COGNEX CORP
Form 10-Q
August 01, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)

[X] Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended July 3, 2016 or

[ ] Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from __________ to __________

Commission File Number 001-34218
COGNEX CORPORATION
(Exact name of registrant as specified in its charter)

Massachusetts	04-2713778
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Vision Drive
Natick, Massachusetts 01760-2059
(508) 650-3000
(Address, including zip code, and telephone number, including area code, of principal executive offices)

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

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

As of July 3, 2016, there were 85,109,036 shares of Common Stock, $.002 par value per share, of the registrant outstanding.

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PART I: FINANCIAL INFORMATION
ITEM 1: FINANCIAL STATEMENTS

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

	Three-months Ended		Six-months Ended	
	July 3, 2016	July 5, 2015	July 3, 2016	July 5, 2015
	(unaudited)		(unaudited)	
Revenue	$147,274	$143,829	$243,479	$245,202
Cost of revenue	35,213	30,508	56,181	52,852
Gross margin	112,061	113,321	187,298	192,350
Research, development, and engineering expenses	19,671	18,302	40,226	35,288
Selling, general, and administrative expenses	42,715	43,241	81,053	83,174
Operating income	49,675	51,778	66,019	73,888
Foreign currency gain (loss)	330	(39)	230	620
Investment income	1,447	957	2,584	1,807
Other income (expense)	222	(55)	429	(365)
Income from continuing operations before income tax expense	51,674	52,641	69,262	75,950
Income tax expense on continuing operations	8,660	9,125	11,363	12,962
Net income from continuing operations	43,014	43,516	57,899	62,988
Net income (loss) from discontinued operations (Note 14)	(255)	198	(255)	1,228
Net income	$42,759	$43,714	$57,644	$64,216
Basic earnings per weighted-average common and common-equivalent share:				
Net income from continuing operations	$0.51	$0.50	$0.68	$0.72
Net income (loss) from discontinued operations	$(0.01)	$—	$—	$0.02
Net income	$0.50	$0.50	$0.68	$0.74
Diluted earnings per weighted-average common and common-equivalent share:				
Net income from continuing operations	$0.50	$0.49	$0.67	$0.71
Net income (loss) from discontinued operations	$(0.01)	$—	$(0.01)	$0.01
Net income	$0.49	$0.49	$0.66	$0.72
Weighted-average common and common-equivalent shares outstanding:				
Basic	85,107	87,199	85,024	86,977
Diluted	86,806	89,185	86,713	88,951
Cash dividends per common share	$0.075	$0.07	$0.145	$0.07

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

COGNEX CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

	Three-months Ended		Six-months Ended	
	July 3, 2016	July 5, 2015	July 3, 2016	July 5, 2015
	(unaudited)		(unaudited)	
Net income	$42,759	$43,714	$57,644	$64,216
Other comprehensive income (loss), net of tax:				
Cash flow hedges:				
Net unrealized gain (loss), net of tax of ($15) and $48 in the three-month periods and net of tax of ($97) and ($25) in the six-month periods, respectively	(302)	237	(879)	(283)
Reclassification of net realized (gain) loss into current operations	190	69	186	179
Net change related to cash flow hedges	(112)	306	(693)	(104)
Available-for-sale investments:				
Net unrealized gain (loss), net of tax of $243 and ($128) in the three-month periods and net of tax of $510 and $6 in the six-month periods, respectively	1,351	(333)	2,632	566
Reclassification of net realized (gain) loss into current operations	(141)	(192)	(128)	(221)
Net change related to available-for-sale investments	1,210	(525)	2,504	345
Foreign currency translation adjustments:				
Foreign currency translation adjustments, net of tax of ($155) and $107 in the three-month periods and net of tax of $174 and ($529) in the six-month periods, respectively	(2,546)	2,450	2,614	(8,240)
Net change related to foreign currency translation adjustments	(2,546)	2,450	2,614	(8,240)
Other comprehensive income (loss), net of tax	(1,448)	2,231	4,425	(7,999)
Total comprehensive income	$41,311	$45,945	$62,069	$56,217

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

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COGNEX CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands)

