require that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. This update will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. We are currently evaluating the requirements of this update and have not yet determined the impact on our consolidated financial statements.

In January 2010, the FASB updated FASB ASC 820, Fair Value Measurements and Disclosures (FASB ASC 820) that requires additional disclosures and clarifies existing disclosures regarding fair value measurements. The additional disclosures include 1) transfers in and out of Levels 1 and 2 and 2) activity in Level 3 fair value measurements. The update provides amendments that clarify existing disclosures on 1) level of disaggregation and 2) disclosures about inputs and valuation techniques. This update is effective for interim and annual reporting periods

beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. These disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We adopted the update on January 1, 2010 as required and concluded it did not have a material impact on our consolidated financial position or results of operations.

In February 2010, the FASB updated FASB ASC 855, Subsequent Events (FASB ASC 855) that requires an entity that is an SEC filer to evaluate subsequent events through the date that the financial statements are issued. For an SEC filer, this guidance also eliminates the required disclosure of the date through which subsequent events are evaluated. This update is effective upon issuance. We adopted the update on January 1, 2010 as required and concluded it did not have a material impact on our consolidated financial position or results of operations.

Note 15 – Litigation

We filed a patent infringement action on January 25, 2001, in the U.S. District Court, Eastern District of Texas (Marshall Division) claiming that The MathWorks, Inc. (“MathWorks”) infringed certain of our U.S. patents. On January 30, 2003, a jury found infringement by MathWorks of three of the patents involved and awarded us specified damages. On September 23, 2003, the District Court entered final judgment in favor of us and entered an injunction against MathWorks’ sale of its Simulink and related products and stayed the injunction pending appeal. Upon appeal, the judgment and the injunction were affirmed by the U.S. Court of Appeals for the Federal Circuit (September 3, 2004). Subsequently the stay of injunction was lifted by the District Court. In November 2004, the final judgment amount of \$7.4 million which had been held in escrow pending appeal was released to us.

An action was filed by MathWorks against us on September 22, 2004, in the U.S. District Court, Eastern District of Texas (Marshall Division), claiming that on that day MathWorks had released modified versions of its Simulink and related products, and seeking a declaratory judgment that the modified products do not infringe the three patents adjudged infringed in the District Court's decision of September 23, 2003 (and affirmed by the Court of Appeals on September 3, 2004). On November 2, 2004, MathWorks served the complaint on us. We filed an answer to MathWorks’ declaratory judgment complaint, denying MathWorks’ claims of non-infringement and alleging our own affirmative defenses. On January 5, 2005, the Court denied a contempt motion by us to enjoin the modified Simulink products under the injunction in effect from the first case. On January 7, 2005, we amended our answer to include counterclaims that MathWorks’ modified products are infringing three of our patents, and requested unspecified damages and an injunction. MathWorks filed its reply to our counterclaims on February 7, 2005, denying the counterclaims and alleging affirmative defenses. On March 2, 2005, we filed a notice of appeal regarding the Court's denial of the contempt motion. On March 15, 2005, the Court stayed MathWorks’ declaratory judgment action, pending a decision on the appeal by the Court of Appeals for the Federal Circuit. On February 9, 2006, the Court of Appeals for the Federal Circuit affirmed the District Court’s January 2005 order. On November 22, 2006, the District Court lifted the stay. The case schedule has yet to be set in this action. During the fourth quarter of 2004, we accrued \$4 million related to our probable loss from this contingency, which consists entirely of anticipated patent defense costs that are probable of being incurred. In the fourth quarter of 2006, we accrued an additional \$600,000 related to this contingency. During the third quarter of 2009, we reduced the accrual by \$2 million and during the first quarter of 2010, we reduced the accrual by an additional \$1,037,000 to reflect a decrease in the estimated costs that are probable of being incurred in this action. To date, we have charged a cumulative total of \$638,000 against this accrual. At September 30, 2010, the remaining accrual was \$925,000.

Note 16 – Subsequent events

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

On October 19, 2010, our Board of Directors declared a quarterly cash dividend of \$0.13 per common share, payable on November 19, 2010, to shareholders of record on November 8, 2010.

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Any statements contained herein regarding our future financial performance or operations (including, without limitation, statements to the effect that we "believe," "expect," "plan," "may," "will," "project," "continue," or "estimate" or other variations thereof or comparable terminology or the negative thereof) should be considered forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of important factors, including those set forth under the heading "Risk Factors" beginning on page 37, and the discussion below. Readers are also encouraged to refer to the documents regularly filed by us with the Securities and Exchange Commission, including our Annual Report on Form 10-K, for further discussion of our business and the risks attendant thereto.

Overview

National Instruments Corporation ("we", "us" or "our") is a leading supplier of measurement and automation products that engineers and scientists use in a wide range of industries. These industries comprise a large and diverse market for design, control and test applications. We provide flexible application software and modular, multifunctional hardware that users combine with industry-standard computers, networks and third party devices to create measurement, automation and embedded systems, which we also refer to as "virtual instruments". Our approach gives customers the ability to quickly and cost-effectively design, prototype and deploy unique custom-defined solutions for their design, control and test application needs. We sell to a large number of customers in a wide variety of industries. No single customer accounted for more than 5% and 4% of our sales in the three and nine month periods ended September 30, 2010, respectively, or 3% of our sales in the years 2009, 2008 or 2007.

The key strategies that management focuses on in running our business are the following:

Expanding our broad customer base

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

Maintaining a high level of customer satisfaction

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

Leveraging external and internal technology

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

We sell into test and measurement ("T&M") and industrial/embedded applications in a broad range of industries and as such are subject to the economic and industry forces which drive those markets. It has been our experience that the

performance of these industries and our performance is impacted by general trends in industrial production for the global economy and by the specific performance of certain vertical markets that are intensive consumers of measurement technologies. Examples of these markets are semiconductor capital equipment, telecom, defense, aerospace, automotive and others. In assessing our business, we consider the trends in the Global Purchasing Managers Index (“PMI”) published by JP Morgan, global industrial production as well as industry reports on the specific vertical industries that we target. Since August 2009, the PMI has had readings above 50 which are indicative of expansion in the industrial global economy, although in recent months, the PMI has been declining. We are unable to predict whether the current expansion cycle, as measured by the PMI, will be sustained throughout 2010 or into 2011.

We distribute our software and hardware products primarily through a direct sales organization. We also use independent distributors, OEMs, VARs, system integrators and consultants to market our products. We have sales offices in the U.S. and sales offices and distributors in key international markets. Sales outside of the Americas accounted for approximately 56% and 54% of our revenues for the three month periods ended September 30, 2010 and 2009, respectively, and approximately 57% and 55% of our revenues for the nine month periods ended September 30, 2010 and 2009, 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 revenues will continue to be derived from international sales. (See Note 12 - Segment information of Notes to Consolidated Financial Statements for details concerning the geographic breakdown of our net sales, operating income, interest income and long-lived assets).

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

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

We have been profitable in every year since 1990. However, there can be no assurance that our net sales will grow or that we will remain profitable in future periods. 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.

Current business outlook

Many of the industries we serve have historically been cyclical and have experienced periodic downturns. Our customers across all industries and geographic regions demonstrated reduced order patterns throughout most of 2009. During the fourth quarter of 2009, we began to see positive trends in the order patterns of our customers and have seen those trends continue during the first nine months of 2010. These positive order trends are consistent with

the expansion we have seen in the global industrial economy as measured by the global PMI, which has risen from 50 in July 2009 to 53 in September 2010. We have seen these positive trends across all geographic regions and across all the vertical markets that we serve although the strength of the trend varies by region and by market. We believe it is likely that the peak of the global PMI for this cycle was reached during the second quarter of 2010 when it reached a high of 58. Moving forward, we expect that the global PMI will trend towards its historical mean and reflect a more moderate rate of expansion. Given the relatively low levels of global inventory, we believe the industrial economy is positioned to manage the moderation of the global PMI, and that we are positioned to grow revenue through this moderating trend. If this expansion cannot be sustained, it could have an adverse effect on the spending patterns of businesses including our current and potential customers which could adversely affect our revenues and therefore harm our business and result of operations. Our key strategies in this economic environment are to maintain a stable gross margin, to maintain a disciplined approach toward operating expenses, and to maintain strong employee productivity. As a result, we expect to increase our operating expenses at a rate closer to that of our revenue growth going forward.

