ZEBRA TECHNOLOGIES CORP
Form 10-Q
August 05, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended July 3, 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: 000-19406

Zebra Technologies Corporation

(Exact name of registrant as specified in its charter)

Delaware	**36-2675536**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

475 Half Day Road, Suite 500, Lincolnshire, IL 60069

(Address of principal executive offices) (Zip Code)

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

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 ¨ 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 definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if smaller reporting company)	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 30, 2010, there were 56,682,261 shares of Class A Common Stock, $.01 par value, outstanding.

Table of Contents

ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES

QUARTER ENDED JULY 3, 2010

INDEX

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)

	July 3, 2010 (Unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash	$ 41,282	$ 38,943
Restricted cash	1,458	1,725
Investments and marketable securities	136,414	114,064
Accounts receivable, net	150,092	150,992
Inventories, net	85,010	79,926
Deferred income taxes	10,562	10,792
Income taxes receivable		4,724
Prepaid expenses and other current assets	18,644	9,771
Total current assets	443,462	410,937
Property and equipment at cost, less accumulated depreciation and amortization	81,141	77,589
Long-term deferred income taxes	33,357	35,842
Goodwill	151,008	153,225
Other intangibles	52,597	55,982
Long-term investments and marketable securities	76,040	91,989
Other assets	4,350	4,915
Total assets	$ 841,955	$ 830,479
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 30,200	$ 28,137
Accrued liabilities	53,152	52,591
Deferred revenue	23,404	24,082
Income taxes payable	1,687	
Total current liabilities	108,443	104,810
Deferred rent	3,278	4,108
Other long-term liabilities	9,581	9,432
Total liabilities	121,302	118,350
Stockholders equity:		
Preferred Stock		
Class A Common Stock	722	722
Additional paid-in capital	125,682	136,104

Treasury stock	(412,972)	(385,831)
Retained earnings	1,016,605	969,195
Accumulated other comprehensive loss	(9,384)	(8,061)
Total stockholders equity	720,653	712,129
Total liabilities and stockholders equity	$ 841,955	$ 830,479

See accompanying notes to consolidated financial statements.

3

Table of Contents

ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS

(Amounts in thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Net sales				
Net sales of tangible products	$ 208,319	$ 161,928	$ 410,403	$ 328,612
Revenue from services and software	27,416	25,748	51,763	51,673
Total net sales	235,735	187,676	462,166	380,285
Cost of sales				
Cost of sales of tangible products	114,663	96,576	243,313	192,435
Cost of services and software	9,893	9,364	19,339	20,305
Total cost of sales	124,556	105,940	243,652	212,740
Gross profit	111,179	81,736	218,514	167,545
Operating expenses:				
Selling and marketing	30,328	24,398	57,828	47,597
Research and development	25,371	20,949	48,443	43,098
General and administrative	19,718	18,077	40,587	39,434
Amortization of intangible assets	2,345	2,575	4,703	5,208
Exit, restructuring and integration costs	576	3,643	2,392	5,940
Asset impairment charges		(1,058)		(1,058)
Total operating expenses	78,338	68,584	153,953	140,219
Operating income	32,841	13,152	64,561	27,326
Other income (expense):				
Investment income	634	247	1,476	1,425
Foreign exchange gain (loss)	361	(131)	560	(1,415)
Other, net	(487)	(19)	(836)	(336)
Total other income (expense)	508	97	1,200	(326)
Income before income taxes	33,349	13,249	65,761	27,000
Income taxes	10,672	4,238	18,351	8,637
Net income	$ 22,677	$ 9,011	$ 47,410	$ 18,363

Basic earnings per share	$ 0.39	$ 0.15	$ 0.82	$ 0.31
Diluted earnings per share	$ 0.39	$ 0.15	$ 0.82	$ 0.31
Basic weighted average shares outstanding	57,489	59,271	57,756	59,821
Diluted weighted average and equivalent shares outstanding	57,737	59,352	58,003	59,896

See accompanying notes to consolidated financial statements.

Table of Contents

ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	Six Months Ended July 3, 2010	Six Months Ended July 4, 2009
Cash flows from operating activities:		
Net income	$ 47,410	$ 18,363
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	16,021	15,947
Equity-based compensation	5,155	5,586
Excess tax benefit from equity-based compensation	(16)	
Gain on sale of assets	(58)	
Asset impairment charges		(1,058)
Deferred income taxes	2,961	1,710
Changes in assets and liabilities:		
Accounts receivable, net	(1,956)	17,512
Inventories, net	(5,383)	10,133
Other assets	(8,664)	(212)
Accounts payable	6,672	(14,479)
Accrued liabilities	779	(21,855)
Deferred revenue	(337)	2,030
Income taxes	5,429	(2,773)
Other operating activities	(683)	1,524
Net cash provided by operating activities	67,330	32,428
Cash flows from investing activities:		
Purchases of property and equipment	(15,053)	(12,648)
Payments for patents and licensing arrangements	(1,634)	(425)
Purchases of investments and marketable securities	(200,939)	(126,605)
Maturities of investments and marketable securities	149,929	100,830
Sales of investments and marketable securities	44,567	55,750
Net cash provided by (used in) investing activities	(23,130)	16,902
Cash flows from financing activities:		
Purchase of treasury stock	(46,767)	(41,600)
Proceeds from exercise of stock options and stock purchase plan purchases	5,033	2,027
Excess tax benefit from equity-based compensation	16	
Net cash used in financing activities	(41,718)	(39,573)
Effect of exchange rate changes on cash	(143)	1,768
Net increase in cash and cash equivalents	2,339	11,525
Cash and cash equivalents at beginning of period	38,943	33,267

Cash and cash equivalents at end of period	$ 41,282	$ 44,792
Supplemental disclosures of cash flow information:		
Income taxes paid	$ 9,472	$ 7,334

See accompanying notes to consolidated financial statements.