	July 3, 2016 (unaudited)	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 54,929	$ 51,975
Short-term investments	294,593	296,468
Accounts receivable, less reserves of $802 and $736 in 2016 and 2015, respectively	61,219	42,846
Unbilled revenue	25,500	24
Inventories	25,882	37,334
Prepaid expenses and other current assets	23,601	15,847
Total current assets	485,724	444,494
Long-term investments	307,703	273,088
Property, plant, and equipment, net	53,406	53,285
Goodwill	81,448	81,448
Intangible assets, net	4,453	6,315
Deferred income taxes	29,083	26,517
Other assets	2,623	2,609
Total assets	$ 964,440	$ 887,756
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 14,157	$ 7,860
Accrued expenses	36,061	33,272
Accrued income taxes	3,238	985
Deferred revenue and customer deposits	15,733	11,571
Total current liabilities	69,189	53,688
Deferred income taxes	326	319
Reserve for income taxes	5,651	4,830
Other non-current liabilities	2,630	3,252
Total liabilities	77,796	62,089
Shareholders' equity:		
Common stock, $.002 par value – Authorized: 200,000 and 140,000 shares in 2016 and 2015, respectively, issued and outstanding: 85,109 and 84,856 shares in 2016 and 2015, respectively	170	170
Additional paid-in capital	330,969	311,008
Retained earnings	603,204	566,613
Accumulated other comprehensive loss, net of tax	(47,699)	(52,124)
Total shareholders' equity	886,644	825,667
	$ 964,440	$ 887,756

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

COGNEX CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Six-months Ended	
	July 3, 2016	July 5, 2015
	(unaudited)	
Cash flows from operating activities:		
Net income	$57,644	$64,216
Adjustments to reconcile net income to net cash provided by operating activities:		
(Gain) loss on sale of discontinued business	255	—
Stock-based compensation expense	11,261	11,577
Depreciation of property, plant, and equipment	5,577	4,816
Amortization of intangible assets	1,862	2,183
Amortization of discounts or premiums on investments	204	377
Realized (gain) loss on sale of investments	(128)	(221)
Revaluation of contingent consideration	(463)	—
Change in deferred income taxes	(2,943)	(2,010)
Change in operating assets and liabilities:		
Accounts receivable	(17,737)	(5,387)
Unbilled revenue	(25,507)	(52,697)
Inventories	11,964	(11,200)
Accounts payable	6,224	(1,645)
Accrued expenses	1,762	(3,887)
Accrued income taxes	2,245	8,719
Deferred revenue and customer deposits	3,998	8,485
Other	(6,907)	(5,323)
Net cash provided by operating activities	49,311	18,003
Cash flows from investing activities:		
Purchases of investments	(455,915)	(222,834)
Maturities and sales of investments	427,196	252,768
Purchases of property, plant, and equipment	(5,347)	(9,525)
Cash paid for purchased technology	—	(10,475)
Net cash received (paid) from sale of discontinued business	(113)	—
Net cash provided by (used in) investing activities	(34,179)	9,934
Cash flows from financing activities:		
Issuance of common stock under stock plans	8,700	21,457
Repurchase of common stock	(8,718)	(35,848)
Payment of dividends	(12,335)	(6,110)
Payment of contingent consideration	(337)	—
Net cash provided by (used in) financing activities	(12,690)	(20,501)
Effect of foreign exchange rate changes on cash and cash equivalents	512	(1,439)
Net change in cash and cash equivalents	2,954	5,997
Cash and cash equivalents at beginning of period	51,975	55,694
Cash and cash equivalents at end of period	$54,929	$61,691
Non-cash items related to discontinued operations:		
Depreciation and amortization expense	$—	$566
Capital expenditures	—	482
Stock-based compensation expense	—	427