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 | | Nine months Ended | |
|---|-----------------------|--------|-----------------------|--------|
| | September 30, 2010 | 2009 | September 30, 2010 | 2009 |
| Net sales: | | | | |
| Americas | 44.0 | % 45.7 | % 42.7 | % 44.6 |
| Europe | 27.2 | 28.3 | 28.5 | 30.1 |
| Asia Pacific | 28.8 | 26.0 | 28.8 | 25.3 |
| Consolidated net sales | 100.0 | 100.0 | 100.0 | 100.0 |
| Cost of sales | 23.5 | 25.4 | 23.1 | 26.0 |
| Gross profit | 76.5 | 74.6 | 76.9 | 74.0 |
| Operating expenses: | | | | |
| Sales and marketing | 36.1 | 39.4 | 37.4 | 41.9 |
| Research and development | 18.1 | 21.2 | 18.4 | 20.9 |
| General and administrative | 7.9 | 7.5 | 8.0 | 9.0 |
| Total operating expenses | 62.1 | 68.1 | 63.8 | 71.8 |
| Operating income | 14.4 | 6.5 | 13.1 | 2.2 |
| Other income (expense): | | | | |
| Interest income | 0.1 | 0.2 | 0.2 | 0.3 |
| Net foreign exchange gain (loss) | 0.2 | 0.5 | (0.4) | 0.3 |
| Other income, net | 0.1 | 0.3 | 0.1 | 0.2 |
| Income before income taxes | 14.8 | 7.5 | 13.0 | 3.0 |
| Provision for (benefit from) income taxes | 2.0 | 1.5 | 1.6 | (0.1) |
| Net income | 12.8 | % 6.0 | % 11.4 | % 3.1 |

Net Sales. Net sales were \$220 million and \$165 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 34%. For the nine month periods ended September 30, 2010 and 2009, net sales were \$623 million and \$475 million, respectively, an increase of 31%. These increases can be attributed to increases in sales volume across all areas of our business. Products in the areas of virtual instrumentation and graphical system design, which comprised approximately 93% of our revenue in the three and nine month periods ended September 30, 2010, saw year-over-year revenue increases of 34% and 31%, respectively. Instrument control products, which comprised approximately 7% of our revenue in each of the three and nine month periods ended September 30, 2010, saw year-over-year revenue increases of 25% and 41%, respectively. For the three and nine month periods ended

September 30, 2009, instrument control products comprised 7% of our revenues, respectively, while virtual instrumentation and graphical system design comprised 93%, respectively. Our instrument control products are the most economically sensitive portion of our revenue. We did not take any significant action with regard to product pricing during the three and nine month periods ended September 30, 2010, and thus, the increase in revenues is attributable to an increase in customer orders.

For the three month periods ended September 30, 2010 and 2009, sales in the Americas were \$97 million and \$75 million, respectively, an increase of 29%, sales in Europe were \$60 million and \$47 million, respectively, an increase of 28% and sales in Asia were \$64 million and \$43 million, respectively, an increase of 48%. We expect sales outside of the Americas to continue to represent a significant portion of our revenue. We intend to continue to expand our international operations by increasing our presence in existing markets, adding a presence in some new geographical markets and continuing the use of distributors to sell our products in some countries. Sales outside of the Americas, as a percentage of consolidated sales, increased to 56% for the three months ended September 30, 2010, from 54% for the same period in 2009.

For the nine month periods ended September 30, 2010 and 2009, sales in the Americas were \$266 million and \$212 million, respectively, an increase of 26%, sales in Europe were \$178 million and \$143 million, respectively, an increase of 24% and sales in Asia were \$179 million and \$120 million, respectively, an increase of 49%. Sales outside of the Americas, as a percentage of consolidated sales, increased to 57% for the nine months ended September 30, 2010 compared to 55% for the comparable period in 2009.

Almost all sales made by our direct sales offices in the non U.S. Americas, in Europe and in Asia Pacific are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in foreign currency exchange rates. For the three months ended September 30, 2010, in local currency terms, our consolidated sales increased by \$59 million or 36%, Americas sales increased by \$21 million or 28%, European sales increased by \$19 million or 40%, and sales in Asia Pacific increased by \$19 million or 45% compared to the three months ended September 30, 2009. During this same period, the change in exchange rates had the effect of decreasing our consolidated sales by \$5 million or 3%, increasing Americas sales by \$602,000 or 1%, decreasing European sales by \$7 million or 15%, and increasing sales in Asia Pacific by \$1.6 million or 4% compared to the three months ended September 30, 2009.

For the nine months ended September 30, 2010, in local currency terms, our consolidated sales increased by \$132 million or 28%, Americas sales increased by \$51 million or 24%, European sales increased by \$32 million or 23%, and sales in Asia Pacific increased by \$50 million or 41% compared to the nine months ended September 30, 2009. During this same period, the change in exchange rates had the effect of increasing our consolidated sales by \$12 million or 3%, increasing Americas sales by \$3 million or 2%, decreasing European sales by \$2 million or 1%, and increasing sales in Asia Pacific by \$10 million or 8% compared to the nine months ended September 30, 2009.

To help protect against a reduction in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue denominated in foreign currencies with forward and purchased option contracts. During the three and nine month periods ended September 30, 2010, these hedges had the effect of increasing our consolidated sales by \$1.4 million and \$4.4 million, respectively. These increases mostly occurred in Europe. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impacted on our consolidated sales for the three and nine month periods ended September 30, 2010 and 2009).

Gross Profit. Gross profit was \$169 million and \$123 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 37%. For the nine month periods ended September 30, 2010 and 2009, gross profit was \$479 million and \$352 million, respectively, an increase of 36%. As a percentage of net sales, gross margin was 77% and 75% for the three month periods ended September 30, 2010, and 2009, respectively, and 77% and 74%

for the nine month periods ended September 30, 2010, and 2009, respectively. The increases in gross profit in absolute dollars and as a percent of net sales for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, are attributed to increased sales volumes as well as our continued efforts to reduce costs throughout our manufacturing cycle.

For the three month periods ended September 30, 2010 and 2009, charges related to acquisition related intangibles and stock based compensation included in cost of goods sold were \$1.3 million and \$1.2 million, respectively. For each of the nine month periods ended September 30, 2010 and 2009, charges related to acquisition related intangibles and stock based compensation included in cost of goods sold were \$3.6 million. For the three month and nine month periods ended September 30, 2010, the net impact of foreign currency exchange rates had the effect of increasing our cost of goods sold by \$1.3 million and \$2.7 million, respectively.

Sales and Marketing. Sales and marketing expenses were \$79 million and \$65 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 22%. For the nine month periods ended September 30, 2010 and 2009, sales and marketing expenses were \$233 million and \$199 million, respectively, an increase of 17%. As a percentage of net sales, sales and marketing expenses were 36% and 39% for the three month periods ended September 30, 2010 and 2009, respectively and 37% and 42% for the nine month periods ended September 30, 2010 and 2009, respectively. Overall, the decrease in sales and marketing expense as a percentage of net sales were due to the 34% increase in net sales during the three months ended September 30, 2010, and the 31% increase in net sales during the nine months ended September 30, 2010, compared to the same periods in 2009.

For the three months ended September 30, 2010, the increase in sales and marketing expenses in absolute dollars was due to an increase in personnel related expenses of \$11 million which includes commissions, variable compensation and benefits as well as an increase in travel related expenses of \$1.8 million during the three months ended September 30, 2010, compared to the same period in 2009. These increases were partially offset by a decrease caused by the net impact of changes in foreign currency exchange rates of \$63,000. For the nine months ended September 30, 2010, the increase in sales and marketing expenses in absolute dollars was due to an increase in personnel related expenses of \$23 million which includes commissions, variable compensation and benefits, as well as an increase caused by the net impact of changes in foreign currency exchange rates of \$5 million. In addition, travel expenses increased by \$3.5 million during the nine months ended September 30, 2010, compared to the same period in 2009.

We plan to continue to make investments in our field sales force during the remainder of 2010. Our field sales expansion during the remainder of 2010 will likely be targeted to strategic areas of opportunity, whether technical or regional. We expect sales and marketing expenses in future periods to continue to fluctuate as a percentage of sales based on recruiting, marketing and advertising campaign costs associated with major new product releases and entry into new market areas, investment in web sales and marketing efforts, increasing product demonstration costs and the timing of domestic and international conferences and trade shows.

Research and Development. Research and development expenses were \$40 million and \$35 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 14%. For the nine month periods ended September 30, 2010 and 2009, research and development expenses were \$115 million and \$99 million, respectively, an increase of 16%. As a percentage of net sales, research and development expenses were 18% and 21% for the three month periods ended September 30, 2010 and 2009, respectively and 18% and 21% for the nine month periods ended September 30, 2010 and 2009, respectively. Overall, the decreases in research and development expenses as a percentage of net sales were due to the 34% increase in net sales during the three months ended September 30, 2010, and the 31% increase in net sales during the nine months ended September 30, 2010, compared to the same periods in 2009.

For the three months ended September 30, 2010, the increase in research and development expenses in absolute dollars was due to an increase in personnel related expenses of \$7 million which includes variable compensation and benefits, offset slightly by a decrease caused by the net impact of changes in foreign currency exchange rates of

\$14,000. For the nine months ended September 30, 2010, the increase in research and development expenses in absolute dollars was due to an increase in personnel related expenses of \$17 million which includes commissions, variable compensation and benefits, as well as an increase caused by the net impact of changes in foreign currency exchange rates of \$1.4 million. We plan to continue to make additional, targeted investments in our research and development group during the remainder of 2010 and into 2011.

We capitalize software development costs in accordance with FASB ASC 985. We amortize such costs over the related product's estimated economic life, generally three years, beginning when a product becomes available for general release. Software amortization expense included in cost of goods sold totaled \$2.8 million and \$2.5 million during the three month periods ended September 30, 2010 and 2009, respectively, and \$8 million and \$7 million during the nine month periods ended September 30, 2010 and 2009, respectively. Internally developed software costs capitalized during the three month periods ended September 30, 2010 and 2009, were \$3.4 million and \$1.3 million, respectively, and \$15 million and \$11 million during the nine month periods ended September 30, 2010 and 2009, respectively. Capitalization of internally developed software costs varies depending on the timing of when each project reaches technological feasibility and the length and scope of the development cycle of each individual project. (See Note 7 - Intangibles of Notes to Consolidated Financial Statements for a description of intangibles).