Table of Contents

ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 Basis of Presentation

Management prepared these unaudited interim consolidated financial statements for Zebra Technologies Corporation and subsidiaries (Zebra) according to the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial information. Accordingly, they do not include all of the information and footnotes required by United States generally accepted accounting principles (GAAP) for complete financial statements. Therefore, these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in Zebra s Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

The consolidated balance sheet as of December 31, 2009 in this Form 10-Q is taken from the audited consolidated balance sheet in our Form 10-K. These interim financial statements include all adjustments (of a normal, recurring nature) necessary to present fairly Zebra s consolidated financial position as of July 3, 2010, the consolidated statement of earnings for the three and six months ended July 3, 2010 and July 4, 2009, and consolidated statement of cash flows for the six months ended July 3, 2010 and July 4, 2009. These results, however, are not necessarily indicative of results for the full year.

Reclassifications. Certain amounts in the prior years financial statements have been reclassified to conform to the current year s presentation. For the three and six months ended July 4, 2009, general and administrative expenses of $674,000 and $1,197,000 were reclassified to selling and marketing expenses. For the three and six months ended July 4, 2009, general and administrative expenses of $334,000 and $680,000 were reclassified to research and development expenses. These reclassifications were made to better reflect costs as they relate to their functional areas. In addition, a write-off of an equity investment in an international technology company in the amount of $767,000 for the three and six months ended July 4, 2009 that was previously presented netted against asset impairment charges was reclassified to investment income in order to be consistent with the 2009 year end presentation. Prior period amounts will differ in the above categories from amounts previously reported.

Note 2 Fair Value Measurements

Financial assets and liabilities are to be measured using inputs from three levels of the fair value hierarchy. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Zebra uses a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

In determining fair value, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible as well as consider counterparty credit risk in the assessment of fair value.

Included in our investment portfolio are three auction rate security instruments. These instruments are classified as available-for-sale securities and are reflected at fair value. Due to events in credit markets, however, the auction events for the instruments held by Zebra as of July 3, 2010, are failed. Therefore, the fair values of these securities are estimated utilizing broker quotations, discounted cash flow analysis or other types of valuation adjustment methodologies at July 3, 2010. These analyses consider, among other items, the collateral underlying the security instruments, the creditworthiness of the counterparty, the timing of expected future cash flows, estimates of the next time the security is expected to have a successful auction, and Zebra s intent and ability to hold such securities until credit markets improve. These securities

Table of Contents

were also compared, when possible, to other securities with similar characteristics. In June 2010, one of the four auction rate securities held at the end of last quarter was called by the issuer. Zebra received proceeds in the amount of $1,650,000 and adjusted other comprehensive income by $200,000. See Level 3 table below for more details.

Of the three auction rate security instruments still held, Zebra deemed one to be other than temporarily impaired and recorded the market value decline in 2008. The decline in the market value of the other securities is considered temporary and has been recorded in accumulated other comprehensive income (loss) on Zebra s balance sheet. Since Zebra has the intent and ability to hold these securities until they are sold at auction, redeemed at carrying value or reach maturity, we have classified them as long-term investments on the balance sheet.

Financial assets and liabilities carried at fair value as of July 3, 2010, are classified below (in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
U.S. government and agency securities	$ 19,811	$	$	$ 19,811
Obligations of government-sponsored enterprises (1)	8,133			8,133
State and municipal bonds	163,241		2,683	165,924
Corporate securities	15,636		2,914	18,550
Other investments	36			36
Investments subtotal	206,857		5,597	212,454
Forward contracts (2)	4,279	1,868		6,147
Money market investments related to the deferred compensation plan	2,894			2,894
Total assets at fair value	$ 214,030	$ 1,868	$ 5,597	$ 221,495
Liabilities:				
Liabilities related to the deferred compensation plan	$ 2,894	$	$	$ 2,894
Total liabilities at fair value	$ 2,894	$	$	$ 2,894

Financial assets and liabilities carried at fair value as of December 31, 2009, are classified below (in thousands):

	Level 1	Level 2	Level 3	Total
Assets:				
U.S. government and agency securities	$ 12,811	$	$	$ 12,811
Obligations of government-sponsored enterprises (1)	10,666			10,666
State and municipal bonds	161,839		4,133	165,972
Corporate securities	13,654		2,914	16,568
Other investments	36			36
Investments subtotal	199,006		7,047	206,053
Forward contracts (2)	851			851
Money market investments related to the deferred compensation plan	3,155			3,155
Total assets at fair value	$ 203,012	$	$ 7,047	$ 210,059
Liabilities:				
Liabilities related to the deferred compensation plan	$ 3,155	$	$	$ 3,155
Total liabilities at fair value	$ 3,155	$	$	$ 3,155

(1) Includes investments in notes issued by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association and the Federal Home Loan Bank.

Table of Contents

(2) The fair value of forward contracts are calculated as follows:

a. Fair value of forward collar contract associated with forecasted sales hedges are calculated using the midpoint of ask and bid rates for similar contracts.
b. Fair value of regular forward contracts associated with forecasted sales hedges are calculated using the period-end exchange rate adjusted for the discount rate (3 month LIBOR rate).
c. Fair value of balance sheet hedges are calculated at the period end exchange rate adjusted for current forward points unless the hedge has been traded but not settled at period end. If this is the case, the fair value is calculated at the rate at which the hedge is being settled.

The following table presents Zebra s activity for assets measured at fair value on a recurring basis using significant unobservable inputs, Level 3, for the three month periods (in thousands):

	Six Months Ended	
	July 3, 2010	July 4, 2009
Balance at beginning of the year	$ 7,047	$ 7,047
Transfers to Level 3		
Total losses (realized or unrealized):		
Included in earnings		
Included in other comprehensive income (loss)	200	
Purchases and settlements (net)	(1,650)	
Balance at end of period	$ 5,597	$ 7,047
Total gains and (losses) for the period included in earnings attributable to the change in unrealized losses relating to assets still held at end of period	$	$

The following is a summary of short-term and long-term investments at July 3, 2010 and December 31, 2009 (in thousands):

	As of July 3, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and agency securities	$ 19,731	$ 116	$ (36)	$ 19,811
Obligations of government-sponsored enterprises	8,010	123		8,133
State and municipal bonds	165,553	737	(366)	165,924
Corporate securities	18,740	231	(421)	18,550
Other investments	36			36
Total investments	$ 212,070	$ 1,207	$ (823)	$ 212,454

	As of December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government and agency securities	$ 12,931	$ 45	$ (165)	$ 12,811
Obligations of government-sponsored enterprises	10,589	82	(5)	10,666
State and municipal bonds	165,366	1,177	(571)	165,972
Corporate securities	16,680	306	(418)	16,568
Other investments	36			36

Total investments	$ 205,602	$ 1,610	$ (1,159)	$ 206,053

8

Table of Contents

The maturity dates of investments are as follows (in thousands):

	As of July 3, 2010	
	Amortized Cost	Estimated Fair Value
Less than 1 year	136,590	136,414
1 to 5 years	71,144	71,994
6 to 10 years	1,336	1,364
Thereafter	3,000	2,682
Total	$ 212,070	$ 212,454

The carrying value for Zebra s financial instruments classified as current assets (other than short-term investments) and current liabilities approximate fair value due to short maturities.