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

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

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Par Value				
Balance as of December 31, 2015	84,856	$ 170	$ 311,008	$ 566,613	$ (52,124)	$ 825,667
Issuance of common stock under stock plans	461	—	8,700	—	—	8,700
Repurchase of common stock	(208)	—	—	(8,718)	—	(8,718)
Stock-based compensation expense	—	—	11,261	—	—	11,261
Payment of dividends	—	—	—	(12,335)	—	(12,335)
Net income	—	—	—	57,644	—	57,644
Net unrealized gain (loss) on cash flow hedges, net of tax of ($97)	—	—	—	—	(879)	(879)
Reclassification of net realized (gain) loss on cash flow hedges	—	—	—	—	186	186
Net unrealized gain (loss) on available-for-sale investments, net of tax of $510	—	—	—	—	2,632	2,632
Reclassification of net realized (gain) loss on the sale of available-for-sale investments	—	—	—	—	(128)	(128)
Foreign currency translation adjustment, net of tax of $174	—	—	—	—	2,614	2,614
Balance as of July 3, 2016 (unaudited)	85,109	$ 170	$ 330,969	$ 603,204	$ (47,699)	$ 886,644

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

COGNEX CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1: Summary of Significant Accounting Policies

As permitted by the rules of the Securities and Exchange Commission applicable to Quarterly Reports on Form 10-Q, these notes are condensed and do not contain all disclosures required by generally accepted accounting principles (GAAP). The Company has provided expanded disclosures related to its revenue recognition accounting policy in this quarterly report on Form 10-Q. Reference should be made to the consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 for a full description of significant accounting policies.

In the opinion of the management of Cognex Corporation (the “Company”), the accompanying consolidated unaudited financial statements contain all adjustments, consisting of normal, recurring adjustments and financial statement reclassifications, including those related to the disposition of a business (more fully described in Note 14), necessary to present fairly the Company’s financial position as of July 3, 2016, and the results of its operations for the three-month and six-month periods ended July 3, 2016 and July 5, 2015, and changes in shareholders’ equity, comprehensive income, and cash flows for the periods presented.

The results disclosed in the Consolidated Statements of Operations for the three-month and six-month periods ended July 3, 2016 are not necessarily indicative of the results to be expected for the full year.

On July 6, 2015, the Company completed the sale of its Surface Inspection Systems Division (SISD). The financial results of SISD are reported as a discontinued operation for all periods presented.

Revenue Recognition

In order to recognize revenue, the Company requires that a signed customer contract or purchase order is received, the fee from the arrangement is fixed or determinable, and the collection of the resulting receivable is probable. Assuming that these criteria have been met, product revenue is generally recognized upon delivery, revenue from maintenance and support programs is recognized ratably over the program period, and revenue from consulting and training services is recognized when the services have been provided. When customer-specified acceptance criteria exists that are substantive, product revenue is deferred, along with associated incremental direct costs, until these criteria have been met and any remaining performance obligations are inconsequential or perfunctory.

For the majority of the Company’s revenue transactions, revenue recognition and invoicing both occur upon delivery. In certain circumstances, however, the agreement with the customer provides for invoicing terms which differ from revenue recognition criteria, resulting in either deferred revenue or unbilled revenue. Invoicing that precedes revenue recognition is common for various customers in the logistics industry where milestone billings are prevalent, resulting in deferred revenue. Conversely, the Company records unbilled revenue in connection with a material customer in the consumer electronics industry. For this arrangement, the Company recognizes revenue for all delivered products when the first production line that incorporates these products is validated, because at that point the remaining performance obligations are inconsequential or perfunctory. Invoicing for all delivered products occurs as the production lines incorporating those products are installed over a period of several weeks. The Company also has a technical support obligation related to this arrangement for which revenue is deferred and recognized over the support period of approximately six months.

Certain customers are offered pricing discounts on current sales based upon purchasing volumes or preferred pricing arrangements, for which revenue is reported net of these discounts.

NOTE 2: New Pronouncements

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

The amendments in ASU 2014-09 will supersede and replace all currently existing U.S. GAAP, including industry-specific revenue recognition guidance, with a single, principle-based revenue recognition framework. The concept guiding this new model is that revenue recognition will depict transfer of control to the customer in an amount that reflects consideration to which an entity expects to be entitled. The core principles supporting this framework include (1) identifying the contract with a customer, (2) identifying separate performance obligations within the contract, (3) determining the transaction price, (4) allocating the transaction price to the performance obligations, and (5) recognizing revenue. This new framework will require entities to apply significantly more judgment. This increase in management judgment will require expanded disclosure on estimation methods, inputs, and assumptions for revenue recognition.