General and Administrative. General and administrative expenses were \$17 million and \$12 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 41%. For the nine month periods ended September 30, 2010 and 2009, general and administrative expenses were \$50 million and \$43 million, respectively, an increase of 16%. As a percentage of net sales, general and administrative expenses were 8% for each of the three month periods ended September 30, 2010 and 2009, and 8% and 9% for the nine month periods ended September 30, 2010 and 2009, respectively. For the three months ended September 30, 2010, the increase in general and administrative expenses in absolute dollars was due to an increase in personnel related expenses of \$2.0 million which includes variable compensation and benefits, as well as an increase in legal expenses of \$2.0 million. This was partially offset by a decrease caused by the net impact of changes in foreign currency exchange rates of \$367,000. For the nine months ended September 30, 2010, the increase in general and administrative expenses in absolute dollars was due to an increase in personnel related expenses of \$4.1 million which includes, variable compensation and benefits, as well as an increase in legal expenses and outside services of \$2 million. In addition, there was an increase due to net impact of changes in foreign currency exchange rates of \$562,000.

Interest Income. Interest income was \$380,000 and \$339,000 for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 12%. This increase is attributable to an increase in invested funds. For the nine month periods ended September 30, 2010 and 2009, interest income was \$1.1 million and \$1.3 million, respectively, a decrease of 21%. This decrease is attributable to continued low yields for high quality investment alternatives that comply with our corporate investment policy. We do not expect yields in these types of investments to increase during the remainder of 2010. The source of interest income is from the investment of our cash and short-term and long-term investments.

Net Foreign Exchange Gain (Loss). Net foreign exchange gain/(loss) was \$426,000 and \$940,000 million for the three month periods ended September 30, 2010 and 2009, respectively. For the nine month periods ended September 30, 2010 and 2009, net foreign exchange gain/(loss) was \$(2.5) million and \$1.3 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 nine months ended September 30, 2010, the movement in many of these exchanges rates was volatile, exceeding 20% in some cases. This volatility reduced the effectiveness of our hedging programs. We cannot predict whether this level of volatility will continue or subside during the remainder of 2010. 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 hedge item attributable to the hedged risk is recognized in current earnings under the line item "Net foreign exchange gain (loss)". Our hedging strategy reduced our foreign exchange gain by \$2.2 million and reduced our foreign exchange gain by \$1.6 million during the three month periods ended September 30, 2010 and 2009, respectively, and increased our foreign exchange losses by \$857,000 and reduced our foreign exchange losses by \$4 million during the nine month periods ended September 30, 2010 and 2009, respectively.

To help protect against the change in the value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales and expenses over the next one to two years, we have a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue and forecasted expenses denominated in foreign currencies with forward and option contracts. For forward contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the forward contracts designated as hedges. For purchased option contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the option contracts designated as hedges, net of the premium paid. Our foreign currency purchased option contracts are purchased "at-the-money" or "out-of-the-money." We purchase foreign currency forward and option contracts for up to 100% of our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, British pound sterling and Hungarian forint) and limit the duration of these contracts to 40 months or less. As a result, our hedging activities only partially address our risks from foreign currency transactions, and there can be no assurance that this strategy will be successful. We do not invest in contracts for speculative purposes. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for a description of our forward and purchased option contracts and hedged positions).

Provision for Income Taxes. Our provision for income taxes reflected an effective tax rate of 14% and 20% for the three month periods ended September 30, 2010 and 2009, respectively, and 12% and (4)% for the nine month periods ended September 30, 2010 and 2009, respectively. The changes in our effective tax rates for the three and nine month periods ended September 30, 2010, compared to September 30, 2009, were due to the following:

| | Three Months Ended September 30 | | Nine months Ended September 30 | |
|---|---|----|--|----|
| Effective tax rate for the three and nine months periods ended September 30, 2009 | 20 | % | (4 |)% |
| Decrease in unrecognized tax benefits for uncertain tax positions as a percent of net income | 8 | % | 8 | % |
| Change in valuation allowance related to deferred tax assets recorded during the period | 9 | % | 37 | % |
| Increased profits in foreign jurisdictions with reduced income tax rates | (17 |)% | (17 |)% |
| Decrease in non-deductible stock-based compensation expense as a percentage of net income | (5 |)% | (5 |)% |
| Enhanced deduction for certain research and development expenses in 2010 | (12 |)% | (12 |)% |
| Decrease in the tax benefit from equity awards that do not ordinarily result in a tax benefit | 1 | % | 1 | % |
| Other | 5 | % | (1 |)% |
| Expiration of the research and development tax credit as of December 31, 2009 | 5 | % | 5 | % |
| Effective tax rate for the three and nine month periods ended September 30, 2010 | 14 | % | 12 | % |

(See Note 9 - Income taxes of Notes to Consolidated Financial Statements for further discussion regarding our income taxes).

Liquidity and Capital Resources

Working Capital, Cash and Cash Equivalents and Short-term Investments. The following table presents our working capital, cash and cash equivalents and marketable securities (in thousands):

| | September 30, 2010 (unaudited) | December 31, 2009 | Increase/ (Decrease) |
|---|--------------------------------------|----------------------|-------------------------|
| Working capital | \$449,706 | \$413,759 | \$35,947 |
| Cash and cash equivalents (1) | 226,844 | 201,465 | 25,379 |
| Short-term investments (1) | 111,903 | 87,196 | 24,707 |
| Total cash, cash equivalents and short-term investments | \$338,747 | \$288,661 | \$50,086 |

(1) Included in working capital

Our working capital increased by \$36 million at September 30, 2010, compared to December 31, 2009, due to the net effect of an increase in current assets of \$87 million offset by an increase in current liabilities of \$51 million. The increase in our current assets was attributed to the increase in our cash, cash equivalents and short-term investments of \$50 million, an increase in accounts receivable of \$18 million, an increase in inventory of \$15 million and an increase in prepaid expenses and other current assets of \$6 million. The increase in our current liabilities was the result of an increase in our accrued compensation of \$24 million, an increase in accounts payable and other accruals and liabilities of \$20 million and an increase in deferred revenue of \$7 million. These increases can be attributed to our overall business growth during the nine months ended September 30, 2010.

Our cash and cash equivalent balances are held in numerous financial institutions throughout the world, including substantial amounts held outside of the U.S., however, the majority of our cash and investments that are located outside of the U.S. are denominated in the U.S. dollar with the exception of \$33 million U.S. dollar equivalent that is denominated in Euro. Most of the amounts held outside of the U.S. could be repatriated to the U.S., but under current law, would be subject to U.S. federal income taxes, less applicable foreign tax credits. In some countries, repatriation of certain foreign balances is restricted by local laws. We have provided for the U.S. federal tax liability on these amounts for financial statement purposes, except for foreign earnings that are considered indefinitely reinvested outside of the U.S. Repatriation, and could result in additional U.S. federal income tax payments in future years. We utilize a variety of tax planning and financing strategies with the objective of having our worldwide cash available in the locations in which it is needed.

Cash Provided and (Used) in 2010 and 2009. Cash and cash equivalents increased to \$227 million at September 30, 2010 from \$201 million at December 31, 2009. The following table summarizes the proceeds and (uses) of cash (in thousands):

| | Nine months Ended September 30, 2010 2009 (unaudited) | |
|--|---|-----------|
| Cash provided by operating activities | \$117,744 | \$90,345 |
| Cash (used by) investing activities | (57,855) | (55,793) |
| Cash (used by) financing activities | (34,510) | (31,252) |
| Net increase in cash equivalents | 25,379 | 3,300 |
| Cash and cash equivalents at beginning of period | 201,465 | 229,400 |

| | | |
|--|-----------|-----------|
| Cash and cash equivalents at end of period | \$226,844 | \$232,700 |
|--|-----------|-----------|

For the nine month periods ended September 30, 2010 and 2009, cash provided by operating activities was \$118 million and \$90 million, an increase of 30%. This increase was primarily due to an increase in net income of \$56 million offset by a net use of cash by operating assets and liabilities of \$28 million compared to the nine months ended September 30, 2009.

Accounts receivable increased to \$122 million at September 30, 2010, compared to \$104 million at December 31, 2009. Days sales outstanding was 49 days at September 30, 2010, compared to 61 days at December 31, 2009. We typically bill customers on an open account basis subject to our standard net thirty day payment terms. If, in the longer term, our revenue increases, it is likely that our accounts receivable balance will also increase. Our accounts receivable could also increase if customers delay their payments or if we grant extended payment terms to customers, both of which are more likely to occur during challenging economic times when our customers may face issues gaining access to sufficient funding or credit.

Consolidated inventory balances increased to \$102 million at September 30, 2010, from \$87 million at December 31, 2009. Inventory turns were 2.0 at September 30, 2010, compared to 1.8 at December 31, 2009. The increase in inventory during the nine months ended September 30, 2010, was driven by an increase in our manufacturing activities in response to the positive order trends we have seen over the first nine months of 2010. Our inventory levels will continue to be determined based upon our anticipated demand for products and our need to keep sufficient inventory on hand to meet our customers' demands. Such considerations are balanced against the risk of obsolescence or potentially excess inventory levels. Rapid changes in customer demand could have a significant impact on our inventory balances in future periods.