Note 3 Investments and Marketable Securities

We classify our investments in marketable debt securities as available-for-sale. As of July 3, 2010, all of our investments in marketable debt securities with maturities greater than one year are classified as long-term investments on the balance sheet due to our ability and intent to hold them until maturity.

Changes in the market value of available-for-sale securities are reflected in the accumulated other comprehensive income caption of stockholders equity in the balance sheet, until we dispose of the securities. Once these securities are disposed of, either by sale or maturity, the accumulated changes in market value are transferred to investment income. On the cash flow statements, changes in the balances of *available-for-sale* securities are shown as purchases, sales and maturities of investments and marketable securities under investing activities.

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

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

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Changes in unrealized gains and losses on available-for-sale securities, net of tax, recorded in accumulated other comprehensive income	$ 204	$ (62)	$ (42)	$ 525

Note 4 Inventories

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

	As of	
	July 3, 2010	December 31, 2009
Raw material	$ 31,181	$ 27,953
Work in process	262	162
Deferred costs of long-term contracts	1,112	1,937
Finished goods	62,370	58,928

Total inventories, gross	94,925	88,980
Inventory reserves	(9,915)	(9,054)
Total inventories, net	$ 85,010	$ 79,926

Table of Contents

Note 5 Goodwill and Other Intangible Assets

Intangible asset data are as follows (in thousands):

	July 3, 2010		December 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets				
Current technology	$ 31,708	$ (18,818)	$ 32,038	$ (17,071)
Patent and patent rights	15,297	(7,938)	13,663	(6,774)
Customer relationships	44,561	(12,213)	44,822	(10,696)
Total	$ 91,566	$ (38,969)	$ 90,523	$ (34,541)
Aggregate amortization expense				
For the year ended December 31, 2009			$ 10,466	
For the six months ended July 3, 2010	$ 4,703			

	As of July 3, 2010
Estimated amortization expense	
For the year ended December 31, 2010	$ 9,360
For the year ended December 31, 2011	9,205
For the year ended December 31, 2012	8,551
For the year ended December 31, 2013	7,202
For the year ended December 31, 2014	3,986
Thereafter	18,996
Total	$ 57,300

Goodwill	July 3, 2010	December 31, 2009
Goodwill at gross cost	$ 265,799	$ 265,799
Impairment charges	(112,184)	(112,184)
Foreign exchange impact	(2,607)	(390)
Goodwill	$ 151,008	$ 153,225

During the second quarter of 2010, Zebra entered into an agreement with an international technology provider to acquire patents and patent rights related to card printer solutions technology. The agreement requires total consideration in the amount of 2,400,000. Zebra has paid 1,350,000 or $1,634,000 in accordance with the agreement through the end of June 2010, and has an obligation to pay an additional 1,050,000 in the third quarter upon completion of the agreement. This agreement provides Zebra with a new distribution partner and enhanced technology solutions and software.

Certain of our intangible assets including goodwill are denominated in foreign currency and, as such, include the effects of foreign currency translation.

We test goodwill for impairment on an annual basis or more frequently if we believe indicators of impairment exist. Factors considered that may trigger an impairment review consist of:

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

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

- Significant negative industry or economic trends,

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

- Significant decline in market capitalization relative to net book value.

If we believe that one or more of the above indicators of impairment have occurred, we perform an impairment test. The performance of the test involves a two-step process. The first step of the impairment test involves comparing the fair values of the applicable reporting units with their aggregate carrying values, including goodwill. We generally determine

Table of Contents

the fair value of our reporting units using three valuation methods: Income Approach Discounted Cash Flow Analysis, Market Approach Guideline Public Company Method and Market Approach Comparative Transactions Method. If the carrying amount of a reporting unit exceeds the reporting unit s fair value, we perform the second step of the goodwill impairment test to determine the amount of impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit s goodwill with the carrying value of that goodwill.

We performed our annual impairment test in June 2010 and determined that our goodwill was not impaired as of the end of May 2010.

Note 6 Costs Associated with Exit or Disposal Activities

In 2008, we announced plans to establish regional distribution and configuration centers, consolidate our supplier base, and transfer final assembly of thermal printers to Jabil Circuit, Inc., a global third-party electronics manufacturer. These actions are intended to optimize our global printer product supply chain by improving responsiveness to customer needs and increasing Zebra s flexibility to meet emerging business opportunities. As a result, substantially all printer manufacturing in our Vernon Hills, Illinois, and Camarillo, California, facilities has been transferred to Jabil s facility in Guangzhou, China.

As of July 3, 2010, we have incurred and expect to incur the following exit costs (in thousands):

Type of Cost	Cost incurred through December 31, 2009	Costs incurred for the six months ended July 3, 2010	Total costs incurred as of July 3, 2010	Additional costs expected to be incurred	Total costs expected to be incurred
Severance, stay bonuses, and other employee-related expenses	$ 7,633	$ 103	$ 7,736	$ 0	$ 7,736
Professional services	5,915	115	6,030	0	6,030
Relocation and transition costs	8,802	1,959	10,761	0	10,761
Other exit costs	30	215	245	0	245
Total	$ 22,380	$ 2,392	$ 24,772	$ 0	$ 24,772

For the six months ended July 3, 2010, we have incurred the following exit costs by segment (in thousands):

Type of Cost	Specialty Printing Group (SPG) costs	Zebra Enterprise Solutions (ZES) costs	Total costs incurred for the six months ended July 3, 2010
Severance, stay bonuses, and other employee-related expenses	$ 94	$ 9	$ 103
Professional services	110	5	115
Relocation and transition costs	1,959	0	1,959
Other exit costs	0	215	215
Total	$ 2,163	$ 229	$ 2,392

For the six month period ended July 4, 2009, we incurred exit, restructuring and integration costs of $1,680,000 for severance (severance, stay bonuses and other employee-related expenses), $133,000 for professional services, $2,469,000 for relocation and transition costs, and $3,000 for other, which totaled $4,285,000. Also included in the line item exit, restructuring and integration costs for 2009 are expenses related to an integration project to combine our acquisitions of WhereNet Corp., proveo AG, Navis Holdings, LLC, and Multispectral Solutions, Inc., to form our ZES segment. Zebra did not incur expenses related to integrating ZES for the six month period ended July 3, 2010 and incurred $1,655,000 for the six month period ended July 4, 2009.