In March 2016, ASU 2016-08, "Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," was issued, in April 2016, ASU 2016-10, "Identifying Performance Obligations and Licensing," was issued, and in May

2016, ASU 2016-12, "Narrow-Scope Improvements and Practical Expedients" was issued. These Updates do not change the core principle of the guidance under ASU 2014-09, but rather provide implementation guidance. ASU 2015-14, "Deferral of the effective date," amended the effective date of ASU 2014-09 for public companies to annual reporting periods beginning after December 15, 2017. Early adoption is permitted, but only beginning after December 15, 2016. The Financial Accounting Standards Board may release additional implementation guidance in future periods. Management will continue to evaluate the impact of this standard as it evolves.

Accounting Standards Update (ASU) 2015-11, "Inventory - Simplifying the Measurement of Inventory"

ASU 2015-11 requires companies to measure most inventory at the lower of cost and net realizable value, thereby simplifying the current guidance under which a company must measure inventory at the lower of cost or market. This ASU eliminates the need to determine replacement cost and evaluate whether said cost is within a quantitative range. This ASU also further aligns U.S. GAAP and international accounting standards. For public companies, the guidance in ASU 2015-11 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. Management does not expect ASU 2015-11 to have a material impact on the Company's financial statements and disclosures.

Accounting Standards Update (ASU) 2016-01, "Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities"

ASU 2016-01 provides guidance related to certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments in this Update affect all entities that hold financial assets or owe financial liabilities. This ASU requires equity investments (except those accounted under the equity method) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment. This ASU also eliminates the requirement for public companies to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet, and it requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements. For public companies, the guidance in ASU 2016-01 is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. Early adoption is not permitted except for certain amendments in this Update. Management does not expect ASU 2016-01 to have a material impact on the Company's financial statements and disclosures.

Accounting Standards Update (ASU) 2016-02, "Leases"

ASU 2016-02 creates Topic 842, Leases. The objective of this Update is to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet, and disclosing key information about leasing arrangements. This ASU applies to any entity that enters into a lease, although lessees will see the most significant changes. The main difference between current U.S. GAAP and Topic 842 is the recognition of lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under current U.S. GAAP. Topic 842 distinguishes between finance leases and operating leases, which are substantially similar to the classification criteria for distinguishing between capital leases and operating leases under current U.S. GAAP. For public companies, the guidance in ASU 2016-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. This ASU should be applied using a modified retrospective approach. Management is in the process of evaluating the impact of this Update.

Accounting Standards Update (ASU) 2016-05, "Derivatives and Hedging - Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships"

ASU 2016-05 applies to all reporting entities for which there is a change in the counterparty to a derivative instrument that has been designated as the hedging instrument. The amendments in this Update clarify that a change in the counterparty does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met. For public companies, the guidance in ASU 2016-05 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. This ASU should be applied on either a prospective basis or a modified retrospective basis. Management does not expect ASU 2016-05 to have a material impact on the Company's financial statements and disclosures.

Accounting Standards Update (ASU) 2016-13, "Financial Instruments - Measurement of Credit Losses"

ASU 2016-13 applies to all reporting entities holding financial assets that are not accounted for at fair value through net income (debt securities). The amendments in this Update eliminate the probable initial recognition threshold to recognize a credit loss under current U.S. GAAP and, instead, reflect an entity's current estimate of all expected credit losses. In addition, this Update broadens the information an entity must consider in developing the credit loss estimate, including the use of reasonable and supportable forecasted information. The amendments in this Update require that

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credit losses on available-for-sale debt securities be presented as an allowance rather than as a write-down and an entity will be able to record reversals of credit losses in current period net income. For public companies, the guidance in ASU 2016-13 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. This ASU should be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. Management does not expect ASU 2016-13 to have a material impact on the Company's financial statements and disclosures.

NOTE 3: Fair Value Measurements

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

The following table summarizes the financial assets and liabilities required to be measured at fair value on a recurring basis as of July 3, 2016 (in thousands):

Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)