For the nine month periods ended September 30, 2010 and 2009, cash used by investing activities was \$58 million and \$56 million, an increase of 4%. This increase was primarily due to an increase in capital expenditures of \$2.1 million and an increase in capitalized software of \$3.7 million compared to the nine months ended September 30, 2009. This was offset by a decrease in the net purchase of short-term investments of \$4.1 million.

For the nine month periods ended September 30, 2010 and 2009, cash used by financing activities was \$35 million and \$31 million, an increase of 10%. This increase was primarily due to an increase in proceeds received from the issuance of common stock through our employee stock purchase plan as well as from the exercise of outstanding stock options of \$22 million, offset by an increase in cash used for the repurchase of our common stock of \$24 million and an increase in dividends paid to our shareholders of \$2.5 million, compared to the nine months ended September 30, 2009.

From time to time, our Board of Directors has authorized various programs to repurchase shares of our common stock depending on market conditions and other factors. Under such programs, we repurchased a total of 1,392,732 shares of our common stock at a weighted average price per share of \$30.06 during the nine months ended September 30, 2010, and 1,443,441 and 4,110,042 shares of our common stock at weighted average prices of \$23.96 and \$25.22 per share, in the years ended December 31, 2009 and 2008, respectively.

On April 21, 2010, our Board of Directors approved a new share purchase plan which increased the aggregate number of shares of common stock that we are authorized to repurchase from 674,098 to 3.0 million. This repurchase program does not have an expiration date.

During the nine months ended September 30, 2010, we received increased proceeds from the exercise of stock options compared to the nine months ended September 30, 2009. The timing and number of stock option exercises and the amount of cash proceeds we receive through those exercises are not within our control and in the future, we may not generate as much cash from the exercise of stock options as we have in the past. Moreover, since 2005 it has been our practice to issue RSUs and not stock options to eligible employees which will reduce the number of stock options

available for exercise in the future. Unlike the exercise of stock options, the issuance of shares upon vesting of RSUs does not result in any cash proceeds to us. (See Note 11 - Stock-based compensation plans for additional discussion of our various stock-based compensation plans).

Contractual Cash Obligations. Purchase obligations primarily represent purchase commitments for customized inventory and inventory components. As of September 30, 2010, we have non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately \$9 million. At December 31, 2009, we had non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately \$7 million.

Guarantees are related to payments of customs and foreign grants. As of September 30, 2010, we have outstanding guarantees for payment of customs and foreign grants totaling approximately \$2.0 million. As of December 31, 2009, we had outstanding guarantees for payment of customs and foreign grants totaling approximately \$5 million.

Off-Balance Sheet Arrangements. We do not have any debt or off-balance sheet debt. As of September 30, 2010 and December 31, 2009, we did not have any relationships with any unconsolidated entities or financial partnerships, such as entities often referred to as structured finance entities, which would have been established for the purpose of facilitating off-balance sheet arrangements. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we were engaged in such relationships.

Prospective Capital Needs. We believe that our existing cash, cash equivalents and marketable securities, together with cash generated from operations and from the exercise of employee stock options and the purchase of common stock through our employee stock purchase plan, will be sufficient to cover our working capital needs, capital expenditures, investment requirements, commitments, payment of dividends to our stockholders and repurchases of our common stock for at least the next 12 months. However, we may choose or be required to raise additional funds by selling equity or debt securities to the public or to selected investors, or by borrowing money from financial institutions. Historically, we have not had to rely on debt, public or private, to fund our operating, financing or investing activities. We could also choose or be required to reduce certain expenditures, such as payments of dividends or repurchases of our common stock. In addition, even though we may not need additional funds, we may still elect to sell additional equity or debt securities or obtain credit facilities for other reasons. If we elect to raise additional funds, we may not be able to obtain such funds on a timely basis or on acceptable terms, if at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing stockholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of our common stock.

Although we believe that we have sufficient capital to fund our activities for at least the next 12 months, our future capital requirements may vary materially from those now planned. We anticipate that the amount of capital we will need in the future will depend on many factors, including:

- general economic and political conditions and specific conditions in the markets we address, including the continuing fluctuations in the industrial economy, and current general economic conditions and trends in the industrial economy in the various geographic regions in which we do business;
- the inability of certain of our customers who depend on credit to have access to their traditional sources of credit to finance the purchase of products from us, particularly if credit market conditions remain uncertain or worsen, which may lead them to reduce their level of purchases or to seek credit or other accommodations from us;
 - the overall levels of sales of our products and gross profit margins;
- our business, product, capital expenditure and research and development plans, and product and technology roadmaps;
 - repurchases of our common stock;
 - required levels of research and development and other operating costs;
 - litigation expenses, settlements and judgments;

- the levels of inventory and accounts receivable that we maintain;
- acquisitions of other businesses, assets, products or technologies;
 - capital improvements for new and existing facilities;
 - our relationships with suppliers and customers; and,
- the level of exercises of stock options and stock purchases under our employee stock purchase plan.

Recently Issued Accounting Pronouncements

See Note 14 - Recently Issued Accounting Pronouncements in Notes to Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Response to this item is included in “Item 2 - Management's Discussion and Analysis of Financial Conditions and Results of Operations” above.

Financial Risk Management

Our international sales are subject to inherent risks, including fluctuations in local economies; fluctuations in foreign currencies relative to the U.S. dollar; difficulties in staffing and managing foreign operations; greater difficulty in accounts receivable collection; costs and risks of localizing products for foreign countries; unexpected changes in regulatory requirements, tariffs and other trade barriers; difficulties in the repatriation of earnings and burdens of complying with a wide variety of foreign laws. The vast majority of our sales outside of North America are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in the foreign currency exchange rates. The change in exchange rates had the effect of decreasing our consolidated sales by \$5 million or 3% and increasing our consolidated sales by \$12 million or 3% for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, respectively. If the local currencies in which we sell our products strengthen against the U.S. dollar, we may need to lower our prices in the local currency to remain competitive in our international markets which could have a material adverse effect on our gross and net profit margins. If the local currencies in which we sell our products weaken against the U.S. dollar and if the local sales prices cannot be raised due to competitive pressures, we will experience a deterioration of our gross and net profit margins. Since most of our international operating expenses are also incurred in local currencies, the change in exchange rates had the effect of decreasing our operating expenses by \$416,000 or 0.4% and increasing our operating expenses by \$7 million or 2% for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, respectively. Currently, we are experiencing significant volatility in foreign currency exchange rates in many of the markets in which we do business. This has had a significant impact on the revaluation of our foreign currency denominated firm commitments and on our ability to forecast our U.S. dollar equivalent revenues and expenses. In the past, these dynamics have also adversely affected our revenue growth in international markets and will likely pose similar challenges in the future. To help protect against changes in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue, cost of sales and operating expenses denominated in foreign currencies with forward and purchased option contracts. During the three and nine month periods ended September 30, 2010, these hedges had the effect of increasing our consolidated sales by \$1.4 million and \$4.4 million, respectively, decreasing our cost of sales by \$374,000 and \$1.8 million, respectively, and decreasing our operating expenses by \$266,000 and \$853,000, respectively. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impacted on our consolidated sales, cost of sales and operating expenses for the three and nine month periods ended September 30, 2010 and 2009).

Inventory Management

The marketplace for our products dictates that many of our products be shipped very quickly after an order is received. As a result, we are required to maintain significant inventories. Therefore, inventory obsolescence is a risk for us due to frequent engineering changes, shifting customer demand, the emergence of new industry standards and rapid technological advances including the introduction by us or our competitors of products embodying new technology. While we adjust for excess and obsolete inventories and we monitor the valuation of our inventories, there can be no assurance that our valuation adjustments will be sufficient.

Market Risk

We are exposed to a variety of risks, including foreign currency fluctuations and changes in the market value of our investments. In the normal course of business, we employ established policies and procedures to manage our exposure to fluctuations in foreign currency values and changes in the market value of our investments.

Cash, Cash Equivalents and Short-Term Investments

At September 30, 2010, we had \$339 million in cash, cash equivalents and short-term investments. We maintain cash and cash equivalents and short-term investments with various financial institutions located in many countries throughout the world. Approximately \$176 million or 52% of these amounts were held in domestic accounts with various financial institutions and \$163 million or 48% was held in accounts outside of the U.S. with various financial institutions. At September 30, 2010, \$81 million or 36% of our cash and cash equivalents was held in cash in various operating accounts throughout the world, and \$146 million or 64% was held in money market accounts. The most significant of our operating accounts was our domestic operating account which held approximately \$14 million or 6% of our total cash and cash equivalents at a bank that carried an A1 rating at September 30, 2010. Our short-term investment balance was comprised of \$59 million or 52% held in our investment accounts in the U.S. and \$53 million or 48% held in investment accounts of our foreign subsidiaries.

We maintain an investment portfolio of various types of security holdings and maturities. Cash equivalents and short-term investments available-for-sale are valued using a market approach (Level 1) based on the quoted market prices of identical instruments when available or other observable inputs such as trading prices of identical instruments in active markets.