Table of Contents

Liabilities and expenses related to exit activities were as follows (in thousands):

	Six Months Ended	
	July 3, 2010	July 4, 2009
Balance at beginning of period	$ 3,038	$ 6,378
Charged to earnings	2,392	4,285
Cash paid	(3,060)	(6,874)
Balance at the end of period	$ 2,370	$ 3,789

Liabilities related to exit activities are included in the accrued liabilities line item on the balance sheet. All current exit costs are included in operating expenses under the line item exit, restructuring and integration costs.

Note 7 Derivative Instruments

In the normal course of business, portions of our operations are subject to fluctuations in currency values. We manage these risks using derivative financial instruments. We conduct business on a multinational basis in a wide variety of foreign currencies. Our exposure to market risk for changes in foreign currency exchange rates arises from international financing activities between subsidiaries, foreign currency denominated monetary assets and liabilities and transactions arising from international trade. Our objective is to preserve the economic value of non-functional currency denominated cash flows. We attempt to hedge transaction exposures with natural offsets to the fullest extent possible and, once these opportunities have been exhausted, through foreign exchange forward and option contracts with third parties.

Credit and market risk

Financial instruments, including derivatives, expose us to counter party credit risk for nonperformance and to market risk related to interest and currency exchange rates. We manage our exposure to counterparty credit risk through specific minimum credit standards, diversification of counterparties, and procedures to monitor concentrations of credit risk. Our counterparties in derivative transactions are commercial banks with significant experience using derivative instruments. We monitor the impact of market risk on the fair value and cash flows of our derivative and other financial instruments considering reasonably possible changes in interest rates and currency exchange rates and restrict the use of derivative financial instruments to hedging activities.

We continually monitor the creditworthiness of our customers to which we grant credit terms in the normal course of business. The terms and conditions of our credit sales are designed to mitigate or eliminate concentrations of credit risk with any single customer. Our sales are not materially dependent on a single customer or a small group of customers.

Fair Value of Derivative Instruments

Zebra has determined that derivative instruments for hedges that have traded are considered Level 1 in the fair value hierarchy, and hedges that have not settled are considered Level 2 in the fair value hierarchy. Derivative instruments are used to manage risk and are not used for trading or other speculative purposes, nor do we use leveraged derivative financial instruments. Our foreign currency exchange contracts are valued using broker quotations or market transactions, in either the listed or over-the-counter markets.

Hedging of Net Assets

We use forward contracts and options to manage exposure related to our pound and euro-denominated net assets. Forward contracts typically mature within three months after execution of the contracts. We record gains and losses on these contracts and options in income each quarter along with the transaction gains and losses related to our net asset positions, which would ordinarily offset each other. Summary financial information related to these activities included in our consolidated statement of earnings as other income (expense) is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 3,	July 4,	July 3,	July 4,

	2010	2009	2010	2009
Change in gains (losses) from foreign exchange derivatives	$ 5,159	$ (2,451)	$ 9,072	$ 801
Gain (loss) on net foreign currency assets	(4,798)	2,320	(8,512)	(2,216)
Foreign exchange gain (loss)	$ 361	$ (131)	$ 560	$ (1,415)

Table of Contents

		July 3, 2010	As of December 31, 2009	
Notional balance of outstanding contracts:				
Pound/US dollar	£	7,960	£	7,500
Euro/US dollar		39,786		37,000
Net fair value of outstanding contracts	$	939	$	(6)

Summary financial information related to the cash flow hedges is as follows (in thousands):

		July 3, 2010	As of December 31, 2009	
Net unrealized gains (losses) deferred in other comprehensive income:				
Gross	$	207	$	31
Income tax benefit		78		12
Net	$	129	$	19

Hedging of Anticipated Sales

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

	July 3, 2010	As of December 31, 2009
Notional balance of outstanding contracts versus the dollar	26,325	
Hedge effectiveness	100%	

	Three Months Ended				Six Months Ended			
	July 3, 2010		July 4, 2009		July 3, 2010		July 4, 2009	
Net gains and (losses) included in revenue	$		$	(17)	$		$	1,353

Forward contracts

We record our forward contracts at fair value on our consolidated balance sheet as either other assets or other liabilities depending upon the fair value calculation as detailed in Note 2 of Zebra s financial statements. The amounts recorded on our consolidated balance sheet are as follows (in thousands):

		July 3, 2010	As of December 31, 2009	
Assets:				
Other assets	$	6,147	$	851

Total	$	6,147	$	851
Liabilities:				
Other liabilities	$		$	
Total	$		$	

Table of Contents

Note 8 Warranty

In general, Zebra provides warranty coverage of one year on SPG printers against defects in material and workmanship. SPG printheads are warranted for nine months and batteries are warranted for twelve months. Warranty coverage for most ZES hardware products is similar, with coverage periods ranging from 90 days to one year depending on the nature of the product. Battery based products, such as location tags, are covered by a 30 day warranty. For ZES software products, the warranty period is generally 90 days and provides coverage against defects in material and workmanship as well as performance materially in compliance with the accompanying documentation. A provision for warranty expense is recorded at the time of shipment and adjusted quarterly based on historical warranty experience.