The goal of our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing the return on our investment portfolio through the full investment of available funds. We place our cash investments in instruments that meet credit quality standards, as specified in our corporate investment policy guidelines. These guidelines also limit the amount of credit exposure to any one issue, issuer or type of instrument. Our cash equivalents and short-term investments carried ratings from the major credit rating agencies that were in accordance with our corporate investment policy. Our investment policy allows investments in the following; government and federal agency obligations, repurchase agreements (“Repos”), certificates of deposit and time deposits, corporate obligations, medium term notes and deposit notes, commercial paper including asset-backed commercial paper (“ABCP”), puttable bonds, general obligation and revenue bonds, money market funds, taxable commercial paper, corporate notes/bonds, municipal notes, municipal obligations, variable rate demand notes and tax exempt commercial paper. All such instruments must carry minimum ratings of A1/P1/F1, MIG1/VMIG1/SP1 and A2/A/A, as applicable, all of which are considered “investment grade”. Our investment policy for marketable securities requires that all securities mature in three years or less, with a weighted average maturity of no longer than 18 months with at least 10% maturing in 90 days or less.

We account for our investments in debt and equity instruments under FASB ASC 320 Investments – Debt and Equity Securities (FASB ASC 320). Our investments are classified as available-for-sale and accordingly are reported at fair value, with unrealized gains and losses reported as other comprehensive income, a component of shareholders’ equity. Unrealized losses are charged against income when a decline in fair value is determined to be other than temporary. Investments with maturities beyond one year are classified as short-term based on their highly liquid nature and

because such marketable securities represent the investment of cash that is available for current operations. The fair value of our short-term investments at September 30, 2010 and December 31, 2009 was \$112 million and \$87 million, respectively. The increase was due to the net purchase of \$25 million of short-term investments which was done to continue the diversification our holdings from money market accounts to debt securities and to take advantage of higher yields associated with longer maturity debt securities.

We follow the guidance provided by FASB ASC 320 to assess whether our investments with unrealized loss positions are other than temporarily impaired. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in other income (expense), net, in our Consolidated Statements of Income.

Interest Rate Risk

Investments in both fixed rate and floating rate instruments carry a degree of interest rate risk. Fixed rate securities may have their market value adversely impacted due to an increase in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or if the decline in the fair value of our publicly traded debt investments is judged to be other-than-temporary. We may suffer losses in principal if we are forced to sell securities that have declined in market value due to changes in interest rates. However, because any debt securities we hold are classified as available-for-sale, no gains or losses are realized in our income statement due to changes in interest rates unless such securities are sold prior to maturity or unless declines in value are determined to be other-than-temporary. These securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), a component of shareholders' equity, net of tax.

In a declining interest rate environment, as short-term investments mature, reinvestment occurs at less favorable market rates. Given the short-term nature of certain investments, the current interest rate environment of low or declining rates will likely negatively impact our investment income.

In order to assess the interest rate risk associated with our investment portfolio, we performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of our investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on our investment positions as of September 30, 2010, a 100 basis point increase or decrease in interest rates across all maturities would result in a \$887,000 increase or decrease in the fair market value of our portfolio. As of December 31, 2009, a similar 100 basis point shift in the yield curve would have resulted in a \$614,000 increase or decrease in the fair market value of our portfolio. Such losses would only be realized if we sold the investments prior to maturity or if there is a other than temporary impairment.

Actual future gains and losses associated with our investments may differ from the sensitivity analyses performed as of September 30, 2010, due to the inherent limitations associated with predicting the changes in the timing and level of interest rates and our actual exposures and positions.

We have noted continued stabilization in the financial markets throughout 2010. As such, we have extended the maturity date of our holdings to include debt securities with maturities of up to 24 months to take advantage of the higher yields associated with longer maturities. However, yields, even at longer maturities, remain at or near historic lows. We weigh the benefit of the higher yields associated with longer maturities against the interest rate risk and credit rating risk, also associated with these longer maturities when making these decisions. We cannot predict when interest rates and investment yields will rise. If yields continue to stay at these low levels, our investment income will continue to be negatively impacted.

Exchange Rate Risk

Our objective in managing our exposure to foreign currency exchange rate fluctuations is to reduce the impact of adverse fluctuations in such exchange rates on our earnings and cash flow. Accordingly, we utilize purchased foreign currency option and forward contracts to hedge our exposure on anticipated transactions and firm commitments. The principal currencies hedged are the Euro, British pound, Japanese yen and Hungarian forint. We monitor our foreign exchange exposures regularly to help ensure the overall effectiveness of our foreign currency hedge positions. There can be no assurance that our foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchanges rates on our results of operations and financial position. Based on the foreign exchange instruments outstanding at September 30, 2010 and December 31, 2009, an adverse change (defined as 20% in the Asian currencies and 10% in all other currencies) in exchange rates would result in a decline in the aggregate settlement value of all of our instruments outstanding of approximately \$13 million and \$22 million, respectively. However, as we utilize foreign currency instruments for hedging anticipated and firmly committed transactions, we believe that a loss in settlement value for those instruments will be substantially offset by increases in the value of the underlying exposure. (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).

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer, Dr. James Truchard, and our Chief Financial Officer, Alex Davern, based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended), required by paragraph (b) of Rule 13a - 15 or Rule 15d - 15, have concluded that our disclosure controls and procedures were effective at the reasonable assurance level, to ensure the timely collection, evaluation and disclosure of information relating to us that would potentially be subject to disclosure under the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder, and that such information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file or submit is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute assurance that the control system's objectives will be met. We continue to enhance our internal control over financial reporting in key functional areas with the goal of monitoring our operations at the level of documentation, segregation of duties, and systems security necessary, as well as transactional control procedures required under Auditing Standard No. 5 issued by the Public Company Accounting Oversight Board. We discuss and disclose these matters to the audit committee of our board of directors and to our auditors. During the three months ended September 30, 2010, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of the Rule 13a - 15 or Rule 15d - 15 that have materially affected, or are likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 15 - Litigation in Notes to Consolidated Financial Statements.

ITEM 1A. RISK FACTORS

Uncertain Economic conditions could materially adversely affect our business. Our business is sensitive to fluctuations in general economic conditions, both in the U.S. and globally. Uncertainty about current global economic conditions poses a risk as businesses may postpone spending in response to tight credit, unemployment, negative financial news, new tax policies, uncertainty in foreign currency markets, and/or declines in income or asset values. This could negatively impact the spending patterns of businesses including our current and potential customers which may have an adverse effect on our revenues and therefore harm our business and results of operations. Other factors that could adversely influence demand for our products include increases in fuel and other energy costs, higher labor and healthcare costs, restricted access to credit, declining consumer confidence, and other macroeconomic factors affecting business spending patterns. Over the last 24 months, the global PMI has reflected these uncertain economic conditions by reaching a low of 33 in December of 2008 and rising to a high of 58 in April 2010. Historically, our business cycles have followed the expansion and contraction cycles in the global Purchasing Managers Index ("PMI"). During the nine months ended September 30, 2010, the PMI had an average reading of 55. A reading above 50 is indicative of expansion in the global industrial economy. Moving forward we expect that the global PMI will trend towards its historical mean and reflect a more moderate rate of expansion. However, we are unable to predict whether the current expansion cycle, as measured by the PMI, will be sustained throughout 2010 and 2011. If this expansion is not sustained, even at moderate levels, it could have an adverse effect on the spending patterns of businesses including our current and potential customers which could adversely affect our revenues and therefore harm our business and result of operations.

We Have Established a Budget and Variations From Our Budget Will Affect Our Financial Results. During the fourth quarter of 2009, we established an operating budget for 2010. Our budgets are established based on the estimated revenue from sales of our products which are based on economic conditions in the markets in which we do business as well as the timing and volume of our new products and the expected penetration of both new and existing products in the marketplace. If demand for our products in the last quarter of 2010 is less than the demand we anticipated in setting our 2010 budget, our operating results could be negatively impacted. If we exceed the level of expenses established in our 2010 operating budget or if we cannot reduce budgeted expenditures in response to a decrease in revenue, our operating results could be adversely affected. Our spending could exceed our budgets due to a number of factors, including:

- additional marketing costs for new product introductions and/or for conferences and tradeshows;
 - increased costs from hiring more product development engineers or other personnel;
 - additional costs associated with our incremental investment in our field sales force;
- increased manufacturing costs resulting from component supply shortages and/or component price fluctuations;
- increased component costs resulting from vendors increasing prices in response to increased economic activity;
 - additional expenses related to intellectual property litigation; and/or
 - additional costs related to acquisitions, if any.

We are Subject to Risks Associated with Our Centralization of Inventory and Distribution. Currently, shipments to our customers worldwide are primarily sourced from our warehouse facility in Debrecen, Hungary. Shipments to some of our customers in Asia are currently made either out of local inventory managed by our branch operations in

various Asian countries or from a centralized distribution point in Penang, Malaysia. We plan to continue to devote resources to centralizing our distribution to a limited number of shipping points. Our centralization of inventory and distribution from a limited number of shipping points is subject to inherent risks, including:

- burdens of complying with additional and/or more complex VAT and customs regulations; and,
- severe concentration of inventory increasing the risks associated with fire, natural disasters and logistics disruptions to customer order fulfillment.

No assurance can be given that our efforts will be successful. Any difficulties with the centralization of distribution or delays in the implementation of the systems or processes to support this centralized distribution could result in an interruption of our normal operations, including our ability to process orders and ship products to our customers. Any failure or delay in distribution from our facility in Hungary could have a material adverse effect on our operating results.

A Substantial Majority of Our Manufacturing Capacity is Located in Hungary. Our Hungarian manufacturing and warehouse facility sources a substantial majority of our sales. During the nine months ended September 30, 2010, we continued to maintain and enhance the systems and processes that support the direct shipment of product orders to our customers worldwide from our manufacturing facility in Hungary. In order to enable timely shipment of products to our customers we also maintain the vast majority of our inventory at our Hungary warehouse facility. In addition to being subject to the risks of maintaining such a concentration of manufacturing capacity and global inventory, this facility and its operation are also subject to risks associated with doing business internationally, including:

- difficulty in managing manufacturing operations in a foreign country;
 - challenges in expanding capacity to meet increased demand;
 - difficulty in achieving or maintaining product quality;
- interruption to transportation flows for delivery of components to us and finished goods to our customers;
 - changes in the country's political or economic conditions; and,
 - changes in the country's tax laws.

No assurance can be given that our efforts to mitigate these risks will be successful. We are currently operating our manufacturing facility in Hungary at a high level of capacity utilization and are selectively increasing our capacity to meet anticipated demand for our products. Any failure to effectively deal with the risks above could result in an interruption in the facility's operation or delays in expanding its capacity, either of which could have a material adverse effect on our operating results and limit our revenue growth opportunities.

In response to significant and frequent changes in the corporate tax law, the unstable political environment, a restrictive labor code, the volatility of the Hungarian forint relative to the U.S. dollar and increasing labor costs, we have doubts as to the long term viability of Hungary as a location for our manufacturing and warehousing operations.

Our long term manufacturing and warehousing capacity planning contemplates a third manufacturing and warehousing facility in Penang, Malaysia. We began warehousing and distribution operations out of Penang, Malaysia via a third party logistics provider on October 1, 2010. We plan to start construction of a manufacturing and logistics facility in Malaysia in the third quarter of 2011, and plan to begin manufacturing operations at our Penang location during the third quarter of 2012. We believe that deployment of our Malaysian manufacturing facility could be accelerated in response to an unfavorable change in the corporate taxation, regulatory or economic environment in Hungary. We can give no assurance that we will be successful deploying our new facility in Malaysia on schedule or in accelerating such deployment if we needed to. Our failure to successfully deploy our new facility in Malaysia or to accelerate the deployment of our Malaysian manufacturing facility in response to unfavorable changes in the corporate taxation, regulatory or economic environment in Hungary, could have a material adverse effect on our ability to meet customer demands, our ability to grow our business as well as our liquidity, capital resources and results of operations. If we succeed in deploying our Malaysian manufacturing facility on schedule and the demand for our products does

not grow as expected, we will have excess manufacturing capacity which will cause an increase in overhead that will negatively impact our gross margins and results of operations.

Concentrations of Credit Risk and Uncertain Conditions in the Global Financial Markets May Adversely Affect Our Financial Condition and Result of Operations. By virtue of our holdings of investment securities and foreign currency derivatives, we have exposure to many different counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks and investment banks. Many of these transactions expose us to credit risk in the event of a default of our counterparties. We have policies relating to initial credit rating requirements and to exposure limits to counterparties, which are designed to mitigate credit and liquidity risk. There can be no assurance, however, that any losses or impairments to the carrying value of our financial assets as a result of defaults by our counterparties, would not materially and adversely affect our business, financial position and results of operations.

Our Income Tax Rate is Affected by our Tax Benefits in Hungary. As a result of certain foreign investment incentives available under Hungarian law, the profit from our Hungarian operation was subject to a reduced income tax rate. This special tax status terminated on January 1, 2008, with the merger of our Hungarian manufacturing operations with its Hungarian parent company. In addition, effective January 1, 2010, a new tax law in Hungary provides for an enhanced deduction for the qualified research and development expenses of NI Hungary Software and Hardware Manufacturing Kft. (“NI Hungary”). During the three months ended December 31, 2009, we obtained confirmation of the application of this new tax law for the qualified research and development expenses of NI Hungary. Partial release of the valuation allowance on assets from the restructuring and the enhanced tax deduction for research expenses resulted in income tax benefits of \$4.5 million and \$1.7 million for the three month periods ended September 30, 2010, and 2009, respectively, and \$12.3 million and \$5.9 million for the nine month periods ended September 30, 2010, and 2009, respectively.

These benefits may not be available in future periods due to changes in Hungary’s political condition or tax laws. The reduction or elimination of these benefits in Hungary or future changes in U.S. law pertaining to taxation of foreign earnings could result in an increase in our future effective income tax rate which could have a material adverse effect on our operating results.

We Rely on Management Information Systems and any Disruptions in Our Systems Would Adversely Affect Us. We rely on a primary global center for our management information systems and on multiple systems in branches not covered by our global center. As with any information system, unforeseen issues may arise that could affect our ability to receive adequate, accurate and timely financial information, which in turn could inhibit effective and timely decisions. Furthermore, it is possible that our global center for information systems or our branch operations could experience a complete or partial shutdown. If such a shutdown occurred, it would impact our product shipments and revenues, as order processing and product distribution are heavily dependent on our management information systems. Accordingly, our operating results in such periods would be adversely impacted. We are continually working to maintain reliable systems to control costs and improve our ability to deliver our products in our markets worldwide. No assurance can be given that our efforts will be successful.

During the nine months ended September 30, 2010, we continued to devote resources to the development of our systems for manufacturing, sales and product services and to the continued development of our web offerings. There can be no assurance that we will not experience difficulties with our systems or web offerings. Difficulties with our systems or web offerings may interrupt our normal operations, including our ability to provide quotes, process orders, ship products, provide services and support to our customers, bill and track our customers, fulfill contractual obligations and otherwise run our business. Any disruption occurring with these systems or web offerings may have a material adverse effect on our operating results. During the nine months ended September 30, 2010, we devoted significant resources to the upgrade of our Americas business application suite to Oracle’s version R12. This upgrade was completed on July 4, 2010. These types of system wide upgrades have the potential to cause significant business disruptions. We have plans to mitigate these potential business disruptions but there is no certainty that our plans will

be effective should such a disruption occur. For the remainder of 2010, we expect to continue to devote resources to the continued development of our web applications and to finalize the upgrade of our Americas business application suite to Oracle's version R12. We currently plan to upgrade our business application suite outside of the Americas to Oracle's version R12 in the second half 2011. Any failure to successfully implement these initiatives could have a material adverse effect on our operating results.

Recent Adoption of Complex Health Care Legislation and Related Regulations and Financial Reform Could Increase our Operating Costs. The recent adoption of the Patient Protection and Affordable Care Act and the related reconciliation measure, the Health Care and Education Reconciliation Act of 2010, and the regulations resulting from such legislation could increase the costs of providing health care to our employees. Due to the complexity of the legislation and the uncertain timing and content of the related regulations, we are unable to predict the amount and timing of any such increased costs. In addition it is likely that we will incur additional administrative costs to comply with certain provisions of this legislation. Due to the fact that many of the rules and regulations have not yet been defined, we are unable to predict the amount of these costs or to what extent we may need to divert other resources to comply with various provisions of this legislation. Additionally, the recently adopted Dodd-Frank Wall Street Reform and Consumer Protection Act could result in increased costs to us either as a result of our efforts to comply with the corporate governance provisions which may be applicable to us or due to the impact of such legislation on the derivative contracts or other financial instruments or financial markets that we utilize in the normal course of our business.

Our Quarterly Results are Subject to Fluctuations Due to Various Factors. Our quarterly operating results have fluctuated in the past and may fluctuate significantly in the future due to a number of factors, including:

- changes in the economy or credit markets in the U.S. or globally;
 - changes in the mix of products sold;
- the availability and pricing of components from third parties (especially limited sources);
 - fluctuations in foreign currency exchange rates;
 - the timing, cost or outcome of intellectual property litigation;
- the difficulty in maintaining margins, including the higher margins traditionally achieved in international sales;
 - changes in pricing policies by us, our competitors or suppliers;
- delays in product shipments caused by human error or other factors; and,
 - disruptions in transportation channels.

Our Revenues are Subject to Seasonal Variations. In previous years, our revenues have been characterized by seasonality, with revenues typically growing from the first quarter to the second quarter, being relatively constant from the second quarter to the third quarter, growing in the fourth quarter compared to the third quarter and declining in the first quarter of the following year from the fourth quarter of the preceding year. This historical trend has been affected and may continue to be affected in the future by broad fluctuations in the global industrial economy, the economic impact of larger orders as well as the timing of new product introductions and/or acquisitions, if any. For example, our first quarter and second quarter of 2009 had sequential revenue declines from the fourth quarter of 2008 and first quarter of 2009, respectively, and the magnitude of the decline in the first quarter of 2009 was greater than what had occurred in the past. If the global industrial economy continues to grow and maintains stability throughout 2010 and 2011, we would expect to return to our typical historical revenue pattern. However, we cannot predict whether the global industrial economy will continue to grow or maintain stability throughout 2010 and 2011. We believe the historical pattern of seasonality of our revenue results from the international mix of our revenue and the variability of the budgeting and purchasing cycles of our customers throughout each international region. In addition, our total operating expenses have in the past tended to increase in each successive quarter and have fluctuated as a percentage of revenue based on the seasonality of our revenue. During 2009, we were able to reduce our operating costs compared to 2008. Some of the cost cutting measures implemented in 2009, such as salary reductions, were discontinued during the nine months ended September 30, 2010. During 2010, we plan to continue our strategic investments in research and development and field sales while limiting expense growth elsewhere.