The following table is a summary of Zebra s accrued warranty obligation (in thousands):

	Six Months Ended	
	July 3, 2010	July 4, 2009
Balance at the beginning of the year	$ 3,813	$ 2,814
Warranty expense	2,594	1,937
Warranty payments	(2,667)	(1,932)
Balance at the end of the period	$ 3,740	$ 2,819

In the European Union, we have an obligation to recycle printers. We reserve for this obligation based on the number of new printers sold after August 13, 2005, and printers sold prior to that date that are returned to us upon our sale of a new printer to a customer. The following is a summary of Zebra s accrued recycling obligation (in thousands):

	Six Months Ended	
	July 3, 2010	July 4, 2009
Balance at the beginning of the year	$ 1,001	$ 1,207
Recycling expense	(43)	(496)
Recycling payments		
Other adjustments	7	164
Balance at the end of the period	$ 965	$ 875

Note 9 Contingencies

We are subject to a variety of investigations, claims, suits and other legal proceedings that arise from time to time in the ordinary course of business, including but not limited to, intellectual property, employment, tort and breach of contract matters. We currently believe that the outcomes of such proceedings, individually and in the aggregate, will not have a material adverse impact on our business, cash flows, financial position, or results of operations. Any legal proceedings are subject to inherent uncertainties, and management s view of these matters and their potential effects may change in the future.

Note 10 Changes to Benefit Programs

Zebra has a Retirement Savings and Investment Plan (401(k) Plan), which is intended to qualify under Section 401(k) of the Internal Revenue Code. During the first quarter of 2009, Zebra announced changes to its 401(k) Plan, profit sharing plan and stock purchase plan. Qualified employees may participate in Zebra s 401(k) Plan by contributing up to 15% of their gross earnings to the plan subject to certain Internal Revenue Service restrictions. Effective March 1, 2009, Zebra reduced the company match to each participant s contribution from 6% of gross eligible earnings at the rate of 50%, to 3% of gross eligible earnings at the rate of 50%. Effective January 1, 2010, Zebra increased the company match to each participant s contribution to a total of 4%. Zebra will match 100% of the first 2% of gross eligible earnings, and also match the next 4% of gross eligible earnings at the rate of 50%. Zebra may contribute additional amounts to its 401(k) Plan at the discretion of the Board of Directors, subject to certain legal limits.

Zebra also has a discretionary profit-sharing plan for qualified employees, to which it contributes a percentage of eligible payroll each year. Zebra announced that it will suspend any contributions to the profit sharing plan for the 2009 plan year and plan years going forward. Participants are not permitted to make contributions under the discretionary profit-sharing plan.

Table of Contents

Note 11 Stockholders Equity

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

	July 3, 2010	December 31, 2009
Preferred Stock		
Par value per share	$ 0.01	$ 0.01
Shares authorized	10,000,000	10,000,000
Shares outstanding		
Common Stock Class A		
Par value per share	$ 0.01	$ 0.01
Shares authorized	150,000,000	150,000,000
Shares issued	72,151,857	72,151,857
Shares outstanding	57,195,930	58,318,983
Treasury stock		
Shares held	14,955,927	13,832,874

During the six-month period ended July 3, 2010, Zebra purchased 1,684,537 shares of common stock for $46,767,000 under board authorized share repurchase plans compared to the six-month period ended July 4, 2009, in which Zebra purchased 2,252,780 shares of common stock for $41,600,000.

Zebra issued 205,961 treasury shares of common stock upon exercise of stock options and purchases under the stock purchase plan during the first six months of 2010. Zebra also issued from treasury shares 375,279 shares of common stock under restricted stock awards during the first six months of 2010. During the first six months of 2009, Zebra issued 141,959 treasury shares of common stock upon the exercise of stock options and purchases under the stock purchase plan and issued 385,182 shares of common stock from treasury shares under restricted stock awards.

Note 12 Earnings Per Share

Earnings per share were computed as follows (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Basic earnings per share:				
Net income	$ 22,677	$ 9,011	$ 47,410	$ 18,363
Weighted average common shares outstanding	57,489	59,271	57,756	59,821
Per share amount	$ 0.39	$ 0.15	$ 0.82	$ 0.31
Diluted earnings per share:				
Net income	$ 22,677	$ 9,011	$ 47,410	$ 18,363
Weighted average common shares outstanding	57,489	59,271	57,756	59,821
Add: Effect of dilutive securities stock options	248	81	247	75
Diluted weighted average and equivalent shares outstanding	57,737	59,352	58,003	59,896
Per share amount	$ 0.39	$ 0.15	$ 0.82	$ 0.31

Potentially dilutive securities that were excluded from the earnings per share calculation consist of options with an exercise price greater than the average market closing price of the Class A common stock as of July 3, 2010. These options were as follows:

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Potentially dilutive shares	1,928,000	2,773,000	1,908,000	2,831,000

Table of Contents

Note 13 Equity-Based Compensation

Zebra has an equity-based compensation plan and a stock purchase plan available for future grants. Zebra recognizes compensation costs using the straight-line method over the vesting period of 1 month to 5 years.

The compensation expense and the related tax benefit for equity-based payments were included in the Consolidated Statement of Earnings as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Cost of sales	$ 322	$ 305	$ 571	$ 586
Selling and marketing	539	362	850	779
Research and development	449	272	806	823
General and administrative	1,614	1,480	2,928	3,398
Total compensation	2,924	2,419	5,155	5,586
Income tax benefit	$ 1,008	$ 774	$ 1,778	$ 1,788

Cash flows resulting from the tax benefits from tax deductions in excess of the compensation cost recognized (excess tax benefits) are classified as financing cash flows in the statement of cash flows. The tax benefits classified as financing cash flows for the six months ended July 3, 2010 was $16,000 and for the six months ended July 4, 2009, was less than $1,000.

The fair value of equity-based compensation is estimated on the date of grant using a binomial model. Volatility is based on an average of the implied volatility in the open market and the annualized volatility of Zebra stock prices over our entire stock history. Stock option grants in the table below include both stock options, all of which were non-qualified, and stock appreciation rights (SAR) that will be settled in Zebra stock. The following table shows the weighted-average assumptions used for grants of stock options and SARs as well as the fair value of the grants based on those assumptions:

	Six Months Ended	
	July 3, 2010	July 4, 2009
Expected dividend yield	0%	0%
Forfeiture rate	9.78%	9.92%
Volatility	39.50%	43.08%
Risk free interest rate	2.26%	2.23%
Range of interest rates	0.06% - 3.41%	0.15% - 3.29%
Expected weighted-average life	5.36 years	5.23 years
Fair value of options and SARs granted	$ 6,527,000	$ 5,613,000
Weighted-average grant date fair value of options and SARs granted	$ 10.65	$ 7.94

SAR activity was as follows:

	Six Months Ended July 3, 2010	
SARs	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	684,058	$ 19.97
Granted	612,681	27.82
Exercised	(6,424)	19.56
Forfeited	(20,086)	21.40

Expired	(273)		19.56
Outstanding at end of period	1,269,956	$	23.74
Exercisable at end of period	164,481	$	19.81
Intrinsic value of exercised SARs	$ 54,000		

For the three months ended July 3, 2010, equity granted above includes SARs with respect to 612,681 shares of Zebra common stock.

16

Table of Contents

The terms of the SARs are established under the 2006 Zebra Technologies Corporation Incentive Compensation Plan (the 2006 Plan) and the applicable SAR agreement. Once vested, a SAR entitles the holder to receive a payment equal to the difference between the per-share base price of the SAR and the fair market value of a share of Zebra stock on the date the SAR is exercised, multiplied by the number of SAR s exercised. Exercised SARs are settled in whole shares of Zebra stock, and any fraction of a share is settled in cash. The SARs granted during the first six months of 2010 vest annually in four equal amounts on each of the first four anniversaries of the grant date and expire 10 years after the grant date.

The following table summarizes information about SARs outstanding at July 3, 2010:

	Outstanding			Exercisable	
Range of Exercise Prices	**Number of Shares**	**Weighted-Average Remaining Contractual Life**	**Weighted-Average Exercise Price**	**Number of Shares**	**Weighted-Average Exercise Price**
$ 19.56-$19.56	603,077	8.84 years	$ 19.56	146,481	$ 19.56
$ 19.57-$27.50	75,686	9.30 years	24.84	18,000	21.83
$ 27.51-$27.82	574,069	9.84 years	27.82	0	0.00
$ 27.83-$29.06	11,647	9.72 years	28.57	0	0.00
$ 29.07-$30.08	5,477	9.70 years	30.08	0	0.00
	1,269,956			164,481	

	Outstanding	**Exercisable**
Aggregate intrinsic value	$ 3,128,000	$ 798,000
Weighted-average remaining contractual term	9.3 years	8.8 years

Stock option activity was as follows:

	Six Months Ended July 3, 2010	
Options	**Shares**	**Weighted-Average Exercise Price**
Outstanding at beginning of year	2,767,887	$ 35.98
Granted	0	0.00
Exercised	(147,472)	25.33
Forfeited	(47,667)	34.16
Expired	(59,900)	35.35
Outstanding at end of period	2,512,848	$ 36.62
Exercisable at end of period	1,985,825	$ 36.60
Intrinsic value of exercised options	$ 570,000	

The following table summarizes information about stock options outstanding at July 3, 2010:

	Outstanding			Exercisable	
Range of Exercise Prices	**Number of Shares**	**Weighted-Average Remaining Contractual Life**	**Weighted-Average Exercise Price**	**Number of Shares**	**Weighted-Average Exercise Price**

$ 1.29-$25.23	601,901	2.93 years	$ 21.01	554,376	$ 21.12
$ 25.24-$36.49	588,426	6.90 years	35.60	336,354	35.35
$ 36.50-$42.28	528,043	6.80 years	40.33	354,285	40.41
$ 42.29-$46.18	465,694	5.18 years	44.90	412,026	45.02
$ 46.19-$53.92	328,784	4.11 years	49.33	328,784	49.33
	2,512,848			1,985,825	

	Outstanding	**Exercisable**
Aggregate intrinsic value	$ 2,296,000	$ 2,065,000
Weighted-average remaining contractual term	5.2 years	4.7 years

17

Table of Contents

Restricted stock award activity, granted under the 2006 Plan, for the period ended July 3, 2010, was as follows:

	Six Months Ended July 3, 2010	
Restricted Stock Awards	**Shares**	**Weighted-Average Grant Date Fair Value**
Outstanding at beginning of year	507,984	$ 23.90
Granted	375,279	27.84
Released	(15,441)	29.86
Forfeited	(14,627)	25.88
Outstanding at end of period	853,195	$ 25.49

As of July 3, 2010, there was $25,495,000 of unearned compensation cost related to awards granted under Zebra s equity-based compensation plans, which is expected to be recognized over a weighted-average period of 2.8 years.

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

	Six Months Ended	
	July 3, 2010	**July 4, 2009**
Fair market value	$ 26.79	$ 19.52
Option price	$ 25.45	$ 17.41
Expected dividend yield	0%	0%
Expected volatility	26%	41%
Risk free interest rate	0.11%	0.15%

Note 14 Income Taxes

Zebra has identified, evaluated, and measured the amount of income tax benefits to be recognized for all of our income tax positions. Included in deferred tax assets are amounts related to federal and state net operating losses that resulted from our acquisition of WhereNet Corp. Zebra s intention is to utilize these net operating loss carryforwards to offset future income taxes paid.

Zebra has concluded all U.S. federal income tax audits for years through 2006. The tax years 2005 through 2009 remain open to examination by multiple state taxing jurisdictions. Tax authorities in the United Kingdom have completed income tax audits for tax years through 2006.

Zebra s continuing practice is to recognize interest and/or penalties related to income tax matters as part of income tax expense. For the three month periods ended July 3, 2010 and July 4, 2009, we did not accrue any interest or penalties into income tax expense.

The effective income tax rate for the second quarter of 2010 was 32.0% compared with 32.0% for the second quarter of 2009. The effective income tax rate for the first six months of 2010 was 27.9% compared to 32.0% for the first six months of 2009. Zebra s effective tax rate for the first quarter of 2010 included a $2,764,000 reduction of federal taxes related to prior years adjustments for intercompany profit in ending inventory which reduced our effective rate for the first six months of 2010 by 4.2%.

Note 15 Other Comprehensive Income

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

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

Unrealized gains (losses) on foreign currency hedging activities relate to derivative instruments used to hedge the currency exchange rates for forecasted euro sales. These hedges are designated as cash flow hedges, and we have deferred income statement recognition of gains and losses until the hedged transaction occurs. See Note 7 for more details.