We Operate in Intensely Competitive Markets. The markets in which we operate are characterized by intense competition from numerous competitors, some of which are divisions of large corporations having far greater resources than we have, and we may face further competition from new market entrants in the future. A key competitor is Agilent Technologies Inc. (“Agilent”). Agilent offers hardware and software products that provide solutions that directly compete with our virtual instrumentation products. Agilent is aggressively advertising and marketing products that are competitive with our products. Because of Agilent’s strong position in the instrumentation business, changes in its marketing strategy or product offerings could have a material adverse effect on our operating results.

We believe our ability to compete successfully depends on a number of factors both within and outside our control, including:

- new product introductions by competitors;
 - product pricing;
- the impact of foreign exchange rates on product pricing;
 - quality and performance;
 - success in developing new products;
- adequate manufacturing capacity and supply of components and materials;
 - efficiency of manufacturing operations;
- effectiveness of sales and marketing resources and strategies;
 - strategic relationships with other suppliers;
 - timing of our new product introductions;
- protection of our products by effective use of intellectual property laws;
 - the outcome of any material intellectual property litigation;
 - the financial strength of our competitors;
- barriers to entry imposed by competitors with significant market power in new markets;
 - general market and economic conditions; and,
 - government actions throughout the world.

There can be no assurance that we will be able to compete successfully in the future.

Our Product Revenues are Dependent on Certain Industries. Sales of our products are dependent on customers in certain industries, particularly the telecommunications, semiconductor, automotive, automated test equipment, defense and aerospace industries. As we have experienced in the past, and as we may continue to experience in the future, downturns characterized by diminished product demand in any one or more of these industries may result in decreased sales, and a material adverse effect on our operating results.

Our Success Depends on New Product Introductions and Market Acceptance of Our Products. The market for our products is characterized by rapid technological change, evolving industry standards, changes in customer needs and frequent new product introductions, and is therefore highly dependent upon timely product innovation. Our success is dependent on our ability to successfully develop and introduce new and enhanced products on a timely basis to replace declining revenues from older products, and on increasing penetration in domestic and international markets. As has occurred in the past and as may be expected to occur in the future, we have experienced significant delays between the announcement and the commercial availability of new products. Any significant delay in releasing new products could have a material adverse effect on the ultimate success of a product and other related products and could impede continued sales of predecessor products, any of which could have a material adverse effect on our operating results. There can be no assurance that we will be able to introduce new products in accordance with announced release dates, that new products will achieve market acceptance or that any such acceptance will be sustained for any significant period. Failure of our new products to achieve or sustain market acceptance could have a material adverse effect on our operating results. Moreover, there can be no assurance that our international sales will continue at

existing levels or grow in accordance with our efforts to increase foreign market penetration.

Our Business is Dependent on Key Suppliers. Our manufacturing processes use large volumes of high-quality components and subassemblies supplied by outside sources. Several of these components are available through limited sources. Limited source components purchased include custom application specific integrated circuits (“ASICs”), chassis and other components. We have in the past experienced delays and quality problems in connection with limited source components, and there can be no assurance that these problems will not recur in the future. Accordingly, our failure to receive components from limited suppliers could result in a material adverse effect on our revenues and operating results. In the event that any of our limited suppliers experience significant financial or operational difficulties due to adverse global economic conditions or otherwise, our business and operating results would likely be adversely impacted until we are able to secure another source for the required materials.

We May Experience Component Shortages. As has occurred in the past and as may be expected to occur in the future, supply shortages of components used in our products, including limited source components, can result in significant additional costs and inefficiencies in manufacturing. If we are unsuccessful in resolving any such component shortages in a timely manner, we will experience a significant impact on the timing of revenue, a possible loss of revenue, and/or an increase in manufacturing costs, any of which would have a material adverse impact on our operating results.

We are Subject to Risks Associated with Our Web Site. We devote resources to maintain our Web site as a key marketing, sales and support tool and expect to continue to do so in the future. However, there can be no assurance that we will be successful in our attempt to leverage the Web to increase sales. We host our Web site internally. Any failure to successfully maintain our Web site or any significant downtime or outages affecting our Web site could have a material adverse impact on our operating results.

Our Products are Complex and May Contain Bugs or Errors. As has occurred in the past and as may be expected to occur in the future, our new software products or new operating systems of third parties on which our products are based often contain bugs or errors that can result in reduced sales and/or cause our support costs to increase, either of which could have a material adverse impact on our operating results.

We are Subject to Various Risks Associated with International Operations and Foreign Economies. Our international sales are subject to inherent risks, including:

- fluctuations in local economies;
- fluctuations in foreign currencies relative to the U.S. dollar;
- difficulties in staffing and managing foreign operations;
 - greater difficulty in accounts receivable collection;
- costs and risks of localizing products for foreign countries;
 - unexpected changes in regulatory requirements;
 - tariffs and other trade barriers;
 - difficulties in the repatriation of earnings; and,
- the burdens of complying with a wide variety of foreign laws.

In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us such as the Foreign Corrupt Practices Act. Although we have policies and procedures designed to ensure compliance with these laws, there can be no assurance that all of our employees, contractors and agents, including those based in or from countries where practices which violate such U.S. laws may be customary, will not take actions in violation of our policies. Any violation of foreign or U.S. laws by our employees, contractors or agents, even if such violation is prohibited by our policies, could have a material adverse effect on our business. We must also comply with various import and export regulations. The application of these various regulations depends on the classification of our products which can change over time as such regulations

are modified or interpreted. As a result, even if we are currently in compliance with applicable regulations, there can be no assurance that we will not have to incur additional costs or take additional compliance actions in the future. Failure to comply with these regulations could result in fines and/or termination of import and export privileges, which could have a material adverse effect on our operating results. Additionally, the regulatory environment in some countries is very restrictive as their governments try to protect their local economy and value of their local currency against the U.S. dollar.

The vast majority of our sales outside of North America are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in the foreign currency exchange rates. The change in exchange rates had the effect of decreasing our consolidated sales by \$5 million or 3% and increasing our consolidated sales by \$12 million or 3% for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, respectively. If the local currencies in which we sell our products strengthen against the U.S. dollar, we may need to lower our prices in the local currency to remain competitive in our international markets which could have a material adverse effect on our gross and net profit margins. If the local currencies in which we sell our products weaken against the U.S. dollar and if the local sales prices cannot be raised due to competitive pressures, we will experience a deterioration of our gross and net profit margins. Since most of our international operating expenses are also incurred in local currencies, the change in exchange rates had the effect of decreasing our operating expenses by \$416,000 or 0.4% and increasing our operating expenses by \$7 million or 2% for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, respectively. Currently, we are experiencing significant volatility in foreign currency exchange rates in many of the markets in which we do business. This has had a significant impact on the revaluation of our foreign currency denominated firm commitments, on our ability to forecast our U.S. dollar equivalent revenues and expenses and on the effectiveness of our hedging programs. In the past, these dynamics have also adversely affected our revenue growth in international markets and will likely pose similar challenges in the future.

Our Business Depends on Our Proprietary Rights and We are Subject to Intellectual Property Litigation. Our success depends on our ability to obtain and maintain patents and other proprietary rights relative to the technologies used in our principal products. Despite our efforts to protect our proprietary rights, unauthorized parties may have in the past infringed or violated certain of our intellectual property rights. We from time to time engage in 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. We from time to time may be notified that we are infringing certain patent or intellectual property rights of others. There can be no assurance that any existing intellectual property litigation or any intellectual property litigation initiated in the future, will not result in significant litigation expense, liability, injunction against the sale of some of our products, and a diversion of management's attention, any of which may have a material adverse effect on our operating results.

Our Reported Financial Results May be Adversely Affected by Changes in Accounting Principles Generally Accepted in the United States. We prepare our financial statements in conformity with accounting principles generally accepted in the U.S. These accounting principles are subject to interpretation by the Financial Accounting Standards Board and the Securities and Exchange Commission. A change in these policies or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change.

Compliance With Sections 302 and 404 of the Sarbanes-Oxley Act of 2002 is Costly and Challenging. As required by Section 302 of the Sarbanes-Oxley Act of 2002, this Form 10-Q contains our managements' certification of adequate disclosure controls and procedures as of September 30, 2010. Our most recent annual report on Form 10-K also contains a report by our management on our internal control over financial reporting including an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2009. Our most recent Form 10-K also contains an attestation and report by our external auditors with respect to the effectiveness of our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act. While these assessments and reports did not reveal any material weaknesses in our internal control over financial reporting, compliance with Sections 302 and 404

is required for each future fiscal year end. We expect that the ongoing compliance with Sections 302 and 404 will continue to be both costly and challenging and there can be no assurance that material weaknesses will not be identified in future periods. Any adverse results from such ongoing compliance efforts could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.