Table of Contents

Unrealized gains (losses) on investments classified as available-for-sale are deferred from income statement recognition until the gains or losses are realized. See Note 3 for more details.

The Consolidated Statements of Comprehensive Income are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Net income	$ 22,677	$ 9,011	$ 47,410	$ 18,363
Other comprehensive income (loss):				
Foreign currency translation adjustment	(967)	6,373	(1,410)	4,792
Changes in unrealized gains (losses) on hedging transactions, net of tax	129	(417)	129	(409)
Changes in unrealized gains (losses) on investments, net of tax	204	(62)	(42)	525
Comprehensive income	$ 22,043	$ 14,905	$ 46,087	$ 23,271

The components of other comprehensive income gross and net of income tax are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Changes in unrealized gains and losses on foreign currency hedging activities:				
Gross	$ 207	$ (669)	$ 207	$ (656)
Income tax (benefit)	78	(252)	78	(247)
Net	$ 129	$ (417)	$ 129	$ (409)
Changes in unrealized gains and losses on investments classified as available-for-sale:				
Gross	$ 327	$ (99)	$ (68)	$ 842
Income tax (benefit)	123	(37)	(26)	317
Net	$ 204	$ (62)	$ (42)	$ 525

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

	As of	
	July 3, 2010	December 31, 2009
Foreign currency translation adjustments	$ (9,752)	$ (8,342)
Unrealized gains and (losses) on hedging transactions:		
Gross	$ 206	$ (1)
Income tax (benefit)	78	
Net	$ 128	$ (1)
Unrealized gains and (losses) on investments classified as available-for-sale:		
Gross	$ 384	$ 452
Income tax (benefit)	144	170

Net	$	240	$	282

Table of Contents

Note 16 Segment Information

Zebra has two reportable segments: Specialty Printing Group (SPG) and Zebra Enterprise Solutions (ZES).

SPG includes direct thermal and thermal transfer label and receipt printers, passive radio frequency identification (RFID) printer/encoders and dye sublimation card printers. Also included in this group is a comprehensive range of specialty supplies consisting of self-adhesive labels, thermal transfer ribbons, thermal printheads, batteries and other accessories, including software for label design and printer network management.

ZES has evolved since the beginning of 2007 with the acquisitions of WhereNet Corp., proveo AG, Navis Holdings, LLC and Multispectral Solutions, Inc. The solutions that these companies provide are generally sold on a contract basis and are typically installed over several quarters. These contracts cover a range of services, including design, installation and ongoing maintenance services.

Segment information is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 3, 2010	July 4, 2009	July 3, 2010	July 4, 2009
Net sales:				
SPG Tangible products	$ 203,887	$ 159,016	$ 403,088	$ 321,513
SPG Service & software	9,239	8,893	17,966	17,164
SPG Net Sales	213,126	167,909	421,054	338,677
ZES Tangible products	4,432	2,912	7,315	7,098
ZES Service & software	18,177	16,855	33,797	34,510
ZES Net Sales	22,609	19,767	41,112	41,608
Total	$ 235,735	$ 187,676	$ 462,166	$ 380,285
Operating profit (loss):				
SPG	$ 52,929	$ 30,088	$ 107,373	$ 64,087
ZES	(3,853)	(3,568)	(9,263)	(6,927)
Corporate and other	(16,235)	(13,368)	(33,549)	(29,834)
Total	$ 32,841	$ 13,152	$ 64,561	$ 27,326

	As of	
	July 3, 2010	December 31, 2009
Identifiable assets:		
SPG	$ 344,518	$ 336,428
ZES	183,018	185,495
Corporate and other	314,419	308,556
Total	$ 841,955	$ 830,479

Zebra records its federal and state deferred tax assets and liabilities in corporate and other as reflected above. Intersegment sales are not significant. Corporate and other includes corporate administration costs or assets that support both reporting segments.

Note 17 New Accounting Pronouncements

In October 2009, the FASB issued update 2009-13, ASC 605, Revenue Recognition: Multiple Deliverable Revenue Arrangements-a consensus of the FASB Emerging Issues Task Force. The revised guidance provides for two significant changes to existing multiple element arrangement guidance. The first relates to the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. This change is significant as it may result in the requirement to separate more deliverables within an arrangement, ultimately leading to less revenue deferral. The second change modifies the manner in which the transaction consideration is allocated across the separately identifiable deliverables. These changes may result in earlier recognition of revenue for multiple-element arrangements than under previous guidance. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We have not yet determined the effect of this standard upon our consolidated financial statements.

In October 2009, the FASB issued update 2009-14, ASC 985, Software: Certain Revenue Arrangements That Include Software Elements a consensus of the FASB Emerging Issues Task Force. This updated guidance is expected to

Table of Contents

significantly affect how entities account for revenue arrangements that contain both hardware and software elements. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We have not yet determined the effect of this standard upon our consolidated financial statements.

In January 2010, the FASB issued update 2010-06, ASC 820, Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements. This updated guidance requires new disclosures related to transfers in and out of Levels 1 and 2. The standard also provides guidance on the disclosures related to Level 3 activities. In addition, existing disclosures related to disaggregation levels and disclosures about inputs and valuation techniques are clarified. This standard is effective for interim and annual periods beginning after December 15, 2009. This standard did not have a material effect upon our consolidated financial statements.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Results of Operations: Second Quarter of 2010 versus Second Quarter of 2009

Consolidated Results of Operations

(Amounts in thousands, except percentages):

	Three Months Ended July 3, 2010	Three Months Ended July 4, 2009	Percent Change	Percent of Net Sales - 2010	Percent of Net Sales - 2009
Net Sales					
Tangible products	$ 208,319	$ 161,928	28.6	88.4	86.3
Service & software	27,416	25,748	6.5	11.6	13.7
Total net sales	235,735	187,676	25.6	100.0	100.0
Cost of Sales					
Tangible products	114,663	96,576	18.7	48.6	51.5
Service & software	9,893	9,364	5.6	4.2	4.9
Total cost of sales	124,556	105,940	17.6	52.8	56.4
Gross profit	111,179	81,736	36.0	47.2	43.6
Operating expenses	78,338	68,584	14.2	33.2	36.5
Operating income	32,841	13,152	149.7	14.0	7.1
Other income (expense)	508	97	423.7	0.1	0.1
Income before income taxes	33,349	13,249	151.7	14.1	7.0
Income taxes	10,672	4,238	151.8	4.5	2.2
Net income	$ 22,677	$ 9,011	151.6	9.6	4.8
Diluted earnings per share	$ 0.39	$ 0.15			