Our Business Depends on the Continued Service of Key Management and Technical Personnel. Our success depends upon the continued contributions of our key management, sales, marketing, research and development and operational personnel, including Dr. Truchard, our Chairman and Chief Executive Officer, and other members of our senior management and key technical personnel. We have no agreements providing for the employment of any of our key employees for any fixed term and our key employees may voluntarily terminate their employment with us at any time. The loss of the services of one or more of our key employees in the future could have a material adverse effect on our operating results. We also believe our future success will depend upon our ability to attract and retain additional highly skilled management, technical, marketing, research and development, and operational personnel with experience in managing large and rapidly changing companies, as well as training, motivating and supervising employees. Our failure to attract or retain key technical or managerial talent could have an adverse effect on our operating results. We also recruit and employ foreign nationals to achieve our hiring goals primarily for engineering and software positions. There can be no guarantee that we will continue to be able to recruit foreign nationals at the current rate. There can be no assurance that we will be successful in retaining our existing key personnel or attracting and retaining additional key personnel. Failure to attract and retain a sufficient number of our key personnel could have a material adverse effect on our operating results.

Our Manufacturing Operations are Subject to a Variety of Environmental Regulations and Costs. We must comply with many different governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous chemicals used in our manufacturing operations in the U.S. and in Hungary. Although we believe that our activities conform to presently applicable environmental regulations, our failure to comply with present or future regulations could result in the imposition of fines, suspension of production or a cessation of operations. Any such environmental regulations could require us to acquire costly equipment or to incur other significant expenses to comply with such regulations. Any failure by us to control the use of or adequately restrict the discharge of hazardous substances could subject us to future liabilities.

We Are Subject to the Risk of Product Liability Claims. Our products are designed to provide information upon which users may rely. Our products are also used in “real time” applications requiring extremely rapid and continuous processing and constant feedback. Such applications give rise to the risk that a failure or interruption of the system or application could result in economic damage or bodily harm. We attempt to assure the quality and accuracy of the processes contained in our products, and to limit our product liability exposure through contractual limitations on liability, limited warranties, express disclaimers and warnings as well as disclaimers contained in our “shrink wrap” license agreements with end-users. If our products contain errors that produce incorrect results on which users rely or cause failure or interruption of systems or processes, customer acceptance of our products could be adversely affected. Further, we could be subject to liability claims that could have a material adverse effect on our operating results or financial position. Although we maintain liability insurance for product liability matters, there can be no assurance that such insurance or the contractual limitations used by us to limit our liability will be sufficient to cover or limit any claims which may occur.

Our Acquisitions are Subject to a Number of Related Costs and Challenges. We have from time to time acquired, and may in the future acquire, complementary businesses, products or technologies. Achieving the anticipated benefits of an acquisition depends upon whether the integration of the acquired business, products or technology is accomplished efficiently and effectively. In addition, successful acquisitions generally require, among other things, integration of product offerings, manufacturing operations and coordination of sales and marketing and R&D efforts. These difficulties can become more challenging due to the need to coordinate geographically separated organizations, the complexities of the technologies being integrated, and the necessities of integrating personnel with disparate business backgrounds and combining two different corporate cultures. The integration of operations following an acquisition

also requires the dedication of management resources, which may distract attention from our day-to-day business and may disrupt key R&D, marketing or sales efforts. The inability of our management to successfully integrate any future acquisition could harm our business. Some of the existing products previously sold by some of the entities we have acquired are of lesser quality than our products and/or could contain errors that produce incorrect results on which users rely or cause failure or interruption of systems or processes that could subject us to liability claims that could have a material adverse effect on our operating results or financial position. Furthermore, products acquired in connection with acquisitions may not gain acceptance in our markets, and we may not achieve the anticipated or desired benefits of such transaction.

Provisions in Our Charter Documents and Delaware Law and Our Stockholder Rights Plan May Delay or Prevent an Acquisition of Us. Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our Board of Directors. These provisions include a classified Board of Directors, prohibition of stockholder action by written consent, prohibition of stockholders to call special meetings and the requirement that the holders of at least 80% of our shares approve any business combination not otherwise approved by two-thirds of the Board of Directors. Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. In addition, our Board of Directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. Our Board of Directors adopted a stockholders rights plan on January 21, 2004, pursuant to which we declared a dividend of one right for each share of our common stock outstanding as of May 10, 2004. This rights plan replaced a similar rights plan that had been in effect since our initial public offering in 1995. Unless redeemed by us prior to the time the rights are exercised, upon the occurrence of certain events, the rights will entitle the holders to receive upon exercise thereof shares of our preferred stock, or shares of an acquiring entity, having a value equal to twice the then-current exercise price of the right. The issuance of the rights could have the effect of delaying or preventing a change of control of us.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information as of September 30, 2010 with respect to the shares of our common stock that we repurchased during the third quarter of 2010.

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs (1) |
|---|----------------------------------|------------------------------|--|--|
| July 1, 2010 to July 31, 2010 | - | - | - | 3,000,000 |
| August 1, 2010 to August 31, 2010 | 378,503 | \$28.87 | 378,503 | 2,621,497 |
| September 1, 2010 to September 30, 2010 | - | - | - | 2,621,497 |
| Total | 378,503 | \$28.87 | 378,503 | |

(1) For the past several years, we have maintained various stock repurchase programs. At December 31, 2009, there were 1,688,327 shares available for repurchase under the program approved in January 2009. On April 21, 2010, our Board of Directors approved a new share repurchase program that increased the aggregate number of shares

of common stock that we are authorized to repurchase from 674,098 to 3.0 million. This repurchase program does not have an expiration date.

ITEM 5. OTHER INFORMATION

From time to time our directors, executive officers and other insiders may adopt stock trading plans pursuant to Rule 10b5-1(c) promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended. Jeffrey L. Kodosky and James J. Truchard have made periodic sales of our stock pursuant to such plans.

ITEM 6. EXHIBITS

| | |
|-----------|--|
| 3.1(1) | Certificate of Incorporation, as amended, of the Company. |
| 3.2(2) | Amended and Restated Bylaws of the Company. |
| 3.3(3) | Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Company. |
| 4.1(4) | Specimen of Common Stock certificate of the Company. |
| 4.2(5) | Rights Agreement dated as of January 21, 2004, between the Company and EquiServe Trust Company, N.A. |
| 10.1(4) | Form of Indemnification Agreement. |
| 10.2(6) | 1994 Incentive Plan, as amended.* |
| 10.3(7) | 1994 Employee Stock Purchase Plan.* |
| 10.5(8) | 2005 Incentive Plan.* |
| 10.6(9) | National Instruments Corporation Annual Incentive Program.* |
| 10.7(10) | National Instruments Corporation Annual Incentive Program, as amended* |
| 10.8(11) | 2005 Form of Restricted Stock Unit Award Agreement (Non-Employee Director).* |
| 10.9(11) | 2005 Form of Restricted Stock Unit Award Agreement (Performance Vesting).* |
| 10.10(11) | 2005 Form of Restricted Stock Unit Award Agreement (Current Employee).* |
| 10.11(11) | 2005 Form of Restricted Stock Unit Award Agreement (Newly Hired Employee).* |
| 10.12(12) | 2010 Incentive Plan.* |
| 10.13(13) | 2010 Form of Restricted Stock Unit Award Agreement (Non-Employee Director).* |
| 10.14(14) | 2010 Form of Restricted Stock Unit Award Agreement (Performance Vesting).* |
| 10.15(15) | 2010 Form of Restricted Stock Unit Award Agreement (Current Employee).* |
| 10.16(16) | 2010 Form of Restricted Stock Unit Award Agreement (Newly Hired Employee).* |
| 31.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document ** |
| 101.SCH | XBRL Taxonomy Extension Schema Document ** |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document ** |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document ** |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document ** |

- (1) Incorporated by reference to the same-numbered exhibit filed with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.
- (2) Incorporated by reference to the same-numbered exhibit filed with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007.
- (3) Incorporated by reference to the same-numbered exhibit filed with the Company's Registration Statement on Form 8-A on April 27, 2004.
- (4) Incorporated by reference to the Company's Registration Statement on Form S-1 (Reg. No. 33-88386) declared effective March 13, 1995.
- (5) Incorporated by reference to exhibit 4.1 filed with the Company's Current Report on Form 8-K filed on January 28, 2004.
- (6) Incorporated by reference to the same-numbered exhibit filed with the Company's Form 10-Q on August 5, 2004.
- (7)

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Incorporated by reference to exhibit 10.3 filed with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

- (8) Incorporated by reference to exhibit A of the Company's Proxy Statement dated and filed on April 4, 2005.
 - (9) Incorporated by reference to exhibit 10.1 filed with the Company's Current Report on Form 8-K filed on June 27, 2006.
 - (10) Incorporated by reference to exhibit 99.2 filed with the Company's Current Report on Form 8-K filed on October 28, 2008.
 - (11) Incorporated by reference to the same-numbered exhibit filed with the Company's Form 10-Q on August 2, 2006.
 - (12) Incorporated by reference to exhibit 10.1 filed with the Company's Current Report on Form 8-K filed on May 17, 2010.
 - (13) Incorporated by reference to exhibit 10.2 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
 - (14) Incorporated by reference to exhibit 10.3 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
 - (15) Incorporated by reference to exhibit 10.4 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
 - (16) Incorporated by reference to exhibit 10.5 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
 - * Management Contract or Compensatory Plan or Arrangement
 - ** In accordance with Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.
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SIGNATURE

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

NATIONAL INSTRUMENTS CORPORATION

Dated:
November 3,
2010

By: /s/ Alex Davern

Chief Operating Officer, Executive Vice President, Chief Financial Officer and Treasurer
(principal financial and accounting officer)