Consolidated Results of Operations Second quarter

Sales

Net sales for the second quarter of 2010 compared with the 2009 quarter increased 25.6% due to a broad-based increase in demand for Zebra products, driven by global economic recovery. This was the second consecutive quarter of strong year-over-year growth. The increase in sales was largely attributable to 30.7% growth in hardware sales (including all printer categories and aftermarket parts). Supplies sales increased 22.4% from greater shipments of labels and thermal ribbons. Printer unit volume increased 32.0% for the second quarter of 2010 compared to levels in 2009.

Sales by product category were as follows (amounts in thousands, except percentages):

Product Category	Three Months Ended July 3, 2010	Three Months Ended July 4, 2009	Percent Change	Percent of Net Sales - 2010	Percent of Net Sales - 2009
Hardware	$ 163,479	$ 125,075	30.7	69.3	66.7
Supplies	43,573	35,588	22.4	18.5	19.0

Service and software	27,416	25,748	6.5	11.6	13.7
Shipping and handling	1,267	1,265	0.2	0.6	0.6
Total net sales	$ 235,735	$ 187,676	25.6	100.0	100.0

Sales increased in all geographic territories due primarily to the global economic recovery. The sales growth on a percentage basis was greatest in Latin America and Asia Pacific because of higher rates of economic growth in those regions. Movements in foreign exchange rates decreased sales by $5,030,000 in the Europe, Middle East and Africa regions for the quarter due principally to a weaker euro against the dollar.

Table of Contents

Sales to customers by geographic region were as follows (in thousands, except percentages):

Geographic Region	Three Months Ended July 3, 2010	July 4, 2009	Percent Change	Percent of Net Sales - 2010	Percent of Net Sales - 2009
Europe, Middle East and Africa	$ 80,774	$ 69,708	15.9	34.3	37.1
Latin America	20,734	14,341	44.6	8.8	7.6
Asia-Pacific	28,538	19,839	43.8	12.1	10.5
Total International	130,046	103,888	25.2	55.2	55.2
North America	105,689	83,788	26.1	44.8	44.8
Total net sales	$ 235,735	$ 187,676	25.6	100.0	100.0

Gross Profit

Gross profit increased 36% due to higher volumes and an improved product mix, with increased sales in high-performance and mid-range table top printers, partially offset by $5,224,000 in higher freight costs in 2010. As a percentage of sales, gross margin improved from 43.6% to 47.2%. The benefit of outsourcing printer production to a third party and continued cost control contributed to increase gross profit. Gross profit was affected by unfavorable foreign currency movements which decreased second quarter gross profit by $4,416,000.

Operating Expenses

Operating expenses for the quarter increased 14.2% due mainly to greater selling and marketing expenses and research and development expenses. Several categories accounted for these increases, including compensation costs which include salaries, benefits, bonuses and commissions. Business development, outside professional services, project expenses, and travel and entertainment expenses all increased over 2009 levels. Exit, restructuring and integration costs decreased $3,067,000 in the second quarter of 2010 as compared to 2009. Zebra s program for outsourcing its manufacturing operations is nearing completion and the related restructuring costs for this program are ending with the second quarter of 2010. In addition, integration costs associated with integrating the Zebra Enterprise Solutions (ZES) businesses were completed in 2009. Asset impairment charges relate to the completion of a detailed second step impairment test in 2009 which resulted in reversing a portion of the year end 2008 asset impairment estimate.

Operating expenses are summarized below (in thousands, except percentages):

Operating Expenses	Three Months Ended July 3, 2010	July 4, 2009	Percent Change	Percent of Net Sales 2010	Percent of Net Sales 2009
Selling and marketing	$ 30,328	$ 24,398	24.3	12.8	13.0
Research and development	25,371	20,949	21.1	10.8	11.1
General and administrative	19,718	18,077	9.1	8.4	9.6
Amortization of intangible assets	2,345	2,575	(8.9)	1.0	1.4
Exit, restructuring and integration costs	576	3,643	(84.2)	0.2	2.0
Asset impairment charges		(1,058)			(0.6)
Total operating expenses	$ 78,338	$ 68,584	14.2	33.2	36.5

Other Income

Investment income for 2009 was reduced by the write-off of an investment in an international technology company in the amount of $767,000. Considering this item, investment income in 2010 actually declined primarily from lower short-term interest rates in the second quarter of 2010 compared with 2009. Zebra recorded a foreign exchange gain in the second quarter of 2010 as the U.S. dollar strengthened during the period against the euro versus 2009.

Table of Contents

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

	Three Months Ended	
	July 3, 2010	July 4, 2009
Investment income	$ 634	$ 247
Foreign exchange gain (loss)	361	(131)
Other, net	(487)	(19)
Total other income	$ 508	$ 97

Operating Income

The operating income increase for the second quarter of 2010 was the result of increased sales and gross profit as noted above.

Income Taxes

The effective income tax rate for the second quarter of 2010 was 32.0% compared with 32.0% for the second quarter of 2009.

Business Groups

Specialty Printing Group

(Amounts in thousands, except percentages):

	Three Months Ended				
	July 3, 2010	July 4, 2009	Percent Change	Percent of Net Sales - 2010	Percent of Net Sales - 2009
Net Sales					
Tangible products	$ 203,887	$ 159,016	28.2	95.7	94.7
Service & software	9,239	8,893	3.9	4.3	5.3
Total net sales	213,126	167,909	26.9	100.0	100.0
Cost of Sales					
Tangible products	110,863	94,218	17.7	52.0	56.1
Service & software	4,157	3,819	8.9	2.0	2.3
Total cost of sales	115,020	98,037	17.3	54.0	58.4
Gross profit	98,106	69,872	40.4	46.0	41.6
Operating expenses	45,177	39,784	13.6	21.2	23.7